Sentry Risk Profiling Process

What is risk profiling?
This term is used a lot but it can be difficult to obtain an exact definition. For the purposes of this process we will define your:

"risk profile" as your tolerance to the risk of capital loss, i.e., how much can you handle losing some of your money

Some people have a low risk profile which means they have a low tolerance to the risk of capital loss whereas others have a high risk profile which means they have a high tolerance to the risk of capital loss.

What can affect your risk profile?

An individual's risk profile may vary depending on the following:

Buoyant investment markets. For example, when we have periods of high share market and property returns over long periods of time it is not unusual for individuals who usually have a low risk profile to start investing in shares and property. There is often the belief that the "good times will continue forever" and/or "I don't want to miss out". They have moved from a low risk profile to a high risk profile. However, share markets and property prices eventually fall with investors losing money. These same investors now move back to their norm being low risk profile investors.

Age of individual. Another change in risk profile can occur as a person approaches retirement age. Often, a younger person will have a higher risk profile and be more prepared to accept capital loss. This could be because they have the capacity to recover any losses through long periods of employment savings. However, a retired individual who has no employment income may have a low risk profile because they are no longer working.

Size of asset base and/or large income sources. Individuals who have a large amount of excess assets may have a higher risk profile as any loss (although undesirable) will not materially affect their standard of living. For example, a person with $10 million may be more willing to accept a loss that a person with $100,000. Likewise, individuals with high incomes, e.g., $200,000 and above, may be more willing to accept a higher risk profile than those on incomes on $40,000 to $50,000.

Temperament of individual. Regardless of their station in life there are some individuals who are high risk takers and those who are not.

Gender. Males tend to take more risks than females.

The Risk Profile Questionnaire

The following questionnaire was developed by 2 scholars in the United States and tested on groups of individuals to determine their risk profile. It is a guide only and will be used as a discussion with you about your risk profile. Each response has a score value and the total of the score equates to a risk profile.

The Grable and Lytton Risk Tolerance Scale (G/L-RTS)

Question number	Question	Score
1	In general, how would your best friend describe you as a risk taker?	
(a)	A real gambler	4
(b)	Willing to take risks after completing adequate research	3
(c)	Cautious	2
(d)	A real risk avoider	1
2	You are on a TV game show and can choose one of the following. Which would you take?	
(a)	$2,000 in cash	1
(b)	A 50% chance in winning $10,000	2
(c)	A 25% chance at winning $20,000	3
(d)	A 5% chance at winning $200,000	4
3	You have just finished saving for an "once-in-a-lifetime" vacation. Three weeks before you plan to leave, you lose your job. You would:	
(a)	Cancel the vacation	1
(b)	Take a much more modest vacation	2
(c)	Go as scheduled, reasoning that you need the time to prepare for a job search	3
(d)	Extend your vacation, because this might be your last chance to go first-class	4
4	If you unexpectedly received $40,000 to invest, what would you do?	
(a)	Deposit it in a bank account	1
(b)	Invest it in safe non-bank high-quality interest earning investments	2
(c)	Invest it in shares or share trusts	3
5	In terms of experience, how comfortable are you investing in shares or share trusts?	
(a)	Not at all comfortable	1
(b)	Somewhat comfortable	2
(c)	Very comfortable	3
6	When you think of the word "risk", which of the following words comes to mind first?	
(a)	Loss	1
(b)	Uncertainty	2
(c)	Opportunity	3
(d)	Thrill	4

7	Some experts are predicting prices of assets such as gold, jewels, collectibles, and real estate (hard assets) to increase in value. Government bond prices may fall. However, experts tend to agree that government bonds are relatively safe. Most of your investment assets are now in high interest government bonds. What would you do?	
(a)	Hold the bonds	1
(b)	Sell the bonds, put half the proceeds into money market accounts, and the other half into hard assets	2
(c)	Sell the bonds and put the total proceeds into hard assets	3
(d)	Sell the bonds, put all the money into hard assets, and borrow additional money to buy more	4
8	Given the best and worst case returns of the four investment choices below, which would you prefer?	
(a)	$500 gain best case; $0 gain/loss worst case	1
(b)	$1,500 gain best case; $500 loss worst case	2
(c)	$5,000 gain best case; $2,000 loss worst case	3
(d)	$10,000 gain best case; $5,000 loss worst case	4
9	In addition to whatever you own, you have been given $2,000. You are now asked to choose between:	
(a)	A sure gain of $1,000	1
(b)	A 50% chance to gain $2,000 and a 50% chance to gain nothing	3
10	In addition to whatever you own, you have been given $4,000. You are now asked to choose between:	
(a)	A sure loss of $1,000	1
(b)	A 50% chance to lose $2,000 and a 50% chance to lose nothing	3
11	Suppose a relative left you an inheritance of $200,000, stipulating in the will that you invest ALL the money in ONE of the following choices. Which one would you select?	
(a)	A bank savings account	1
(b)	A unit trust that owns shares and bonds	2
(c)	A portfolio of 15 common shares	3
(d)	Commodities like gold, silver, and oil	4
12	If you had to invest $40,000, which of the following investment choices would you find most appealing?	
(a)	60% in low-risk investments, 30% in medium-risk investments, 10% in high-risk investments	1
(b)	30% in low-risk investments, 40% in medium-risk investments, 30% in high-risk investments	2
(c)	10% in low-risk investments, 40% in medium-risk investments, 50% in high-risk investments	3

