There is Risk and There is Risk

Jan 15 2018

The penny finally dropped a couple of months ago during a client conversation about the risk of investing in the equity markets. The client was reluctant to commit money to the investment markets and gave me several reasons - "the markets were too high and ready to crash", "there were safer alternatives", "I never fully recovered my money from the 2008 Credit Crisis" - to justify his point of view.

And that got me thinking about how the financial industry views risk and how our clients perceive risk. For the financial industry, risk includes the possibility of outliving your money, not achieving your lifestyle goals, not saving enough, not maximizing investment returns by being too conservative and not being properly diversified to protect against sudden or unexpected market turbulence if one sector or country experiences a crisis, etc. Risk for our industry does not include market corrections where the value of a portfolio drops for a period of a few weeks or months only to recover. We call that a "fluctuation" or "correction" but never a loss, so long as you do not actually sell your investments during a bad patch.

Some investors on the other hand, refer to a market drop - such as during 2011 in the Canadian investment markets - as a loss, as if their portfolio ended that year lower. But, the fact that the portfolio recovered the following year does not change the perception that they "lost" money even though they may not have sold any of their holdings in 2011.

When advisors talk about market corrections or risk, they are often referring to normal cyclical corrections in the order of 5% or 10%. These are considered "normal" by the financial industry as the global economy seems to march onwards and upwards over time. History shows this to be true and thus the financial industry tries to reassure investors that the sky is not falling during these types of corrections. Even minor corrections of a couple of percent today seems to throw the media and other commenters into spasms of fear and doom and gloom!

And this is where the penny dropped. Investors use the same words as the financial industry but attach different meanings to those words. When investors in recent times talk about risk, and never getting caught in a down market again, they are referring to the 40% plus downturns that hit global markets during the worst of the 2008 Great Recession. Investors now use that experience to establish their emotional benchmark of what they wish to avoid in the future. The better the markets seem to be doing and the higher they seem to recover from the lows of 2008, the more skittish they seem to become.

As former US Federal Reserve Chairman Ben Bernanke stated in 2009*: "As a scholar of the Great Depression (1930's), I honestly believe that September and October of 2008 was the worst financial crisis in global history, including the Great Depression." Yes, it was bad, but it does not need to colour or affect your decisions as an investor forever going forward.

Human beings crave certainty, stability and predictability and want to jump on a sure thing. Lots of investments seem to be more attractive today. We see many quality companies whose profits are rising. Investing in quality companies is what made Warren Buffett wealthy. We all want the same level of wealth as him, but are we really willing to pay the emotional price, including the volatility or the ups and downs and uncertainty that investing entails? You are either betting on a bad outcome for the investment markets or being optimistic about the progress of human society and the resulting emergence and growth of profitable companies along the way.

What is your view of the future? Keep these thoughts in mind as you contact our office [1] during the upcoming RRSP season to discuss your investment options [2]. It takes courage to be positive!

[*] **Forbes Magazine,** ***Ben Bernanke: The 2008 Financial Crisis Was Worse Than The Great Depression*** **[3]. Retrieved on December 14, 2017.**

Tags: risk management [4]
investments [5]
investment planning [6]

Source URL:https://marvinnickel.com/e-newsletter/2018/2018-01/article-1.htm

Links
[1] https://marvinnickel.com/contact-us [2] https://marvinnickel.com/your-investments [3] https://www.forbes.com/sites/timworstall/2014/08/27/ben-bernanke-the-2008-financial-crisis-was-worse-than-the-great-depression [4] https://marvinnickel.com/taxonomy/term/50 [5] https://marvinnickel.com/taxonomy/term/17 [6] https://marvinnickel.com/taxonomy/term/9