



Course «Investment project management»


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Investment risks

Investment Choices



- ◎ 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
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Stocks



- 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.

Bonds

- 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.



Cash

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.



What is Return?

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.



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

Rate of 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.

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.

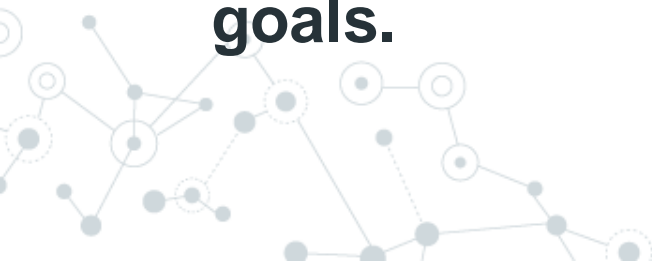
Yield

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.

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% ($\$1 \div \$25 = 0.04$).

What is risk?

A decorative network diagram in the top right corner, consisting of various sized grey circles connected by thin grey lines, forming a complex web-like structure.

- ⊙ 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.
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Types of Financial Risks


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



Market Risk

A decorative network diagram in the top right corner, consisting of various sized circles (nodes) connected by thin lines, some solid and some dashed, creating a complex web-like structure.

◎ **Market risk is the risk that the value of your investment will decrease due to moves in market factors. The four standard market risk factors include:**

- **Equity risk**
 - **Interest rate risk**
 - **Currency risk**
 - **Commodity risk**
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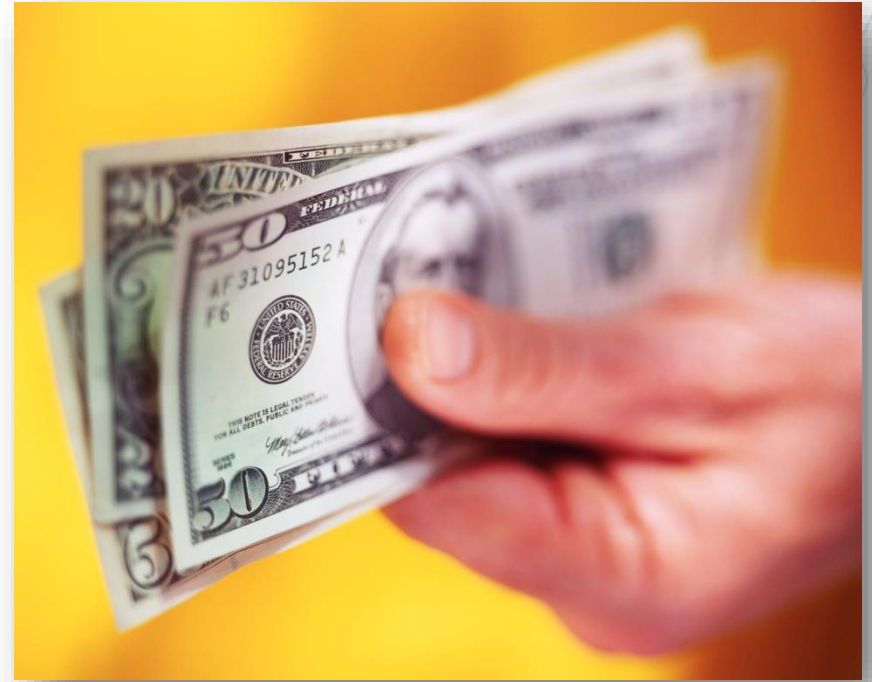
Inflation Risk

Inflation risk is the risk that the interest you're earning may fall below the inflation rate.



Liquidity Risk

Liquidity risk is defined as the ease with which an investor can convert an investment to cash without negative impact on either capital or return.



What Is The Best To Reduce Risks?




The best way to reduce risks is by diversifying your investments. Simply stated, don't put all of your eggs into one basket. Diversification can be defined as: An investment strategy that can reduce market risk by combining a variety of investments

Risk Tolerance

- ◎ Risk tolerance can be defined as an investor's ability to withstand losses caused by one or more of the different types of risk.
- ◎ When dealing with investments and risk there is a simple rule of thumb: higher risk investments potentially produce higher returns.
- ◎ Your goal should always be to improve your returns (earnings) without taking on too much risk.