13	Your trusted friend and neighbour, an experienced geologist, is putting together a group of investors to fund an exploratory gold mining venture. The venture could pay back 50 to 100 times the investment if successful. If the mine is a bust, the entire investment is worthless. Your friend estimates the chance of success is only 20%. If you had the money, how much would you invest?	
(a)	Nothing	1
(b)	One month's salary	2
(c)	Three month's salary	3
(d)	Six month's salary	4

Profile	**Min**	**Max**		**Your score was**
Secure	13	18		
Conservative	19	24		
Moderately conservative	25	30		
Moderate	31	36		Information about what your score means is detailed below.
Moderately aggressive	37	42		
Aggressive	43	47		

Some asset classes and how they behave

Some asset classes are:

- Cash
- Fixed interest (this is mainly for institutional investors)
- Property
- Listed Shares
- Alternatives

Most investment options/structures, e.g., super, unit trusts, deal with the above asset classes. Some of the characteristics of the assets classes when investing **directly** are:

Item	Cash	Fixed Interest	Direct Property	Listed Shares	Alternatives
Liquidity	Usually within 24 hours	Depending on term of investment	Usually a number of months but can be longer	Usually within 3 days but for some shares there may be no liquidity, e.g. some smaller companies.	Depending on the investment which includes assets such as gold, derivatives, hedge funds. Can be a number of months.
Risk of capital	Usually None	None to high, e.g., banks would be regarded as secure whereas some fixed interest products offered by private firms have seen investors lose all their money	Low but depends on the area and prevailing economic conditions	High. Some companies have lost all their value whereas other larger firms have dropped in value by 60% at times.	High. Prices vary greatly.
Cost to transact	Nil unless there are maintenance fees	Usually nil for the initial purchase but will be some fees to buy and sell	State government stamp duty to purchase. Optional agent's fees to sell.	Usually low. Full service brokers usually cost around 1% of amount transacted. On-line brokers charge much less	Low to high depending on nature of investment
Typical time you should stay invested	Immediate	Depending on term of investment	Usually 5 years or more	Usually 7 years or more	Usually 7 years or more
Tax efficiency	None	None	Good	Good	None to good

Caution: The characteristics when investing through a structure may be totally different. This is because the structure may have its own rules. For example, when investing in shares through a unit trust, the investor may not have access to cash as quickly as if the investor owned the underlying shares directly – it could take weeks to receive their money.

Historical perspective on risk

To give an idea of how much the value of investments can fluctuate study the table below.

Characteristics	Australian shares	International shares	Australian listed property	Diversified alternatives	Australian Fixed interest	Australian cash	Australian Inflation
Average historical return	12.84%	12.51%	12.17%	13.23%	10.02%	8.73%	4.24%
Average real return	8.60%	8.27%	7.93%	8.99%	5.78%	4.49%	N/A
Worst return over any 12 months	-40.45%	-33.38%	-58.24%	-18.95%	-6.19%	2.48%	-0.45%
Best return over any 12 months	86.13%	92.86%	53.32%	39.38%	25.74%	19.28%	12.41%
Likelihood of a negative return (1 year in …)	4.42	3.70	8.06	10.39	31.62	Never	51.38
Probability of a negative return	22.63%	27.01%	12.41%	9.62%	3.16%	0.00%	1.95%

*This data is based on the period 31 December 1979 to 28 February 2015.

The results are averages only. In real life, investment returns are random, e.g., you cannot read the above table and state that **exactly** every 4.42 years Australian shares will give you a negative return. Sometimes negative returns occur 2 years in a row and you may then get 8 years of positive returns.

