Certified Financial Services, LLC
600 Parsippany Road Suite 200
Parsippany, NJ 07054

Richard Aronwald
www.richardaronwald.com
Financial Specialist

How Risky Is That Risk Assessment Questionnaire?

"Investing should be more like watching paint dry or watching grass grow. If you want excitement, take $800 and go to Las Vegas."
-Paul Samuelson

If you've ever walked into the office of a brokerage firm, chances are you were handed a "risk assessment questionnaire," or something like it. The purpose of this quiz is to assess how much risk you are comfortable with when it comes to investing.

To determine your risk assessment profile, you'll proceed to answer questions such as:

"Would you be willing to take risks in order to meet your long-term financial objectives or would you rather protect your principal at the expense of future gains?"

"Would it be acceptable to experience a 30% loss if it was followed by a 30% gain later on?" (We'll be looking at this question in more detail below).

"Will you need this money in ten, twenty or twenty-five years?"

A computer program will then use this information to assign you a risk tolerance label such as "moderately conservative" or "aggressive." A chart will then be generated with recommendations to "diversify" your assets into a variety of stocks, bonds and/or mutual funds.

Here are some of the problems with this common scenario:

1. Only a limited menu of investment options are presented.

If your broker presents you with a narrow choice of stocks or bonds, why wouldn't you question whether or not these are your only options? Unfortunately your broker may only be offering financial products rather than "financial strategies." Many brokers are often uninformed about any "out-of-the-box or Uncommon" financial strategies….this includes "fee-based only" advisors as well.

The consumer assumes that stocks, bonds, mutual funds or Hedge Funds are the preferred options, as no other choices are typically offered. You invest your assets according to the computer-generated chart, when your best strategies might be literally "off-the-chart"!

2. Psychological pressure is brought to bear on the consumer by the risk assessment process.

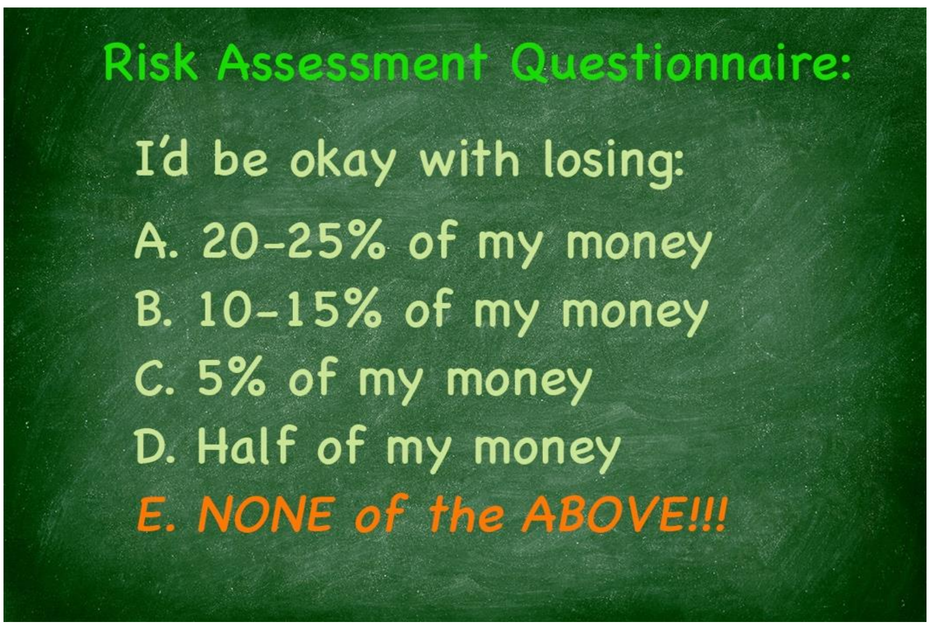
The questionnaires serve the purpose of convincing those taking it that a certain level of risk is necessary. You might withhold questions or protests rather than appear hesitant or foolish in front of a professional, especially one assuring you that you have plenty of time for the market to work its magic. You might be told that you "can afford to take some risk," or even that you need to take on risk due to the "low interest rate environment".