Risk versus Reward




- ◎ **“No pain, no gain” - those words come close to summing up the relationship between risk and reward.**
 - ◎ **The reward for taking on risk is the potential for a greater investment return.**
 - ◎ **If you have a financial goal with a long time horizon, you are likely to make more money by carefully investing in asset categories with greater risk, like stocks or bonds, rather than restricting your investments to assets with less risk, like cash equivalents.**
 - ◎ **On the other hand, investing solely in cash investments may be appropriate for short-term financial goals**
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Investment Styles



How you decide to allocate your assets—whether you choose a conservative, moderate, or aggressive allocation mix based on your tolerance for risk—is sometimes called your investing style, or profile

Your investing style reflects your personality, but it is also influenced by other factors like your age, financial circumstances, investment goals, and experience.




Conservative Investing Style




Conservative investors make capital preservation, or safeguarding the assets they already have, their priority. Because they normally aren't willing to put any of their principal at risk, conservative investors usually have to settle for modest returns.

The portfolios of conservative investors are typically heavily allocated in bonds, such as U.S. Treasury bills, notes, and bonds, highly rated municipal bonds, and insured investments, such as certificates of deposit (CDs) and money market accounts.



The Risks of a No-Risk Portfolio



- **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.**
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Moderate Investing Style

- 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.



Aggressive Investing Style

- **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.**




Contrarian 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.**



Asset Allocation



- ◎ **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**
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Time Horizon

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




Risk Tolerance

- 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.



Why Asset Allocation Is So Important



- ◎ **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.**
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The Connection Between Asset Allocation and Diversification

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.




Fundamentals of 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.
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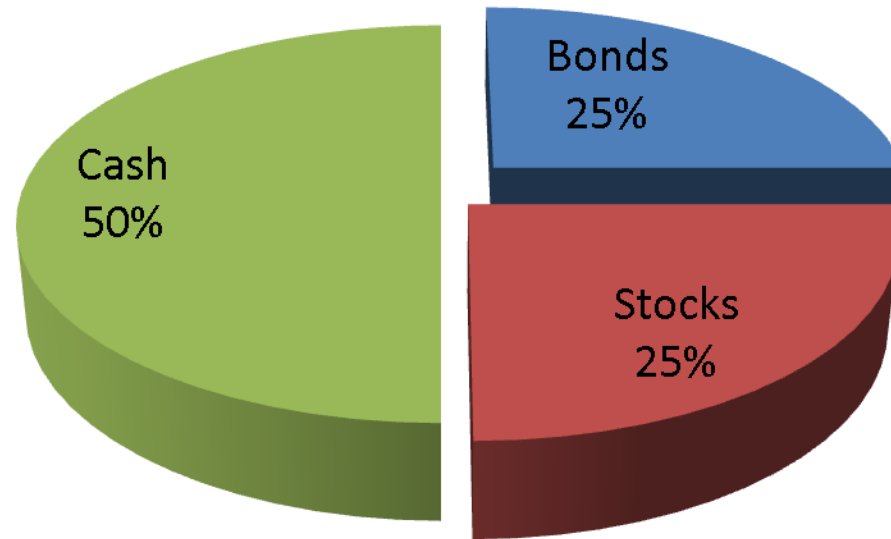
Changing Your Asset Allocation



