Investment Risk Management
By Gary Case

So far 2008 is the year for investment risk management. There are several keys to preserving and growing your nest egg. The first is to manage your emotions. Most investors, most of the time, buy and sell portfolio positions at suboptimal times because of emotion. In fact, a study of returns from 1986-2006 shows the S&P 500 gaining an average of 11.8% annually while the average equity fund investor achieved only 4.3% (source: Dalbar, Inc.). A surprisingly large portion of a financial planner's time is spent assisting clients in managing the emotions dealing with portfolio funding.

In addition to managing emotions, gaining clarity on your current financial position and accumulation/income goals, creating an Investment Policy Statement, properly allocating among multiple asset classes, using multiple strategists/managers, and adjusting your portfolio to current market conditions can all help maintain and grow the value of your portfolio.

Gaining clarity with respect to your financial personality involves exploring aspects such as your investment time horizon, liquidity needs, risk tolerance and income needs. Once clarity is achieved, create an investment policy statement that:

- establishes expectations, objectives and guidelines for investing
- details asset classes and the allocation among various classes
- creates a framework for risk/return
- encourages effective communication between investor and planner

Asset allocation drives the long-term performance of your portfolio more than any other single factor. Using multiple asset classes most often has the effect of reducing portfolio volatility while increasing returns over an unallocated portfolio. Something as simple as adding international stocks to a portfolio can have a dramatic effect in this regard.

By using multiple strategists and money managers, you can get the best ideas of the best in the money management business. As different managers interpret data and implement strategies, they can add value to a portfolio in much the same manner as asset allocation.

Finally, applying hedging, alpha enhancement, absolute returns, long-short strategies, moving to cash, and other risk management tools, your portfolio can be customized to best reflect current market conditions. Your financial planner should be able to explain to you the various risk management tools used to help protect and grow your portfolio.

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