

St. Joseph School finlit Course  
7th Grade & 8th Grade  
Winter Term 2022 - 2023  
February 8, 2023

Planning for the future  
Class 27:  
Managing  
Risk

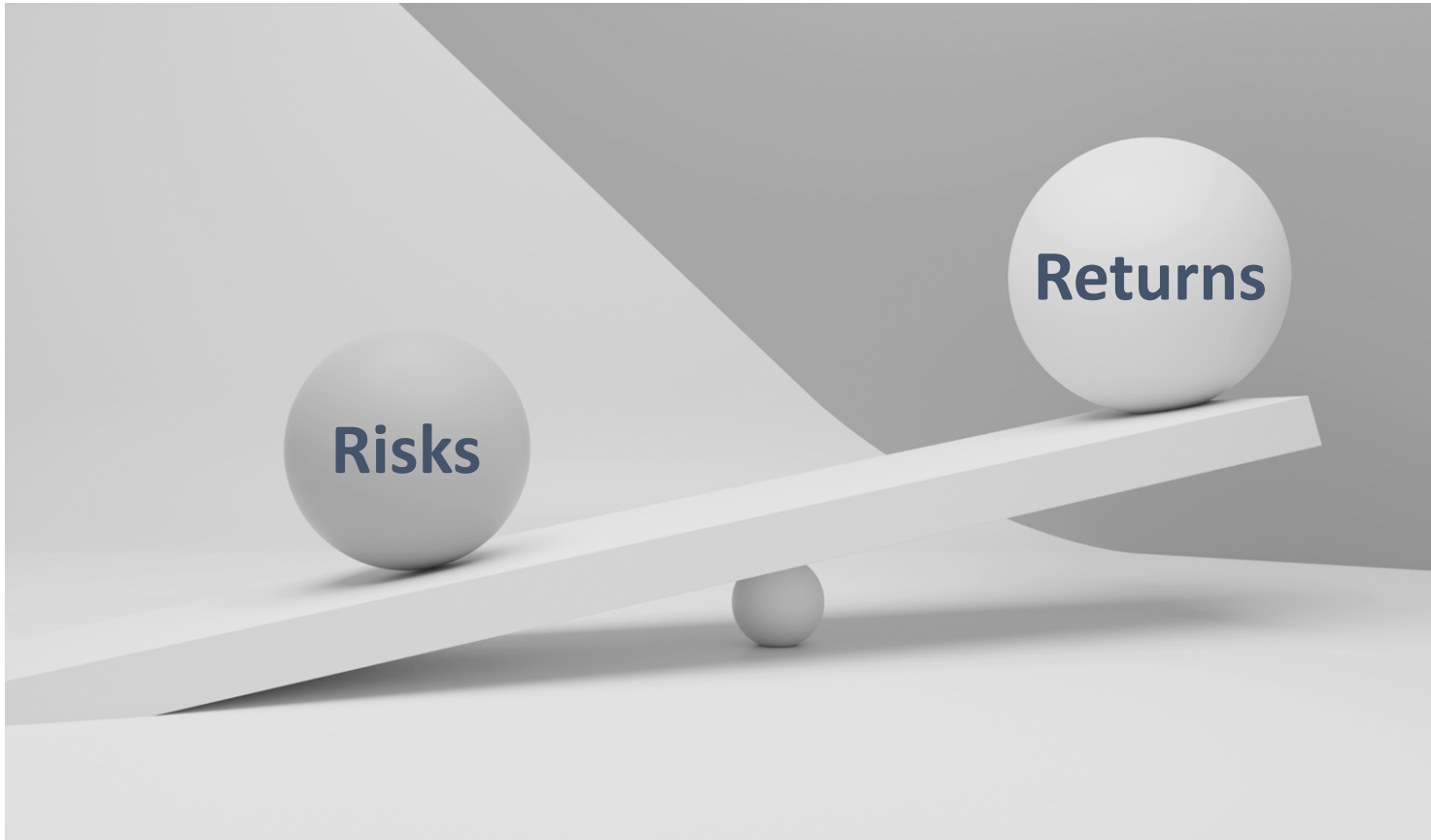




# NITWOM

## News In The World Of Money

02/08/2023: Alphabet shares fall 8% following Google's artificial intelligence event. Shares of Alphabet tumbled Wednesday after the company held an event that showed off its new artificial intelligence chatbot called Bard. Google officially announced Bard on Monday, and the company said it will begin rolling out the technology in the coming weeks. Google's event took place just one day after Microsoft hosted its own AI event at its headquarters in Redmond, Washington. [[Source](#)]