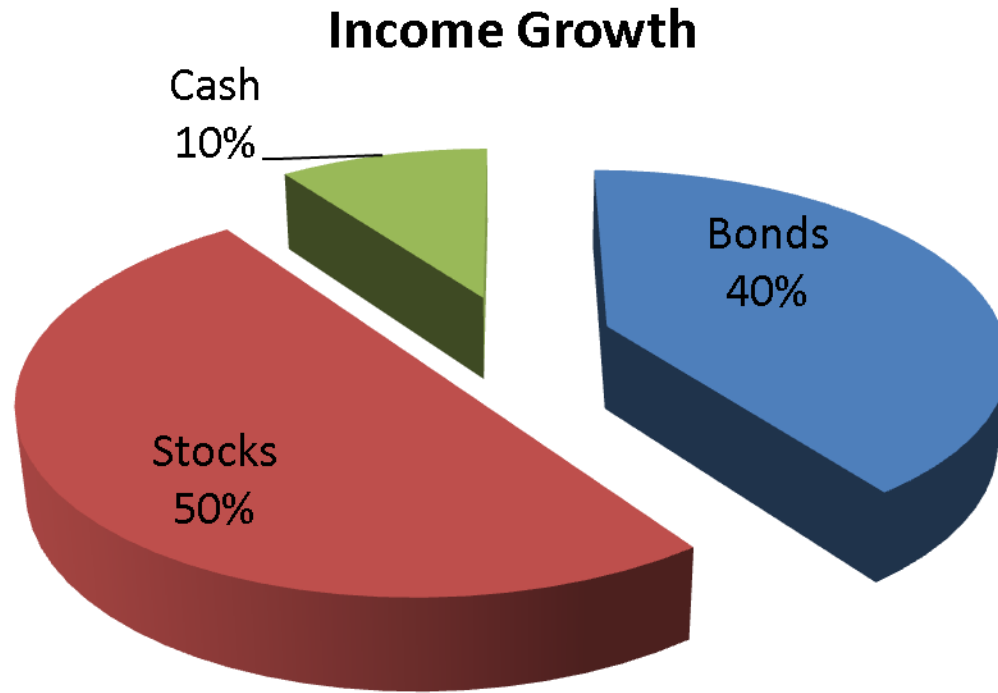
- ◎ **The most common reason for changing your asset allocation is a change in your time horizon.**
 - ◎ **As you get closer to your investment goal, you'll likely need to change your asset allocation.**
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Asset Allocation Strategies

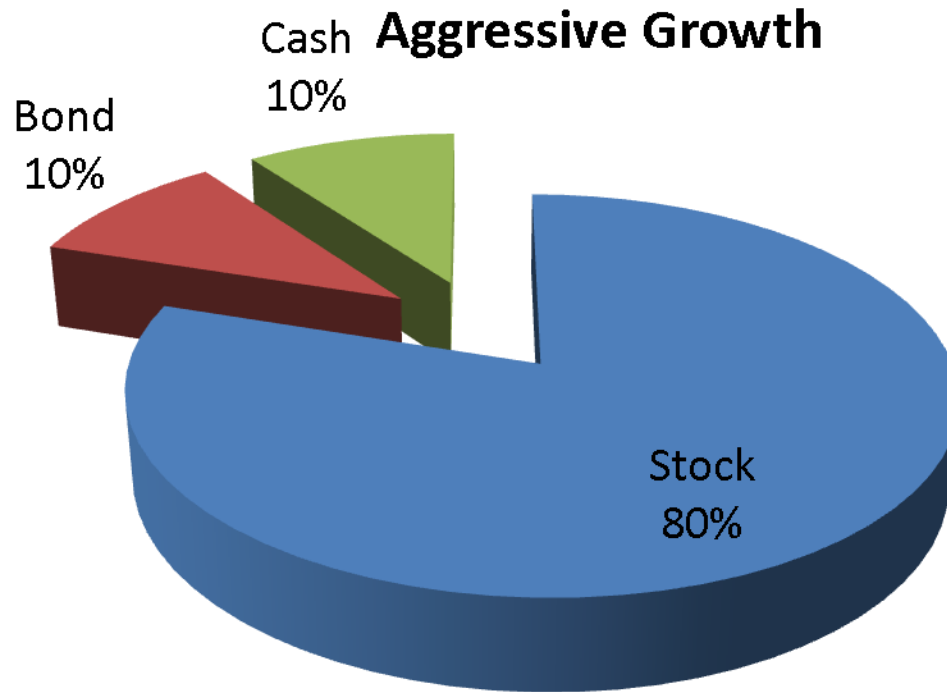
Conservative Investment



Asset Allocation Strategy




Asset Allocation Strategy




Rebalancing



- ◎ **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.**
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When to Consider 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).
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Perspective: Benefits of “Buy and Hold”



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:

- ① First, you will be charge transaction fees each time you buy and sell;
 - ② Second, the more you trade in an account, the sooner you will pay taxes on your gains and the higher your taxes will be.
 - ③ 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.
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