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Risk by asset class

Understanding the risk characteristics of each asset class can help you decide how to balance your portfolio.

An asset class is a group of investments with similar risk and return characteristics. One way to diversify your portfolio is to invest in different asset classes. As risk in a portfolio increases, there is greater potential to earn higher returns. But the risk comes with a greater chance of losing money.

RISK/POTENTIAL RETURN

ASSET CLASS	RISK/RETURN DRIVERS	ROLE IN PORTFOLIO
Real estate For example, Real Estate Investment Trusts (REITs)	• Risks and rewards of ownership • Interest rates • Rents • Capital gain/loss on sale of direct holdings	• Diversification • Generation of return • Protection against inflation
Foreign stocks	• Risks and rewards of ownership • Profits of foreign companies • Exchange rates • Foreign investment risk	• Diversification • Generation of return • Protection against inflation • Foreign currency exposure
Canadian stocks	• Risks and rewards of ownership • Profits of Canadian companies • Favourable tax treatment for dividends	• Diversification • Generation of return • Protection against inflation
Bonds	• Rights of a creditor • Interest rates • Creditworthiness of issuer • Duration • Reinvestment risk • Inflation	• Diversification • Income generation • Protection of capital
Cash*	• Rights of a creditor • Interest rates • Inflation	• Diversification • Income generation • Protection of capital • Cushion for unexpected expenses • Reserve to take advantage of unexpected opportunities

*Cash includes investments such as bank deposits, guaranteed investment certificates (GICs), treasury bills (T-bills), commercial paper and bank acceptances. Treasury bills are regarded as risk-free for all practical purposes. Bank deposits and GICs, to the extent they are covered by the Canada Deposit Insurance Corporation (CDIC), are also risk-free. Other cash instruments carry varying degrees of risk, depending on the creditworthiness of the issuer.

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An asset class is a group of investments with similar risk and return characteristics. One way to diversify your portfolio is to invest in different asset classes. As risk in a portfolio increases, there is greater potential to earn higher returns. But the risk comes with a greater chance of losing money.

You can invest in five main asset classes that range from low risk with low potential return to high risk with high potential return.

Here are the types of asset classes ranging from high risk with high return to low risk with low return. The first asset class is real estate. Real estate has the highest risk and the highest potential return. One example would be Real Estate Investment Trusts (REITs).

Risk and return drivers for real estate include:

- Risks and rewards of ownership
- Interest rates
- Rents
- Capital gain or loss on sale of direct holdings

The role of real estate in a portfolio includes:

- Diversification
- Generation of return
- Protection against inflation

The second asset class is foreign stocks. Foreign stocks have medium to high risk and medium- to high-potential return.

Risk and return drivers for foreign stocks include:

- Risks and rewards of ownership
- Profits of foreign companies
- Exchange rates
- Foreign investment risk

The role of foreign stocks in a portfolio includes:

- Diversification
- Generation of return
- Protection against inflation
- Foreign currency exposure

The third asset class is Canadian stocks. Canadian stocks have medium risk and medium-potential return.

Risk and return drivers for Canadian stocks include:

- Risks and rewards of ownership
- Profits of Canadian companies
- Favourable tax treatment for dividends

The role of Canadian stocks in a portfolio includes:

- Diversification
- Generation of return
- Protection against inflation

The fourth asset class is bonds. Bonds have medium to low risk and medium- to low-potential return.

Risk and return drivers for bonds include:

- Rights of a creditor
- Interest rates
- Creditworthiness of issuer
- Duration
- Reinvestment risk
- Inflation

The role of bonds in a portfolio includes:

- Diversification
- Income generation
- Protection of capital

The final asset class is cash. Cash includes investments such as bank deposits, guaranteed investment certificates (GICs), treasury bills (T-bills), commercial paper and bank acceptances. Treasury bills are regarded as risk-free for all practical purposes. Bank deposits and GICs, to the extent they are covered by the Canada Deposit Insurance Corporation (CDIC), are also risk-free. Other cash instruments carry varying degrees of risk, depending on the creditworthiness of the issuer.

Cash is the least risky asset class and has the lowest potential return.

Risk and return drivers for cash include:

- Rights of a creditor
- Interest rates
- Inflation

The role of cash in a portfolio includes:

- Diversification
- Income generation
- Protection of capital
- Cushion for unexpected expenses
- Reserve to take advantage of unexpected opportunities