Stock Market "corrections" occur on a regular basis…when you are young, it is easier to leave your portfolio as is. As you get older, it is much more difficult to leave your portfolio as is. A 60 year old sees his/her account goes down substantially… psychologically, it is very difficult to just do nothing and leave your portfolio as is. Often, older investors make conservative changes ("Cash" position) during this "correction "and miss the upside should the market return to previous levels.

You may feel subtly pressured, but rest assured, stock market risk is not some necessary financial rite of passage, no matter what you are told.

3. The client is forced to act based solely on conjecture and speculation (otherwise known as guesswork).

You might have the stomach for extreme sports such as Helicopter skiing or mountain-climbing, but that is not an indicator of how well you can stomach losing your hard-earned money. However, you will be asked to project how you will feel about hypothetical financial scenarios that will drive your investments for decades to come.

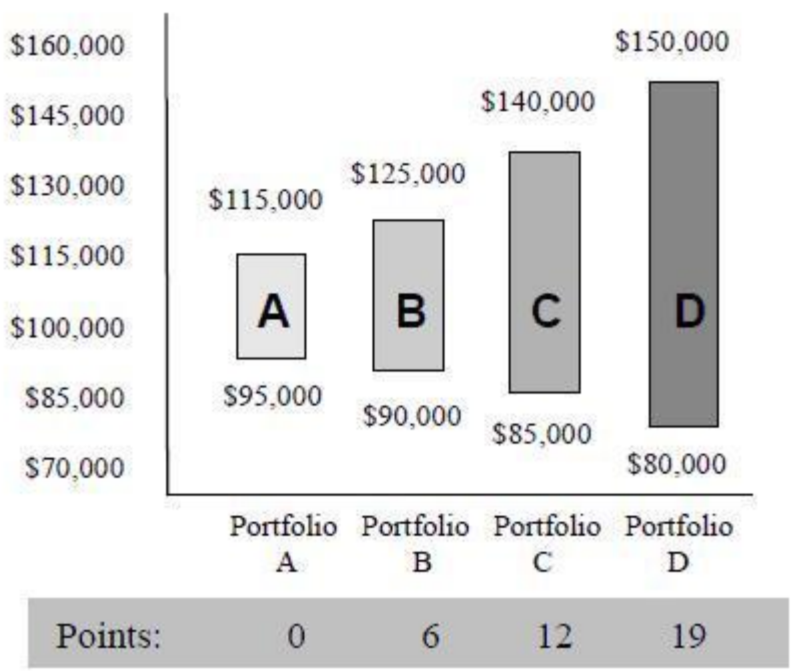


4. The future performance of conservative, moderate or aggressive portfolios is also nothing more than a "best guess."

The famous disclaimer goes "past results are no guarantee of future performance". And yet all the recommendations you receive will be based on the practice of looking at how similar investments performed in the past!

"We don't believe in guesswork when it comes to your risk." This ironic statement comes from the website of an advisory firm. Their clients can choose between 32 possible responses in an effort to provide "a technical approach to investment planning and management." Each choice is assigned a numerical value and then added up to arrive at a score that will dictate the entire basis of their financial approach.

However, none of the assigned categories (conservatively moderate, moderate, moderately aggressive and aggressive) present the possibility of a 45-50% loss, which many investors experienced in 2008-2009. Instead, a hypothetical $100,000 portfolio is shown as having a limited range of growth and shrinkage:



Therefore, investors are asked to predict how much they are comfortable losing, while the broker cannot guarantee the portfolio will perform in those ranges.

5. An illusion of security is fostered by risk assessment questionnaires.

A broker making recommendations might predict that a portfolio won't realize more than a 5 or 10% loss, when a much larger loss is actually feasible.

