

Eoghan Gavigan

Shoot for the higher returns, not thrills



In the sport of target pistol shooting there is a saying, “slow is smooth, smooth is fast”, which refers to the way to approach drawing and firing a pistol quickly and accurately. The learner shooter who focuses on practising the correct technique slowly, only building in speed later, will win the day nine times out of ten.

The reason is that what seem like minor suboptimal movements that creep in when trying to draw a pistol quickly will slow you down more than your attempt at speed will hurry you up.

Something similar could be said of investing. When investors try to run before they can walk, the result is often suboptimal. It is not

uncommon for advisers to receive approaches from clients who have unrealistic return objectives given their financial situation and proposed investment term.

An investor with limited resources or income who wants to make a large return from their investment in a defined timeframe is playing a game of “Hollywood or bust”. His problem is that he doesn’t have sufficient capacity for risk. It’s a concept that often doesn’t get sufficient consideration in these situations.

This is especially relevant given the losses suffered in recent times by investors in unregulated investments, as these are often concentrated in one or a small number of projects which, when they

fail, fail big. Many column inches have been devoted to these in recent months, and to the stories of investors who have been left destitute.

A common thread in these accounts is that the investment was high risk and the investor couldn’t afford a loss. These stories seem to be told only in retrospect, but it is possible to incorporate capacity for risk – sometimes referred to as capacity for loss – into the investment process.

If an investor’s financial situation indicates that a loss of part or all of their capital would be detrimental to their future financial wellbeing, then they do not have capacity for loss. The client’s age would be relevant here.

For example, an investor

who is approaching retirement and does not have a lot of resources has a very low capacity for loss, as losing some or all of the funds is going to have a detrimental effect on their standard of living in retirement, if not



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immediately. A person who is younger, has more resources and is seeking to invest only a portion of their resources has a higher capacity for loss.

It’s not binary, it’s a continuum, and every investor lies somewhere on it. This is one reason why an adviser can recommend an investment with confidence only as part of a full financial planning exercise. You must understand the adequacy of investors’ finances to assess their capacity for loss as well as their required return.

Investors in unregulated products are generally seeking returns of a higher magnitude over a shorter timeframe. The risk attaching to these is far higher and is unsuitable for most investors. By contrast, the level of

diversification achieved by investing in an index fund, for example, makes these types of investments suitable for a much wider audience.

We didn’t hear of many such failed investments in the years after the global financial crisis because, although most investors had never heard of the concept of capacity for loss at the time, having seen first-hand what could happen when you aimed too high, they knew they didn’t have it. A return of 15 to 20 per cent a year was considered very good in the mid-Noughties, but by the end of the decade most investors would have been happy with a return of 0 per cent – that is, to have simply got their capital back.

Investors are more prone

to make moonshot investments during the late stages of periods of positive returns, when risk is a forgotten concept and the pain of previous losses has faded from memory. It would be disingenuous not to acknowledge that the fees paid to advisers probably also play a role.

They say that if you are excited by investing, you’re probably doing it wrong. The investment that is right for you will probably be boring. So before signing on the dotted line, consider for a moment that you might be better off getting your thrills on the shooting range.

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