CBL WEALTH MANAGEMENT
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Financial Literacy

Part 3

Market Snapshot

Closing Values as of 04/18/2019

Dow	26,560
S&P 500	2,905
Nasdaq	7,998
Gold	$1,276

Understanding Risk

Investment risk comes in many forms, and it's not always where you think it is. I think if you polled the average investor they would say that stocks are "risky" while bonds are not. They might even suggest bonds are where you invest when you don't want any risk. In that same poll you might find that the average investor defines risk as the potential to lose money. The reality is, bonds aren't safe and there is more to risk than just losing money.

In general, risk falls into two main categories; Risk of loss & Purchasing power risk. There are 2 main types of risk associated with "risk of loss"; Market risk and interest rate risk. Market risk is pretty straight forward, it is the risk that an investment will decline in value because economic or business conditions change. Because market risk is so clearly tied to owning shares in a company or other investment and having those shares lose value, investors often associate this risk with the stock market. When market risk is applied to bonds it is called "credit risk" or the risk that a company will not be able to repay its debts.

Interest rate risk is a little less obvious yet it can result in substantial losses when not accounted for. Interest rate risk is specific to fixed income investments such as bonds. Interest rate risk is the probability of a decline in the value of an asset resulting from unexpected fluctuations in interest rates. Since interest rate is one of the primary drivers of a bond's price, changes in the interest rate environment, whether expected or not, will impact the market value of fixed income assets. Bond values have an inverse relationship to interest rates, when interest rates fall bond prices/value increases …when rates are rising bond values fall. The further out the bond's maturity the larger the price movements will be. One way to limit interest rate risk is to diversify the quality and maturity of bonds in your portfolio. In a low rate environment were rising interest rates are a real possibility reducing exposure to longer maturities in favor of short or very short maturities can further reduce interest rate risk. Of course, reducing maturity length can also reduce the amount of interest that is paid.

There are many other forms of financial risk but the last one we will discuss here is purchasing power risk. Unlike market risk and interest rate risk, purchasing power risk is not about an investment actually losing money, in fact, it can apply to bank deposits and cash under the mattress. Purchasing power risk is used to describe the impact excess inflation has on the future value of your money. When the rate of inflation is greater than your investments rate of return the future cash flow produced by your portfolio may not be enough to maintain a comfortable lifestyle. Failing to account for inflation, or investing aggressively enough to outpace inflation, can have the same negative effect as losing money. The best defense against purchasing power risk is to save aggressively and own an appropriate amount of quality stocks in your portfolio. If you make it your goal to simply preserve dollars you will inevitably fall victim to purchasing power risk as inflation erodes your dollar's ability to purchase goods and services.

With a number of other risks I could have discussed, why did I choose to highlight these three? Because it is important to know that ALL investments and asset classes have risk and that "loss" can come in many different forms. Risk can't be eliminated but there are steps you can take to reduce your portfolio risk and still achieve your long term financial goals.