Invest...don’t gamble
Thomas Dickson gives some financial advice

A s I write this, a new coa-
tition government, led by
David Cameron, has an-
nounced its intention to reform
income tax structures and con-
sider cutting corporation tax.
Slightly further afield, the Eu-
ropean Union is on tenterhooks
as it waits to see what effect
the recent rescue bid for Greece
will have on the value of the Euro.
The financial markets are always
quick to react to political flux and
no doubt, these political develop-
ments, both in U.K. and in Europe,
will be reflected economically.

While speculation is always
rife, nobody actually knows what
is going to happen, or indeed
how macro-economic trends
could impact on assets closer to
home, such as dental practice
valuations. The reality is that the
markets will always be volatile
and reactionary - one week, going
up (“FTSE up 5.16 per cent due
to Euro Aid package for Greece”)
and the next, plummeting (“FTSE
loses £100bn in a week.”)

So, should we really worry
about short term trends and does
it matter to the average dental
professional who might be consider-
ing investing in the stock market?

If you are a day trader or one
of those rare dentists who likes
to indulge in a spot of spread
betting or FOREX trading, then
financial speculation based on
guesses about future outcomes
is bound to excite you. However,
what you’d really be doing is
gambling. This can have its re-
wards but also clearly puts you
at a greater risk of experiencing
financial losses.

Investing in the stock market
does not have to be about gam-
bling, though. Those interested
in reaping more modest but
steadier rewards need to be pre-
pared to play the long game.
For the majority of people, this option
holds far more appeal.

Recent research conducted
by Morningstar looked at in-
vestments made in the U.K. stock
market over a series of 10 year
increments spanning the period
between 1984 and 2009. The
survey revealed that on aver-
age, during each decade, inves-
tors never lost their money. Put
another way, had you invested
during any one of the 181 pos-
sible 10 year time frames, you
would not have lost money.

My advice would therefore be
to ignore all the hype surround-
ing the latest ups or downs in
the market and consider those
investment returns that can be
made over the long term

However, the way you choose
to invest is largely down to pref-
erence. Which brings us to an-
other matter: risk tolerance.

Risk Tolerance
People react differently to risk.
Some see it as an opportunity;
others, as a threat to their secu-
ritv. Still others are prepared
to take risks in one area of their
life, but not in others. Risk toler-
ance is the level of risk a person
will willingly accept and is best
thought of as a continuum rang-
ing from risk-avoidance to risk-
seeking behaviour.

Earlier, I mentioned the day
traders and speculators. Who
enjoy trading in the short term.
Clearly, this type of investor has
a high risk tolerance. However,
research shows that the major-
ity of people are more risk-averse
than risk-seeking. Faced with a
choice between a certain profit
and an uncertain but probably
larger profit, a sizeable majority
choices the certain (but probably
smaller) profit.

Given the results of the Morn-
ingstar study, it would seem that
costs is well-placed and a more
conservative approach invol-
volving lower risk investments,
on the long-term is much less
likely to lose you money.

However, the whole issue of
financial risk is a difficult one.
On the one hand, low risk tol-
érance prevents many people
from doing as well as they could
financially. On the other, some of
life’s most unpleasant finan-
cial surprises arise when people
expose themselves to a level of
risk beyond that of their comfort
zone, i.e. their risk tolerance.
It therefore depends very much
on your risk tolerance profile – a
psychological trait that can now
be measured using psychometric
profiling techniques.

Although psychological pro-
filing has not with it’s share of
controversy, it is now widely
accepted as a useful tool for as-
sessing people’s overall behav-
iorial tendencies. This includes
investment risk, which can now
be measured using Risk Profil-
ing systems such as Finametrica.
If you are interested in learning
more about your risk profile, you
should contact your independent
financial adviser, who may well
have access to such tests.

Types of investment
Risk tolerance naturally deter-
mines the type of investment
people feel most comfortable in
making.

Investments usually take the
form of one of two types: unit
trusts and shares. In terms of
risk, the latter usually involves
more risk than the former.

Because investment shares
are a more direct form of invest-
ment – buying shares in a list-
ed company, for example, their
market value can fluctuate fairly
substantially. This makes them
a slightly riskier form of invest-
ment than unit trusts, which
spread risk by buying shares in
a range of companies, which is
then managed through one fund.

As an investor, you would buy
units in that particular unit trust
fund and hope that the difference
between the performances of
high and low risk shares helped
to balance out the overall value
of each unit over time. However,
it is worth noting that the overall
degree of risk you are prepared to
depend on the investment strategy
of the trust; is it in established
companies or smaller, riskier
emerging markets?

Clearly those investors who
are risk-averse would be advised
to not only opt for longer-term
investments, but also consider-
ing investing in unit trusts, rather
than shares.

So, assuming that you are
able to invest in the stock market,
and hold on to that investment for
ten plus years, and are willing to
ignore those commentators who
think you should sell this tomor-
row or hoy that now, you’ll prob-
ably end up making some money.

At that stage, your main prob-
lem will be how to reduce the tax
on your capital gains – but that
is the subject of another article,
especially if the government de-
cides to raise the thresholds in
this area.

The figures above are for
guidance only to reflect the
position at the time of writing.
The value of investments can go
down in value as well as up. It is
therefore important that you un-
derstand the risks and your com-
mitments.

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