When You're Serious…

by Bradley R. Newman, CFP®

Not All 10% Returns are Created Equal

It's often said that "life's a journey, not a destination" and the same is true with managing an investment portfolio. Not to minimize the importance of the end result; however, the route that you take to obtain that end result is just as important.

The extreme volatility from the 2008 – 2009 financial crises provided the most severe environment to illustrate this concept; while most investors have recovered their losses, the wild ride they took has left a lasting impression. More recently, the volatility that we have seen in 2015 has reminded us that we don't like to see significant fluctuations in our portfolios.

Although you will never be able to completely eliminate the volatility associated with the journey, you can certainly make the journey more enjoyable with some preparation before you start.

How Will You Get There?

The first step is to gain an understanding of your propensity to accept volatility, or your risk tolerance. It is common to feel more comfortable with risk when discussing it or thinking about it conceptually versus when you are experiencing it first-hand.

As a point of reference, many people who in 2007 indicated that they would be able to handle a significant decrease in portfolio values because they had time to recover, had very different feelings in 2008 when they actually experienced significant declines. Putting dollar figures to percentage declines will aid you in having more real-life conversations about volatility – talking about a 10% decline on a one million dollar portfolio is very different than talking about losing $100,000.

Risk-Adjusted Return

The concept deals with absolute returns versus relative returns or how much risk was assumed to generate the return during any given period of time. As you compare different portfolio structures or investment strategies, it becomes very apparent that not all 10% returns are created equal. If *Portfolio A* took twice as much risk as *Portfolio B* for the same 10% return, you can see how *Portfolio A* significantly underperformed *Portfolio B*; with two times as much risk, you should expect a 20% returns. The end result is that *Portfolio A* significantly underperforms on a risk adjusted basis.

Focus On What You Need

The best way to avoid taking more risk than is prudent is to focus on what you need, not what you can get. By structuring your portfolio to earn the returns that you need to meet your goals and not the highest absolute returns that you can get, you will increase your ability to keep volatility in check.

To quantify your needs, there is no substitute for detailed retirement planning projections. The myriad of rules-of-thumb and basic online calculators will be fine for most people in their 20's or 30's, but as your income and portfolio grow there are nuances and variables specific to your circumstances that need to be taken into account.

When Is It Time To Change Course?

Rest assured that the course you start on today will need to changed, or at least be adapted, over time. Your comfort level with risk will change over time, your need to accept risk will change over time, and the risk environment will change over time. Each of these variables needs to be considered as you reevaluate the level of risk in your portfolio. This macro decision needs to be revisited at least once a year.

Assess Your Situation

There is no single investment approach that will be appropriate for everyone. Do your analysis to determine what makes sense for you and keep in mind that your approach will need to adapt. Quantify the risk you are currently accepting and make decisions accordingly.

One of the most fundamental and significant investing mistakes that you can make is taking risk that you don't need to take.

Bradley R. Newman, CFP® is with Roof Advisory Group, Inc., an independent investment management and financial advisory firm based in Harrisburg. The firm is a fee-only Registered Investment Advisor that provides portfolio management and financial planning services for individual and institutional clientele. The firm's email address is invest@roofadvisory.com.