Perpetual Private

A GUIDE TO UNDERSTANDING RISK

WHAT IS RISK?

Risk is the exposure of someone or something valued, to danger, harm, or loss. Investing your money to achieve your financial goals will always contain risk.

In financial terms, risk can be described as:

- the risk of permanent loss of capital, or
- the risk of inadequate return.

It is impossible to avoid all risks when you invest. Before making an investment decision, it is important you understand how these risks may impact you.

There are also non-investment risks that may impact your ability to protect your family, your lifestyle and your wealth.

Whilst it is not possible to detail every risk, we have outlined in this document the significant risks discussed in your financial plan, or Statement of Advice (SOA) as well as additional information to help you understand the risks and benefits relevant to the recommendation.

Please contact your Perpetual Private Adviser if you do not understand anything, or need further information.

NON-INVESTMENT RISKS

There are numerous risks that can impact you, your family, your lifestyle and your wealth.

Your health

In the event that you become ill, you may temporarily or permanently be unable to earn income and support your lifestyle.

Your estate

Your wealth may be exposed to claim both now and in your death.

For example divorce, being sued or having your will challenged.

Your death

Will your family be able maintain their lifestyle after you have gone?

HOW DO YOU MANAGE NON-INVESTMENT RISK?

You can manage these risks by engaging with professionals such as financial advisers, accountants and estate planning specialists.

Implementing sufficient insurance cover and having a robust estate planning structure in place will help mitigate these risks.

INVESTMENT RISKS

YOUR ATTITUDE TO RISK

WHAT DOES RISK MEAN TO YOU?

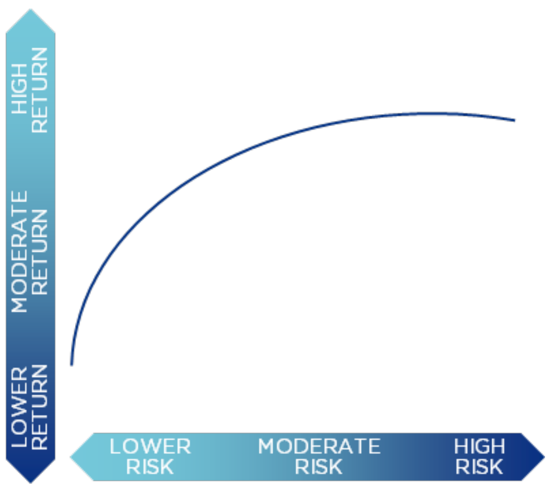
Risk can mean different things to different people. Your level of risk will vary depending on the time frame you have to achieve your goal and your appetite for risk.

If you have a long investment timeframe, then you can afford to ride out the short-term volatility of financial markets. But if your investment timeframe is shorter, or you are more risk adverse, then more conservative (safer) investments may be more appropriate.

THE RELATIONSHIP BETWEEN RISK AND RETURN

In general, higher potential returns usually come with higher risk while lower risk investments generally make lower returns. This is known as risk/return trade off.

CHART 1: RISK AND RETURN

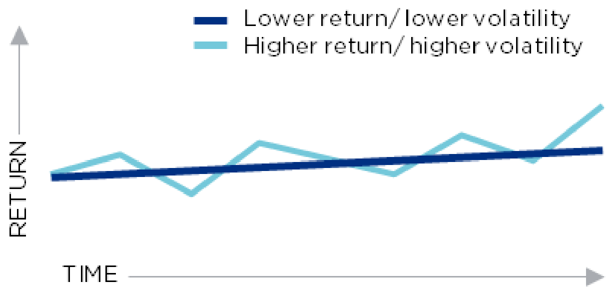


Source: Perpetual.

The important thing is to understand the risks and then keep within a level you are comfortable with.

Your investment returns will likely fluctuate over the short term for higher risk investments. This is known as volatility.

CHART 2: RETURNS AND VOLATILITY



Source: Perpetual.

Your risk assessment will determine your agreed 'risk profile' and this will shape a suitable investment portfolio for you.