## Recap Risk and Return Tradeoffs

- **Risk** means the potential to lose principal on investments
- **Returns** mean the **financial gains** on investments
- Equities, such as stocks, generally provide opportunities for **higher returns**, but carry **heavier risks**
- Fixed income, such as bonds, generally carry **lighter risk**, but provide opportunities for **lower returns**

# Recap Investment Risks: Two categories

## Manageable Risk

- technically this is known as **idiosyncratic risk**
- risks related to an **individual security** or **very specific group** of securities
- **Example:** The U.S. government implements windfall profit taxes on oil companies. What might this do to oil company stocks?
- You can do something about it

## Unmanageable Risk

- technically this is known as **systematic risk** or **market risk**
- risks related to **all securities** or **many groups** of securities
- **Example:** A 10-mile-wide asteroid strikes the earth. What does this mean for humanity, let alone the financial markets?
- You cannot do anything about it

# Recap Investment Risks: Two categories

Can reduce, but never eliminate these risks

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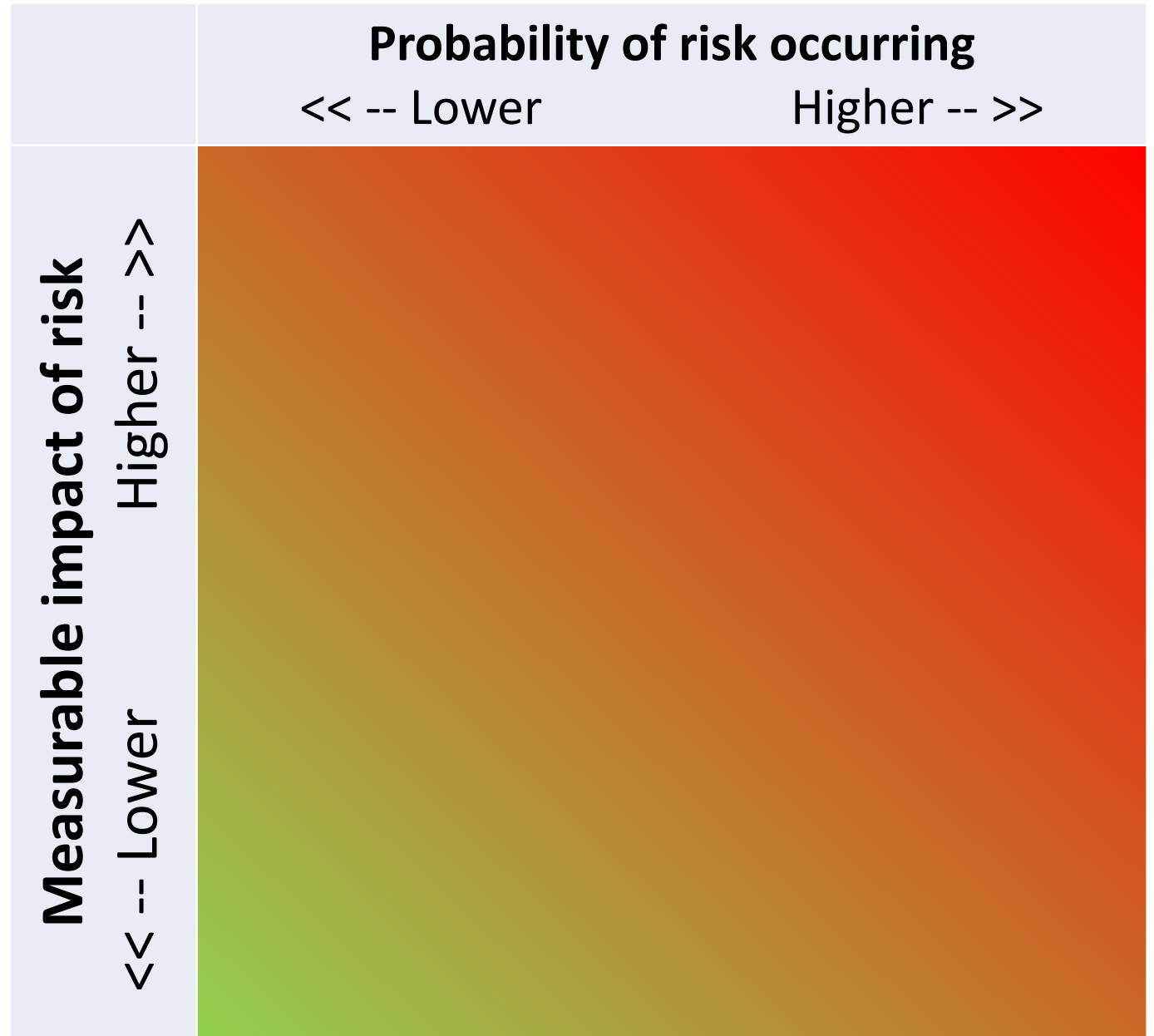
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# Evaluating and quantifying risks

