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# Financial Instruments Risks

### *Market Risk*

Market Risk, also known as "undiversifiable risk," "volatility" or "systematic risk," affects the overall market or a broad sector, not just a particular financial instrument or company, and it cannot be mitigated through diversification. It is the risk of an adverse change of price of a portfolio or an asset as a result of changes in the entire market or an entire market segment.

### *Credit Risk*

The risk of loss of principal or loss of a financial reward stemming from an issuer's failure to repay any type of debt, or meet a contractual obligation. In bond markets credit risk relates to: (a) the price fall due to increased credit risk of the issuer (increased credit spreads, decreased credit ratings, etc), (b) the risk that the issuer will not fulfill its obligations, such as coupon and principal payment for any reason, including bankruptcy or other insolvency proceedings. This risk is higher in the emerging markets and in securities with low credit rating (below investment grade).

### *Interest rate risk*

Refers to changes in the yield of an investment due to interest rate fluctuations. A shift in the yield curve would result in a change in a bond's price. If the level of yields / yield curve is higher than it was at the time of initial investment, early liquidation in these securities will be realized at a price lower than the price of the initial investment. This risk is higher in emerging markets and in high yield bonds.

### *Liquidity Risk*

The risk that a given security or asset cannot be traded quickly enough in the market, due to the lack of marketability to prevent or minimize a loss (or make the required profit). The lack of supply or demand may affect the price considerably. This risk is higher if the investment is made in markets with low liquidity or in unregulated markets. Specifically, in the case of investments on derivative financial instruments traded outside stock markets (Over The Counter – OTC Markets), there is no certainty that a secondary market will exist at all times.  Low liquidity may render a bond redemption difficult, especially in emerging markets or in case the security is a low credit rated bond (below investment grade).

### *Foreign Exchange risk*

Derived from unfavourable changes in currency rates, adverse changes in exchange rates, and in gold prices; may lead to lower than expected yields. Foreign Exchange Risk, also known as exchange rate risk or currency risk, exists when a financial transaction is denominated in a currency other than that of the base currency of the investor. This risk is higher for emerging market currencies (emerging markets).

### *Clearing and Settlement Risk*

The risk that a counterparty does not deliver a security or cash as per agreement. Such risk is higher in the case of countries in different time zones or with clearing systems that are not interconnected as well as in the case of low liquidity financial instruments.

### *Counterparty Risk*

Counterparty risk, also known as Default Risk, is the risk to each party of a contract that a counterparty will default on its contractual obligations or generally its commitments.

### *Custodian Risk*

The risk of loss of assets under custody because of actions or omissions on the part of the custodian or because of fraud when the custodian or any third party assigned with the safekeeping of particular assets is rendered uncreditworthy.

### *Operational Risk*

The risk of incurring losses caused by the inadequacy or ineffectiveness/failure of internal procedures, persons and systems, or by external events; it includes legal risks.

### *Legal Risk*

The risk that may arise from legal changes or actions that may cause a change in the expected yield. Legal risks may render illegal investments that were legal. This includes possible changes in tax legislation. Generally, legal risk depends on multiple political, economic and other factors.

### *Country Risk*

The risk arising on developments in political, diplomatic and military level, electing government and specific governmental choices. It includes the case of  a country defaulting on its obligations (Sovereign Risk). These developments may adversely affect the course of prices of specific securities. This risk is higher in countries with unstable political environment and low fiscal performance.

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***Insufficient Supervision Risk***

Concerns financial instruments of which the issuer is domiciled in countries where the market regulation systems may offer reduced protection to investors (usually, the so-called "offshore" jurisdictions).

***Reinvestment Risk***

The risk of loss incurred due to reinvestment of premature cashflows in a lower than anticipated yield due to a premature / unexpected termination of a particular investment. A bond recall or early redemption by the issuer, partly or wholly, before its maturity and the reinvestment of the cashflow may result in a lower than expected yield to maturity / YTM of the investment.

***Inflation Risk***

Inflation Risk, also known as Purchasing Power Risk, arises from the decline in value of securities cash flow due to inflation, which is measured in terms of purchasing power. Triggered when inflation changes unexpectedly and implies the uncertainty over the future real value (after inflation) of an investment. This risk is higher in emerging markets.

***Concentration Risk***

The risk of loss arising from a large position in a single asset or market exposure. An excessive concentration arising from heavily lopsided exposure to a particular group of counterparties can give rise to Credit Risk, Liquidity Risk or Market Risk losses.

***Leverage Risk***

This risk arises (especially in derivatives) when the amount of the required safety margin for opening a position is small compared to the total value of the underlying position, so that a small change in the value of the underlying will have a proportionately much higher impact on the capital that has been and/or will need to be invested in order to retain the position. Moreover, the potential loss is disproportionately higher in invested capital than the loss on the underlying asset.