Know the Risks Of Investing — And Not Investing

Investing involves risk — and so does not investing. You should know how both these types of risk can affect your ability to reach your financial goals.

Let's start with the risks associated with investing. There's not a single investment risk because different types of investments carry different types of risk. Here's a look at three investment categories and some of the risks connected with them:

• *Stocks* – When you invest in stocks or stock-based mutual funds, you will incur the risk that the value of your investments may decline. Stock prices can fall for any number of reasons – lower-than-expected earnings, a change in management, change in consumer tastes, and so on. Although the historical trend for stocks has been positive, there will always be periods when prices are down. One way to help defend against this volatility is to hold stocks for the long term, rather than constantly buying and selling, and to own a mix of stocks from different industries and even different countries.

• *Bonds* – When market interest rates rise, the value of your bonds can decline because investors won't pay full price for them when they can get the newer ones that offer higher rates. Another type of risk associated with bonds is credit risk, which essentially describes the risk that the bond issuer may default, potentially disrupting your flow of interest payments. However, you can help mitigate this risk by purchasing investment-grade bonds that receive the highest credit ratings from independent rating agencies.

• *Certificates of deposit (CDs)* – Although CDs are generally considered safe because their principal is guaranteed, they do carry reinvestment risk — the risk that you won't be able to reinvest the proceeds of a maturing CD at the same interest rate. To help protect against this risk, you could own CDs of varying maturities. When market rates are low, you'll still have your longer-term CDs paying higher interest, and when market rates rise, you can reinvest the money from your maturing shorter-term CDs into the new, higher-paying ones.

Now, let's turn to a completely different type of risk — the risk of not investing. And this risk is easy to understand: If you don't invest, or if you consistently invest only in the most conservative vehicles, your money may not grow enough to allow you to reach your important long-term goals, such as a comfortable retirement.

Of course, this doesn't mean you should never own conservative investments, including CDs and some types of bonds. When you're saving for a short-term goal, such as a down payment on a house, a wedding or a long vacation, you want the money to be there when you need it, so an investment that offers protection of principal may be appropriate, even if it doesn't provide much in the way of growth.

For those long-term goals, though, you may need to build an investment portfolio that contains growth potential and that reflects your personal risk tolerance and time horizon. Over time, your risk tolerance may change. As you get closer to retirement, you may want to take a somewhat more conservative approach — but you'll always need some elements of growth.

When you invest, risk can't be eliminated, but it can be managed. Keeping this in mind, consider a long-term investment strategy that allows for risk but also offers the possibility of reward.

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