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Economico

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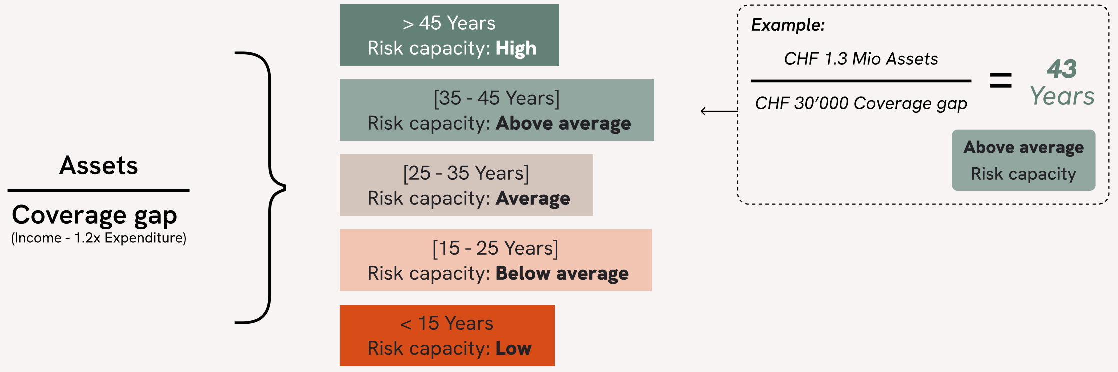
Economico Flash ⚡#16

Investment strategy: What is my risk capacity?

Chart of the week: Determining risk capacity at retirement



Source: Own representation

According to the last Economico Flash, your risk capacity and your risk appetite are the two key parameters for determining your risk profile and thus the target range of your personal investment strategy. You need economics to determine your objective risk capacity and psychology to determine your risk appetite. We believe that the financial and advisory industry should focus on the former and leave the assessment of personal risk appetite to the client and investor (or their psychologist). The exact measurement of a private investor's risk capacity requires the modeling (as accurately as possible) of all future personal income or expenditure as well as all his assets and liabilities. In this context, we use the term asset-liability management (ALM) for private investors. This can be done, but is - well - quite complex and fraught with considerable forecasting uncertainties.

For people who are beginning to think about retirement, however, the risk capacity can be approximated using a relatively simple key figure. To do this, you first calculate the so-called coverage gap as the difference between income (after retirement) minus budgeted expenditure (also after retirement). For unforeseen expenses, a safety margin is added to the expenses - the 20% used for this in the illustration is more gut feeling than science. The assets (at retirement; including capital withdrawals from the second and third pillars) are then set in relation to this coverage gap plus the safety margin.

The interpretation of this key figure is very simple: how many years will the assets saved at retirement be sufficient to finance the coverage gap? If the value is more than 45 years, we consider your risk capacity to be high and therefore an investment strategy with a focus on real assets and equities to be reasonable. However, if your assets are already depleted after 15 years after retirement, you can hardly afford to lose value on the capital markets and are better off with low-risk, fixed-interest investments.

On Economico, we have provided a simple risk profiling function that may help you to determine your investment strategy.

Take aways

- Risk capacity and risk appetite as key parameters for investment strategy
- Risk capacity at retirement ≈ Assets / coverage gap