

# FINANCIAL POST

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## **Rich are rising out of the ashes wiser**

**Michael Nairne, Serious Money**

Thomas Edison famously stated: "A failure teaches you that something can't be done -- that way."

Affluent investors, still reeling from the losses of the Great Meltdown, are identifying where their financial advisors failed them and are demanding improvements.

One of the central lessons of the past few years is that the world's financial markets are much riskier than many envisioned. As one wealthy investor said to me, "I knew global markets could fall, but I never suspected they could fall so far, so fast, in unison. And my brokers were as surprised as I was."

Not unexpectedly, investors want better risk management.

According to Capgemini/ Merrill Lynch's 2010 World Wealth Report, wealth management firms that serve high-net-worth investors are trying to respond to this demand.

Many are attempting to get a better understanding of their clients' risk tolerances with more thorough questioning and more calibrated risk profiles, while providing more portfolio options.

Having looked at dozens of risk assessment systems used by different investment firms, I can state unequivocally this is a much needed improvement. Most risk tolerance questionnaires are too skimpy and fail to comprehensively measure risk. Both risk capacity -- the financial capability to accept risk -- and risk attitude -- the psychological capability to bear risk -- have to be assessed.

A doctor won't prescribe treatment without a complete medical profile, neither should an investment advisor.

Also, categorizing clients as either "conservative, moderate or aggressive" and placing them into one of three corresponding portfolio models just isn't fine-tuned enough when stocks plunge by 50% and there is a gaping 15% return difference between the models.

Imagine a shoe store that only offered three sizes -- it would soon be out of business.

Unfortunately, many investors don't realize their portfolio doesn't fit until they are deeply in the red.

Scenario analysis is another tool to improve risk management. Savvy investors want to know how a particular investment allocation or product might perform under varying economic circumstances.

In today's bi-polar world, both deflation and inflation are concerns.

I am finding that affluent investors want a strategic perspective on their portfolios that answers vital questions. How do all the pieces -- the various asset classes and managers -- work together? What is the downside for my entire portfolio in another market freefall?

Fortunately, with today's computer software, sophisticated advisors can show a client how their recommended asset mix performed in prior market meltdowns.

At the two extremes, an investor can see how their mix performed during the 48% market decline of 1973-'74, a time of oil shortages and rapidly escalating inflation, as well as the 57% plunge of 2008-'09, a period of credit crisis and rapid disinflation. If the downside is unacceptable, a less risky portfolio is in order.

More transparency is also being demanded. Investors want to better understand products, performance and fees, as well as any conflicts an advisor or their firm may have. In 2009, many regretted they didn't heed the warnings about risk buried in the fine print.

Affluent investors want more specialized advice. Instead of a single investment generalist, they want a team comprised of their portfolio manager, investment specialists and tax experts.

Failure often sparks progress. Affluent investors will better endure the next market slump because they voiced their demands today.

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