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THE REGISTER CITIZEN

MARKET MATTERS: How much risk can you tolerate?

By Joseph Matthews
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How much risk can you tolerate?

Would you parachute from a plane? Climb a rocky cliff? Or, is a walk in the park more your speed?

What about with your money? How much risk can you tolerate with your investments?

The answer depends on your financial goals and where you stand in relation to the milestones of your life. Perhaps you are just out of college and starting your first job. Maybe you are buying a vacation home or a boat. Retirement may be an afterthought, or you may be packing up to spend weekdays on the golf course already.

Certainly, the answer to how much risk an investor can handle will change at different points in your financial life. The answer also depends on your personality. Even the word “risk” itself can spark different reactions. For you, does “risk” suggest potential loss or uncertainty — or potential opportunity?

Your willingness (or unwillingness) to engage in extreme sports that involve high speeds, heights, and levels of danger may not translate into the same attitude towards money. Your behavioral predisposition is important, but it is only one factor in the measure of investment risk tolerance.

Young investors with many years of investing ahead generally can tolerate more risk as they have more time to recover from a temporary setback. Beyond your age and timeline, you should also consider factors such as your estimated future earning capacity, as well as any assets you hold at the moment — your home, your savings, your pension, the contents of your safe, and so on.

Gauging your risk tolerance is a multi-layered endeavor, but you can start by getting a sense of what sort of a financial risk-taker you are in general. For instance, say you have spent the last year planning your dream vacation. If you unexpectedly lost your job just a few weeks before your departure date, would you cancel the trip? Or would you not only go, but extend it?

Or, say your neighbor — a brilliant young computer whiz and recent Ivy League grad — is gathering investors to fund his exciting new startup. This venture potentially could reap many times the initial investment, or none at all. Would you invest a month's salary, or three months' worth, or six? The amount you may be willing to invest plays into your risk factor. Perhaps that money was set into a stable portfolio that had modest returns and you are exploring other options to boost your portfolio's performance. If this is something you are considering, consult a financial adviser.

The point is, risk tolerance is a tricky measure, suggesting your willingness to accept the possibility of a loss, in exchange for the possibility of a greater return. Trying to remain risk-free, as much as possible, may mean you are sacrificing the potential for growth in your portfolio. But you must ask yourself if you can stomach swings of the pendulum in a portion of your portfolio's value over time.

If you have low tolerance for risk, you may be the type of person who panics when the pendulum swings to the "loss" side, and this may prompt you to sell at exactly the wrong time. Making decisions based on headlines — such as volatility in the market, when the market declines sharply, or when the market is on a sharp upswing — is not wise. Instead, review how you are investing to achieve both your short-term and long-term financial goals, and then make a decision that best fits your financial plan.

Trying to remain risk-free, as much as possible, could mean you are sacrificing the potential for growth in your portfolio. Consequently, that could translate to affecting your retirement.

On the other end of the spectrum are those who have a high tolerance to risk, those who, perhaps, are willing to "risk it all" for a larger payout. These investors themselves may be very well versed in investing and have keen insight into the markets, or have advisors who do. Stable sources of income, such as high-paying jobs or long-term investments, also may give them the ability to tolerate more risk.

A middle-of-the-road approach to risk tolerance would, of course, balance the two extremes; combining more stable assets and securities with less volatility. This type of investor may have several years left in his or her investing horizon, will be level-headed in decision making, and will be careful to widely diversify a portfolio to best reach his or her goals.

So, what are high risk investments and what are those with lower risk?

I believe investing in start-up companies, for example, involves greater risk than investing in storied blue-chip companies with long histories of improving profits and dividends.

Do your homework. Research your options. Is the potential investment a likely walk in the park or a dangerous climb up a rocky cliff?

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