

# INVESTMENT RISK MANAGEMENT



- As counterintuitive as it may sound, avoiding risk altogether can make conservative investors vulnerable to other types of risk—notably inflation risk.
- If you invest so conservatively that your invested assets barely keep pace with the rate of inflation (which has averaged 3% annually), then your invested assets may barely be growing at all in terms of real buying power.
- If you're also paying taxes on those assets, then they may in fact be shrinking compared to inflation. That's why a conservative investment strategy can make it difficult to meet long-term investment goals, such as a comfortable retirement.

## THE RISKS OF A NO-RISK PORTFOLIO



- Moderate investors seek a middle course between protecting the assets they already have and achieving long-term growth.
- For instance, a portfolio that is invested 35% in large cap domestic stocks, 15% in small-company and international securities, and 50% in bonds, might be considered very moderate—even conservative—for someone with 30 or 40 years until retirement.



## MODERATE INVESTING STRATEGIES



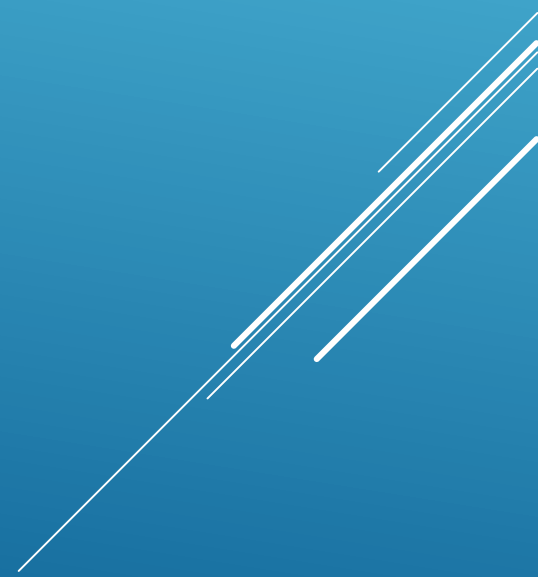
- Aggressive investors focus on investments that have the potential to offer significant growth, even if it means putting some of their principal at risk.
- They may allocate 75% to 95% of their portfolios in stock and stock mutual funds, including substantial holdings in more speculative investments, such as emerging market and small-company stock and stock funds.

## AGGRESSIVE INVESTING STYLE



- A contrarian investor's approach is to flout conventional wisdom. Contrarians buy investments that are currently out of favor with the market and avoid investments that are currently popular.
- they believe that stocks that are undervalued by the market may be poised for a rebound, while stocks that are currently popular may be overvalued, have already peaked, or may not be able to meet investor expectations.

## CONTRARIAN INVESTING STYLE



- ▶ Asset allocation involves dividing (mixing) an investment portfolio among different asset categories, such as stocks, bonds, real estate, and cash among others.
- ▶ There are two main factors you need to take into consideration when defining your asset allocation:
  - ▶ Time horizon
  - ▶ Risk tolerance

# ASSET ALLOCATION



Your time horizon is the expected number of months, years, or decades you will be investing to achieve a particular financial goal.

