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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 (increasing from Cash to Real estate)

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.