# Do you feel comfortable with your *financial risk*?


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**ARE YOUR PANTS ON FIRE?**
**By Fred Dunbar**

What do you think of when you hear someone say, “Liar, liar, pants on fire”? Do you think of the popular children’s phrase, or perhaps your mind drifts back to “Liar Liar,” the 1997 movie with Jim Carrey? Not me. I think about people who stop into our office for the first time and discuss risk. I like to say that people lie. They don’t mean to, but they do, specifically on how they perceive themselves as risk takers.

One of the things that affects how your portfolio performs is your risk tolerance. Basically, how much risk are you comfortable taking to meet your goals?

When we first meet a client, we ask them to share their goals with us. Next, we help assess their risk comfort zone. We like to keep things simple. We start by asking them to rate their risk tolerance on a scale of 1 (can’t sleep at night if they have any chance of losing money) to 10 (willing to risk it all if they can get a great return). If you’re single, it’s easy to answer the above question, since if you get it wrong the only person you have to answer to is yourself. If you are married or have a partner, then it becomes a little more complicated. Generally, we find that one of the partners is more conservative, while the other is more of a risk taker. This is common, since opposites attract — one is a saver, the other a spender. The important thing is to have them both agree on how much risk they are willing to accept to meet their goals. We explain that we want to help them have a SWAN (sleep well at night) portfolio. So, regardless of what they see or hear in the news, neither will panic.

During the initial discovery meeting, we need to pinpoint their risk tolerance to make sure we design a portfolio they will be happy with. It is not just with the investment return but also their panic threshold.

Many investors who do their own investing might find the risk they take is not indicative of their comfort zone. Research generally shows that people aren’t very good at evaluating their own risk tolerance. They might feel that they are a moderate risk taker, but when the value of their investments goes down 10 percent or more, they panic. In reality, they are someone who should be more conservative. They want stock-market returns but don’t like it when we go through a volatile period like we did in early February. Over the past several years, people have gotten used to increasing market returns and generally wrongly believe that the markets are stable with no risk present.

People long for simplicity and would like to answer a couple of questions that will tell them how much risk they should take. Many like a risk-tolerance worksheet that will quantify their answers with a score. It’s only a start, but many worksheets will give you a cumulative score that will tell you what type of a risk taker you are.

Here is an example of a worksheet developed by one of our third-party vendors, Advisys, Inc. It might help with assessing your ability to handle risk, while pursuing your goals. Please take the time to cover the bottom of the article, which shows you your risk based on a number … No peeking now.

1. When making a long-term investment, you plan to hold the investment for:
   - A. 1 to 2 years (1 point)
   - B. 3 to 4 years (2 points)
   - C. 5 to 6 years (3 points)
   - D. 7 to 8 years (4 points)
   - E. 9+ years (5 points)

2. If you owned an investment that fell 20 percent over a short period of time, what would you do?
   - A. Sell all of the investment (1 point)
   - B. Sell a portion of the investment (2 points)
   - C. Sell nothing (3 points)
   - D. Buy more of the investment (4 points)

3. Generally, you prefer an investment with little or no fluctuation in value, and you are willing to accept a lower return associated with this investment.
   - A. Strongly agree (1 point)
   - B. Agree (2 points)
   - C. Disagree (3 points)
   - D. Strongly disagree (4 points)

4. When it comes to investing in stocks and bonds, you describe yourself as a:
   - A. Very inexperienced investor (1 point)
   - B. Somewhat inexperienced investor (2 points)
   - C. Somewhat experienced investor (3 points)
   - D. Experienced investor (4 points)
   - E. Very experienced investor (5 points)

5. How optimistic are you about the long-term prospects of the economy?
   - A. Pessimistic (1 point)
   - B. Unsure (2 points)
   - C. Somewhat optimistic (3 points)
   - D. Optimistic (4 points)

6. Lastly, what do you hope your portfolio value will be 10 years from now?
   - A. A little higher than it is today (1 point)
   - B. Moderately higher than it is today (2 points)
   - C. Substantially higher than it is today (3 points)

Just before December 2007 (what we are now calling the start of the Great Recession), we met with a new client who we will call Helen (not her real name). When we went through the above to assess her risk, she gave me a number of 7 in regard to risk she was comfortable accepting to meet her goal. Helen had just retired, had a comfortable pension, and was receiving Social Security. Helen scored a 16 on the risk-tolerance worksheet. Well, the markets started to move down, and Helen called a couple of times. When we reassessed her risk, she came in with the same numbers she had given me several weeks earlier. Finally, I asked Helen to stop by my office. I said, “Either you are lying to me, or I haven’t been listening to you.” I pride myself on my listening ability. She assured me she was not lying. We adjusted Helen’s risk tolerance to conservative, and agreed to keep monitoring her account.

Now, here are the numbers, so you can score yourself from the above worksheet.

Score of 6 to 12: You are conservative, and your primary goal is to preserve your principal.
Score of 13 to 18: You are a moderate risk taker and generally will attempt to balance income and growth.
Score of 19+: You are an aggressive risk taker and tend to concentrate heavily in stocks, focusing on potential growth.

Now, did you lie to yourself, or does this accurately depict your risk tolerance? Chances are it does not, but it is a start. Now that you are on the path to adjusting your risk to match your comfort zone, relax and take a stroll on the beach, and enjoy this early spring weather.

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