# TIME HORIZON





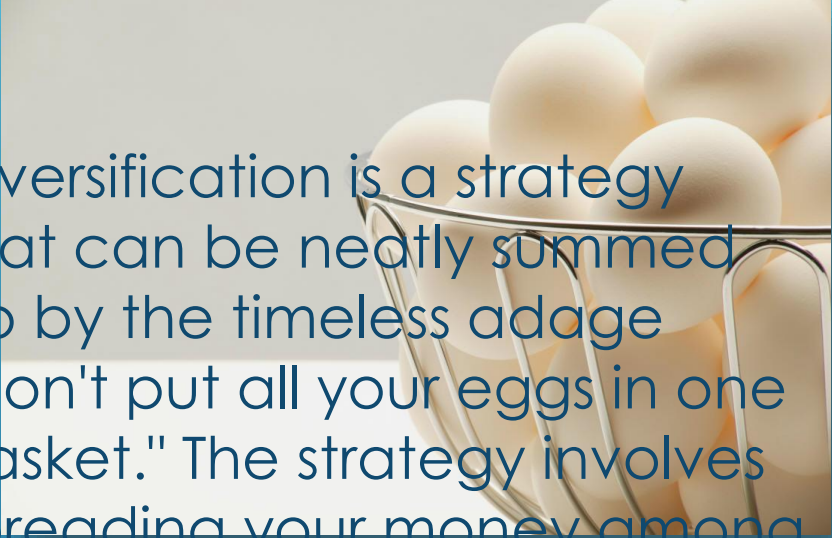
- Risk tolerance is your ability and willingness to lose some or all of your original investment in exchange for greater potential returns.
- An aggressive investor, or one with a high-risk tolerance, is more likely to risk losing money in order to get better results.
- A conservative investor, or one with a low-risk tolerance, tends to favor investments that will preserve his or her original investment.

# RISK TOLERANCE



- ▶ By including asset categories with investment returns that move up and down under different market conditions within a portfolio, an investor can hedge against significant losses. Historically, the returns of the three major asset categories have not moved up and down at the same time.
- ▶ Market conditions that cause one asset category to do well often cause another asset category to have average or poor returns.
- ▶ By investing in more than one asset category, you'll reduce the risk that you'll lose money and your portfolio's overall investment returns will have a smoother ride.

# WHY ASSET ALLOCATION IS SO IMPORTANT



Diversification is a strategy that can be neatly summed up by the timeless adage "Don't put all your eggs in one basket." The strategy involves spreading your money among various investments in the hope that if one investment loses money, the other

investments will more than make up for those losses.

## THE CONNECTION BETWEEN ASSET ALLOCATION AND DIVERSIFICATION

- ▶ A diversified portfolio should be diversified at two levels:
  - ▶ *between* asset categories and
  - ▶ *within* asset categories.
- ▶ In addition to allocating your investments among stocks, bonds, cash equivalents, and possibly other asset categories, you'll also need to spread out your investments within each asset category.
- ▶ The key is to identify investments in segments of each asset category that may perform differently under different market conditions.

# FUNDAMENTALS OF DIVERSIFICATION

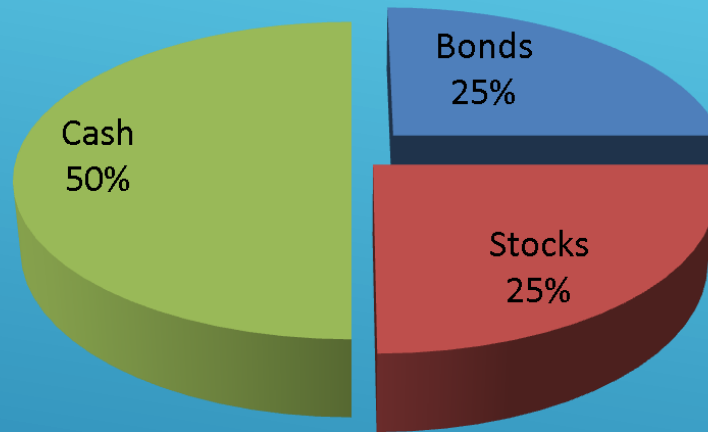


- ▶ The most common reason for changing your asset allocation is a change in your time horizon.
- ▶ As you get closer to your investment goal, you'll likely need to change your asset allocation.

