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Risk Management

Risk management can broadly be divided into two categories:

- Systematic Risk (Market Risk)
- Unsystematic Risk (Specific Risk)

These categories help you as investors to understand and categorize the type of risk you may encounter in your respective Investment portfolio.

1. Systematic Risk: Risks that are inherent to an ENTIRE market or a specific segment of the market. This risk cannot be eliminated through simple diversification because it affects all investments to some extent. Systematic Risk is driven by external factors that impact the overall economy or financial markets. Causes may be ->
    a. Market risk
        i. Market Sentiment
        ii. Geopolitical Events
        iii. Natural Disasters
    b. Economic Factors
        i. Recession & Economic Slowdowns
        ii. Interest rate risk
            1. Federal Reserve Policies
            2. Yield Curve Changes
        iii. Inflation risk
    c. Currency & exchange rate risk
        i. Foreign exchanges Risk
    d. Political & regulatory risk
        i. Government Policies
        ii. Global Trade Relations
    e. Global Economic Events
        i. Global Financial Crises
        ii. Pandemics
    f. Commodity Price Volatility
        i. Energy Prices
        ii. Commodity Supply & Demand
    g. Political Instability
        i. Political Events
    h. Natural Resource Scarcity
        i. Resource Availability
        ii. Climatic Change Risk
    i. Technology Risk
        i. Tech Disruptions
        ii. Large scale Cyber Security Threats
    j. Geo-Political Conflicts
        i. Increased Market Volatility
        ii. Supply chain Disruptions
        iii. Interest Rate Adjustments
        iv. Global alliance & Trade relations
        v. Economic Downturn

vi. Economic Downturn
vii. Humanitarian & Social Impact

k. Black Swan Events
   i. Unpredictable Shocks
   ii. Market Meltdowns
l. Investor Confidence
   i. Global Economic Outlook
m. etc …………

2. Unsystematic Risk: Also known as specific risk or idiosyncratic risk, is the risk that is specific to an individual Investment or a particular company. This type of risk unlike systematic risk, can be reduced through diversification. Causes may be ->
   a. Business Risk
   b. Regulatory Risk
      i. Industry Specific
      ii. Trade Policies
   c. Industry & Sector Specific risk:
      i. Competitive Pressure
      ii. Technologies Changes
      iii. Supply chain Disruptions
   d. Company Specific risk:
      i. Management risk
      ii. Financial risk
      iii. Legal & regulatory issues
   e. Operational Risk
      i. Production Issues
      ii. Quality control
      iii. Logistical Challenges
   f. Financial Risk
      i. Credit Risk
      ii. Liquidity Risk
   g. Human Resource Factors:
      i. Key Employee Departures
      ii. Labor strikes
   h. Technological risk
      i. Cyber Security Risk
      ii. Obsolescence
   i. Market Position & Brand Perception
      i. Reputation
      ii. Market Saturation
   j. Environmental and Social Factors
      i. Regulations
      ii. Social Issues
   k. Legal & Litigation Risks
      i. Lawsuits
      ii. Intellectual Property Disputes

l. Supply chain Vulnerabilities
    i. Supplier reliability
    ii. Global Supply chain risk
m. Firm Financial Structure
    i. Debt levels
    ii. Leverages
n. Consumer Trends & Preferences
    i. Trends & behaviour
    ii. Demographic Changes
o. Mergers & Acquisition
    i. Integration Risk
    ii. Poor Implementation
    iii. Strategic Misalignment
p. Product & Innovation Failure
    i. Product Failures
    ii. Technologies Obsolescence
q. Brand Reputation
    i. Negative Publicity
    ii. Social Media Impact
r. etc ………

Different Strategies to deal with Systematic and Unsystematic risk respectively are as follows.

1. Managing Systematic Risk
    a. Diversification
        i. Strategy: Investment spread over **different** Asset Classes, Industries, and geographic regions.
        ii. Rationale: Mitigate the risks caused by adverse events impacting a specific sector or market.
    b. Asset Allocation:
        i. Strategy: Allocating investments in different asset classes like stocks, bonds, and real estate based on risk tolerance and investment goals
        ii. Different asset classes respond differently to economic conditions. A well-balanced portfolio provides a buffer against the impact of systematic events.
    c. Risk Hedging:
        i. Strategy: Use of derivatives, options, and futures to hedge against potential losses.
        ii. Hedging allows investors to protect their portfolios from adverse market moments during times of heightened uncertainty.
    d. Risk Monitoring
        i. Monitoring of economic Indicators, geopolitical events, and market trends
        ii. Early identification allows proactive portfolio adjustments and risk management.
    e. Macro Risk Management
    f. Safe-Haven Assets Investments
        i. Government Bonds, gold
        ii. Defensive assets

   g. Tactical Dynamic Asset Allocation
      i. Adaptability
      ii. Capturing Opportunities
   h. Active Investment Management over Passive
   i. Scenario Analysis
   j. Global Diversification

2. Managing Unsystematic Risk
   a. Diversification within Industries
      i. Strategy: A variety of companies in the same industry as Impact is company-specific.
      ii. Rationale: Mitigating risk across individual companies while maintaining exposure to overall sectors
   b. Research & Due diligence
      i. Strategy: Diving deep and analyzing the individual company thoroughly before making Investment decisions
      ii. Rationale: Helps Discover potential risks associated with Individual companies
   c. Innovation & Adaptability
      i. Strategy: Check the company's ability to innovate and adapt in the face of pure disruption.
      ii. These companies are better position to navigate uncertainties and mitigate unsystematic risk
   d. Insurance
   e. Assessment of Firm's Management Qualities
   f. Stress Testing
   g. Checking the Quality of Customer Relationship Management of a firm including Feedback
   h. Ethical leadership and Governance
   i. Scenario Planning and Simulation.

Must see: Practical Implementation of some of the Basic risk management concepts in the form of code and algorithm provided below in the colab notebook link. Please have a look.

https://colab.research.google.com/drive/13XBGAOrXo5gDmGOAxZ7dZIp48JvvbCVe?usp=sharing

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Hope this helps

Thank you

Be careful

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