However, it is important to note that except for cash and generally fixed interest all the other investments are speculative over the short term. As an example, if you happened to invest $10,000 in Australian shares in the worst year you would have lost $4,420 by the end of that year and your investment would only be worth $5,580.

Minimising risk

Except for placing all your money in cash in one of the big 4 Australian banks, it is difficult to reduce risk completely (even then it is not guaranteed 100% but it would be reasonable to assume if one of the big 4 Australian banks went bankrupt the Australian economy would be in a big mess). One way to minimise risk is to have some money in most of the different assets classes. The mix is infinitely variable. However, 6 typical mixes are given below.

Investor profile characteristics:

	INVESTOR PROFILE					
	Secure	**Conservative**	**Moderately Conservative**	**Moderate**	**Moderately Aggressive**	**Aggressive**
Investment Objective	Provides income from cash like securities while preserving the capital value of your investment.	Provides a relatively stable investment by investing primarily in defensive assets while maintaining a small exposure to growth assets.	Provides a relatively stable investment by investing primarily in fixed interest assets while maintaining a moderate exposure to growth assets.	Provides a balanced investment return by investing mostly in a mix of defensive and growth assets.	Provides a potential investment return greater than the diversified balanced strategy by investing mostly in growth assets.	Provide a high growth investment return from exposure to International and Australian Listed Shares.
Suitability	Investors seeking stability of capital combined with high liquidity. Possibility of a negative return is unlikely. However, over time the relative return should be low and has little protection against inflation.	Investors should expect some short to medium term fluctuations in the value of their investment. There is a relatively small probability of a negative return over short to medium term investment periods.	Investors should expect some short to medium term fluctuations in the value of their investment. There is a relatively small probability of a negative return over short to medium term investment periods.	Investors should expect short to medium term fluctuations in the value of their investment. There is a moderate probability of a negative return over short to medium term investment periods.	Investors should expect short to medium term fluctuations in the value of their investment. There is a high probability of a negative return over short to medium term investment periods.	Investors should expect to experience short to medium term fluctuations in the value of their investment. There is a high likelihood of a negative return in a given investment period.
Income/growth Objective	Income only. No growth	Mainly income. Very low growth	Mainly income. Low growth.	Balance between income and growth	More growth than income	Low income. Mainly growth
Liquidity	Usually within 30 days if using a managed fund	Usually within 30 days if using a managed fund	Usually within 30 days if using a managed fund	Usually within 30 days if using a managed fund	Usually within 30 days if using a managed fund	Usually within 30 days if using a managed fund
Minimum Investment Term	No minimum	3 years	4 years	5 years	6 years	7 years
Expected Long Term Return	CPI + 0.5%	CPI + 1.5%	CPI + 2.5%	CPI + 3.5%	CPI + 4.5%	CPI + 5.0%
Average historical profile return (%pa)	8.73%	10.25%	10.84%	11.43%	12.02%	12.61%

***Note – even where there is a minimum time frame there is no guarantee you will receive 100% of your capital back after the minimum time frame and over a market cycle**
****These asset allocations are as below.**
*****Returns from 31 Dec 1979 to 28 Feb 2015**