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- How likely is the risk to occur?
- What is the measurable impact if the risk occurs?

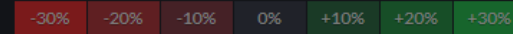


# S&P 500 Components 1-Year Performance



Use mouse wheel to zoom in and out. Drag zoomed map to pan it.  
Double-click a ticker to display detailed information in a new window.  
Hover mouse cursor over a ticker to see its main competitors in a stacked view with a 3-month history graph.

Source: [S&P 500 Map \(finviz.com\)](https://finviz.com)



VIEW Map Bubbles

MAP FILTER

S&P 500

World

Full

Exchange Traded Funds

1 Year Performa...

Quick search ticker

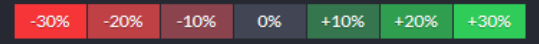
- A Agilent Technologies, Inc.
- AAL American Airlines Group...
- AAP Advance Auto Parts, Inc.
- AAPL Apple Inc.
- ABBV AbbVie Inc.
- ABC AmerisourceBergen Cor...
- ABT Abbott Laboratories
- ACGL Arch Capital Group Ltd.
- ACN Accenture plc
- ADBE Adobe Inc.

Standard and Poor's 500 index stocks categorized by sectors and industries. Size represents market cap. Fullscreen Share map



Use mouse wheel to zoom in and out. Drag zoomed map to pan it. Double-click a ticker to display detailed information in a new window. Hover mouse cursor over a ticker to see its main competitors in a stacked view with a 3-month history graph.

Source: [S&P 500 Map \(finviz.com\)](https://finviz.com)







*What does this phrase mean to you, "don't put all your eggs in one basket?"*

A photograph of a woven basket filled with several brown eggs, resting on a dark wooden surface. The basket is made of light-colored straw and is filled with about a dozen eggs. The background is a dark, textured wooden surface with vertical planks. The overall lighting is soft and natural, highlighting the texture of the eggs and the wood.

# Diversification

A risk management strategy that mixes a variety of investments within a portfolio. A diversified portfolio contains a mix of asset types, securities, and investment vehicles, which reduces effects single asset risks.

# Select Diversification Approaches

- Company diversification – including securities from many companies in a portfolio to **reduce single company risks**
- Sector and industry diversification – including securities from many parts of the economy to **reduce single sector risks** or **single industry risks**
- Asset class diversification – including securities of many asset classes (ex. stocks, bonds, real estate, commodities, etc.) to **reduce certain macroeconomic risks**
- Geographic diversification – including securities from many countries to **reduce certain geo-political risks** or **single country risks**



# Small Group Exercise

Assess a portfolio's risk  
and diversification.  
Select 1 Presenter.

