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Understanding risk

Client Fact Sheet - July 2012

Inflation risk

Inflation risk is the risk that the real value (i.e. the purchasing power) of your investment may not keep up with inflation. This risk will occur if your investment is likely to provide a net (after tax) return less than the prevailing inflation rate.

Re-investment risk

In a fixed interest investment, re-investment risk is when you may have to accept a lower rate of interest when re-investing for another fixed term because of changes in market interest rates.

Liquidity risk

Liquidity risk is the risk that you may not be able to readily cash in your investment when you need immediate access to your funds in which case you may have to:

- redeem your investment at less than face value and make a loss, or
- agree to have the current interest rate adjusted because the investment was not retained to maturity, or
- wait until your investment matures, which could mean you miss out on other opportunities that may arise in the meantime.

Market risk

Market risk is the risk that investment market movements will result in investment values falling. For example, if you buy shares in a gold mining company at a certain share price and the price of gold falls (for whatever reason), it is highly likely that the price of your shares in the gold company will also fall.

Credit risk

In a fixed interest investment, a credit risk is when the company you have invested in is unable to pay the income you have earned, or to repay you when you sell your shares.

Regulatory risk

Regulatory risk is the risk that government policy or legislation willchange, which could impact on the effectiveness of your investment strategy.

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Currency risk

If you own assets overseas or foreign shares, you may face a currency risk. This is where the value of currenciesfluctuate and affect the return from overseas investments. A rise in the Australian dollar may reduce the value of your overseas asset. You can pay to hedge against this risk by contracting to buy or sell a certain currency at a specific exchange rate at a future date.

Diversification risk

Diversification risk is the risk of investing in one or few asset classes, or even a single investment, such as a rental property or a solicitor's mortgage. The performance and eventual repayment of your investment depends on the performance of this single investment. Many investment professionals recommend diversifying and may use the saying "don't put all your eggs in the one basket".

Timing risk

Timing risk is the rhe risk that in attempting to time market entry/exit you will be exposed to increased short term volatility, and may end up "buying in at the top, or selling out at the bottom". It is also very important for you to have an appropriate investment time frame in mind. Some people may invest in assets intended for the long term, with a view to making short term gains. These people are often disappointed if they have to sell their investment at a loss. Most people cannot time the market successfully.

Pricing/value risk

Pricing or value risk is the risk that your investment may be purchased at too high a unit cost, and will drop in value when the market re-assesses its worth. This is often evident when a boom market withstands a correction – those who bought in just before or when the market had reached its top will lose the most.

Manager risk

A manager risk is the risk that an investment is made only on past performance, without considering staff, ownership, market, regulatory or strategy changes.

Strategy risk

Strategy risk is the risk that an investment strategy may no longer be appropriate for you because of the impact of legislative or policy changes on your financial circumstances or objectives. This is why you should review your portfolio regularly.

Technical Services

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07/2012