Your guide to risk and reward

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We’d all like our money to grow substantially without risking our original investment amount. Unfortunately this isn’t possible.

Almost all investment involves some degree of risk. What’s important is that you understand and are comfortable with the risks you’re taking.

For example, if you put your money in a bank account there’s almost no risk, but the interest you’ll get – your ‘reward’ – will probably be quite low.

On the other hand, investing your money in a single company’s shares is high risk, as you’re dependent on that one company. If something happens to the company, it will change the value of your shares and in the worst case, you could lose all your money. However, your reward is potentially much greater, as you could make a large gain.

Higher risk does mean the potential for higher rewards, but it also comes with a greater chance of the value of your money going down in value. On the other hand, a lower risk has a smaller chance of loss, but your money will normally grow less.

You should make sure you understand and are prepared to take these risks before you choose what you invest in.

Can I reduce risk to my investment?

You can't get rid of risk completely, so it's important to manage it carefully.

Spreading your investment risk

You can diversify risk by putting your money in different types of investment with varying levels of risk, for example, company shares, fixed interest securities, property and cash.

Pooling your investments

When you invest just on your own, it's likely you'll only be able to make a small number of different investments. However, if you buy into funds that pool many investors' money, you'll be able to buy a share of a much wider range of investments. The value of your investment will still go down if the market goes down, but it's likely that you will lose less if individual investments do not do well.

Pooled investment funds can invest in a wide range of investment types, for example:

- Fixed interest securities (such as corporate bonds, government bonds, or both).
- Commercial property.
- Company shares.
- Cash or cash-like investments.

Wherever you choose to invest, putting your money in a range of investment types means that, if something happens to one of your investments, your overall loss may be reduced. Hopefully, your other investments will not have lost money or may have gained in value.

What are the different types of risk?

There are many different types of risk and it's important to make sure you know what could happen to your money. We've set out some of the main types of risks, and we will give you more information on each product or fund when you are making your choice where to invest. There could be a risk to:

The amount you invest

- You may not get back as much as you put in.
- Investments generally go down and up in value, some types more than others. – For example, share prices generally change daily.
- If you take any money out, less is left to grow, so it may be less likely that you'll achieve your goals.

However, in most cases, you won't be able to take money out of your pension pot until you are at least aged 55.

Your investment goal(s)

- Your investment may not give you the lump sum you'd like or need in the future. You may need to invest more along the way, if it's off target.

The income you hope to receive

- Your investment may not give you the income you'd like or need, now or in the future. This is important if you need a particular amount of income from your investments or pension.

The value of your money through inflation

- The real value of the money you hold in a deposit account may reduce because of the effect of inflation.
- Similarly, the value of your investment may not keep up with inflation.
- So, inflation may reduce what you can buy with the value of your investment in the future.

Getting at your money when you want it

- You may not be able to get your money as quickly as you need it, especially in a pension plan where your money is normally tied up until you reach age 55.
- It isn't always possible to cash in investments instantly. For example, property may take a long time to sell.

Having to take income at a specific time

- The value of individual investments can go down and up every day.
- Investment markets sometimes experience catastrophic conditions where the value of all investment types goes down dramatically. It can take some time for markets to recover from these events.
- Investment types may generally fall or rise in value over longer periods due to economic conditions such as rising inflation or interest rates.
- This means that you might buy or sell investments at what may turn out with hindsight to be the wrong time.
- It's not possible to know the future so you need to make sure you're happy with when you buy and sell.

If you have a specific target date when you need your money, for example, at retirement, there is a risk that investment conditions may not be favourable at that time. This means you should think about moving your money to less risky areas in the years before you need it.

If you choose to invest in a lifestyle profile, your investment will automatically switch between different funds with the aim of reducing investment risk as you approach your selected retirement date. In other words, each time an automated switch takes place, a proportion of your investment in one fund will be sold and your money from this sale will be used to buy units in another fund. As this switching process is automatic, you should be aware that you won't have any control over the timing of when you buy and sell your investments.

Your money due to abnormal events

- On occasions the value of one or more investment types may fall dramatically. This may be preceded by a period of strong growth, sometimes called a 'bubble'. The emergence of a 'bubble' is not always obvious and may only be seen after the event and it is rarely possible to accurately predict a substantial market fall.
- This may mean that fund risks become greater than indicated when investment prices get near to their peak. Then there may be an anxious period when prices fall dramatically and are depressed for a period of time before any recovery.