# Small Group Exercise Sample Portfolio

Investment Description	Economic Sector	Type	Investment Value
Apple (AAPL)	Technology	Stock	\$6,000
Microsoft (MSFT)	Technology	Stock	\$2,000
Tesla (TSLA)	Consumer Cyclical	Stock	\$1,000
US Treasury BILL 06/01/2023 [4.682% Yield to Maturity]	Government	Bond	\$1,000
Apple Inc. 2.4% 05/03/2023 [2.541% Yield to Maturity]	Technology	Bond	\$2,000

# Small Group Exercise Questions



What is the percentage weight of each investment within the portfolio? Hint: First, determine the total portfolio value.



What observations do you have of the portfolio?



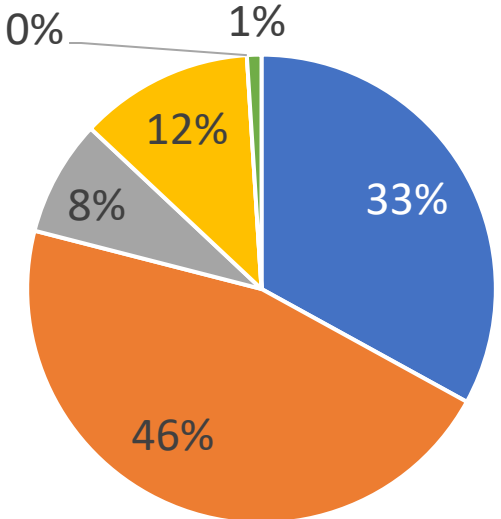
What might be some of the risks for the securities in the portfolio?



Do you think this is a well diversified portfolio? Why or Why not?

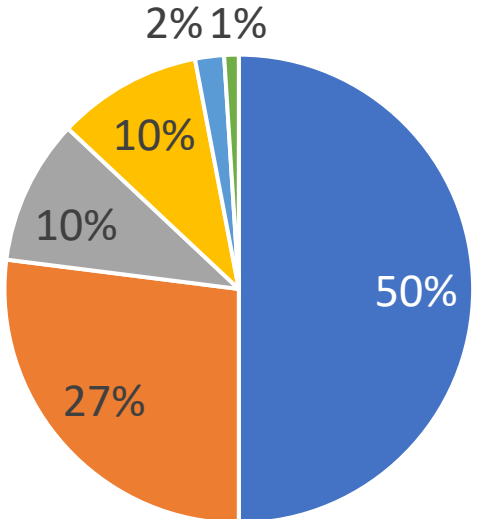
# Examples of Risk-Based Diversified Portfolios

**Lower Risk** with Lower Potential Long Term Financial Rewards



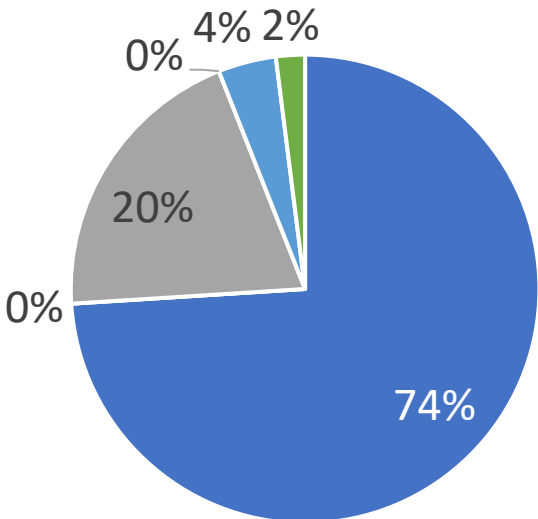
- US Stocks
- US Bonds
- Foreign Stocks
- Foreign Bonds
- Real Estate
- Commodities

**Moderate Risk** with Moderate Potential Long Term Financial Reward



- US Stocks
- US Bonds
- Foreign Stocks
- Foreign Bonds
- Real Estate
- Commodities

