

# Types of Investment Risk

Whenever an individual takes cash and puts it to work in any form of investment, he or she does so with the anticipation of receiving a return on the money. At some future point in time, the investor expects to get back both the principal amount and something extra as well. The possibility that an investment will return less than expected is known as “investment risk.”

## Risk vs. Reward

One of the great truths of the investment world is that risk and reward go hand in hand. The greater the risk an investor is willing to undertake, the greater the potential reward. If an investor is willing to assume only a small amount of risk, the potential reward is also low. In an ideal world, there would be no risk to any investment. Unfortunately, such a risk-free investment does not exist.

There is also more than one type of risk. An investor must understand each type of risk, and use that knowledge to create a portfolio of investments that balances the level of risk assumed, with the desired investment return.

## Market Risk

In simple terms, market risk can be defined as the possibility that downward changes in the market price of an investment will result in a loss of principal for an investor. For many, market risk is most closely associated with the ups and downs of the stock market.

Market risk exists for other investments as well. For example, the market price of bonds and other debt investments will move up and down in response to changes in the general level of interest rates. If interest rates rise, bond prices generally fall. If interest rates decline, bond prices generally rise. Tangible assets such as real estate and gold, or collectibles such as art or stamps, also face market risk.

Over time, a number of strategies have been developed to help reduce market risk.

- Invest only dollars that are not required to meet current needs. This helps avoid having to sell an asset when the market may be down.
- Develop a long-term approach. A longer time horizon allows an investor to ride out market ups and downs.
- Diversify your investments over a number of asset categories, such as stocks, bonds, or cash, and tangible investments such as real estate. Holding assets in different investment categories reduces the possibility that all investments will be down at the same time.