money matters

The many faces of risk

by J. Lynn Davidson
Special to Q-Notes

You tuck your nest egg safely away in a certificate of deposit at your neighborhood bank and you think you don't have to worry about it. Your principal is secure, your return is guaranteed and your investment is federally insured. But, you may be surprised to hear that there's no such thing as an absolutely safe investment. That's because risk takes many forms — many of which you should consider as you create your investment strategy.

If you tend to be a conservative investor, you're not alone. In fact, a survey conducted by The Gallup Organization and the Employee Benefit Research Institute revealed that nearly seven out of 10 investors favor the safe side when it comes to risk. Because they fear the loss of principal, many of them choose low-risk, low-reward investments like bank CDs. But, the comfort that comes with that strategy could be costly.

An example cited by Consumers Union of the US, Inc, illustrates why this is true: By purchasing a tried-and-true Treasury note paying 6.9 percent interest, you'll collect $690 a year on a $10,000 investment. If you plan to use the interest as income and you are in the 28 percent tax bracket, you would get to keep just $497. Assuming a steady 4 percent inflation rate, in 10 years you would need $735 to buy what $497 gets for you today. In this case, over a period of time, taxes and inflation left you with negative returns on your seemingly safe investment. You can see by this example where some of the other "faces" of risk come into play.

The key kinds of risk to consider

Market Risk — Seemingly unrelated factors, from world events to tax laws to the threat of interest rate increases, can cumulatively affect securities prices.

Interest Rate Risk — A sustained rise in interest rates usually causes trouble for stocks and pain for bonds. After all, who would want to pay full price for an 8 percent bond when new bonds pay 10 percent? A variation on interest-rate risk occurs when rates decline. Called "reinvestment risk," this occurs when a recently matured bond (or any other fixed income security) is replaced with one offering a lower interest payment.

Economic Risk — In a growing economy, stock prices tend to rise. Similarly, when the economy slows down, stock prices usually decline.

Inflation Risk — With inflation hovering around 3 percent in recent years, inflation risk is less threatening than it was in the late 1970s. Yet even during periods of moderate inflation, "safe" investments like money market funds, CDs and bonds can erode in value and reduce your returns. That results in a loss of purchasing power — one of the greatest concerns for investors living on fixed incomes.

Credit Risk — Investors who purchased bonds issued by companies that ultimately went bankrupt learned about credit risk the hard way. That's why bond quality is an important factor for investors to consider.

Is time on your side?

Time can be your best ally when determining your risk-reward strategy. If you don't need access to your money for 10 to 15 years, the stock market may be an investment vehicle for you. Despite its recent gyrations, the market has historically trended higher over the long term and has outperformed fixed-rate investments. Of course, it's important to keep in mind that the stock market's past performance is no guarantee of future results. If you don't have the luxury of a long time frame, diversifying your holdings may be a way to balance risk. By investing in a variety of asset classes — bonds, stocks, etc. — you can help cushion your investments during market downturns and lessen the effect of inflation.

The main thing to remember is that your investment strategy should reflect your goals and risk tolerance. Even though you probably won't ever completely eliminate risk in your life, make sure that the level of risk in your investment portfolio feels comfortable to you — and allows you to rest easy at the end of the day. ▼

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Military

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responsibility to 'judge the wisdom and fairness' of any policy under the Constitution, we will lose. Gays serving our country will lose. And all Americans will lose. Our heartfelt thanks should go out to Lieutenants Holmes and Watson for their service to our country and their dedication to trying to make the world a better place for us all."

Holmes and Watson have not announced whether they plan to appeal the decision. The next possible step for them is to ask the full court for the Ninth Circuit Court of Appeals to rehear the case *en banc*. Some argue that the *Holmes/Watson* decision directly conflicts with other Ninth Circuit opinions such as *Meinhold v. Department of Defense* where the court ruled that it was impermissible for the Navy to discharge someone who stated that he is gay. [*Ed. Note: See separate article in this issue for an update on Keith Meinhold's case.*]

The *Holmes/Watson* decision joins other cases which have upheld "Don't Ask, Don't Tell, Don't Pursue," including *Thomasson v. Perry* and *Selland v. Perry* from the Fourth Circuit Court of Appeals, and *Richenberg v. Perry* from the Eighth Circuit Court of Appeals. The United States Supreme Court has declined to review the *Thomasson* or *Selland* cases; the court has not ruled whether it will review the *Richenberg* case.

Another case that remains outstanding is that of *Able v. Cohen* being litigated by Lambda Legal Defense and Education Fund and the ACLU. On July 2, Judge Eugene Nickerson for the District Court for the Eastern District of New York ruled that the military's "Don't Ask, Don't Tell, Don't Pursue" policy is unconstitutional creating "special rules" that treat gay servicemembers differently than heterosexual servicemembers for saying and doing the same things. The Second Circuit Court of Appeals will hear the appeal of that case at the end of this year. ▼