The Risks of "Safe" Investments

Why do some people think that bonds are always safe? Any investment has risk, and you have to be especially careful when someone tells you that he has a great investment that pays a high return and has no risk. To immediately debunk that claim ask him (or ask yourself) why, if it's such a safe investment, the company doesn't just borrow the money from the bank. Bonds and fixed-income investments have risks, too.

* Interest rate risk: When interest rates rise, people who have locked in a lower yield discover that their bonds decrease in value. For example, let’s say you own a $50,000 bond that pays 3%. After you have bought the bond, if rates for similar issues rise, say to 5%, the principal value of your investment drops. It drops, since a 3% return pales in comparison to a 5% yield. If you hold your 3% bond to maturity, you will get your principal paid back, but if you need to sell it beforehand, you will likely lose money. That is interest rate risk – the fear that if you have to sell your bonds before maturity you’ll potentially lose out on regaining your full principal. Check out "Why Interest Rate Risk is Important": https://youtu.be/lHajM5ZT08s
* Credit risk: Higher yield usually means greater risk. Frequently, investors are mesmerized by high-yield bonds and ignore the reason for the high yield. Higher yield bonds mean that there is a greater chance the bond might default. Read "Are Junk Bonds Worth The Higher Yield?" http://www.talkmarkets.com/content/bonds/are-junk-bonds-worth-the-higher-yield?post=54504
* Bond funds can diversify away some risk, but they have no guaranteed maturity date. Get a free copy of "The Retirement Planning Book" and read the chapter, "Choose a Bond Fund for Greater Diversification." Sign up at www.GoldsteinOnGelt.com to get the book now.

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