The specific features of the fund you have chosen

When you buy a product from Legal & General, you'll have a choice of funds you can put your money in. We'll explain the risks associated with each fund in the fund factsheets which you can look at before you invest.

The funds you choose have risks linked to what they invest in; for example, a fund might invest in currencies other than British pounds. This means that the fund manager will need to change your money into the other currencies and back again when you want to cash in. If the other currencies go down or up in value, this will affect the amount you get back and might reduce any investment gain or increase any investment loss.

If you are invested in a lifestyle profile, you'll need to check the fund factsheets for each of the funds that form part of that strategy to identify all the potential risks that your investment may be exposed to.

Your attitude to risk

When you're deciding whether and where to invest, it's really important for you to understand your attitude to investment risk.

We believe there are four main factors that make up a person's attitude to risk:

- Whether you prefer certainty or like speculating with your money.
- How prepared you are to accept the ups and downs of investing – both in the short term and the long term.
- How much you can afford to lose.
- What you want from your money and when.

There is a default investment option for those members who don't want to make investment decisions. However, if you wish to make your own investment choices, we can't tell you what your attitude to risk is or where you should put your money. If you're not confident making these decisions, you should seek advice. Whatever you do, you need to make sure you're comfortable with the risks of investing and the risks of the specific funds that you choose.

Once you've made an investment it's important to keep your own attitude to investment risk and the risk profile of your investment portfolio under review. Your circumstances might change and so you may want to change the amount of risk you're exposed to.

Also, some investments might perform better than others, meaning you have more money in one investment compared with another. If those two investments have different risk ratings, this might result in your current portfolio being more or less risky than you chose at outset.

Risk rating our funds

We organise our funds into seven risk rating categories.

These categories are based on the risks we think they present to your money and assume you will keep your investment for at least five years. It's really important you understand that the risk rating of a fund may be significantly higher if you invest in a fund for a shorter time period. This means you should always be prepared to keep your money invested for at least five years.

Our risk ratings aim to give you an idea of the potential for you to lose money over time. However, they cannot predict what actually will happen, or when. Future investment conditions might mean that you lose more than is currently suggested by the risk rating.

Risk ratings are designed to be an indicator of the fluctuations in value that a fund may experience over time. However, funds can perform higher or lower than the risk rating that they have been given.

Our risk rating methodology

Risk ratings are calculated based on the operational and market volatility of a fund using weekly or monthly returns over a suitable period of time. We aim to use 5 years worth of fund performance to calculate a risk rating

Where a fund doesn't have enough historic performance, we use an alternative to fill the gap – for example, the fund's benchmark.

Risk can be interpreted in many ways; to some people it means the likelihood of achieving a return below their expectations.
To others, it could be as simple as the chance of losing money. These risks all have one thing in common: uncertainty. The volatility of returns is the most common measure of uncertainty and this is what we use to determine our risk rating.

Volatility refers to the rate at which the price of a fund fluctuates in value over a period of time.

Example

Volatility intervals	Risk rating
0 - 0.5%	1
0.5 - 2%	2
2 - 5%	3
5 - 10%	4
10 - 15%	5
15 - 25%	6
25% +	7

Let's say that two funds both grew by 100% over five years – but one fund is rated a 3 and the other a 7. Why is that?

We look at whether this growth is steady over that period, or whether the fund value is volatile: with short-term significant falls and increases.

The same goes for two funds that both lost, say, 20% over five years. The risk rating shows you how bumpy the ride may be, rather than whether you're likely to get a greater return.

We update our fund documentation annually and calculate the latest fund risk ratings as part of this exercise. We review these risk ratings regularly and reflect the volatility in the fund value over a suitable period of time.

We use a standard industry approach to calculating fund risk ratings without knowing your personal attitude to the different risks that exist.

Therefore, when you're looking at where to invest it's important that you don't just rely on our fund risk rating. You need to think carefully about all the different risks we've outlined and decide your view on them. Your circumstances and outlook are unique and so if you've any doubts or questions, you should seek advice.

What should I do now?

Once we've received your first contribution, you can log in to Manage Your Account to find out more about the funds available to you. If you're ready to do so, you can also make your own investment decisions.

If you'd like to make your own investment choices but feel you need more help, we strongly recommend that you speak to a financial adviser. You can find one in your local area at unbiased.co.uk. Please note that advisers will usually charge for their services.

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Q0042214 02/24 DC002639