



Independent Innovative Individualized

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Successful People as Investors:

Understanding Portfolio Risk

Many of my clients wonder about the risk in their portfolios, and how best to manage that risk. Understanding how to incorporate risk into the investment process can often mean the difference between investing, and investing wisely.

Understanding The Difference Between Risk and Uncertainty

In the context of investing, there are factors over which we have control, and events over which we have no control. Portfolio risk is something that may be controlled. The most basic and obvious tenet of controlling risk is not to put “all of your eggs in one basket”. While investing always entails some risks, many investors may be taking on too much or too little risk without even realizing it. For example, there may be overlap in the securities the accounts hold in which you are invested, so while you think your portfolio is sufficiently diversified – it really may not be. Or, you may have a disproportionate amount of your portfolio invested in low-risk, low return investments thereby forgoing the potential returns of equities and other asset classes that could be critical to achieving your long term financial goals.

Uncertainty by contrast, can refer to events over which investors have no control. Geopolitical instability, fiscal crises of European Union countries, and catastrophic events such as the gulf oil spill or Japan tsunami cannot be controlled, but can derail markets and threaten portfolio savings.

One of the most important elements of prudent portfolio management is to clearly establish what your tolerance for risk is – and should be – given your own investment goals.

Diversification May Reduce Risk

Financial professionals cannot quantify diversification within a portfolio as a tool to enhance returns; but we can quantify it as a strategy to reduce risk.

By investing in a variety of asset classes and across a range of geographies, sectors and styles, the impact of any poor performing single investment is reduced. This is the value of strategic asset allocation. Managing your risk requires evaluating each individual investment to understand how it impacts the overall risk of your portfolio.

Periodic Rebalancing Controls Risk

Whether done annually or semi-annually, investors should review and adjust their portfolios to help stay on track with their financial goals. Rebalancing mandates examining risk and return, and may often require investors to sell off a portion of their best performing investments in order to maintain the overall asset allocation that best matches their risk/return objectives.

Investing tends to be more complex than trying to pick a winning stock. That’s why it makes good sense to seek the help of a financial professional who can assist you through a disciplined process that evaluates risk within the context of your overall portfolio and your long term investment goals.