



Financial DNA[®]

Risk: Born or Made?

Case Study

Hard-Wired and Subjective Risk

1. The correct starting point is inherent “hard-wired” behavior – stable over time including under pressure or duress– overall decision-making approach & propensity
2. Then look at impact of “learned behavior” which produces **subjective risk tolerance**
3. Impact on general risk profile: experiences, knowledge, value systems
4. Impact on “financial” risk profile: financial experiences, current situation, perceptions, market direction, temperaments, understanding of and aptitude for asset classes & strategies, investment education, age
5. **Subjective risk** can be managed with education and awareness

Risk: Born or Made?



Peter: Accountant

•Decision-Making Style :

- Extensive due diligence
- Careful decisions
- Asset mix :
 - Much property
 - Some stocks
 - Own business

Robert: Motivational Speaker.

•Decision-Making Style :

- Minimal research
- Quick decisions
- Asset mix :
 - Many stocks
 - No property
 - Own business

Risk: Born or Made?



Robert: Cautious

- Buffett-style approach to stocks, considers them the safest investment available.
- Extensive funds management experience
 - 20 year+ timeframe
- Looks at minimal criteria because he is **spontaneous** – does not like extensive detail.

Peter: Risk-Taker

- Property investor developer, willing to take significant risks if there is good chance of success.
 - Extensive background in property.
- Performs extensive due diligence because he is **planned** – not comfortable without extensive detail.

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An investor's inherent propensity regarding Adventurousness stays stable over time, but the level of investment risk they are comfortable with is influenced by:

- Environment – their family's investments and attitudes
- Education – their knowledge level about a particular asset class
- Experience – whether good or bad

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- Robert is able to accept price volatility in the stock market because he buys a diverse range of companies, focusing on future prospects and dividends. He sees stocks as very low risk, because he is sure that the companies he owns ‘will still be there tomorrow.’
- Peter has a high level of financial astuteness, and explores all possibilities before committing to a transaction. However, he will commit to strategies even when he is not guaranteed a good outcome. He is prepared to take risks, as long as he knows what they are beforehand.

Relating Risk Profile to Portfolio Construction

- The “Bold” subfactor in the Core Life Profile reflects natural propensity for taking risk, i.e. prepared to take chances
- The “Risk Tolerance” subfactor in Core Life Profile reflects the ability to handle the consequences of taking risk
- These 2 traits need to be considered together to provide an indication of the appropriate level of risk for the client
- **HOWEVER**, assessing risk for portfolio construction needs to be done after discussion with the client, i.e. also need to account for learned behaviors (developed through education and experience)
- A naturally cautious person may still be comfortable with a high level of risk if he/she understands the product/risks
- Stage 2 (Financial Directions Profile) assists with getting more insight