What Risks Are You Taking in Your Investments?

Description

All investments come with risk. Let's consider the kinds of risk different investments may have.

Are you maintaining purchasing power from your investments?

Due to inflation, something that cost $100 20 years ago costs nearly $117 today. The average annual rate of inflation since 2007 has been ~1.6%. So, if your investments had delivered a rate of return of ~1.6%, you would have maintained your purchasing power.

If you invest in GICs, you're guaranteed to get your principal back. As a result, some people see GICs as low-risk investments. However, there's risk in putting your money in GICs. Because of today's low interest rate, the interest you earn may have trouble keeping pace with the long-term inflation rate of 3-4%.

By aiming for a higher rate of return, perhaps double that of the long-term inflation rate, investors can enjoy a better life in the future when they harvest those gains. To get returns of 6-8%, investors most likely need to turn to stocks.

What are the risks of investing in stocks?

The textbook definition of risk would probably be a measure of volatility. Stocks are viewed as risky because of their volatile share prices.

However, a better way to view risk for real-world application is if there’s a high chance of capital loss, or if you could sell your shares at desired prices when you need your money back.

Capital losses can occur if companies go bankrupt. But, more commonly, investors can’t hold on to their stocks when a big correction occurs.

During the Financial Crisis, the market sold off, including quality businesses such as **Royal Bank of Canada** (TSX:RY)(NYSE:RY) and **Brookfield Asset Management Inc.** (TSX:BAM.A)(NYSE:BAM).

From peak to trough between 2007 and 2009, Royal Bank stock fell ~47%, and Brookfield Asset Management stock fell ~62%! That was a very irrational time. However, investing through that and looking back in hindsight are very different experiences. The market had very negative sentiments, and people were in fear of losing their life savings at the time.

At the end of the day, investors should know what kind of businesses they hold in their portfolios, such that when a big correction occurs, they’ll be able to hold on.

We never know when a market correction or a correction in a specific industry or stock will occur. So, it’s usually a safer way to invest by buying stocks that are trading at discounts versus stocks that are expensive.

Investor takeaway

By aiming for a reasonable rate of return of 6-8%, investors can more than maintain their purchasing power without taking on excess risk. Royal Bank and Brookfield Asset Management both look reasonably valued and would be great buys on dips.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:BN (Brookfield Corporation)
2. NYSE:RY (Royal Bank of Canada)
3. TSX:BN (Brookfield)
4. TSX:RY (Royal Bank of Canada)

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