Risky Business:
Types of Investment Risk

Executive Summary

Risk is something that is ever present in the investment world. With very few exceptions, every investment vehicle carries with it a certain degree of risk. While there is no way to get around taking on risk, knowing the different types of investment risk can help you and your advisor put together a portfolio that minimizes over exposure to any one risk factor. Below are some of the most common and impactful risks to your investments.

What you Need to Know

1. Inflation Risk
   Inflation risk is essentially the risk that your investments growth will not keep up with the rate of inflation and therefore reduce both your purchasing power and return on investment. Fixed income vehicles, such as bonds, are especially prone to inflation risk.

2. Business Risk
   Business risk is the possibility that a company's profits could be lower then expected. This could be due to a number of factors such as employee strikes, new products, competing firms, bad public relations, among other things. Almost all investment products are subject to this risk.

3. Political Risk
   Political risk is associated with unfavorable changes in government policy and how said policies effect business within the country. For example, if a government raises tax rates for foreign investors, then they make their country unattractive to investors who may make their investment elsewhere.

4. Liquidity Risk
   A security that is difficult to sell is said to be illiquid, and therefore is experiencing liquidity risk. If an asset cannot be quickly converted to cash at a fair price, it may cause the investor to miss buying or selling opportunities.

5. Interest Rate Risk
   Investors are exposed to interest rate risk when there is a changing interest rates. For example, fixed income securities (bonds) have an inverse relationship to interest rates. Therefore, if the interests rise then bond price will fall, and vise versa.

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6. Currency Risk
   Currency risk, or foreign exchange risk, is the risk that an investor will incur losses resulting in unfavorable change in exchange rates. Currency risk presents itself to anyone who has foreign investments.
7. Default Risk
   Default risk occurs when a company issue more debt than it can financially maintain. When this happens, the company is at risk for defaulting on their debt and therefore not making interest payments or repaying loan principal due.

The risks mentioned above are all examples of ***non-systematic risks.*** These types of risks can occur independent from the market as a whole and may only affect a certain group of securities. Non-systematic risk can be greatly reduced with proper diversification.

There are however, risks that cannot be eliminated from a portfolio. These are known as ***systematic risks.*** Systematic risks are always present, cannot be eliminated, and exist in all asset classes. Also known as market risk, systemic risk cannot be diversified away and effects the market as a whole.

The Bottom Line

Risk is unavoidable and is unfortunately something that investors need to plan for. Investors should work with their advisors to ensure that their portfolios are diversified in a way that aligns to their personal risk tolerance.

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