



The reality of risk

When it comes to investing, risk is the possibility that you may lose some or all of your investment, or that your investment may not increase in value. Take the stock market for example. After reaching a record high in October 2007, it began an erratic and sometimes dizzying descent, with no clear indication of what the future holds.

Where is it headed next and what does that mean for your retirement savings? Not knowing the answer to that question is the concept behind **market risk**.

But did you know that there are other types of risk associated with investing? Here are the key risks retirement plan investors face, along with tips for managing them.

It's important to understand the risks associated with investing and to assess your comfort level with risk regularly.

Key investment risks

Market risk	This is the possibility that an investment (e.g., a stock) will decline in value. As a result, if you sold the investment, you would receive less than what you initially paid for it.
Credit risk	This is the possibility that the issuer of an investment (e.g., a corporate bond) may not live up to its financial obligations. A default by the issuer could mean that you lose your invested capital and the expected interest payments.
Inflation risk	This is the possibility that the value of a long-term asset you hold (e.g., a money market fund) may not grow enough to keep up with inflation, reducing your purchasing power as a result.
International risk	This is the possibility that a country's government will suddenly change its policies. Events such as wars, revolutions, embargos and the appointment of officials with unfavorable economic policies can negatively impact the financial markets, especially concerning investments related to that country.
Economic risk	This is the risk that the economy will suffer a downturn as a whole. Such an event generally affects all the financial markets across the board, from product prices to the job market.
Industry risk	This is the risk that a specific industry will suffer a downturn. Often, industries related to the one that experiences problems will suffer as well.

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RP-14294 (10/08)

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Determining your comfort zone

To determine your own risk comfort level, ask yourself one question: are you willing to tolerate greater volatility for potentially higher returns from your investments, or do you place more emphasis on quality (with less risk)? Several factors may influence the amount of risk you can comfortably accept in your investment plan, including:

- Your age (the younger you are, the more investment risk you may be able to take on)
- Family situation (being single, divorced, married or with children are situations that all factor into the equation)
- Income (the higher your income, the more risk you may be able to take on)
- Financial goals (goals such as saving for retirement, college, a new home, or a car must all be addressed)
- Level of financial knowledge (the more you know about investing, the more comfortable you may become with risk)

Tips for managing risk

Diversify your investments. Make sure your asset allocation strategy includes investing a portion of your savings in all the major asset classes, including stock funds, bond funds and cash equivalents.¹

Stay the course. Investing for retirement is a long-term commitment. Don't chase the latest investment fads.

Investor, know thyself! When it comes to investing, the greater the risk is, the greater the reward may be. However, if you are fairly risk-averse, that's okay. It's your financial future and you are the one that has to be able to sleep at night. The important thing is to start somewhere. Make sure you review your risk tolerance on an annual basis, particularly if your personal situation changes (such as an increase in income or some other event that might put you in a situation to take on a bit more risk).

¹ Diversification does not ensure a profit or protect against loss in a declining market.

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