

## **Understanding Investment Risk**

**First of all, it is necessary to understand investment risk. No get-rich scheme will ever bring you peace and security. No method of investing, no category of investing, and no investment vehicle will shorten the time needed to see a financial return.**

If someone insists that they have a way for you to easily make a greater than average return on any investment, hang up the phone or turn and run in the other direction. With regard to your money, there will always be someone more than willing to separate you from it. Just remember that hot tips lead to burnt fingers.

If you're like many investors, you want to get the highest possible return on your investments while assuming the least amount of risk. Unfortunately, finding a comfortable balance between risk and reward can be difficult.

When planning your investment strategy, you need to determine your risk tolerance level. The amount of risk you can handle in your portfolio depends on several factors—your age, family situation, your current income and your financial goals.

The amount of risk you are willing to assume can help you determine the types of investments you may include in your portfolio.

There are several types of risk that every portfolio can be exposed to. Investment gains and losses can result from such factors as economic conditions and changes in the financial markets. In building your portfolio, you should be aware of some of the categories of risk.

### **Liquidity Risk**

Liquidity risk means not being able to liquidate an investment quickly while keeping the original investment amount intact. This can occur with investing in bonds where the bond must be held to maturity in order for you to achieve a specific interest return. It can also be a risk should you invest in a particular stock, but find that the price is down at the same time you need to get your hands on the cash invested in that specific equity.

For this reason, any dollars you need to access for the purpose of educational spending or maybe the purchase of a house should never be invested in the equities market.

## **Inflation Risk**

Inflation risk is the danger that inflation will reduce the purchasing power of your investment over time. Low-yielding investments such as savings accounts and money market funds may not earn enough to outpace rising prices.

## **Economic Risk**

Economic risk can surface due to the fact that slow economic growth will be too weak to sustain or improve the return on a particular investment. For example, the price of shares in growth companies that require a strong economy to sustain earnings may fall during an economic slowdown. Again, as in the case of liquidity risk, you would not want to invest any dollars required for education or other short-term needs into an investment that would have a substantial economic risk attached to it.

## **Interest Rate Risk**

Interest rate risk occurs when changes in interest rates cause the value of certain investments to decrease. For example, when interest rates rise, the market value of fixed-income securities, such as bonds, declines. Bond investors hate inflation because it erodes the value of bonds' fixed interest payments. Investors are locked into the lower rate as the market rates rise. However, this type of risk may hold less potential for major financial damage.

## **Market Risk**

Market risk is the risk associated with market fluctuations that can depress the value of particular investments. All stocks and bonds can be affected by downturns caused by fraud, war, or calamity. Additionally, certain types of investments can experience a major downturn should there be a slowdown in a specific industry or category of investments. Factors such as political developments, market cycles, changing investor sentiments or reaction to previous excessive rises or declines can all contribute to market volatility. Higher interest rates hurt stocks because they can slow the economy, which can crimp a company's revenue. They boost corporate borrowing costs and make stocks less attractive relative to interest-paying investments.

## **Company Risk**

If a company's stock value decreases due to financial difficulties, this creates an instant company risk. Internal factors such as inefficient production and poor management or external factors such as problems with the industry, the economy, or trade can contribute to company risk.

### **Specific Risk**

Specific risk involves any occurrences that may affect only a particular company. For example, the death of the founder, political developments, or heavy debt can affect a particular firm adversely. Some huge companies that have been around for a very long time, even with great products and unsoiled reputations, have fallen into the wrong hands and ended up worthless due to fraud and misrepresentation.