Session Five: Assessing Risk Vocabulary

People are exposed to some type of risk every day – whether it's from *skateboarding or skydiving or investing*. Age, lifestyle, and personality all factor into your willingness and ability to withstand risk.

***Risk** is the chance of losing all or part of the value of an investment.*

A fundamental idea in finance is the relationship between risk and return. The greater the amount of risk an investor is willing to take, the greater the potential return.

***Risk tolerance** is how much risk you are willing to take.*

Risk tolerance is based on several factors including age, time horizon (lifestyle, and personality).

Time horizon is the amount of time before the invested funds need to be **liquidated** (turned to cash).

For example, if an investor needs their investments to be liquidated in the short term, they have a **short time horizon**. The investor is more likely to invest in lower risk investments that may have low or moderate potential returns. These investments are lower risk because they have a low potential of loss due to market conditions, company bankruptcies, or other factors.

Younger investors have a **long-time horizon**. They may invest in higher risk investments for higher potential returns because they have more time to recoup possible losses. *(opposite)*

Financial stability and personality also play a role in determining your risk tolerance.

Do you have a steady income? Or do you need to have cash accessible to pay for everyday expenses?

Are you risk adverse? Or do you consider yourself a risk taker in order to gain more return?

After determining your time horizon and considering your lifestyle, income, and personality, you can determine what type of portfolio you would like to build.

Risk Pyramid

Summit (Aggressive/Speculative)- Small & medium cap stocks

Middle (Moderate)- Blue-chip/large cap stocks, mutual funds, corporate bonds

Bottom (Conservative)- municipal and treasury bonds

This risk pyramid breaks down the types of investments you may want to include in your portfolio. All these investments are part of The Stock Market Game simulation. If you are looking to build an aggressive portfolio, you may want to invest in stocks that are small or medium cap. Moderate investors may want to purchase blue-chip or large cap stocks, mutual funds and/or corporate bonds. And finally, conservative investors may want to purchase municipal or treasury bonds.

Whether you're a conservative, moderate, or aggressive investor, all investors should practice risk management to protect their gains and ensure long-term financial health.

Risk management is having strategies that help mitigate risks associated with your investments.

Question to Consider: What type of portfolio do you want to build: conservative, moderate, or aggressive? How does this align with your investment goals and strategy?