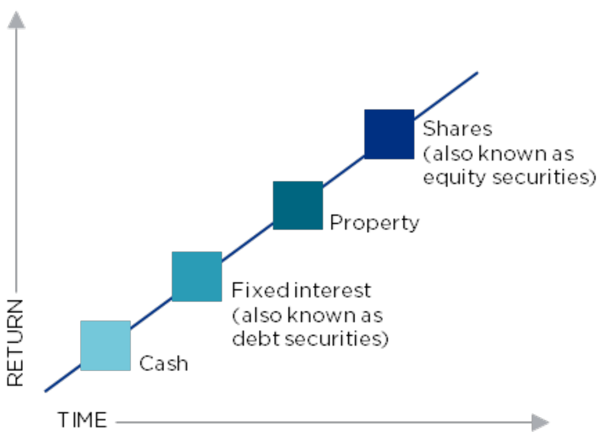
ASSET CLASS AND INVESTMENT RETURN

Investments can be broadly categorised into two asset classes – Defensive and Growth.

Defensive assets reduce the risk of capital loss but offer lower rates of potential return. In contrast, growth assets have the potential to achieve a higher rate of return over the long term but this comes with greater risk of fluctuations in investment value.

Defensive assets include cash and fixed interest such as bonds. Growth assets include shares and property.

CHART 3: RISK AND RETURN COMPARISON



Source: Australian Bankers Association, *Smart Investing*

RISKS YOU SHOULD BE AWARE OF

There are a number of specific risks to consider when making investment decisions:

INVESTMENT RISK

The value of your investment may fall for a number of reasons, including the risks set out below, which means that you may receive less than your original investment when you withdraw.

MARKET AND ECONOMIC RISK

Certain events may have a negative effect on the value of investments within a particular market. These events may include changes in economic, social, technological or political conditions, as well as market sentiment.

For example, during the global financial crisis (GFC, issues with some mortgage investments impacted global stock markets.

ASSET RISK

A particular asset may fall in value, which can result in a reduction in the value of your investments.

For example, if a share such as BHP drops in value and you sold these shares you would realise a loss.

CURRENCY RISK

For investments in international assets, which have currency exposure, there is potential for adverse movements in exchange rates to reduce their Australian dollar value.

For example, if an Australian dollar rises in value, the value of international investments expressed in Australian dollars may fall.

INTEREST RATE RISK

Changes in interest rates may have a negative impact, either directly or indirectly, on investment returns.

For example, a drop in interest rates will lower the return on cash and fixed interest type investments.

CREDIT RISK

The issuer or party to a transaction may not repay the principal, make interest payments or fulfil other financial obligations in full and/or on time.

The market value of an investment can also fall significantly when the perceived risk of a fixed income security increases or its credit rating declines.

For example, Government or Corporate bonds may not be repaid.

LIQUIDITY RISK

The absence of an established market or shortage of buyer for an investment can result in a loss if a holder of an investment needs to sell it within a particular timeframe. A shortage of liquidity can also result in delays in the payment of withdrawals.

For term deposits, liquidity risk is the risk of not being able to access your investment in a term deposit prior to its maturity date and/or without penalty.

For direct property, liquidity risk is the risk of not being able to sell the property quickly if you need to access your funds within a particular timeframe.

DERIVATIVES RISK

A derivative is a financial instrument that derives its value from the price of a physical security or market index. Some investment managers many use derivatives in the management of their underlying funds for a range of investment activity.

Derivative values can fluctuate significantly and in some circumstances, a derivative may be more volatile than the underlying asset or index. The value of a derivative contract may fall as a result of an adverse movement in the underlying asset or index. Losses can be magnified where a greater exposure is created through the derivative position than is backed by the assets of a fund.

Derivatives may also be subject to liquidity risk and/or counterparty risk. Depending on market conditions, derivative positions can be costly or difficult to reverse.

COUNTER-PARTY RISK

A loss may occur if the other party to a contract defaults on their obligations under the contract.

LEGAL AND REGULATORY RISK

Changes in legislation and differences between rules (including interpretation of the law) in domestic and foreign markets, including those dealing with superannuation, taxation, accounting and investments, may adversely impact your investments.

