BNY | INVESTMENTS

The 5 Ws of DOWNSIDE RISK

WHAT is downside risk?

Investing can be like a ladder, in order to climb in value (or reward), you risk a steeper fall (or loss). Downside risk is the potential fall from your ladder (or investment) – how likely you are to fall and how far.

WHO does it impact?

Downside risk can impact anyone with investments. It can be particularly harmful for those making withdrawals from their investments.

WHY is it particularly impactful to those in retirement?

Nobody wants to lose money, but it can be particularly bad during retirement.

If you are taking a retirement income from your investments and the market falls you could find that you have to sell more of your investments to generate the income you need. This means that your savings could run out sooner than you expect.

WHEN is managing downside risk most important for those in retirement?

Managing downside risk is important throughout retirement but particularly in the early stages of retirement. Losing money early in retirement can be particularly difficult to recover from, and a failure to manage downside risk could result in running out of money too soon.

WHERE can you invest to manage downside risk?

Ways you may consider to manage downside risk include:

1. You can take less risk overall and invest in cash. This will mean your downside risk will be low, but so will your potential for rewards. In other words, using our first analogy, you would have a very small ladder.
2. You could invest in assets which tend to have lower downside risk but still offer the potential for reward. These could include some fixed income funds, equity income funds, and funds that focus on quality companies.
3. You could divide your savings between lower-risk investments (such as cash and fixed income) and higher-risk investments. Your lower-risk investments should allow you to meet your income needs in the short-term giving your higher-risk investments time to grow.

Dividend(s): A sum paid regularly by a company to its investors as a reward for holding their shares.

Equity income funds: Funds that invest in shares of companies that are expected to pay higher dividends.

Fixed income funds: Fixed income investment securities pay investors fixed interest or dividend payments until their maturity date. Fixed income funds hold those securities or bonds. A bond is a loan of money by an investor to a company or government for a fixed period in exchange for a fixed interest rate payment and the repayment of the loan at the end of the period. However funds may offer variable income. (Fixed income funds that hold shorter-term bonds tend to have lower downside risk).

Quality companies: Financially strong companies that have generated superior and stable profitability.