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POSSIBLE RISKS OF STOCK INVESTMENT

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ABSTRACT: Although stock investing offers a chance to build wealth, there are hazards involved that investors should carefully assess. This article examines the several dangers that come with investing in stocks, such as market volatility, economic downturns, problems specific to a firm, and geopolitical events. Additionally, it looks at behavioral risks like lack of variety and emotional decision-making. Investors must comprehend these risks in order to make wise choices, create risk management plans, and match their portfolios to their risk tolerance and financial objectives. In order to reduce possible losses, this research emphasizes the value of education, long-term planning, and wise investment strategies.

KEYWORDS: financial risk, stock, investment, financial market, economic downturn, behavioral risk, portfolio, risk tolerance.

INTRODUCTION

A key component of contemporary financial markets, stock investing is a vital tool for wealth creation and capital allocation in the global economy. According to financial economics, stocks are a significant asset class that mixes an exposure to different types of risk with return potential. Real-world market dynamics frequently deviate from the rational conduct and efficient pricing assumed by traditional finance theory, such as the Capital Asset Pricing Model (CAPM) and the Efficient Market Hypothesis (EMH). Investors are exposed to a wide range of risks that can have a substantial impact on portfolio performance, from firm-specific events and behavioral distortions to macroeconomic shocks and systematic market fluctuations.

The goal of the paper is to present a thorough analysis of the primary risks connected to stock investing, broken down into systematic and unsystematic elements. Volatility, interest rate risk, corporate governance concerns, regulatory and geopolitical uncertainty, and abnormalities in investor sentiment are given special attention. This work advances our knowledge of how risk appears in equity markets and how diversification, asset allocation, and policy action might mitigate it by combining ideas from empirical research with classical finance theory.

LITERATURE REVIEW

According to Mittal (2010) the decision-making is affected by the loss version, as one of the factors. This loss aversion is one of the psychological biases that influence the decision-making process particularly the investment decision. This is also categorized as the investors' behavior fearing the loss which will determine the level of one's courage in taking investment risk or commonly referred to as the risk taking. Investors are classified as risk seekers if they are making an investment decision with a high risk taking, in addition to the so-called risk averse or the low risk taking behavior. Such a high or low risk taking is strongly influenced by the problem domain, namely the gain or loss domain. During the former, their tendency for the risk-taking is lower than that of the latter, the loss domain (Kahneman and Tversky (1979), Neale et al., (1986), Seo et al., (2010), Phuachan (2010). One will sell his shares more quickly worrying that prices are going to decline when in the gain domain. Meanwhile, while in the loss domain, the action will tend to be a high risk taking expecting that prices will rise again.

METHODOLOGY

So as to identify widely acknowledged risks associated with stock investments, such as market volatility, liquidity risks, and geopolitical uncertainties, a thorough literature review was carried out, examining academic papers, financial reports, and market studies;
-A number of case studies of past stock market crashes and notable downturns were examined to demonstrate the practical implications of investment risks;
 - Correlations between identified risks and stock market swings were established through the analysis of quantitative data on economic indicators and stock market performance.

