

Investor Insight

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Is Risk a Four-Letter Word?

Is risk is just a nasty, “four-letter” word? Indeed, taking unnecessary risks can result in consequences if events don’t work out as planned. Yet, we all know that those who are willing to take calculated risks may have the potential to end up with results that are successful, whether in investing or life in general. Furthermore, avoiding all risks sometimes brings costly adverse consequences as well.

When it comes to our finances, the key is to recognize the risks and to manage them in the context of your assets and your personal circumstances. For most of us, balance is important.

Risk Takes Many Forms

Investment risk comes in many forms. Most often, a discussion of risk is associated with equities, but there are different risks associated with all asset classes. With regard to equities, some factors in assessing the risk of any stock may include:

- **Specific Company Factors** — What is the historical record of earnings and dividend payouts? Is the balance sheet sound, or overextended by leverage and thus vulnerable to interest rate risk? Has management demonstrated the leadership qualities required of outstanding companies? Is the company a leader in its industry, able to set market standards, or is it vulnerable to predatory attacks by the competition?
- **Industry Factors** — What are the key factors driving industry demand? Who sets prices? Regulated industries may have more predictable earnings, payouts and business operations together with relatively lower valuations (thus, less risk). At the other extreme, fast-growing companies in glamorous industries may sport higher valuations as a result of investor enthusiasm.
- **Market Risk** — What are the relative merits of equities in general today versus other classes of investments? During a market cycle, it is not uncommon for all stocks to fall (or rise), irrespective of quality or corporate merits.

Dekker Hewett Group
Canaccord Genuity Wealth Management
609 Granville St., Vancouver, BC, V7Y1H2
T: 604.699.0852
E: dhginfo@canaccord.com
www.dekkerhewettgroup.com

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Here are some other risks, not specific to equities:

- **Political Risk** — Governments can change their minds as to their professed policies. This is true for emerging nations where the tradition of business may not yet be well established, but also in Canada where a new government can break promises and change the rules.
- **Inflation Risk** — Will the value of your assets keep pace with the deterioration of your currency's buying power?
- **Outliving Your Money** — This is a natural concern for those facing retirement. However, resorting to non-growth investments in an effort to avoid the risk of losing money can exacerbate a situation that retirees may be trying to avoid.

Manage Risk, Don't Avoid It

Every individual's circumstances are unique, but it is rare that any investment expert would recommend a completely risk-averse solution to any investor.

For example, those nearing retirement might want to maintain a healthy component of growth in their investment assets to assist their ongoing income potential. Especially in today's low interest environment, this may suggest some use of quality growth equities rather than sole reliance on fixed-income or deposit vehicles. Tax considerations will also figure prominently in any solution as well. But reliance on just one investment class because of its low tax rate may offer more risk than warranted.

Risk should be kept in context with investor needs. A balanced approach and careful selection of individual securities should result in an acceptable profile with the objective of creating satisfying overall returns for the investor. At the end of the day, risk doesn't have to be that four letter word!