

# Risk Management Reference Sheet

Quick reference for understanding and managing financial risks

Risk Type	Definition	Example	Management Strategy
Market Risk	Possibility of losses due to factors affecting overall financial markets (recessions, political events, global crises)	Stock portfolio drops 20% during economic recession	Diversification, long time horizon, avoid panic selling
Financial Risk	Risk related to a company's ability to manage debt and meet financial obligations	Company goes bankrupt and bondholders lose investment	Research company financials, credit ratings, avoid over-concentration
Inflation Risk	Possibility that purchasing power decreases as prices rise over time	\$10,000 in savings loses 26% purchasing power over 10 years at 3% inflation	Include growth investments, consider I-bonds, TIPS
Fraud Risk	Danger of losing money due to scams, deception, or fraudulent schemes	Ponzi scheme promises 20% guaranteed returns with "no risk"	Due diligence, verify credentials, avoid too-good-to-be-true offers
Liquidity Risk	Risk that you cannot sell an investment quickly without significant loss	Real estate cannot be sold quickly during market downturn	Maintain emergency fund, balance liquid and illiquid investments
Interest Rate Risk	Risk that bond values decrease when interest rates rise	Bond values drop when Federal Reserve raises rates	Bond laddering, shorter durations, diversified fixed income

## Risk Tolerance Profiles

### Conservative (Low Risk Tolerance)

**Characteristics:** Short time horizon, low income stability, high liquidity needs, uncomfortable with volatility

**Suggested Allocation:** 20% Stocks / 50% Bonds / 30% Cash

### Moderate (Medium Risk Tolerance)

**Characteristics:** Medium time horizon (5-10 years), stable income, balanced goals, can tolerate some fluctuation

**Suggested Allocation:** 50% Stocks / 35% Bonds / 15% Cash

### Aggressive (High Risk Tolerance)

**Characteristics:** Long time horizon (10+ years), high income stability, low liquidity needs, comfortable with volatility

**Suggested Allocation:** 80% Stocks / 15% Bonds / 5% Cash

## Asset Classes by Risk Level

- Low Risk:** Savings accounts, CDs, Treasury bonds, money market funds
- Moderate Risk:** Investment-grade bonds, balanced funds, blue-chip stocks, REITs
- High Risk:** Growth stocks, small-cap stocks, emerging markets, sector funds
- Very High Risk:** Options, futures, cryptocurrency, penny stocks

## Risk-Return Tradeoff

- Higher potential returns = Higher risk
- Lower risk = Lower potential returns
- No investment is completely risk-free
- Time horizon affects appropriate risk level
- Diversification can reduce risk without proportionally reducing returns

## Diversification Strategies

### Asset Class Diversification

- Stocks for growth
- Bonds for income/stability
- Cash for liquidity
- Real estate for inflation hedge

### Sector Diversification

- Technology
- Healthcare
- Consumer goods
- Financial services
- Energy/Utilities

### Geographic Diversification

- U.S. domestic stocks
- International developed markets
- Emerging markets
- Global bonds

### Time Diversification

- Dollar-cost averaging
- Regular contributions
- CD laddering
- Bond laddering

## Red Flags: Warning Signs of Investment Fraud

- **Guaranteed high returns with no risk** - All investments carry some risk
- **Pressure to invest immediately** - "Limited time offer" or "Act now"
- **Unregistered investments** - Check SEC.gov or FINRA BrokerCheck
- **Unlicensed sellers** - Always verify credentials
- **Can't explain the strategy clearly** - If it sounds too complex, be cautious
- **Missing documentation** - Legitimate investments provide prospectuses and disclosures
- **Difficulty receiving payments** - Trouble withdrawing money is a major red flag

## Key Formulas and Concepts

### Rule of 72 (Doubling Time)

Years to Double = 72 / Annual Return %

Example: At 8% return, money doubles in 72/8 = 9 years

### Inflation Impact

Real Return = Nominal Return - Inflation Rate

Example: 5% return - 3% inflation = 2% real return

### Age-Based Allocation Rule

Stock % = 110 - Your Age (or 100 - Age for conservative)

Example: Age 25 = 85% stocks, 15% bonds; Age 60 = 50% stocks, 50% bonds

### Emergency Fund Target

Emergency Fund = Monthly Expenses x 3 to 6 months

Higher job instability or health concerns = target 6 months

## Before Investing

- Build emergency fund first
- Pay off high-interest debt
- Define your goals and timeline
- Assess your risk tolerance
- Research investment options

## During Investing

- Diversify across asset classes
- Invest regularly (dollar-cost averaging)
- Rebalance periodically
- Avoid emotional decisions
- Keep costs low

## Risk Management

- Never invest what you can't afford to lose
- Match risk to time horizon
- Review and adjust as life changes
- Stay informed but avoid overreacting
- Seek professional advice when needed

## Key Takeaway

Risk is inherent in all financial decisions, but it can be managed effectively through education, diversification, and honest self-assessment. Understanding your personal risk tolerance and matching it with appropriate investment strategies allows you to pursue your financial goals while maintaining peace of mind. Remember: the goal isn't to eliminate risk entirely, but to take

appropriate risks that align with your goals, timeline, and comfort level. Start with a solid emergency fund, diversify your investments, stay patient during market volatility, and adjust your strategy as your life circumstances change.

---

PFL Academy - Chapter 5.5: Understanding Monetary Risks

This reference sheet is for educational purposes. Consult a financial professional for personalized advice.