Even people who have lost 50% of their portfolio value doubt a repeat crash could happen again. The 2008-2009 losses are seen as being a one-time glitch in the system, even though practices such as investing in derivatives, CDO's and other risky strategies with other people's money have either continued or resumed.

Even Berkshire Hathaway shares couldn't sidestep the economic downturn. In September 2008, Berkshire Hathaway shares had reached a high point of $147,000. By March, 2009, that number had plummeted more than 52% to $70,050. It eventually came back to $147,000 per share.

If the most profitable investor of all time can be caught unaware by a Wall Street crash, how reliable will a questionnaire and a computer algorithm be in keeping your investments safe?

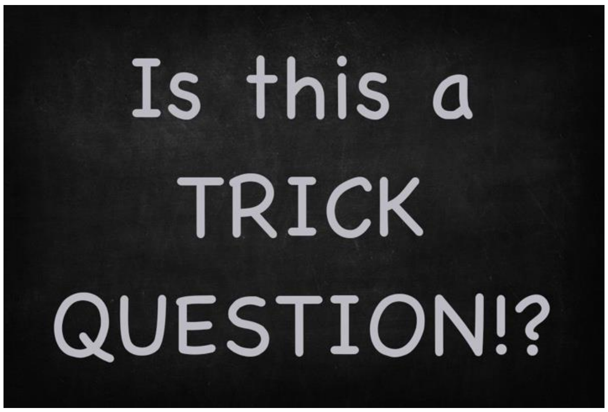
6. An acceptable loss for whom?

Remember the profile question that asked how an investor would feel about a 30% loss if it was followed by 30% gain? If you do the math, it is obvious that the question will catch most people off guard.

Let's say the hypothetical $100,000 portfolio loses 30% — that would leave $70,000. But then if there is a 30% increase, all is well, right? Not exactly, as 30% of $70,000 would be $21,000, bringing the principal back to only $91,000. This is still a total loss of 9%, not counting any penalties or fees.

(That is the difference between the average rate of return versus the actual rate of return, and investors should be made aware of this.)

Who Benefits The Most From A Risk Profile?



At this point, it should be clear that a risk assessment questionnaire may not be the best path for your financial future. In the words of Tamris, a financial consultancy firm, "An investor enters a wealth and asset management relationship with expectations. If these expectations are not carefully managed and assessed by the advisor, there will be conflicts later on in the relationship."

Ultimately, a risk assessment questionnaire is not the best way to start your financial strategy.

If the investment strategy results in a low or negative return, it isn't the responsibility of the broker. After all, you were the one directing how your money was invested, according to risk tolerance levels determined by your profile. Checking off "Aggressive" tends to protect the broker (brokerage firm) far more than it does the investor.

A risk assessment questionnaire can also be used to get you to buy into such financial half-truths, such as:

- You can't get decent returns through safe investments.
- Big returns/gains are only obtained by those willing to embrace aggressive strategies.
- It is customary to let someone else control your assets until they are needed for retirement. Then to only give you what you need for income.
- It isn't your Broker's job to protect you from losses, it's only their job to help you assess your level of risk tolerance.

Learn the Whole Truth:

There are simple financial strategies that you can implement to create "Financial Success" under many circumstances. Strategies that reduce your risk, increase Asset protection while achieving investment results you are comfortable with. Strategies that are in the best interest of you and your family rather than those who base their financial recommendations on risk assessment questionnaires.

Visit my website www.richardaronwald.com and go to "Resources" and read about these financial strategies. There are many books discussing these strategies ("Highly Recommend Readings") as well as many "Articles" and past "Newsletters". Or just call me ☺

Certified Financial Services, LLC
Richard Aronwald
Financial Specialist
raronwald@cfsllc.com

600 Parsippany Road Suite 200
Parsippany, NJ 07054
973 263-0622
richardaronwald.com