

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)

$$\text{Years to Double} = 72 / \text{Annual Return \%}$$

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

Inflation Impact

$$\text{Real Return} = \text{Nominal Return} - \text{Inflation Rate}$$

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

Age-Based Allocation Rule

$$\text{Stock \%} = 110 - \text{Your Age (or } 100 - \text{Age for conservative)}$$

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

Emergency Fund Target

$$\text{Emergency Fund} = \text{Monthly Expenses} \times 3 \text{ to } 6 \text{ months}$$

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.