



Fisher Funds

Investor Education Centre

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Risk and Reward

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Risk is the ugly twin sister of reward when it comes to investing.

All investments carry some risk, and you have to accept risk if you want to reap the rewards of investing. The higher the potential rewards, the higher the risks associated with an investment. For some people, the very thought of risk makes them uncomfortable so they avoid investing in anything other than the safest of investments. But actually, there is risk associated with taking the safe option – the risk of not achieving your financial objectives.

According to the dictionary, risk is “the possibility of loss or injury”. While investing in perceived “riskless assets” may let you sleep well at nights, you risk not having choices available to you later in life because you can’t afford them.

Risk cannot be avoided when investing, but there are ways that risk can be managed. At its simplest, risk can be managed through diversification. We talked about that recently – spreading your eggs among a number of different baskets so that one single egg (or investment) won’t have too big an impact.

Risk can also be managed through research and experience. An example from everyday life is that most people who have never experienced a bungee jump regard it as scary and high risk. But seasoned bungee jumpers feel more and more comfortable with each jump because experience lets them understand the risks and take necessary precautions to minimise them. Every jump still carries risk, but experience makes it that much easier to cope with. The same applies to investing.

I remember early in my career when I first began researching companies and recommending which of them was a Buy, Sell or Hold. Talk about sweaty palms every time one of my recommended stocks fell in price or announced some news! But I soon learned that if I had researched them well and understood the key factors that drove their profitability, I could sleep at night without having to worry about all the extraneous factors. A good example of managing risk is the way two of my portfolio companies expanded their operations into Australia.

There used to be a perception that if a New Zealand company expanded its business internationally, it became riskier because of the uncertainty of operating in a different country with different rules and customs. I tended to invest in companies based in New Zealand because there was something comfortable about investing in my ‘own backyard’. But then Michael Hill and Mainfreight, who had been very successful in New Zealand, decided to build their operations in Australia.

Both management teams managed the risks associated with international expansion by thoroughly researching the market, starting small (Michael Hill opened just two stores in Australia), and manning the operations with experienced staff from New Zealand. Within eleven years, Michael Hill was earning more from its international operations than its New Zealand business, while nearly half of Mainfreight’s \$900 million revenue now comes from its international business. These rewards illustrate that some risks, managed carefully, are well worth taking.

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