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“Mitigating risk: Is it risky business?”

By Michael Kazakewich

In recent years, investors have been inundated with products attempting to mitigate risk and perform during tail events in the market. Books written for a mass audience have touted asset allocation models optimized to reduce portfolio risk. Television commentators have highlighted methods to reduce risk, suggesting that their methods are appropriate for every viewer.

The problem with these methods, however, is the advice applied to the investor with a $100,000 IRA is the same as that applied to the individual with a $30 million dollar portfolio. Because these solutions are designed to be accessible to everyone, they ultimately fail to be useful to anyone.

We have found that the only way to effectively mitigate risk is not through a product, but through the intensive, personal process of financial planning. **The difference is in being proactive as opposed to predictive.**

Predictive models assume the market follows discernible patterns and that if you understand what they are, you can make an educated guess as to how it may react under different scenarios. Such guesstimates can be made only on the basis of computer-driven algorithms or human assumptions based on experience. And of course it is appealing to believe that one can tactically side-step risky times in the market.

The problem, though, is that when everyone possesses the same set of data points (historical market trends) and inputs them into their tactical models, that data loses its significance because the outcome is “gamed” by the desired result or outcome. In short, markets are governed by another huge variable: human behavior, which is very difficult to model or predict, so inevitably the model works—until it does not.

The proactive approach, in contrast, is client focused and planning based; customized to the client’s goals and objectives; and most importantly, to his or her risk tolerance. Through the process we determine how much risk a client needs to take, rather than how much risk he or she wants to take.

When engaging a new client, we employ a process called “risk budgeting.” This consists of segregating assets into three pools based on their risk profile: safety, market and aspirational. Each pool is distinguished by the level of risk or volatility inherent in the assets that reside there. The safety pool is comprised of assets that, if lost, would have a material impact on one’s lifestyle. Homes, cash, and life insurance policies are relegated to the safety pool. Assets in this pool may not keep pace with inflation, but their relative stability is paramount.

The market pool is comprised of portfolio assets. These are the workhorse assets, which over time, produce the capital growth and income to supply the safety pool with income to maintain lifestyles. The goal of assets in the market pool is to outperform inflation.

The aspirational pool, in contrast to the safety pool, houses assets that are more risk oriented. A concentrated position in an employer’s stock, an illiquid hedge fund or the assets for a family foundation may reside in this pool. When allocating assets to this pool, we look for enhanced return commensurate with the increased risk or volatility inherent in the asset.

Once we understand not only where the exposures lie in a client’s situation, but also his or her goals and objectives, we can begin to make recommendations that respond to the client’s needs.

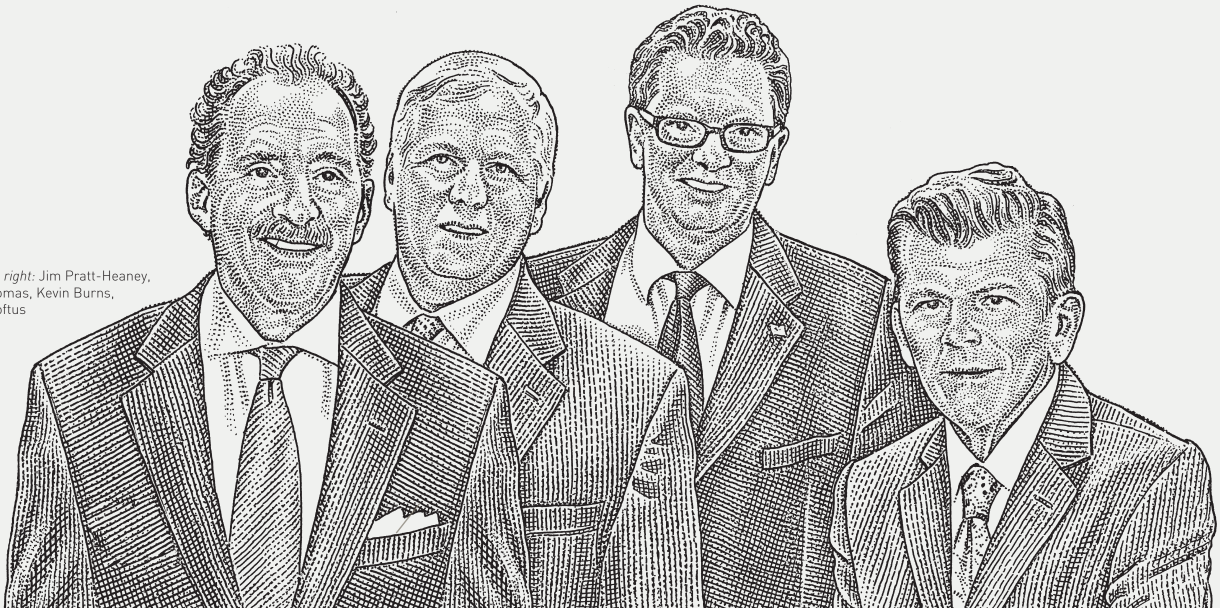
Past performance is no guarantee of future results. There is no guarantee the views and opinions expressed in this article will come to pass. LLBH Private Wealth Management, LLC (LLBH) is an SEC-registered investment advisor located in Westport, CT. Contact LLBH or refer to the Investment Adviser Public Disclosure website (www.adviserinfo.sec.gov). For additional information about LLBH, including fees and services, send for our disclosure brochure as set forth on Form ADV from LLBH using the contact information herein. Please read the disclosure brochure carefully before you invest or send money.

"The only way to effectively mitigate risk...is through the intensive, personal process of financial planning."

—Michael Kazakewich

How to reach Michael Kazakewich

I look forward to discussing how I can help you reach your financial goals. I can be reached directly at 203.683.1529.



Left to right: Jim Pratt-Heaney, Bill Lomas, Kevin Burns, Bill Loftus

Who Are Our Clients?

LLBH Private Wealth Management is a Registered Investment Advisory (RIA) firm, created to work with entrepreneurs and senior executives who became wealthy because they made great decisions. Our disciplined process ensures that we see the complete picture of your financial situation so that we can make informed and suitable recommendations to help you accomplish your goals and objectives. Our process also works for those who have been thrust into decision-making roles due to life-changing events such as retirement, the sale of a business, a divorce or a death in the family. Just as they do in their professional lives, our clients want a thorough and candid process in order to make smart decisions about their financial lives. Simply put, LLBH clients respect our ability to get things done.

Assets Under Management
$900 million

Minimum Fee for Initial Meeting
None required

Minimum Net Worth Requirement
$10 million (investment services)

Largest Client Net Worth
$500 million

Financial Services Experience
120 years (combined)

Compensation Method
Asset-based

Primary Custodian for Investor Assets Pershing, A BNY Mellon Company

Professional Services Provided
Planning, investment advisory, money management, advanced wealth transfer planning and corporate services

Association Membership
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