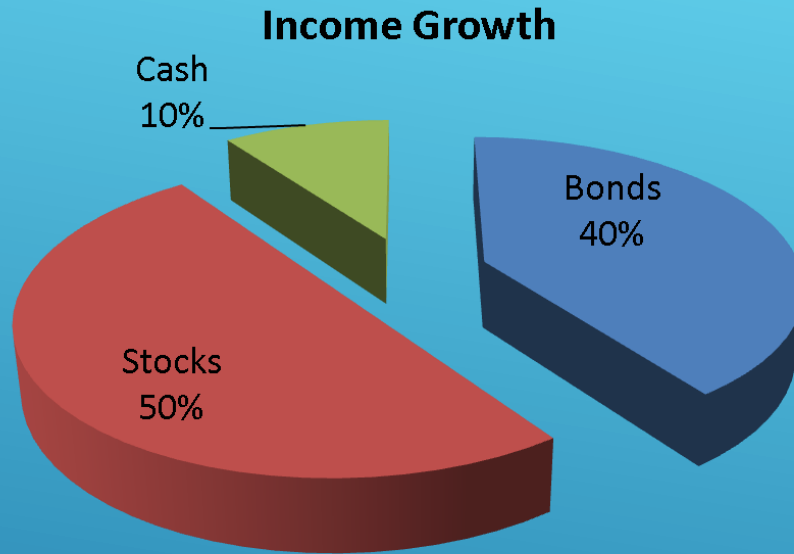
# CHANGING YOUR ASSET ALLOCATION



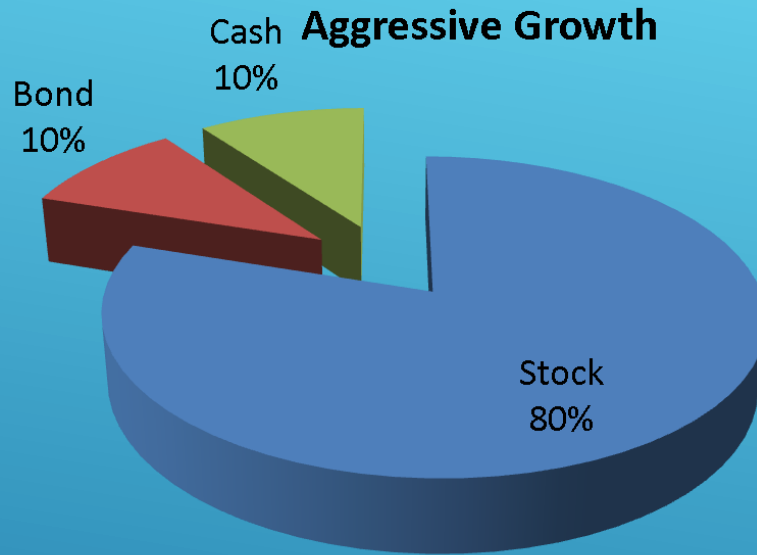
## Conservative Investment



ASSET ALLOCATION STRATEGIES



# ASSET ALLOCATION STRATEGY



# ASSET ALLOCATION STRATEGY

- ▶ Rebalancing is bringing your portfolio back to your original asset allocation mix.
- ▶ This is necessary because over time some of your investments may become out of alignment with your investment goals. You'll find that some of your investments will grow faster than others.
- ▶ By rebalancing, you'll ensure that your portfolio does not overemphasize one or more asset categories, and you'll return your portfolio to a comfortable level of risk.

# REBALANCING



- ▶ You can rebalance your portfolio based on:
  - ▶ the calendar (such as every six or twelve months)
  - ▶ or on your investments (when the relative weight of an asset class increases or decreases more than a certain percentage that you've identified in advance).

# WHEN TO CONSIDER REBALANCING



In unstable market environments, it is important to stick to a well-considered investment plan. There are substantial long-term benefits in buying securities and holding a diversified investment portfolio instead of trading stocks or mutual funds frequently. In fact, frequent trading can reduce your returns for many reasons, among them:

- ▶ First, you will be charge transaction fees each time you buy and sell;
- ▶ Second, the more you trade in an account, the sooner you will pay taxes on your gains and the higher your taxes will be.
- ▶ Third, it's is virtually impossible to time the market. You don't want to jump into a hot investment just in time to see it cool off.

THE LONG TERM PERSPECTIVE:  
BENEFITS OF “BUY AND HOLD”

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