What Investment Risks Should I Know About?

Taken by itself, the word "risk" sounds negative. But broken down into what it really stands for in terms of investing, it begins to be a little more manageable. By understanding the different types of risk and keeping an eye on your investments, you may be able to manage your money more effectively. Remember, strategic investing doesn’t mean "taking chances" so much as "making decisions." Long-term investing and diversification may be some of the most effective strategies you can use to help manage investment risk; however, neither guarantees against investment loss.

Inflation Risk

The main risk from inflation is the danger that it will reduce your purchasing power and the returns from your investments. If your savings and investments are failing to outpace inflation, you might consider investing in growth-oriented alternatives such as stocks, stock mutual funds, variable annuities, or other vehicles.

Interest Rate Risk

Bonds and other fixed-income investments tend to be sensitive to changes in interest rates. When interest rates rise, the value of these investments falls. After all, why would someone pay full price for your bond at 2% when new bonds are being issued at 4%? Of course, the opposite is also true. When interest rates fall, existing bonds increase in value.

Economic Risk

When the economy experiences a downturn, the earnings capabilities of most firms are threatened. While some industries and companies adjust to downturns in the economy very well, others — particularly large industrial firms — take longer to react.

Market Risk

When a market experiences a downturn, it tends to pull down most of its securities with it. Afterward, the affected securities will recover at rates more closely related to their fundamental strength. Market risk affects almost all types of investments, including stocks, bonds, real estate, and others. Historically, long-term investing has been a way to minimize the effects of market risk.

Specific Risk

Events may occur that only affect a specific company or industry. For example, the death of a young company's president may cause the value of the company's stock to drop. It's almost impossible to pinpoint all these influences, but diversifying your investments could help manage the effects of specific risks.