WORTH MAGAZINE · ESTABLISHED 1992

WORK \ FINANCE \ LIFE

W
Gavin Newsom: An interview with the man who hopes to lead California—and offer a new vision of America.

F
They were once the darlings of Wall Street. But after years of underperformance, what's next for hedge funds?

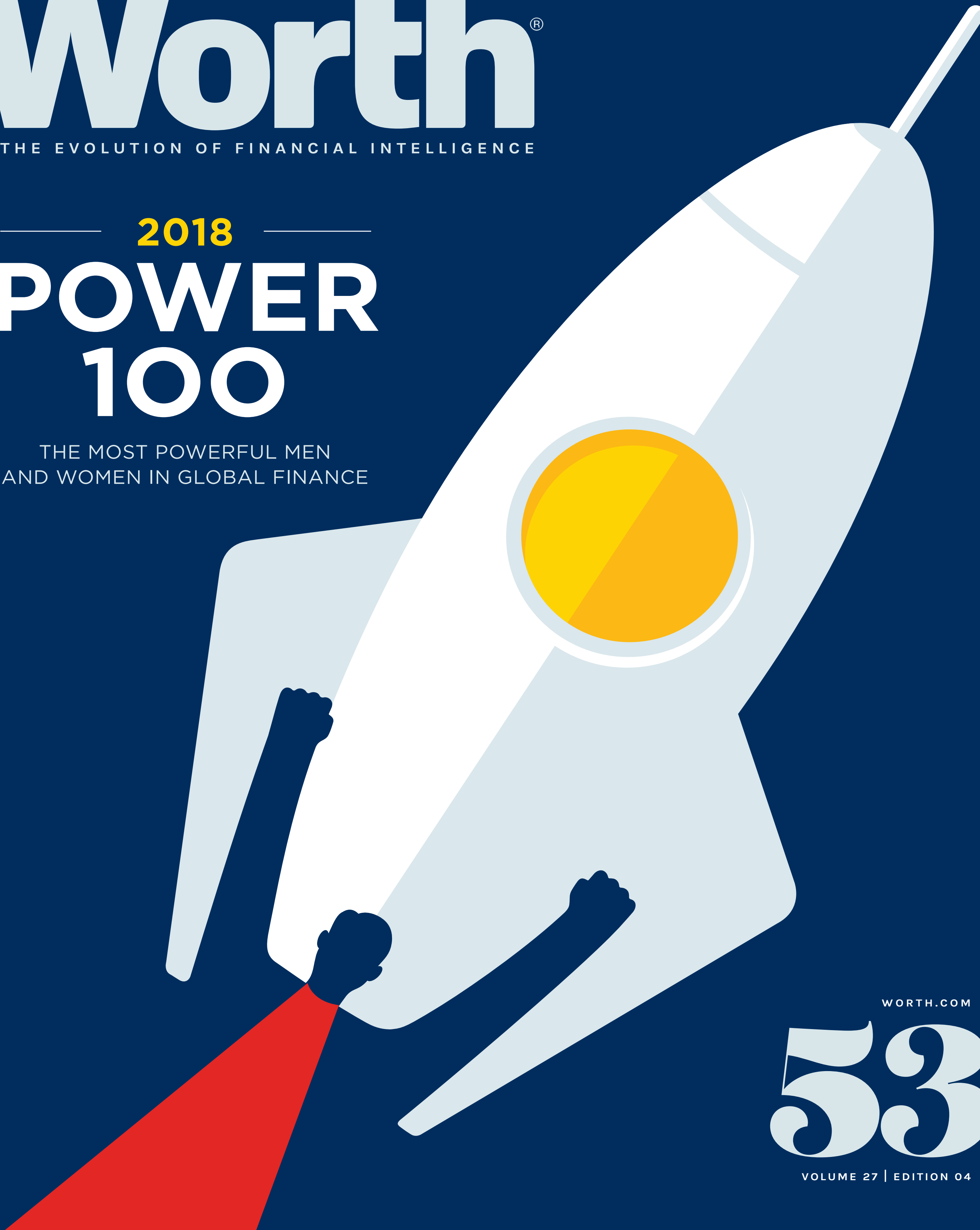
L
From watches to barware to travel accessories, classic style reigns in *Worth*'s annual holiday Gift Guide.

Worth®

THE EVOLUTION OF FINANCIAL INTELLIGENCE

2018 POWER 100

THE MOST POWERFUL MEN AND WOMEN IN GLOBAL FINANCE



WORTH.COM

53

VOLUME 27 | EDITION 04

Q:

What are five key risks of investing?

BY MICHAEL S. SCHWARTZ

Michael S. Schwartz, CFP®, AEP®,
Chief Executive Officer,
Wealth Management Advisor

MAGNUS FINANCIAL GROUP LLC

Investing without taking at least some risks may seem fruitless. But investing without understanding those risks is just plain senseless. Before you try to make money in the market, you should understand the following five key risks of investing:

MARKET RISK

Don't put all your eggs in one basket. That's the motto of many financial planners, but diversification takes you only so far. If stocks go down, bonds may go up to offset the losses. However, if negative news sends shock waves through the markets, all types of investments can sink.

