

## **Risk and the New Year**

**Dylan B. Minor PhD, MS, CFP®, ChFC, CLU, CIMA®**  
**Chief Investment Officer**

This past month I had a take-your-daughter-to-work day with my daughter Julia at the Omega Financial Group office. Her first question, even before my first cup of coffee, was: “Daddy, what do you do here?” The best I could muster on the spot was: we help people make good decisions about how to spend, save, and grow their money. She seemed content with that answer, but continued with many more questions. I decided to try to answer some of them by bringing her through the process of how we allocate one’s investment funds, including giving her a risk test. She then asked me another insightful question: “Why don’t you just put of all your money into the highest returning investment?” I realized rank-ordering investments on average return is not the best framing; indeed, it is easy to forget that average returns are, well, returns on average. Historically, it has been conventional wisdom that large US stocks should average 10% return per annum, in the long-run. And what is the long run? For Julia, it’s about 6 months. What about for grownup investors? It wasn’t long ago that we finished a ten-year period where you could have beaten the SP500 by simply burying all of your money in a coffee can (bag?) in your backyard; even after ten years, the “highest return” may not be the highest return, not even close to it. Meanwhile, the riskiness of an asset, if we measure risk in terms of volatility of returns, tends to be reasonably stable over time. In short, we can be relatively assured of the risk of an asset, but not its return, even for a long time.

But when we speak of risk, we do need to be more comprehensive than simply thinking of the volatility of prices. Some are also concerned with the risk of simply losing one's investment. A current example is Bitcoin, which was likely the one of the best investments (or speculations?) of 2013. This new digital currency has essentially a fixed supply that became strained as new users and speculators alike jumped into the currency. Indeed, while the currency was trading around \$13 US dollar to \$1 Bitcoin last January, it reached some \$1,200 US dollars to \$1 Bitcoin in December, which represents an over 9,000% one-year return! <sup>1</sup> Although exciting, to be sure, Bitcoin is also an example of something that can readily turn an investment into a value of zero, as it is not a centrally supported, sanctioned currency.

There are, in fact, many other forms of risk beyond the potential loss of principal we should be planning for: longevity risk, sequencing risk, political risk, and purchasing power risk, just to name several more. And, of course, there is the risk of not taking the right amount of risk---either too much or too much little risk based on your goals and preferences. It is this latter class of risk for which we are excited to be providing you with an updated risk assessment; if you have not already received this document, you should shortly. I spent many hours poring over the voluminous advancements made these past decades in behavioral finance and economics that have gone largely undiscovered by the wealth management industry, as well as engaging in some additional proprietary research to design the survey. Look for some results from this survey in the coming months, as well as its integration into an additional platform that we are adding to our Optimized Wealth Integration<sup>®</sup> process.

As far as the New Year, the most likely state of the world, in my view, is continued economic growth, especially for the US as we continue to lead the global economic recovery. To be sure, Europe and the developing economies are continuing to face challenges as they experience an uneven recovery. This all means that the FED will likely continue to reduce its monetary support, as it already has begun to do, albeit in measured form. Although such slackening of monetary support seems to worry the US stock market in the short run, it is further evidence of sufficiently robust economic growth. This most likely case should also include modestly rising interest rates and subdued inflation.

Of course, there are many other possible states of the world, though they are less likely to occur, in my view, than the above outcome. The major risks to the above outcome that I see are political in nature, which is why we have some positions in our portfolios for these states of the world.

Whatever the New Year brings, it ought to be another exciting year, in which I hope you find health, happiness, and prosperity! Meanwhile, I am happy to report that Julia has put her financial house in order---her budget is now in place, savings are strong and growing, and she's even making some philanthropic contributions!

<sup>1</sup><http://bitcoincharts.com/charts/mtgoxUSD#rg360ztgSzm1g10zm2g25zv>

Omega Financial Group, LLC is a Registered Investment Adviser. The opinions expressed in this commentary are solely for general informational purposes and are not intended to provide specific advice or recommendations for any individual or on any specific security. Advisory services are only offered to clients or prospective clients where Omega Financial Group LLC and its representatives are properly licensed or exempt from licensure. Past performance is no guarantee of future returns. Investing involves risk and possible loss of principal capital. No advice may be rendered by Omega Financial Group LLC unless a client service agreement is in place.