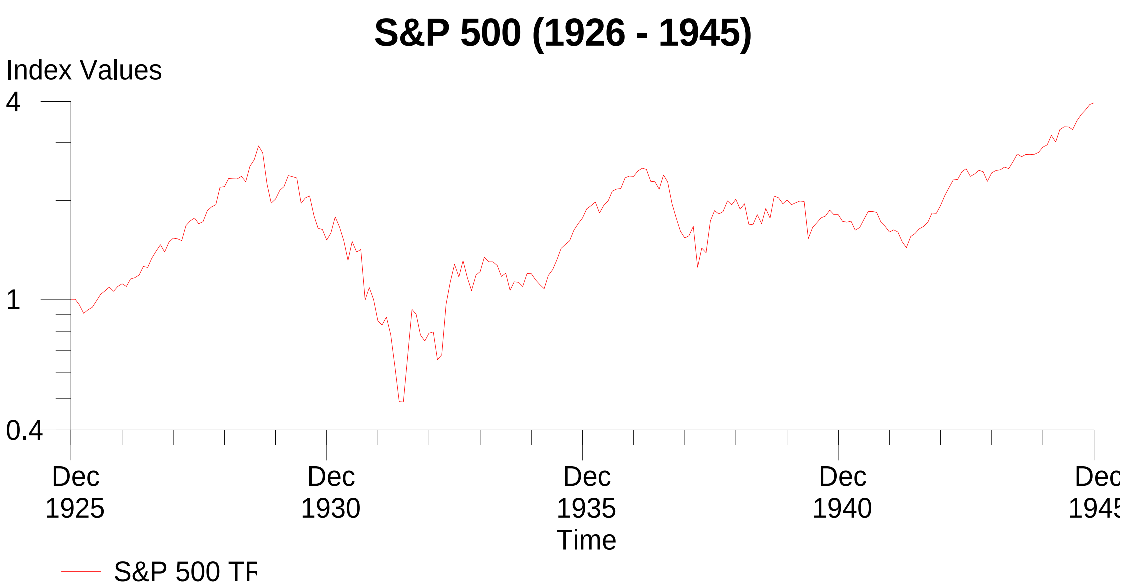
INTEGRIS
WEALTH MANAGEMENT

RISK

Personal Investing Series
Article 6

Academics think of risk in terms of volatility. Volatility is simply the ups and downs of security prices. It is the squiggles, if you will, on a price or return chart. The chart below shows the cumulative return on the S&P 500 from the speculative period before the Great Depression through the end of World War II.



The bigger the squiggles, the greater the volatility. As you can see, there was some serious volatility going here during this time period.

The average investor has a hard time with this. The average investor says only the "down" squiggles are risk, the "up" squiggles are profit. If you are of this mind, you are missing a subtle but important point. That point is that if an investment is capable of going up in a big way, it is also capable of going down in a big way. While we all loved the 20% to 30% annual returns from the S&P 500 from 1995 through 1999, we were reminded in 2000 through 2002 that the S&P 500 goes down also.

A true story. I remember an institutional investment manager that was fired after generating a 30% return in 3 months. The investment as in a specially designed portfolio that was supposed to generate stable, consistent returns of about 1% per month. So what is wrong with 30% in 3 months? The client hired the manager to generate stable, consistent returns. If the manager could make 30% in 3 months, he could probably lose a similar amount in a different 3 month period when things go badly. That is not stable or consistent. That is what professional investors look for - what kind of return do I want long term, and can I afford the volatility in the meantime?

Average investors should do that too. If you think about investing in something because it has gone up in a big way, think about the risk that implies and assess whether you can live with that risk.

In the following article I will talk about another aspect of risk.

Gifford Lehman
updated 3-2006