SMART INSIGHTS FROM PROFESSIONAL ADVISERS

Use the Right Tools to Build a Portfolio Made to Withstand Modern Worries

Tools like Riskalyze and Monte Carlo simulations can help ensure your portfolio meets your investment goals while still allowing you to get a good night's sleep.

By MATTHEW C. PECK, CERTIFIED FINANCIAL PLANNER | SHP Financial
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It's tough enough to tune out the noise from a 24/7 news cycle when every nugget seems to quickly make its way from a headline to a tweet to a meme to a skit on late-night TV.

But add in what is now a global economy, and it's nearly impossible for investors to avoid worrying about the risk tied to each new geopolitical rumbling, whether it's a trade war with China, fragile foreign economies, concerns about cybersecurity or Middle East tensions.

It's a lot to keep up with, because you're busy living your life. You're working. You're taking care of your family. You're paying your bills. And when you have free time, it's for golfing or gardening or watching football with your friends — not necessarily figuring out how every world crisis might impact your bottom line.

Be Informed, But Not Obsessed

It's OK to just say no to breaking down every detail from the BBC, CNBC, NPR and Fox Business. Your nerves will likely be the better for it.

You don't need to become an expert on every world event and how it could affect the markets. What you should understand, though, is what effect volatility could have on your holdings and how you, personally, are likely to react when the markets go up and down. When it comes to investing, greed is *not* good. Neither is fear. And if you can avoid giving in to those emotions, you're more likely to stay on course to meet your goals.

Risk Assessment Gets More Specific

The good news is that in recent years, there have been fantastic improvements in the tools advisers use to measure investors' tolerance for risk, both emotionally and financially. We're no longer locked into determining someone's investing style based on a brief questionnaire that focuses mostly on age, income and how they feel that day about market volatility. And we're better at providing a portfolio mix that clients feel comfortable with because they understand why they have what they have.

We're also less likely to see clients simply and subjectively labeled as conservative, moderate or aggressive.

Why is that important? Imagine you just walked into your adviser's office after winning big with a scratch-off ticket. You might feel financially aggressive in that moment. But what if you walked into the office on a day that you didn't win the lottery — instead you paid a big bill that day, or you just heard bad news about the market? On that day, you might feel more conservative about how much money you'd be willing to lose through your investments. Gauging how someone feels at a specific moment has never been a particularly effective way to identify how much risk a person could truly accept.

But now there are software programs, such as Riskalyze, that take a deeper dive into determining what your investment comfort level might be. Instead of three categories (conservative, moderate or aggressive), investors get a risk-tolerance score between 1 and 100. And that score can be used to build a portfolio that's a better match for a person's investing needs and wants.

Put Your Portfolio to the Test

We can stress-test your current and/or proposed portfolio to assess its chances for long-term success. We can demonstrate how your portfolio would be impacted should we experience a financial crisis similar to what happened in 2008, or what would happen in a strong year, like 2013. And we can show you in dollars, rather than percentages, the likely loss or gain you'll experience over certain time frames. (After all, 5% might not seem like much of a loss, but how much does that number actually represent? If it means $50,000, $100,000 or $250,000 could go missing from your nest egg, and you're close to retirement, you might want to reconsider what you're doing.)

Another measurement that can produce a portfolio that better suits an individual's or couple's goals (and stomach for loss) is a Monte Carlo simulation that will model the probability of different outcomes for your investments. Thanks to modern technology, we can now run this simulation quickly and easily, and make more informed decisions using the information it provides.

Based on how volatile your holdings are and the time frame you're looking at, we can give you an idea of where you could be in the best of times, where you could be in the worst of times and where the average could be, historically speaking.

And that's crucial. Because what most people really want to know when they're planning for retirement is where they could end up. What's the reward for the amount of risk they're taking? Will they have a mansion and a yacht? Could they lose everything and run out of money at 80? Or will they be able to maintain the lifestyle they currently have without any financial hiccups?

What Too Much Worrying Means

If you find yourself fretting about these questions more often than you'd like, talk to a financial adviser.

If you can get a true understanding of your vulnerability to risk — and if you feel your portfolio is consistent with your needs, goals and personality — you should be able to ride out the ups and downs of both market cycles and news cycles without worrying so much about how every twist and turn could affect your hard-earned savings.

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