



DO YOU UNDERSTAND YOUR INVESTMENTS?

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CARLA SEELY – Guest Columnist

Over the years I have met many investors and based on our conversations, I can confidently state that it appears only half of them actually know what they have invested in. More importantly, they do not have a complete understanding of the risks associated with their investments. Certainly the potential for reward tends to outweigh the downside of the investment. However, risk and reward are two key components in understanding the type of investment you should be looking at.

Risk, in general, is defined as the possibility of sustaining a temporary or permanent loss. This is true in the world of investments. Investments that are termed “high risk” have a significant possibility of experiencing large swings in their returns. In the simplest of terms risk is a measure of whether a surprise will occur – both positive and negative. For example a company’s revenue and profits may explode suddenly and as a result the stock price may rapidly move upward, a positive surprise for the stockholders. Sometimes a company’s results are poor and the stock will begin a downward spiral in price, a negative surprise for the stockholders.

Investing individuals will have very different tolerances for risk, and their tolerance will change during their lifetimes. In general, if an investor needs cash within a short period of time, then that investor should not put money into high risk vehicles. On the other hand, if

an investor has a very long time horizon, then that investor should seriously consider choosing investments that offer the best possibility of good returns. The long period of time before that person needs the money offers the investment a chance to grow and occasional downturns will most likely be offset by other gains.

“You work hard for the money you make so it is equally important to work hard to understand how to make the most out of your investments.”

Many investors understand the principles of diversification and risk well enough to know it is unwise to “put all of their eggs in one basket”. However many do not always know how to avoid this in practice. Most successful investors will tell you, diversification is key. A diversified

investment portfolio not only reduces unwanted risk, but also contributes to a potentially more profitable portfolio. Having a well-diversified portfolio doesn’t necessarily mean buying a second investment; it means branching out into other asset classes.

Always do your homework and never invest in anything that you don’t understand. The more you know, the better off you will be. This requires that you take the time to learn and pay attention to events that might affect you. You work hard for the money you make so it is equally important to work hard to understand how to make the most out of your investments. It’s important to understand how each of your investments fit in with the rest of your portfolio and with your overall strategy.

Finally, it is imperative that you read the fine print. Make sure that you understand the restrictions and fees associated with



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your investments. Is there a minimum level at which you can invest? Is there a cost to get into the fund (front-end load) or get out of the fund (back end load)? Is there a minimum commitment time or locked in period? What is the penalty for making withdrawals? How is the investment advisor compensated? Is the advisor paid a salary or commission or a combination of both?

There is no golden rule to investing; there is no right or wrong answer. The key questions that you must always ask yourself are “Do I understand what I am investing in?” and “Do I understand the risks associated with my investment?”

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