Investment risk and insurance companies

DQ1 One of the most basic rules of investment is that higher risk leads to higher returns. People that are risk averse tend to choose investment options that are low risk such treasury bills and banks certificates of deposit which are guaranteed up to $250, 000 by the FDIC. I believe there is a point in which risks becomes unbearable and instead of assuming a risk the investor is acting more like a betting man. An example of a scenario in which risks became invalid would be a portfolio fully composed of penny stocks. Penny stocks are the most risky type of common stocks. Another example of the same scenario would be having a portfolio composition of only junk bonds. DQ2 The insurance industry is one of the largest industries in the world. In 2001 after the 9/11 event the insurance industry lost billions of dollars due to massive losses that occurred due to this man made event. Insurance companies charge its customers a premium for their insurance policies. One of the ways that insurance companies mitigate risk associated with life insurance is by forcing its customers to take a medical exam prior to giving out a policy. Risk behaviors such as being a smoker are taken into considerations. Smokers will pay a higher premium than non-smokers due to the heath risks associated with that behavior. If a person has cancer or HIV prior to signing a policy the insurance companies will either reject the customer or charge an extremely high premium. Insurance companies analyze the risk of natural disaster in a region to determine the proper premium to charge its customers 3. I agree with you that the answer to the question will depend on a variety of circumstances. Take for example three investors that have $1, 000. Each investor will invest differently based on their tolerance towards risk. A risk adverse investor will not be interested in investing in penny stocks or junk bonds, while an aggressive investor may include some of these instruments as part of their portfolio due to their optimism and lack of fear towards losing their money. I personally once invested in a penny stock that went from $0. 35 to $1. 50 in a period of six weeks. I have a profit of over $1000 in the purchase and sale of that common stock. 4. I agree with you that it is very important to have home insurance. A home is the biggest investment most people have as part of their portfolio of assets. I do not own a home, but if I did I would definitely put insurance against fire and natural disasters such as flooding, hurricanes, tornados, or earthquakes. After a natural event sometimes insurance companies have to pay billions of dollars in benefits. Sometimes is hard to visualize how insurance companies make money since they often have to payout their policies. 5. I agree with you that often insurance companies have to accept the risk of the transaction. The strategy of transferring risk by transferring some of their policies is a great strategic approach. It is similar to what the lenders of student loans do to reduce their risks. I have noticed that often student loan companies sell off their accounts to other vendors. Insurance companies can trade policies with other companies or sell them in order to reduce risks. 6. In Las Vegas people can gamble legally which is rare in the U. S. where casinos are banned in a lot of states. There are always loopholes to gambling and despite the denial of most Wall Street members sometimes the stock market can be a major gamble. Two financial instruments that are pure gamble are penny stocks and junk bonds. I once bet in a penny stock and won big time. I received a return of 5: 1 on my investment in other words I turn a penny stock worth $0. 30 into $1. 50 sales price. Junk bonds pay extremely high coupon rates, but many of them default prior to maturity date. 7. I agree with you that risk is a matter of perception because risk is relative to the eyes of the beholder. I have not invested much in the stock market during my life, but about 7 years ago I created a $1, 500 portfolio. Some people say that common stocks are risky; I do not see it that way. My portfolio was composed 100% of common stocks including one penny stock. In my opinion the penny stock was not risky at all because when I bought it I realized that a new accounting change was going to positively impact the financial statements of the company. 8. One of the biggest mistakes companies make is releasing products that are not ready to market. These types of products can hurt the company’s image because they are often defective. Defects are a sign of low quality. When companies get the reputation of offering low quality the sales price of the product goes down. Establishing internal controls in the manufacturing process can improve the quality of the products. It is a risky proposition to introduce products that are not ready to market due to poor quality control testing and poor research and development. 9. I am similar to you in regards to my tolerance for risk. Despite me being an aggressive investor, I am often passive in the workplace. I need to learn how to convert my risk tolerance into my attitude and workplace behavior. People that have good people skills and are proactive in their communication abilities often move up the corporate ladder quickly. You mentioned in your response that buying insurance for credit cards or other accounts in terms of sickness is a bad investment due to the low chances of ever occurring. I defer in opinion I think is a good investment because you never know when sickness might strike. 10. I agree with you that categorizing your risk is a good strategy. If you are a person that never gets into accident or receive a speeding ticked you should contract an insurance companies that offers rewards for safe driving. One of the most important insurance types is home insurance. A home represents the biggest investment of the majority of American people. I also liked that your response mentioned the three most important things to insured which were property, income, and liability. My current insurance coverage does not cover all three aspects.