

ifs Student Investor 2009/10 – Worksheet 6

INVESTMENT RISK

All investments involve some **risks** because the future is unknown. Some investments are riskier than others and you will only buy a riskier investment if it also gives you the possibility of **higher returns**. High risk means you can lose a lot but also that you have the possibility of higher return. Some people are more willing to take risks than others. Some people are very risk averse so they prefer to earn less from their investments but also to avoid surprises. Your **risk aversion** will determine what type of investment you will choose.

A stock is a very risky investment because you may lose some of your money when the stock price falls, or possibly all your money if the company goes bankrupt. When you buy a stock you become a partner of that business for good or bad. If you make an investment with *low risk*, you will receive a low predictable reward. Taking a high investment risk means that *potentially* you can receive a high reward. Stocks are risky investments and for this reason they also may provide much higher returns than a savings account. It is important that you assess what types of risk you are willing to face in exchange for the possibility of higher return. Some shares might be riskier than others. Big solid companies that have a stable stream of income have lower risks than new companies with lower market capitalisation and unstable profits. Some companies do not produce profits and their stock prices are based on forecasted future income.

Activity 6.1

Do this quick personal check by ticking the most relevant choice to each question.

Question	Yes	No	Maybe
1 I would lend my best friend £5 for a few days			
2 I would lend my best friend £50 until their next pay day			
3 If I won £500 I would prefer to put it in a savings account			
4 If I won £500 I would put £250 in a savings account and invest the rest in shares			
5 If I won £500 I would invest it all in shares			

Depending on your answers (check them with the person next to you, or a friend, or your teacher) you could be 'risk averse', meaning you have a cautious attitude, or a 'risk taker', meaning you have an appetite for risk.

One is not 'better' than the other, but your type influences your personal investment decisions.

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Activity 6.2

The graph below shows a comparison of the movements in share prices for BP, the oil giant; Lloyds Banking Group, the financial services company; and easyJet, the low-cost airline company.



- BP Plc
- Lloyds Banking Group
- easyJet

Source: www.reuters.com

Which company do you think is the riskier one? Why? Imagine that you were deciding to invest in November 2008. What would have happened if you had bought easyJet? And what would have happened if you bought Lloyds Banking Group? Bearing in mind your personal approach to risk, which company would you be most likely to buy based on this information?

Tip Compare the performance of each stock on a monthly basis.

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Activity 6.3

BAE Systems is the UK's biggest defence company and a world leader in the arms, military defence and aviation markets. It supplies a wide range of services covering all sectors, from military defence (air, land, sea and aerospace) to the civil aviation market.

BAE Systems Share Price

November 2008 to October 2009



Source: www.londonstockexchange.com

What are the risks of investing in BAE Systems? What would have happened if you invested in BAE Systems in late January 2009?

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Now look at the following article:

<http://www.guardian.co.uk/world/2009/oct/01/bae-systems-editorial>

How does political news impact on share prices?

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Activity 6.4

ICI is a large, international company. Traditionally, investors have considered it to be a safe company in which to buy shares. Click on this web link, read the brief article and then answer the questions that follow:

<http://news.bbc.co.uk/1/hi/business/2883653.stm>

What were the consequences for investors on 25 March 2003? What were the causes of the share price crash?

Click on the following web link to see what happened on 29 July 2004:

<http://news.bbc.co.uk/1/hi/business/3935971.stm>

And what happened in January 2008:

<http://news.bbc.co.uk/1/hi/business/7168348.stm>

What deal did the ICI shareholders get?

Activity 6.5

Go to the websites below and find out what 'risk-return trade-off' means:

www.investopedia.com/terms/r/riskreturntradeoff.asp

www.investopedia.com/university/concepts/concepts1.asp

Activity 6.6

Finally, here's another look at your attitude to risk. Click on:

www.money.aol.com

Go to 'Investing', then 'Investing Basics', then try the quiz on 'What Kind of Investor Are You?' Did you come to the same conclusion as when you did activity 6.1?

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