

INVESTMENT RISK MANAGEMENT



After completing this module you should be able to:

- ▶ Recognize different investment options
- ▶ Understand the concept of yield
- ▶ Recognize what are investment risks
- ▶ Understand how to reduce risks
- ▶ Understand what is risk tolerance
- ▶ Recognize the different investment styles
- ▶ Understand the concepts of asset allocation, diversification and rebalancing
- ▶ Recognize different allocation strategies
- ▶ Understand the importance of time on the market
- ▶ Understand the meaning of socially responsible investments

MODULE OBJECTIVES

- ▶ You should know that a vast array of investment products exist—including stocks, mutual funds, corporate and municipal bonds, exchange-traded funds, money market funds, and U.S. Treasury securities.
- ▶ Let's take a closer look at the characteristics of the three major asset categories.
 - ▶ Stocks
 - ▶ Bonds
 - ▶ Cash

INVESTMENT CHOICES



- In financial markets, stock is the capital raised by a corporation through the issuance and distribution of shares.
- Stocks have historically had the greatest risk and highest returns among the three major asset categories.



STOCKS



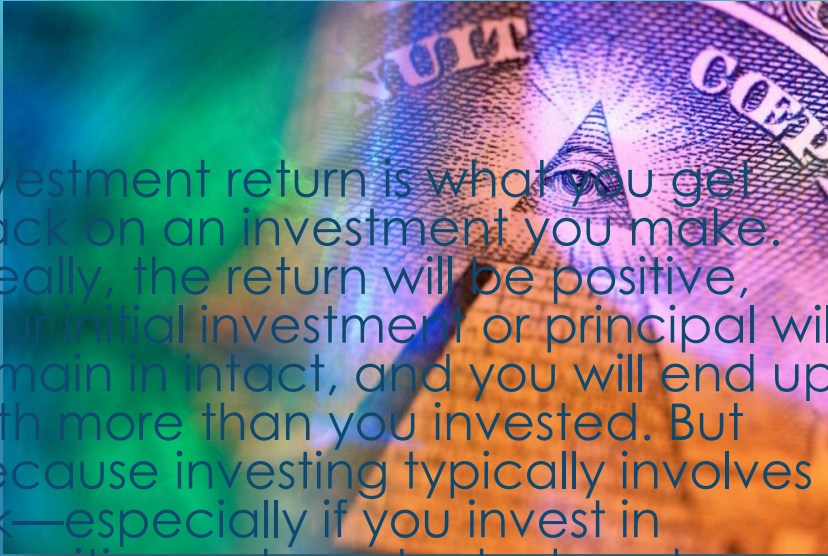
- Bonds are a long-term loan certificate issued by governments and organizations in order to raise capital. The capital is repaid with interest.
- Bonds are generally less volatile than stocks but offer more modest returns.

BONDS

Cash and cash equivalents - such as savings deposits, certificates of deposit, treasury bills, money market deposit accounts, and money market funds - are the safest investments, but offer the lowest return of the three major asset categories.

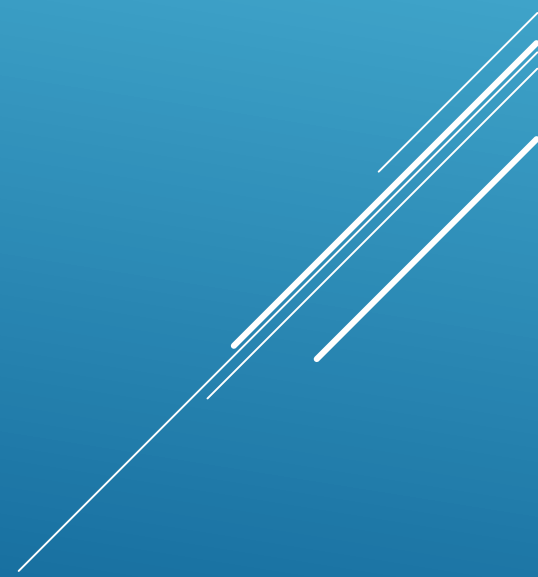
CASH





Investment return is what you get back on an investment you make. Ideally, the return will be positive, your initial investment or principal will remain intact, and you will end up with more than you invested. But because investing typically involves risk—especially if you invest in securities such as stocks, bonds, or mutual funds that invest in stocks and bonds—your returns can be negative, and you can wind up with less money than you initially invested.

WHAT IS RETURN?



For example, let's say you buy a stock for \$30 a share and sell it for \$35 a share. Your return is \$5 a share minus any commission or other fees you paid when you bought and sold the stock. If the stock had paid a dividend of \$1 per share while you owned it, your total return would be a gain of \$6 a share before expenses.

Total return = Gain or loss in value
+ investment earnings

RETURN

Compare a return of \$5 per share on a \$30 investment with a return of \$5 per share on a \$60 investment. In both cases, your dollar return is the same. But your rate of return, which you figure by dividing the gain by the amount you invest, is different.

RATE OF RETURN

In this comparison, the rate of return, also called the percent return, on the \$30 investment is 16.67% ($\$5 \div \$30 = 16.666$) while the rate of return on the \$60 investment is 8.33% ($\$5 \div \$60 = 8.333$)—just half.

For example, if a stock pays annual dividends of \$1 per share when the price is \$35, the current yield is 2.9% ($\$1 \div \$35 = 0.02857$). However, if you bought the stock for \$25, and used that number as the basis of your yield, that same \$1 dividend would be 4% ($\$1 \div \$25 = 0.04$).

The yield on an investment is the amount of money you collect in interest or dividends, calculated as a percentage of either the current price of the investment or the price you paid to buy it.

YIELD

- ▶ Risk can be defined as the chance or possibility of loss.
- ▶ In financial terms is defined as the degree of uncertainty regarding the rate of return on and/or the principal value of an investment.
- ▶ Part of becoming a good investor is understanding the types of risks you will face.
- ▶ On the other hand, you will need to know how much financial risk you can afford in order to reach your goals.

WHAT IS RISK?





- There are three types of risks you need to become aware of:
 - Market Risk
 - Inflation Risk
 - Liquidity Risk

TYPES OF FINANCIAL RISKS