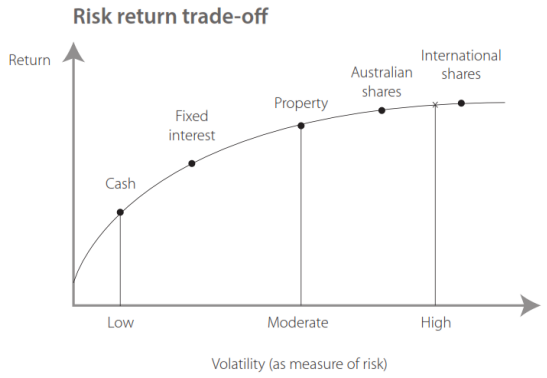
RISK VERSUS RETURN

Investment risk and return are closely related. In general, the higher the degree of risk associated with an investment, the higher the probability for greater returns, but also losses. Higher risk investments are more suitable for high growth or 'aggressive' investors.

Low risk investments on the other hand, such as cash, offer relatively lower returns because of the security of the investment and are more suitable for risk adverse or 'conservative' investors. This is called the risk/return trade-off and is used as a guide to the asset allocation that is most appropriate for you.

The long term risk/return trade off between different asset classes is illustrated in the following graph:



With this in mind, any investments recommended should be consistent with your risk tolerance level.

While most of us relate the term risk to the level of investment price fluctuation, there are many other factors to consider.

Types of risks

- Legislative risk is the risk that there are changes to government policy in terms of tax, superannuation and pension regulations, which are unforeseen at the time of the initial investment.

- Risk of not diversifying is the risk that if you put all of your investment into one asset class, a fall in that class will adversely affect the total value of your portfolio.
  This is primarily a concern if, at the time of the fall in the market, you need to draw on your capital. You may, therefore, be forced to sell some of your assets at the bottom of the market. Fortunately, each of the asset classes tend to run in different cycles, so if one is performing well, and another is not, your overall portfolio returns may be 'smoothed' by investing across a number of different asset classes. Diversification is a strategy aimed at reducing the impact that any one asset class will have on your overall portfolio.

- Timeframe risk is the risk that your investments may not be suitable to your specific needs. It is important to focus on two critical factors: your objectives and your timeframe for investment.

- Inflation risk is the risk that the value of growth in your income and investments may not keep pace with the rate of growth in prices (inflation). This is most likely to happen if you choose a very conservative investment. The risk is that you will achieve poor 'real return' (inflation-adjusted return) on your capital.

- Market timing risk: Anticipating market movements can be extremely difficult, as no two business cycles are the same. A strategy of trying to time the entry and exit from investment markets will expose you to greater short-term volatility and there is a range of evidence to suggest such a strategy does not consistently add to returns over time. Generally speaking, it is time in the market that counts, not necessarily the timing.

- Investment risk: This is the variability, or volatility, in the level of investment returns. In general, cash is regarded as a low risk investment because investment returns are relatively stable. In contrast, shares and property are considered to be higher risk investments because returns frequently move up and down and investors are less certain of the return that they will receive.

What you want to achieve from your portfolio will ultimately influence the style and level of risk that you will need to accept.

At your review, your financial planner will consider the performance of investments and any changes in the asset allocation along with your objectives to determine any changes in risk within your portfolio.