RESULTS AND DISCUSSIONS

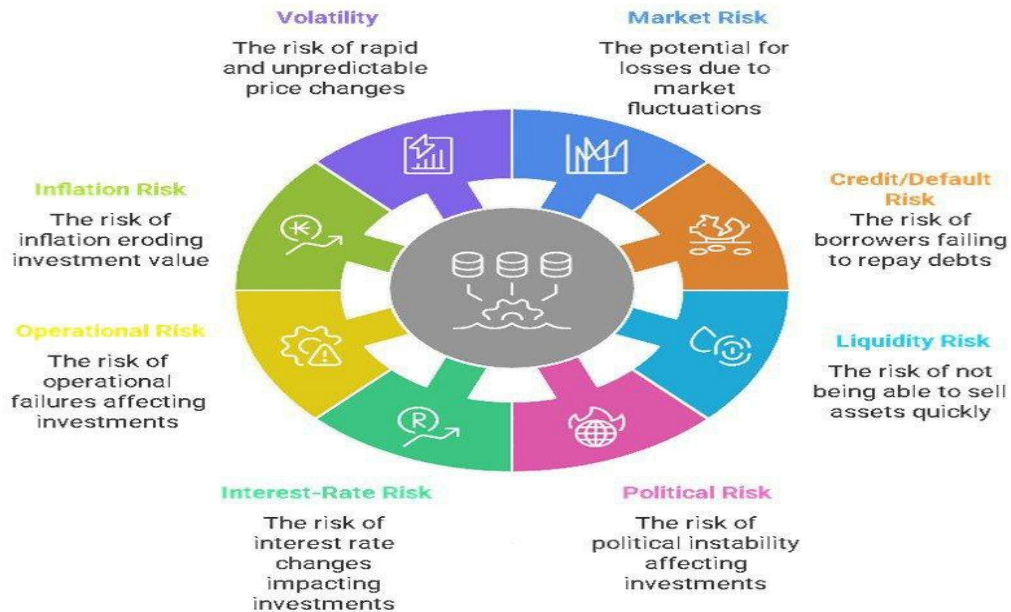

Figure1: types of stock investment risks [1]

Equity values changes with the overall market. A broad market downturn such as a recession or financial crisis can notably decrease the price of stocks. For instance, U.S equities fell roughly 20% in the 2022 sell-off as a result of high inflation and Fed rate hikes, leading worries of investors. Stocks can recover in upcycles (as they did in 2023-2024), however, market risks implies losses are always possible. Volatility is high-the S&P 500 saw many swings in 2024–25

[1] Prepared by the author.

as Fed policy announcements cased sharp up-and-down moves.[2]

Figure 2: S&P 500 Index Value.

Source: U.S. Bank Asset Management Group.

Chart depicts daily changing values of the Standard & Poor's 500 Index, an unmanaged index of stocks. It is not possible to invest directly in the index. Past performance is no guarantee of future results.

When a corporation can go bankrupt, stocks do not have an official credit rating. When debt holders are paid off, equity is wiped out, so stockholders usually lose their entire investment. Equity investors are therefore exposed to a meant "default risk": if a company defaults or fails (for instance, if corporate bonds experience trouble), its shares may lose all of their value. Large bankruptcies (such as those of retail or automobile companies during recessions) drove stockholders to zero, making this clear.

It can be more difficult to sell small-cap or emerging-market equities quickly without affecting the price, although large-cap companies on major exchanges are typically very liquid. Stocks that are typically liquid can also gap down during stressful circumstances (like in March 2020). Illiquidity in the short term may result from rapid fire sales, such as program selling. Circuit breakers and other regulatory protections, however, reduce the probability of flash crashes. The government can take action which impacts corporate valuations and earnings. There is a risk from new taxes, tariffs, antitrust decisions, or geopolitical unrest. For instance, trade wars or tariffs (like those between the US and China) can negatively impact international companies, and more rigorous data or ESG rules in the US and the EU might put pressure on industries like technology or energy. Any sudden shift in trade policy, corporate tax laws, or even nationalizations can reduce returns, which is considered political risk. (Political risk includes trade, taxes, regulations, and other government acts that might reduce investment returns.)[3]

Interest rates have an impact on stock values. Growth stocks typically decline as interest rates rise because the discount rate on future earnings rises as well. Recent history demonstrates this: as Fed policies drove Treasury yields up in 2022–2023, small-cap and tech stocks underperformed. A 10-year Treasury yield of about 4.5% is excessive even in 2025, according to analysts, and a jump to about 5% "would be more problematic" for equities. High borrowing costs reduce business profitability, particularly for highly leveraged organizations, which

[2] https://www.usbank.com/investing/financial-perspectives/market-news/how-do-rising-interest-rates-affect-the-stock-market.html

[3] www.investopedia.com

lowers share values. Fed rate announcements can trigger quick changes in the stock market. For example, equities fell before rising in December 2024 when the Fed indicated fewer rate cuts.[4]

