CREATING PROSPERITY BY CONNECTING INVESTMENT OPPORTUNITIES TO INVESTORS

Dutch Caribbean Securities Exchange

INVESTORS' CORNER

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Risk in Investments and the Importance of Diversification

Part 1

"The biggest risk is not taking any risk."

Mark Zuckerberg

What do you understand when you hear risk diversification? "Sounds like a big terminology that investment professionals throw around so that they sound and look smart!" – one of my friends responded when I asked her. What do you think it is? Is it something that you could comfortably explain to a friend or family member? I am sure you could fathom a guess for each of the individual terms. I am confident one can explain or at least give real-life examples of what risk is to them and also what diversification or any of its derivatives (diversify, diverse) means. But put the words together and then – poof! Understanding goes through the door! Well, today I want to invite you back into the conversation as I explore risk diversification and its critical role in investments. In my opinion risk diversification is one of the most important concepts in investments that all investors must understand!

So, if you want to get serious about investing, or just want to start to learn more about how to get into investments, this is one concept that you must know! Join me, let me share with you! We will take baby steps, let us tackle each word by itself and then we will explore its importance.

What comes to mind when you think about risk? If you walk across a busy street, no matter how careful you are, there is always the possibility that a car might come out of nowhere and hit you. The possibility of getting hit by a vehicle is the risk in this case. Therefore, risk is simply the chance that something unfavorable will happen.

In the investment world, the goal for an investor is to earn as much money on the initial money that he is investing. Something favorable would, therefore, include the investor earning a very high return or profit. While, something unfavorable would be not earning anything or worse, losing part or in some cases all of the initial money that the investor has originally invested. So, when we talk about risk in the field of investments, we are referring to the chance that the investor doesn’t earn any money or the chance that the investor earns less than what he had wanted or expected or even worse the possibility that the investor loses even his original money invested.

The higher the chance of the unfavorable event – earning less than you had wanted - the higher we would say is the investment risk. Let us go back to our real-world example. The possibility – or risk of being hit and badly hurt by a car- might be high or low depending on how well you cross the street, right? In one instance, if you used the pedestrian crossing, you looked to see if there are incoming cars, you waited for the drivers of the cars to acknowledge you and then you cross only after the drivers of the car stopped to give you pass – then the risk of getting hit by a car is significantly low. But what about if you rushed onto the same busy road, not checking to make sure that there are no cars coming towards you? The risk of you getting hit and being seriously hurt is so much higher! Similarly, there are investments whose risks are very high, because the investment would expose the investor to a greater possibility of the investor losing his initial money invested.

Now that you have a working understanding of risk, join me for the next publication where we tie in diversification and delve further into really understanding the importance of risk diversification in investments.

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