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IS RISK A FOUR LETTER WORD?

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"There are risks and costs to action. But they are far less than the long range risks of comfortable inaction" – John F. Kennedy

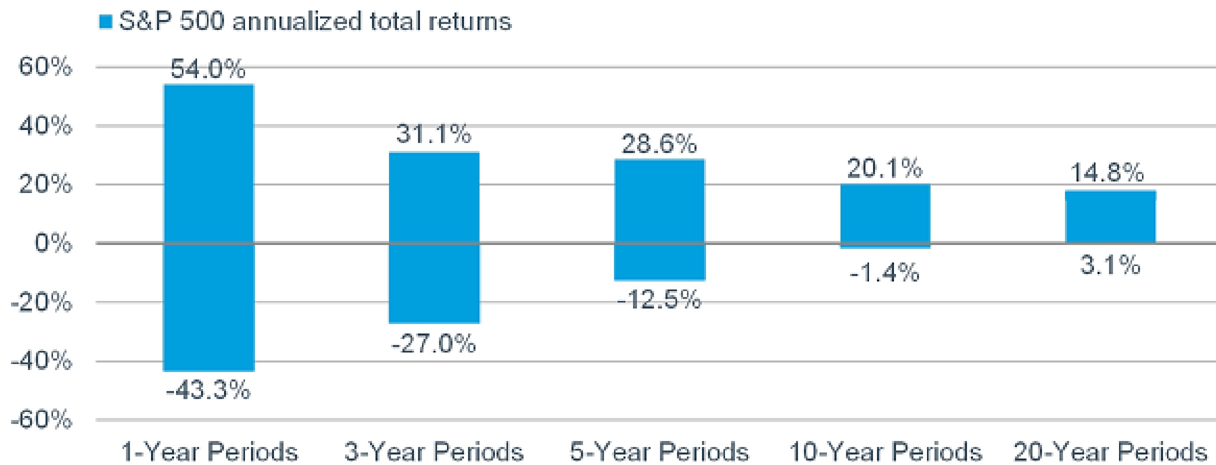
In light of recent market volatility, risk might have you feeling like it's a four letter word lately. Are all four letter words necessarily bad, however? They certainly can be but that would depend on both your perspective and their application (after a bad golf swing comes to mind)! As a four letter word, risk, and in particular investment related risk, has both negative and positive connotations but depends, again, on both your perspective and application.

As children we were all told to not touch the stove or to be careful around stairs and so risk aversion gets instilled in us from a very early age. But without fire you can't cook and eventually in order to get where you need to go you are going to have to learn how to deal with stairs. As adults we know that there is risk of injury in exercising but we do so anyway for the potential reward of living a longer and healthier life. Risk and the resulting reward of a wonderful meal, a beautiful view or an active lifestyle are part of our everyday lives and generally speaking, we manage these types of risks with far fewer emotions than we do the risks associated with our investments. A lot of that could have to do with our understanding of investment related risk and our emotional sensitivity about money because of what it can do for our families and the lives we want to personally live. But if we embrace prudent risk taking as a path to life's rewards, a means to an end if you will, then perhaps the way we think about risk and react to it can begin to change.

For most investors, investment risk is associated with the overall volatility of their portfolio and the chance that when they need the capital it will be worth less than is required. Volatility, however, can be managed through a sound asset allocation plan which involves allocating capital to asset classes of varying risk levels and return profiles in such a way that an overall level of return/volatility is achieved given your individual goals, time horizons, objectives etc. If you get the asset allocation right and then maintain an investment perspective consistent with your time horizon, there shouldn't be too many sleepless nights, even during the inevitable pockets of market turbulence.

Part of the confidence in this approach lies in the fact that while markets will correct from time to time; they can and do historically recover. In fact, according to JP Morgan's July 2015 edition of "Guide to the Markets", the average intra-year correction in the S&P 500 over the past 35 years has been 14.2% (median 10%) and yet the market ended up closing in positive territory in 27 out of those 35 years.

Furthermore, according to Wealthfront, market declines between 10-20% take 107 days on average to recover their lost ground. Of course steeper declines take longer to recover but they too have historically recovered as innovation, earnings, valuation and global growth eventually take over. Lastly, unlike actual gambling where the longer you sit at the casino the greater the odds are that you'll lose, with investing, it's the opposite as the below chart from the Schwab Center for Financial Research illustrates.



Source: Schwab Center for Financial Research with data provided by Standard and Poor's. Every 1-, 3-, 5-, 10-, and 20-year rolling calendar period for the S&P 500 Index was analyzed from 1926 through 2014. The highest and lowest annual total returns for the specified rolling time periods were chosen to depict the volatility of the market. Returns include reinvestment of dividends. Indexes are unmanaged, do not incur fees or expenses, and cannot be invested in directly. Past performance is no indication of future results.

Therefore, with the proper asset allocation, quality holdings and a long term view there is less to fear in the long-term risk of the market.

In closing, it could be helpful in times like these to think of the risk of specific asset classes and holdings within your investment portfolio not as potential adversaries ready to attack your well-being at any time, but view them rather as a collection of diversified return streams that over time are like different channels of a river, working their way in and around various obstacles eventually filling up a lake, your financial lake, somewhere down the line. Warren Buffett and other noted long-term focused investors have said that if we focus on *what* we own - a collection of diverse, high quality assets representing a varied set of return streams, (our words), the "*when*" will largely take care of itself given enough *time* and that is the kind of four letter word that will help you sleep better at night.

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