This is what is called systematic risk, better known as *market risk*. No matter how safe any investment seems, or how good any diversification strategy sounds, you should be sure you can withstand all of your investment prices falling, no matter what the financial models predict. Market dives have occurred periodically, including significantly in the 1940s, 1970s and more recently in 2008. Such events will likely happen again. The bottom line: *If you've got money in the market, you've got risk.*

INTEREST RATE RISK

Many financial assets are tied to interest rates. After all, they represent the "price" of money, so as interest rates change, so do investment values. Interest rate risk is most often associated with fixed-income investments (bonds), but it applies to stocks as well. If you, as an investor, are holding a 30-year, zero-coupon bond, an increase in rates from 3 percent to 4 percent could cause the bond's price to fall a staggering 25 percent.

On the other hand, if you're holding

shares of stock and the Federal Reserve Bank increases interest rates unexpectedly, stock prices will likely fall, too. So, no matter how well you think your investments are going to perform, keep in mind that *changing interest rates may change those plans.*

TAX RISK

Death and taxes may be certain, but tax risk is the wild card. It's the risk that tax laws may change in an unfavorable way. For instance, perhaps you buy some foreign stocks whose dividends are nontaxable, but later, the government imposes a higher tax on dividends inversely causing prices to fall in response to the adverse change.

The tax implied on an investment in effect provides a negative or positive return on the underlying investment. If you compare ordinary income versus capital gains tax treatment, an investor may receive a lower return on the investment with capital gains treatment and have more money in his or her pocket than someone subject to ordinary income tax.

By way of example, assume that a $100,000 investment earns 10 percent over the next 12 months (i.e., capital appreciation). If that investor sells the security at that 10 percent gain and generates ordinary income, and is in the highest tax bracket, he or she could be subject to a 39.6 percent tax on the $10,000—or $3,960 in taxes.

On the other hand, if that investment earns you 10 percent and after being sold is subject to long-term capital gains (with the investor being in the highest tax bracket), the tax rate implied will be approximately 24 percent. The same $10,000 of realized gains would have an embedded $2,400 of taxes, or 14 percent incremental money in your pocket. The lesson? *Paying attention to the tax risk inherent in your portfolio* can be a tremendous benefit to an investor!

COUNTERPARTY RISK

For any contract, there's always a risk to each party that the counterparty will not live up to the terms.

By way of example, when you purchase a life insurance product, the carrier that issues the contract is deemed the counterparty risk in this transaction. Understanding how the institution is set up (e.g., privately owned, publicly traded, etc.) will allow an investor to identify the inherent risk.

For instance, a mutual insurance company is owned by policyholders, not shareholders, and as such, a life insurance contract is a participating policy. This means that each year the company pays a dividend, which in effect is a return of premium to the underlying policyholders. *This helps to reduce the counterparty risk in the transaction on a relative trade.*

CREDIT RISK

Credit risk relates to when a borrower fails to meet debt obligations, usually due to adverse changes in interest rates or credit ratings.

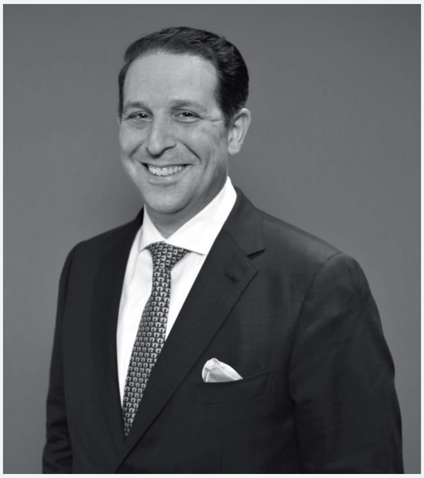
Bonds are generally safe investments, at least compared to stocks—until the issuer starts missing payments. No matter what's happening with interest rates, if an issuer misses a payment, that bond price will likely drop. The issuer may then have favorable debt-to-equity ratios, but if his or her credit is downgraded, it will likely trigger higher borrowing costs for the company on new bonds issued, and that can then cause defaults on the existing ones.

U.S. Treasury securities are considered to be among the safest investments because they are backed by the "full faith and credit" of the U.S. government. The risk-free rate is the rate of return of an investment with no risk of loss. Most often, the rate of either the current Treasury bill (T-bill), or long-term government bond yield, is used as the risk-free rate. *What "credit quality" refers to is the likelihood of that institution being able to make its payment obligations in a timely manner.*

Warren Buffett has said that "the stock market is a device for transferring money from the impatient to the patient." As it happens, the market may be even better at transferring money from the uninformed to the informed.

But if you are at least aware of these five key investing risks, you'll be in a better position: The market won't necessarily be any safer for you, but at least investing won't seem senseless. ●

ABOUT MAGNUS FINANCIAL GROUP LLC



Magnus Financial Group LLC provides personalized services to existing and emerging high net worth individuals, families and businesses. The firm utilizes offensive and defensive financial-planning approaches, encompassing asset management, risk management, tax planning, retirement income distribution planning and estate preservation. Michael S. Schwartz, CEO, was named by the *Financial Times* to the Top Financial Advisor List in 2017.

EXPERTISE

Financial Services Experience	Professional Services Provided	Target Net Worth for Planning Services
19+ YEARS	Financial planning, money-management services, investment-advisory services, insurance and risk management planning	$10M

magnusfinancial.com | michael.schwartz@magnusfinancial.com
800-339-1367 | 280 Park Ave., 25th Floor West, New York, NY 10017

Michael S. Schwartz, CFP®, AEP®
CEO, Wealth Management Advisor

Magnus Financial Group LLC
280 Park Avenue, 25th Floor West
New York, NY 10017
Tel. 800-339-1367

michael.schwartz@magnusfinancial.com
magnusfinancial.com

REPRINTED FROM
Worth®
WORK | FINANCE | LIFE