



Risk Return

A Most Ignored Aspect

Risk-Return is all about achieving a fine balance between the lowest possible risk and the highest possible return.

Every problem is like a red signal! If you wait for some time, it will turn into green. Two decades back when I started my practice in personal finance space, I was very clear on the virtues of investing “Patience & Perseverance”, which was aptly inculcated into our value system.

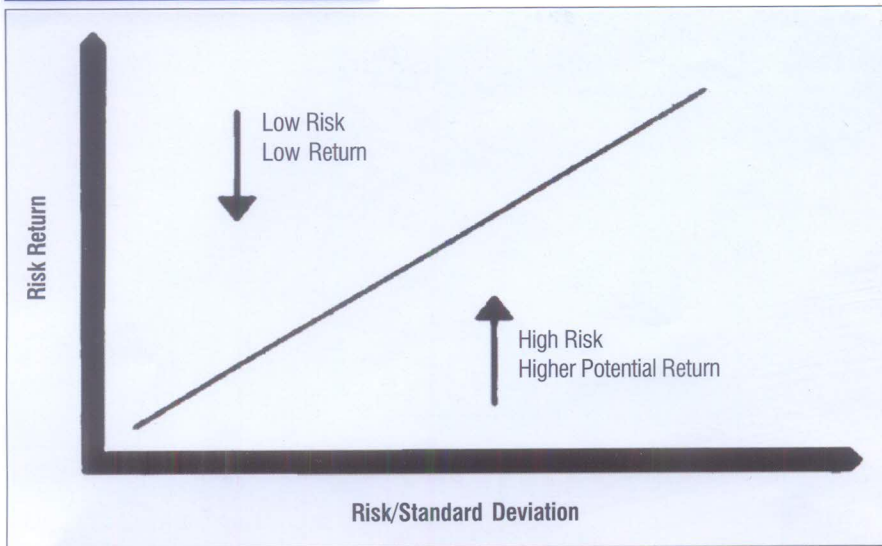
Risk comes from not knowing what you are doing.

Warren Buffett

The Contemporary Approach:

The best way to describe Risk-Return is the “Ability to Sleep Fine”. Some investors handle financial risks better than others due to their current financial situation, investment horizon and most important realistic returns expectations.

Various facets observed under risk-return during our practice:



Risk is the possibility that an investment's actual return will be different from expected.

Risk is that you might not be able to meet a financial goal because selection of an investment did not give the required Return on Investment (ROI).

Risk is, one did not give enough time for a portfolio to grow and redeemed the investments before time.

Risk is also investing in financial products which were least understood and one just chose to chase the returns, which were mere huge promises.

Risk is also not knowing the profile (conservative, moderate and aggressive). As a result of that, investment returns are way away from one's profile.

Risk is also not keeping the investment strategy aligned either tactically or strategically keeping in mind the current or future return prospect.

Risk is also about NOT reviewing portfolio composition, allocation, returns from time to time and NOT taking corrective measures.

Risk means you have the possibility of losing some, or even all, of your original investment. Low levels of uncertainty (low risk) are associated with low potential returns. Low risk-low potential returns; high risk-high returns.

Risk is measured by standard deviation in statistics. Simply put, risk means that there is a probability of losing some, or even all, of your initial investment. Deciding what amount of risk you are willing to take comfortably with

your investments is extremely critical and will help you take crucial decisions while investing.

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ciated with low potential returns, while higher levels of risk are normally expected to yield higher returns.

Types of investment risk

Market risk: The risk of investments declining in value because of economic developments or other events that affect the entire market.

- Liquidity risk
- Concentration risk
- Credit risk

- Reinvestment risk
- Inflation risk
- Horizon risk
- Longevity risk

For more understanding of risk-return, Let us look closely at our derived km/hr concept.

A vehicle moves at varied speed during its journey. Speed we travel depends on many factors, risk taking ability, overtakes we do, how skilful we are, how cautiously we drive, stoppages which may come, breakdowns which may happen, repairs which may be required. Similarly, in investments, we need to find out that km/hr, i.e., ROI at which one wants the portfolio to grow.

The Contrarian Approach towards risk-return/reward can be explained with the below-mentioned example:

Aadith had invested ₹2000 per month in mutual fund under systematic investment plan for next 20 years. Objective was kids' professional education planning.

