

# Del Mar Times

## *Assessing your risk tolerance may help you sleep*



John Schooler

What is the maximum percentage you would be willing to lose in any one year? Suppose that an investment you held for one year lost 15 percent of its value but its performance was similar to other investments of that type. What would you do?

What would cause you more stress—not owning stocks when the market rises or owning stocks when it drops? Of course, all investments involve risk. Identifying and recognizing your personal risk tolerance is critical to choosing a portfolio and is an important first step in any investment decision.

There are many types of investment risk. Depending on your goals and time frame, you may be able to tolerate some forms more than others. For example, how exposed is your portfolio to the following general risks?

- Market risk: the possibility that the value of your portfolio will fall as a result of broad stock price declines.
- Inflation risk: portfolio returns that don't outpace the rising cost of living.
- Shortfall risk: a chosen investment strategy that won't provide the return needed to achieve a particular goal.
- Interest rate risk: the losing end of the seesaw effect in which interest rates rise, bond prices fall, and vice versa.

The better you understand the risks, the better you can assess your risk tolerance, which is not easily measured. It depends on individual, sometimes intangible, factors, including emotions and past experiences. However, the process of measuring risk tolerance has come a long way. Decades ago, it may have been gauged by asking investors if they had ever considered perilous activities, like hang gliding or mountain climbing. Today, surveys and questionnaires have been

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designed to help measure investors' risk tolerance relative to other investors. An investor might fall on the "risk averse" end of a scale, the "risk tolerant" end or somewhere in between. Risk tolerance tools are also being advanced through use of psychometrics, incorporating psychology and statistics.

More important than tools, perhaps, is the input of an experienced professional. Risk tolerance should be compared with an investor's risk requirement—level of risk needed in order to pursue a particular financial objective. An individual with limited risk tolerance but aggressive goals, for example, may need assistance structuring a portfolio that can potentially bridge the gap.

Investing in the markets can be a war between fear and greed. Investors who can control both of these can profit.

Many stocks had gains last year. This can drive people to invest in stocks that they would normally avoid. At times, people warring with fear and greed buy aggressively at market highs and then panic when the market corrects. This can lead them to sell stocks at a low price—to see the market move higher.

It is important to take a long-term approach to the market. Buy when all others are selling, and if you need to sell, sell when all others are buying. In other words "buy low, sell high." Do this in the context of an overall strategy and asset allocation plan. Some stocks may not recover, so be careful what you buy.

To take advantage of market fluctuations, dollar cost average by putting the same amount into a mutual fund or security on a regular basis over a period of time. This allows for you to buy fewer shares at the highs and more shares at the lows. You get an average price and do not have to try to time the market.

Having an overall strategy will allow you to invest in different types of stocks and better control your long-term plan. Knowing your risk tolerance will also aid in controlling fear and greed.

Part of an investment advisor's service includes reviewing your risk tolerance. Together you can assess risk tolerance and crosscheck the results against your portfolio. This will help determine if you need to change your investment policy. It also will help you sleep better.

Contact: [john@wfpsecurities.com](mailto:john@wfpsecurities.com)