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12 questions to ask before investing

Which investment best suits my risk profile?

Determining your risk profile is one of the most important aspects of investing, yet many people don't take their time to adequately work this out. This leaves them exposed to more risk than they can handle and robs the investor of getting the best out of his or her investment. We have already explained how to identify your risk profile: ask yourself how much time you have to invest and how you would react to a 10% loss in your portfolio. If you did this correctly, the next question to ask is: "which investment (s) is/are appropriate for my risk tolerance?"

Why is this important?

If a doctor was able to diagnose your sickness correctly but failed to give you a remedy, would you consider it very helpful? The whole point of diagnosis is to recommend the right combination of drugs or treatment. Matching your risk tolerance to a suitable investment product is the equivalent of diagnosis and treatment. As an investor, correctly matching your risk tolerance to the appropriate investment product helps you to get the most from your investment.

How can we determine a suitable investment?

Different investments behave differently. Although all investments have a degree of risk, they vary in their level of risk. This risk is linked to the volatility of the investment - whether it's relatively stable or fluctuations are significant. To select a suitable investment, first of all, you should be looking at the risk profile of the investment and secondly, consider the time you have left to invest, known as your time horizon.

Here's what you should look out for based on your risk tolerance.

Low risk profile: An investor with a low risk tolerance is one that cannot stomach a lot of volatility and is more suited to low-risk investment products and conservative portfolios. For you, money market an fixed-income investments will be most suitable. These products are safe because their risk-return profile is low and returns over the years have been relatively stable. At Databank, these would be Treasury Bills, MFund and EdIFund Tier 1.MFund, for example, has posted a return rates ranging from 28% to 12% in the last 11 years. This gap is relatively small if compared to return rates of other riskier investment products. Investors with a short-term horizon (investing for less than a year) should also consider investing in low-risk investment products.

Medium risk profile: You should choose balanced mutual funds or stocks of large, healthy companies if your risk tolerance is medium. At Databank, the mutual funds to go for would be BFund, ArkFund and EdIFund Tier 2. These products have a mix of fixed income investments and equity as medium risk investors are able to take on some level of risk, although not too much. The balance is effective because while equity is high risk, the fixed income will help to neutralise the impact of wild fluctuations and significant changes to the investment while still growing your investment. In addition, you can invest in any of the investments for the low-risk profile.

High risk profile: Equity is ideal for the investor with a high risk tolerance. Equity mutual funds or stocks are unpredictable and can change drastically from one day to the other. But with this high volatility and uncertainties come the potential of very high returns. Epack, Databank's equity investment fund, for example, has gone as high as 137% and as low as -12.21% in the past 23 years. This shows a very wide gap and an investor may never be able to predict in which direction his returns would go. But since he/she is patient and is in for the long term, he/she is likely to grow the investment significantly. This is another reason why high-risk investments are ideal for investors who have a long-term investment horizon (more than 5 years). You can also invest in any of the products for low and medium risk if your risk profile is high.

A note to equity investors

As already stated, investing in equity comes at a high risk–return rate. If you are in for the return, you have to be ready for the risk too. One of the most common investment mistakes is a rush to exit the stock market at the wrong time. It is never a good idea to leave during a stock market recession because the market could quickly pick up in a number of days while you have sold your shares. By the time you decide to reinvest, those peak days would have been over.

The best is to stay invested for as long as possible. That way you give your money the opportunity to grow back even if you make some losses along the way. History has proven that markets always bounce back after a recession and it is the patient investor who gets rewarded.

Invest wisely. Invest with Databank.