For example, changes to Superannuation may impact your investments as well as your ability to access your retirement funds when and how you wish.

Portfolio concentration risk

Investing in a smaller number of investments may lead to more volatile returns than investing in a more diversified portfolio.

For example, holding 80% of your portfolio in s single stock such as BHP exposes your wealth to any change in the BHP share price.

INVESTMENT STRATEGY RISKS

The investments you choose with your adviser may involve specific risks. You should also refer to the relevant disclosure document for each of your chosen investments for details about any specific investment risks.

For example, an investment strategy may be selected to meet your retirement goals. Prolonged softness in returns may not allow you to meet your goals.

MANAGED INVESTMENT RISKS

The following risks are inherent with investing in any managed investments:

- Manager risk- the risk that the manager does not meet their obligations.
- The investment professionals employed by an investment manager may change, which may affect the future performance of a managed investment.
- Investing in a managed investment may have a different tax outcome than investing in assets directly because of the application of tax laws to the fund and the impact of investments and withdrawals by other investors.
- Transactions may be suspended, which may result in delays in paying withdrawal requests
- The managed investment may be terminated.
- For example the success of the managed investments returns may depend on some key individuals. If these individuals leave the manager, returns may be compromised.

INFLATION RISK

The possibility your investment return is below the inflation rate which reduces the spending power of your money.

GEARING RISK

Gearing (or borrowing to invest) can be undertaken directly by the investor or within a managed fund. Gearing magnifies both losses and gains. The more you borrow, the greater the risk you have as you have a legal obligation to repay the loan regardless of the performance of your investments.

PERPETUAL'S APPROACH TO MANAGING RISK WITH OUR CLIENTS.

We can't eliminate all risks, however Perpetual aims to mitigate the risks by utilising a number of methods.

RISK PROFILE ASSESSMENT

Your adviser will determine the appropriate level of risk for you by conducting the risk profile assessment.

ENGAGING YOU

We are here to help. Your adviser will be available to explain and assist you with the questions you have. Regular review can assist with reducing investment strategy risk.

PERPETUAL INVESTMENT PHILOSOPHY

Our investment philosophy is to first protect and then grow the wealth of our clients.

Our approach to portfolio construction and investing is based around the following key principles:

- We take a long-term approach to investing
- We believe quality investments will yield benefits in the long-run and our recommendations are based on this foundation
- We are responsive to client needs and provide long-term strategic investment advice
- We aim to protect our client's wealth by minimising downside risk.

We aim to protect your wealth and manage risk by:

- Diversifying across asset classes, industry sectors and individual investments
- Ensuring that investments in your portfolio meet Perpetual's stringent quality investment criteria.

DIVERSIFICATION

No one type of security, asset class or investment manager always delivers the best performance. Diversification helps you ride out the ups and downs of financial markets by spreading your money across different asset classes, markets and regions and; investment managers.

Across asset classes

Markets for varying asset classes perform differently at different times, which means when returns for one asset class are high, returns for another asset class may be low. By having your funds spread across a number of different investment types, your overall returns will be less volatile.

This may assist with mitigating portfolio concentration risk and asset risk.

Across markets and regions

Spreading your investments within each asset class across a wide range of countries, currencies, industries and stocks ensures your investment is not concentrated in a particular region or industry. This reduces the impact of a region or industry downturn has on your investment portfolio.

This may assist with mitigating market risk and currency risk.

Across investment managers

Different investment managers or fund managers adopt different styles. By combining a range of investment managers with complementary investment styles your money is not concentrated in any one style in each asset class.

This may assist with mitigating investment strategy risk, portfolio concentration risk, derivatives risk (not all fund managers use derivatives) and the risk of reliance on any single manager.

This may assist with mitigating managed investment risk.

This document is prepared by Perpetual Trustee Company Ltd (PTCo) AFSL 236643 and contain general information on the risks and benefits associated with financial planning strategies and products. It must be read in conjunction with the Statement of Advice prepared by PTCo advisers. July 2017.

MORE INFORMATION
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