<table>
<tr><th></th><th colspan="12">Investor Profile without alternatives</th></tr>
<tr><th></th><th colspan="2">Secure</th><th colspan="2">Conservative</th><th colspan="2">Moderately conservative</th><th colspan="2">Moderate</th><th colspan="2">Moderately aggressive</th><th colspan="2">Aggressive</th></tr>
<tr><td>Average real return over inflation (%pa)</td><td colspan="2">4.49%</td><td colspan="2">5.97%</td><td colspan="2">6.57%</td><td colspan="2">7.16%</td><td colspan="2">7.75%</td><td colspan="2">8.34%</td></tr>
<tr><td>Worst return over any 12 months</td><td colspan="2">2.48%</td><td colspan="2">-4.51%</td><td colspan="2">-6.69%</td><td colspan="2">-15.73%</td><td colspan="2">-25.16%</td><td colspan="2">-34.68%</td></tr>
<tr><td>Best return over any 12 months</td><td colspan="2">19.28%</td><td colspan="2">27.27%</td><td colspan="2">34.66%</td><td colspan="2">42.23%</td><td colspan="2">49.81%</td><td colspan="2">57.38%</td></tr>
<tr><td>Likelihood of a negative return (1 year in …)</td><td colspan="2">Never</td><td colspan="2">67.67</td><td colspan="2">9.90</td><td colspan="2">6.55</td><td colspan="2">5.01</td><td colspan="2">4.41</td></tr>
<tr><td>Probability of a negative return</td><td colspan="2">0.00%</td><td colspan="2">1.48%</td><td colspan="2">10.10%</td><td colspan="2">15.27%</td><td colspan="2">19.95%</td><td colspan="2">22.66%</td></tr>
<tr><th></th><th colspan="12">Asset allocation</th></tr>
<tr><td>Australian shares</td><td>0%</td><td rowspan="4">0%</td><td>8%</td><td rowspan="4">20%</td><td>18%</td><td rowspan="4">40%</td><td>28%</td><td rowspan="4">60%</td><td>38%</td><td rowspan="4">80%</td><td>48%</td><td rowspan="4">100%</td></tr>
<tr><td>International shares</td><td>0%</td><td>10%</td><td>18%</td><td>26%</td><td>34%</td><td>42%</td></tr>
<tr><td>Australian listed property</td><td>0%</td><td>2%</td><td>4%</td><td>6%</td><td>8%</td><td>10%</td></tr>
<tr><td>Diversified alternatives</td><td>0%</td><td>0%</td><td>0%</td><td>0%</td><td>0%</td><td>0%</td></tr>
<tr><td>Australian Fixed interest</td><td>0%</td><td rowspan="2">100%</td><td>56%</td><td rowspan="2">80%</td><td>42%</td><td rowspan="2">60%</td><td>28%</td><td rowspan="2">40%</td><td>14%</td><td rowspan="2">20%</td><td>0%</td><td rowspan="2">0%</td></tr>
<tr><td>Australian cash</td><td>100%</td><td>24%</td><td>18%</td><td>12%</td><td>6%</td><td>0%</td></tr>
</table>

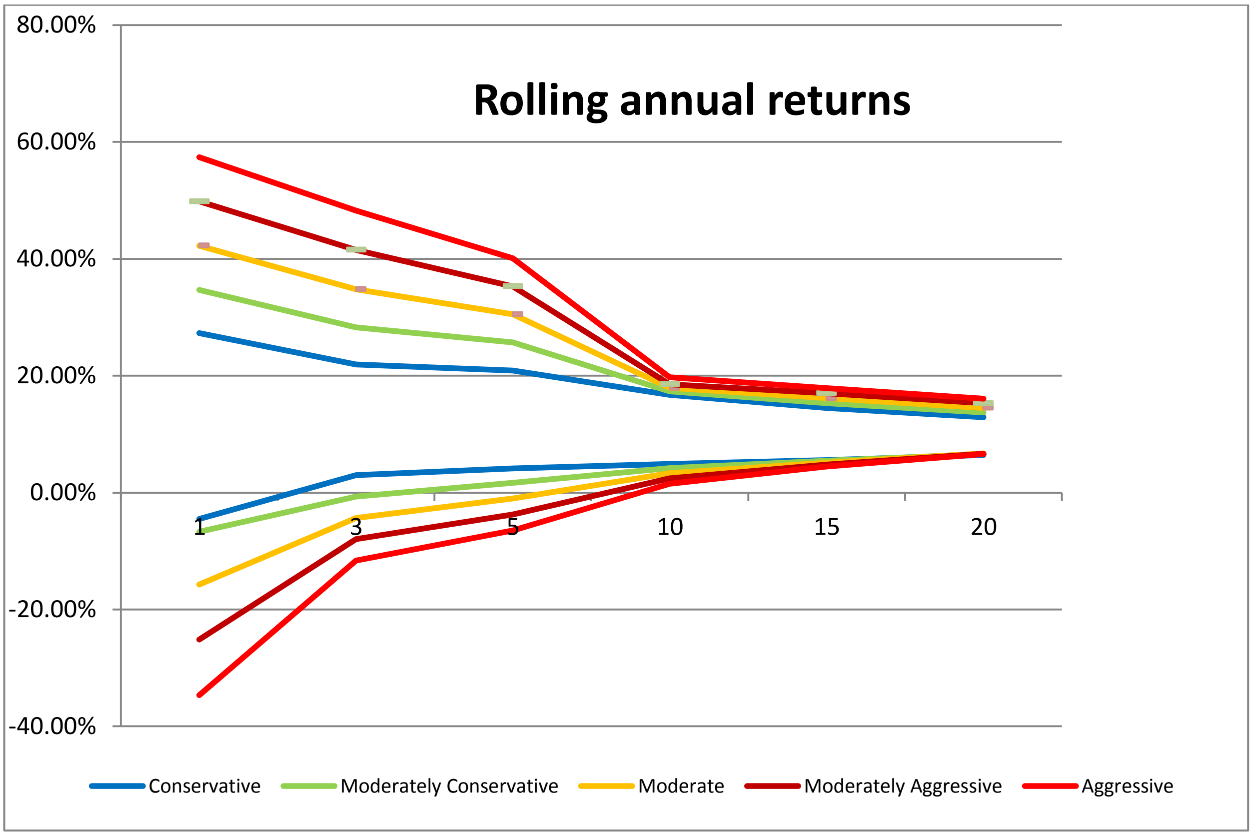
***Note – even where there is a minimum time frame there is no guarantee you will receive 100% of your capital back after the minimum time frame and over a market cycle**
**** Returns in the top half of the table exclude alternatives.**
*****Returns from 31 Dec 1979 to 28 Feb 2015**