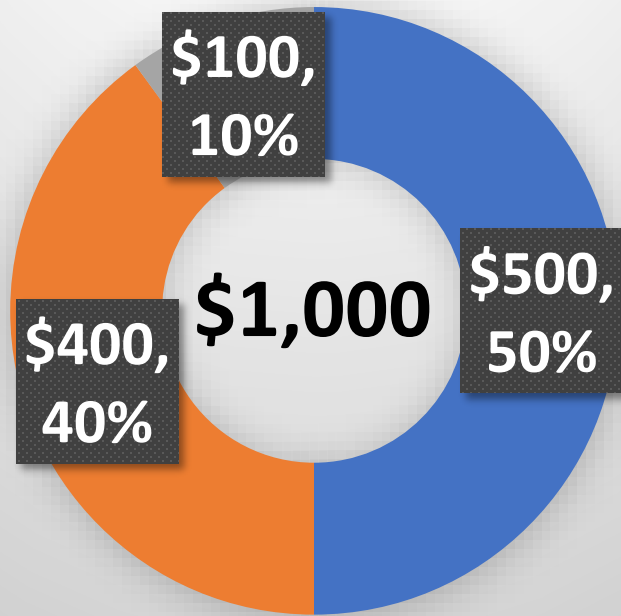
**Higher Risk** with Higher Potential Long Term Financial Reward



- US Stocks
- US Bonds
- Foreign Stocks
- Foreign Bonds
- Real Estate
- Commodities