In the 10th year, Aadith chose to withdraw that investment for reason related to risk in global financial market and did not complete the tenor.

Here the returns are not mediocre, it is 13.51%. But the portfolio growth as compounding takes time; SIP of ₹2000 in 10 years has grown to ₹4.80 lakh.

What if Aadith had taken another approach of risk reward aspect, that is, given time for the investment to grow.

Staying invested for another 10 years and completing 20 years was the original investment objective. What Aadith had achieved was magic of compounding. Annualized Return of 20.28%; not only that corpus grew for 4.80 lakh to 50.54 lakh, all other factors remained constant.

It is important to note that higher risk does not always mean higher returns. While the risk-return trade-off indicates that higher risk gives us the probability of higher returns, there are no guarantees. Higher potential returns could also lead to higher potential losses.

Time plays a very important part in building up investment portfolios.

Futuristic perspective

The government bonds represent the lower end of this risk/reward scale since their chances of default are almost zero. This represents risk-free return, which means, you can earn this rate of return virtually without any potential risk. But earning 6% in a scenario where inflation is around 8% means that the value of your savings is steadily eroding. Traditionally, equity funds have given much more every year over the long term. To earn this potential higher return from equities, you will have to take on higher risk on your investments. This excess return over the risk-free return is 'risk premium'.

Scheme Name	No. of SIP Installment	Average NAV	Absolute Return
HDFC-Equity Fund (G)	120	390.097	100.22%
Total Investments	SIP Value as on 08-04-2019	Current NAV as on 10-04-2019	Annualized Return
₹2,40,000	₹4,80,524	673.767	13.51%

Source: www.oxygenfin.com

Spread your portfolio among asset classes – Bonds, Cash, Equity, etc.

In the asset classes, diversify the risk. E.g. while investing in equity, diversify among large cap, mid and small cap and across Sectors/Themes; while investing in bonds, invest across various Coupons, Rating, Maturities, etc.

have to take on additional risk to earn a higher potential return on your portfolio. Risk needs to be considered at all investing stages and for different goals.

You cannot eliminate investment risk. But two basic investment strategies can help manage both systemic risk (risk affecting the economy as a whole) and non-systemic risk (risks

that affect a small part of the economy, or even a single company).

Asset Allocation: By including different asset classes in your portfolio (shares, funds, real estate, bonds, etc.), you increase the probability that some of your investments will provide satisfactory returns even if others are flat or losing value.

Diversification: When

you diversify, you divide the money you have allocated to a particular asset class, such as stocks, among various categories of investments that belong to that asset class. Diversification has its emphasis on variability. You don't put all your investment eggs in one basket.

The upshot is all investments carry some degrees of risk. By better understanding the nature of risk and taking steps to manage those risks, you put yourself in a better position to meet your financial goals. ■

Disclaimer: Examples in the article are for representation purpose only, they do not constitute guidance nor invitation to invest.

Scheme Name	No. of SIP Installment	Average NAV	Absolute Return
HDFC-Equity Fund (G)	240	231.109	953.10%
Total Investments	SIP Value as on 08-04-2019	Current NAV as on 10-04-2019	Annualized Return
₹4,80,000	₹50,54,866	673.767	20.28%

Source: www.oxygenfin.com

Defining the suitable risk level for you is not as simple as it sounds. Like most decisions on financial planning, your investment decision would depend on your goals, income, expenses, current savings, etc. Many of us may not be able to tolerate the short-term market fluctuations. Risk tolerance has more to do with your IQ rather than with EQ. And, this is where 'Diversification' can come to your rescue. Diversification is an effective risk management tool. It aims to mix a variety of instruments and asset classes in your portfolio to minimize the impact of any one asset class on the overall performance of your portfolio. A well-diversified portfolio has more likelihoods to give a risk adjusted returns.

It has been seen that mutual funds can help you achieve this.

Arriving at your risk-taking ability and an ideal diversification plan is a highly personalised process and all of us need to customize it to suit our requirements. Seeking the help of Investment Guidance Provider/Independent Financial Advisor may be a smart idea to achieve this.

Generally, the higher the potential return of an investment, the higher the risk. There is no guarantee that you will actually get a higher return by accepting more risk. Diversification enables you to reduce the risk of your portfolio without sacrificing potential returns. Once your portfolio has been fully diversified, you

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