All types of investment risks

Steven Podnos *8:30 a.m. EDT May 16, 2016*

When investing, we may encounter unanticipated risks. There are more of these that can be detailed here, but I'll run over just a few to consider.

Owning a home is actually a risky venture for some people. Since most of us buy the home with leverage (we borrow say 80 percent of the value of the home), a small drop in home prices can result in a catastrophic effect on the investment return. A twenty percent drop in price wipes out 100 percent of your equity. Just about anyone who invested in a home between 2000 and 2007 encountered this risk. This risk can be mitigated by making a smaller purchase and by buying when prices have already dropped a great deal. That's not so simple to accomplish however. Owning the home over a very long term also may mitigate the risk as residential real estate tends to appreciate at a 1-2 percent rate over the long term. You won't really regain the loss of purchasing power like this, but may recover some of a decrease in absolute pricing.

Another "hidden" risk is high investment costs. I typically see costs from 2-4 percent on accounts at brokerage houses and insurance products (annuities and life insurance). In a low return world, you don't have a chance to come out well with these costs. The costs are often hidden well, and take some sleuthing. It seems reasonable to pay around 1 percent a year or less for fiduciary advice as well as an asset allocation. The cost of the investments themselves shouldn't run much over $^1/_2$ percent per year. Larger accounts should be "all in " at under 1 percent a year. If you are paying substantially more than this (especially with larger accounts), you might do some checking around. The most common complaint I hear from people who suffer this risk is "my accounts just don't seem to be growing." Guess why.

Another risk is owning employer stock in a retirement plan or investment account. From time to time I encounter someone with a retirement plan stuffed with employer stock. These individuals are exposed through both their jobs and their investments to the same risk-that risk being a problem involving the employer. Many major American corporations have been quite risky in this regard (think Enron, GM, and even General Electric stock). It makes more sense to be invested in a diversified fashion than to own employer securities.

A final risk here is that of insurance company or investment house solvency. There are many products in the investment and insurance world that depend on the continued solvency of issuing organizations. For example, if you have life or disability insurance issued by a "shaky" company, you might not have the protection you've been paying for. Many homeowners in Florida found out in 2004 that their small homeowner company insurance plans did not possess the resources to pay them as promised. If you are depending on an annuity stream of payments or long term care benefits, you should hope your insurance company is financially strong. Often the highest paying annuities are backed by the weakest companies.

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