# Over time portfolio balances drift, generally weighting to riskier investments

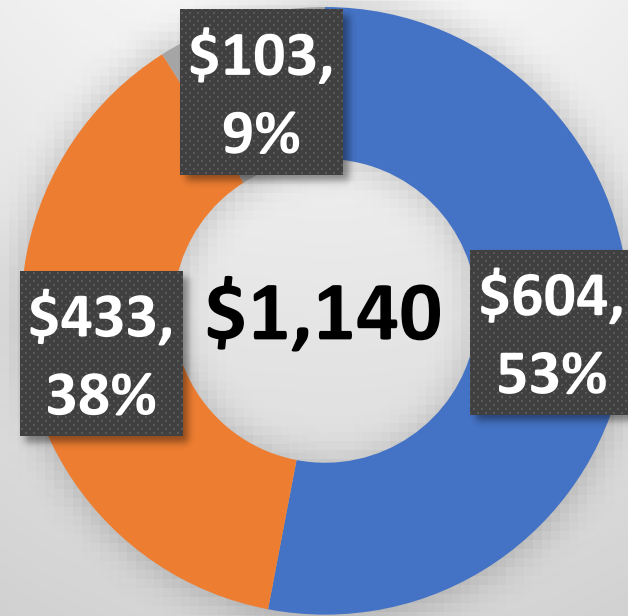
Starting Portfolio Composition



■ Stocks ■ Bonds ■ Cash

Portfolio Drift Over Time Example

Ending Portfolio Composition



■ Stocks ■ Bonds ■ Cash





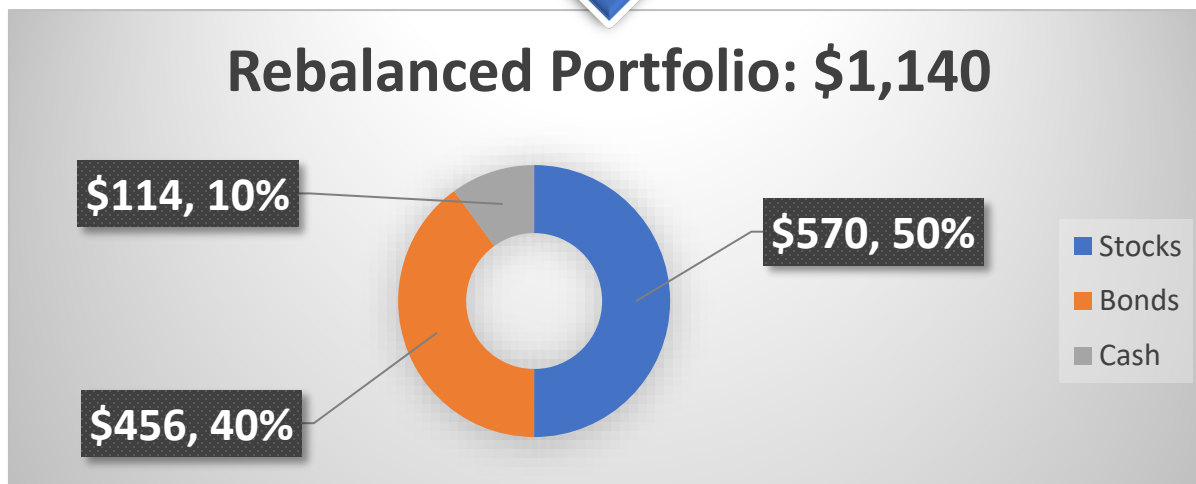
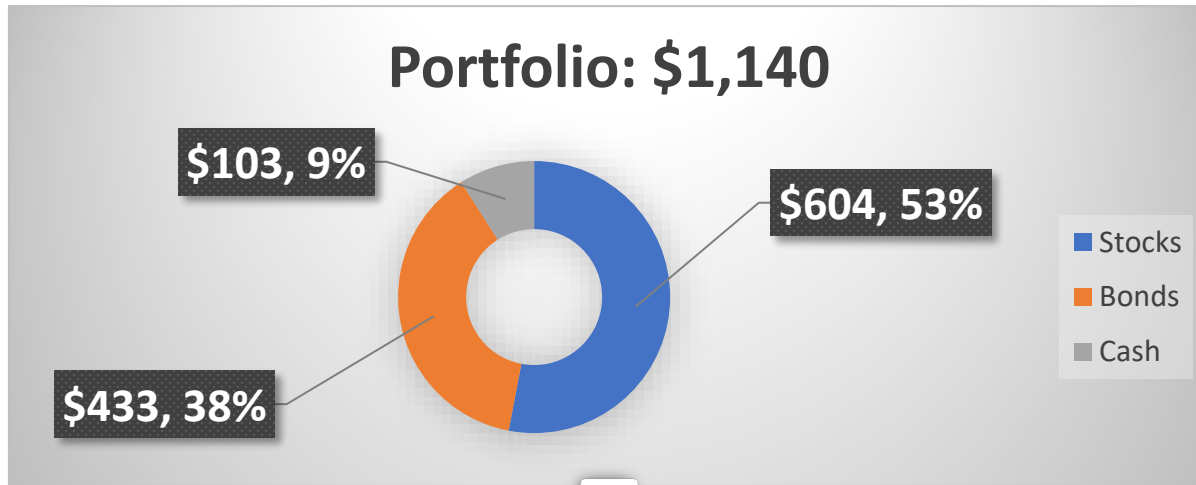
*Why do  
portfolios tend  
to weight  
toward riskier  
investments  
over time?*

The background is a dark red surface with a light gray notebook-like texture. A pencil is positioned diagonally across the center. Two pie charts are visible: one in the upper left and one in the lower right. The word 'Rebalancing' is written in large white letters across the center.

# Rebalancing

A risk management strategy that changes the weightings of assets in an investment portfolio by buying or selling securities to reach the desired portfolio composition.

# Rebalancing an investor's portfolio



- Presume the investor's starting portfolio composition still satisfies the intended S.M.A.R.T. financial objectives
- Recall the investor's starting portfolio composition was **50% stocks, 40% bonds, and 10% cash.**
- The investor could **sell \$34 of stocks** and **buy \$23 of bonds** and **buy \$11 of cash.**
- This action **rebalances** the investor's portfolio composition to 50% stocks, 40% bonds, and 10% cash.



*Why do you  
think portfolio  
rebalancing  
could help  
manage  
investment  
risks?*

# Coming Up on Investments – Deep Dives Into...

- ✓ 1. Introduction
- ✓ 2. Financial Objectives,
- ✓ 3. Managing Risk,
- 4. **Equities (Stocks),**
- 5. Fixed Income (Bonds),
- 6. Mutual Funds & ETFs, &
- 7. Putting it All Together.





## Key Takeaways

- Manageable risks can be reduced, but never eliminated
- Diversification reduces manageable single-asset risks by mixing a variety of investments in a portfolio
- Rebalancing reduces portfolio drift risks by aligning a portfolio to a desired risk-appropriate composition