Rolling maximum and minimum returns

The chart below shows you how the various portfolios above have performed historically since Jan 1980 over rolling time periods. Eg, a 10 year rolling time period may start in Jan 1980 and end in Dec 1989, the next one will start in Jan 1981 and end in Dec 1990, etc.
The top lines are the maximum returns the various portfolios have ever achieved over the relevant time frames whereas the lower line is the minimum return.

Some interesting conclusions can be drawn from the results below:

- You should invest in the right portfolio to suit your goal, eg, don't invest in an aggressive portfolio if you need your money in 5 years as it can take 7 to 10 years to get your money back if investments perform poorly from the start.
- All the portfolios converge to a lowest return of about 7% to 8% over the long term, ie, 20 years or more. What does this mean for you? Provided you can put up with the short term volatility, you should invest in the high growth portfolio. Therefore, superannuation assets that can't be withdrawn for 20 years or more should be in aggressive assets. This way you have the chance of getting the higher return because the lower return will look after itself.



Returns from 31 Jan 1979 to 28 Feb 2015

Sentry Risk Profiling Process

Determining your risk profile

Determining your risk profile is not a “tick the box” approach. It requires time on your part and the adviser’s part. Things you can do to help in the process are:

- Educate yourself about the different investment options available
- Determine your timeframe and look at the above table to see which profile may be suitable
- Are you interested in preserving the spending power of your capital? Then you most likely need some growth investments. However, these investments come at the risk of capital loss. In some instances the capital loss could be substantial.
- Do you want income? Then cash and fixed interest investments would be more appropriate
- How quickly do you need access to your capital? Cash is the quickest followed by shares.
- Do you want the returns to be tax effective? If yes, then growth investments are probably more appropriate but they have higher risk.
- Can you achieve your goals without taking risk or taking lower risk, i.e., do you need to invest in growth investments?

Remember you may have different risk profiles for different objectives. Your risk profile for a holiday next year may be such that cash is the only viable option. However, your superannuation money (which you may not be able to access for many decades) may suit a moderate or aggressive investor profile.

Resolving your risk profile with your goals and objectives

Sometimes there may be a conflict between when you need your funds and your risk profile, e.g., you may wish to go on a $10,000 holiday in a year’s time but you have a risk profile which tolerates highly volatile investments, i.e., shares. There is a conflict – do you invest in shares and run the risk that your $10,000 would be worth less in a year’s time or do you take the secure path and place the $10,000 in a bank account.

The law requires us to consider your goals and objectives but at the same time consider your personal circumstances. As a result of this conflict we would take a cautious approach and recommend investments that are more likely to allow you to achieve your goals rather than rely on your risk profile. This means in the holiday example we would recommend a bank account as opposed to share investments.

Determining/choosing your risk profile

Option 1 From the questionnaire above, the investor profile tables above and from our discussions please choose the investor profile that you believe suits you. If you believe that you fit somewhere between 2 profiles then simply tick 2 profiles.	☐ Secure ☐ Conservative ☐ Moderately conservative ☐ Moderate ☐ Moderately aggressive ☐ Aggressive ☐ Investor choice (see below)
Option 2 If you believe none of the risk profiles suit you then you are free to choose your own mix of investments. Simply allocate percentages in the area to the right.	Australian shares ……..………..% International shares ……………..…..% Property ………..…….% Alternatives ………..……..% Fixed interest …………..…..% Cash ………..……..% Total 100 %

Client declaration

I/we have read this document and have chosen the appropriate risk profile(s) which I believe suits my particular circumstances. I understand an exact asset allocation into each asset class may not be possible and that a 10% variation is considered normal.

Client 1……………………………………………………….. Date …………………….

Client 2……………………………………………………….. Date …………………….

Note: If you have 2 different goals, the risk profile may be different for each goal. If so, please provide sufficient notes, identifying each investment amount and the relevant risk profile.