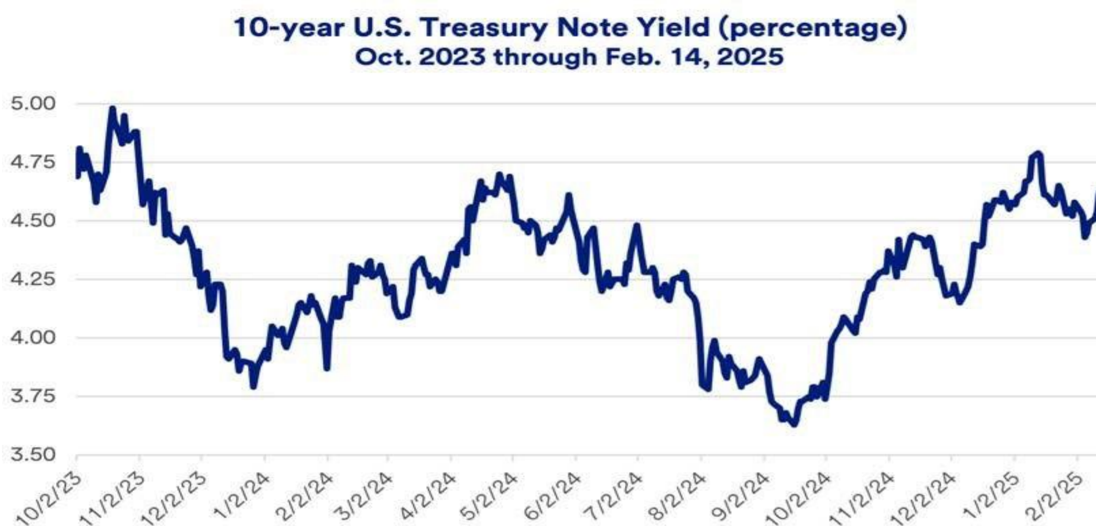

Figure 3. Source: U.S. Department of the Treasury, Daily Treasury Par Yield Curve Rates. As of Feb. 14, 2025.

Firm-level risks like fraud, poor management, and cyberattacks can affect stocks. Stocks may decline due to accounting irregularities or business scandals (e.g., Enron or WorldCom demonstrated how governance failures undermined equity value). Markets can be momentarily disrupted even by clearinghouse outages or mistakes in trading systems. Stock value can be affected by operational failures at the company or exchange level, as shareholders depend on management to carry out strategies effectively.

Real stock returns are eroded by rising inflation. Nominally, equities can stay up with inflation in the long run, but significant, unexpected price increases can lower valuations as consumers pull back and corporations confront increased input prices. In the past, equities have generally outperformed inflation, although equity returns have frequently underperformed during times of severe inflation, such as the 1970s. Markets are currently benefiting from falling inflation (and lowering inflation expectations), but sustained inflation is still a worry that can lower price/earnings multiples.

News and investor mood affect equity prices. The VIX, also referred to as the "fear index," rose above 30 at times of crisis (such as the 2020 COVID-19 sell-off) and continued to be above long-term norms in 2022–2024. Factor rotations and tech stock "meme mania" can lead to significant movements even during slower times. U.S. markets were "very volatile" in 2025, according to one analyst, with significant swings based on policy and economic data. In fact, this implies that stock investors need to be ready for large fluctuations in value.[5]

CONCLUSION AND RECOMMENDATIONS

Investing in stocks has the potential to generate significant returns, portfolio growth, and long-term wealth creation. But just like any other investment, it has risks that investors need to be aware of and take precautions against. Market volatility, performance problems unique to a company, economic downturns, liquidity risks, and irrational decisions motivated by greed or fear are the main concerns.

Recommendations to Avoid or Mitigate Stock Investment Risks:

[4] www.usbank.com

[5] TRV Risk Monitor. ESMA Report on Trends, Risks and Vulnerabilities. No. 2, 2024. ISBN 978-92-95235-24-3

1. (Diversication of portfolio) Not investing in the same stock or sector with diversifying across industries, geographies, and asset classes reduces the negative imact of one investment poor performane.

2. Short-term volatility is a feature of stock markets. Investments can profit from compound growth and recover from market downturns when a long-term strategy is used.

3. Recognize the company's core competencies, including its leadership, business model, financial health, and market trends. Steer clear of risky investments based on rumors or advice.

4. The one investing should determine risk tolerance with evaluation of their time horizon, financial objectives, and emotional resilience to losses and should not take on more risk than they can afford; instead, must invest appropriately.

5. Stay up to date on economic statistics and market situations. However, try to stay away from responding rapidly to news cycles or daily variations.

6. Investing consistently (e.g., dollar-cost averaging) is frequently more successful than attempting to forecast market highs and lows, which is quite challenging even for experts.

7. Consult a financial expert when it is necessary. They can assist in creating a customized investment plan according to your unique situation.

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