

Managing Risk in Uncertain Times

The national and global response to the terrible events of September 11 has been both heartfelt in its empathy and adamant in its resolve. For their parts, central banks in the United States, in Europe, and in Asia have mounted aggressive, coordinated efforts to provide liquidity. The U.S. government has quickly pumped more than \$40 billion into the recovery and rebuilding effort. Such stabilizing initiatives are incontrovertible proof that the U.S. economy is vital to economic growth worldwide.

It is also true that U.S. stocks are now undervalued by nearly 20 percent relative to bonds, investor sentiment is unjustifiably bearish, and corporate earnings are expected to rebound sharply sometime in 2002. Some investors have sought safety in bonds and short-term cash equivalents, but 30-day T-bills are now trading with yields near 2.0 percent and are expected to go even lower. With inflation running at a 2.5 percent annual rate, investors are losing purchasing power even in these “safe” investments. This unprecedented scenario strongly suggests that investors should not only hold onto their existing equity positions, but should consider adding to them, within the parameters of their long-term asset allocation strategy.

There's Nothing Like a Down Market to Test Your Investment Strategy

When market volatility yields a rash of selling, the media works hard to fan the flames of investor panic. Phrases like “investors dumped stocks” and “assets fled to the safe haven of cash” fill the newspapers. Talking heads on the evening news and CNN earnestly wonder if the “sell off” will continue. The resulting barrage of scary sounding terms is enough to make even seasoned investors wonder if they too should sell.

During these media-driven frenzies, you never hear anyone mention the fact that every



stock dumped by one investor was bought by another. Even stocks that investors abandoned got bought by someone else - every single share.

Equally unmentioned is that many of the investors who took profits by selling may lose a substantial portion of those gains to the taxman. While pulling your money out of the market may be the trendy thing to do on a day when the markets are down, it might not feel so chic on April 15.

What to do When Markets Turn “Bad”

What should you do when the markets drop? If you're a long-term investor with a well-planned investment strategy, you probably shouldn't do much of anything.

Think about it for a minute. Does a rise or fall in the market today have any impact at all on your long-term financial needs? Without even knowing who you are, I can already tell you that the answer to this question is no. Nothing that happens in the market today will change the amount of money that you will need in the future.

Likewise, daily fluctuations in the stock market have no impact on the expected results of a good investment

strategy. In other words, if your strategy is sound, you can sleep well at night regardless of what happened in the market during the day.

A Good Strategy: What it is and How to Get One

A good investment strategy is an approach to money management based on your personal financial needs, risk tolerance, and time horizon. It results in a composite of investments that have a high likelihood of reaching a particular goal within a specifically defined time frame and tolerance for risk. A sudden drop in the stock market does not change the likelihood that this strategy will be successful.

Develop your strategy before you invest your first dollar. Know why you're investing to begin with. In other words, write your last chapter first. Understand the investments you are about to make. Understand the risks and the potential rewards, and make sure you are comfortable with them. Know why you are putting your money into every investment that you make, how long you expect to hold the investment, and what you expect to get out of it. Set realistic expectations for projected investment returns. Find out if there are tax implications and, if so, what impact they will have on your portfolio.

Remember, the financial markets are cyclical. Although they tend to go up in the long term, they don't go up in a straight line. Never have. Never will. If you are biting your nails when you hear that the markets are down or losing sleep worrying about your money, maybe it's time to rethink your strategy.

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