WHAT IS RISK TOLERANCE?

Your investment style matters, and so does your investment horizon.

by Paul Myers, ChFC, CRPC

When you meet with a financial advisor, at some point the talk will turn to your "risk tolerance" or "risk profile" … and you may receive a questionnaire intended to gauge it. Well, it seems simple enough: the financial advisor is learning how conservatively or aggressively you would like to invest. But actually, a risk profile signifies more than that.

Styles for profiles. Financial advisors often use a few model portfolios which they adapt for the unique needs of each client. Your risk profile indicates which of these model portfolios might become a good basis for your own, custom portfolio.

Investors are usually categorized as "conservative", "moderate" or "aggressive", with in-between categories of "moderately aggressive" and "moderately conservative" also applicable based on questionnaire responses.

How conservative are you? If you absolutely do not want to risk losing money, and if your first priority is consistent income to live on, you are a *conservative* investor. If these are your concerns and you are retired or about to retire, you should not be offered high-risk investments. If you retire with an aggressive portfolio and your investments tank, it could take (many) years to rebuild your savings, years you might not have. However, many pre-retirees and new retirees are *moderately conservative:* they are cautious with money in their lives and don't want to take on a risky portfolio, but they still have a need to accumulate assets because they have either started saving for the future too late or lost assets as a result of market downturns or poor or unfortunate financial decisions.

How aggressive are you? *Aggressive* and *moderately aggressive* investors commonly want to match or beat the stock markets, or save for retirement at a highly accelerated rate. Some are "market junkies" who watch Wall Street on a daily basis. Most of them expect to build substantial wealth someday; most of them are young or in the middle stage of life; most of them have NOT been hit hard financially as a result of investing, and many of them have substantial income or savings. The moderately aggressive investor is willing to wait a bit longer to reach his or her goals, while the aggressive investor tends to be in a hurry by comparison.

Who is the moderate investor? Typically, the *moderate* investor starts investing roughly about the time of major life events – that first stable job with a corresponding 401(k), a marriage, the start of a family. Often, the moderate investor is a younger investor saving or investing for long-term goals (usually their child's college education and retirement). These midlife investors frequently have a "balanced" portfolio, with a mix of conservative and riskier investments across varied investment classes. The portfolios of moderate investors are often fine-tuned or revised to become more conservative as they age. These investors are willing to accept some losses and risks

and are pragmatic and usually educated about the realities of investing and their investment options. Some moderate investors are retired or nearly retired, having either retained their investment stance out of necessity (they need to continue accumulating assets in retirement) or out of preference (they do not want to "miss out" when the bulls run on Wall Street).

Why risk tolerance is so important. Decades ago, you used to hear "horror stories" about seniors losing their life savings as a result of inappropriate investments. Things have changed for the better: we now have questionnaires and in-depth discussions about risk tolerance. It is a very important factor not only in terms of investing, but in terms of the client-advisor relationship. If you'd like to learn more about different investment styles or you feel you might be taking on too much risk as you invest, I would urge you to speak with a qualified financial advisor.

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