VANTAGE POINTE
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MANAGING RISK IN YOUR PORTFOLIO

Some investors may only look at a portfolio's recent return when evaluating its performance. However, the return number does not explain the risk taken to acquire these returns and thus provides limited information. While we may view risk as something to avoid, taking risk is actually necessary in order to produce the returns needed to help investors achieve specific goals, such as the funds needed for retirement. In fact, we can think of risk as the fuel of a portfolio. Just as a car's fuel efficiency is important, we should consider our portfolio's risk efficiency important as well. In order to know if a portfolio is 'risk efficient' we need to understand these risks and attempt to only take the type and amount of risk necessary to manage a well-performing portfolio. In a balanced portfolio consisting of equities, bonds and alternatives, there are different types of risk. In this article we will focus on two that have a big impact on a portfolio's performance: market risk and interest rate risk.

We'll first look at the market risk when investing in equities that make up a significant portion of most portfolios. If a high amount of market risk is taken to produce a portfolio's return, then the portfolio stands a good chance of only performing when equity markets move up strongly. As we know, equity markets can have big downturns as well, so it is important to attempt to take only the market risk that is necessary to produce good returns.

> *"...taking risk is actually necessary in order to produce the returns needed to help investors achieve specific goals..."*

SHARPE RATIO

The Sharpe Ratio is one measure we use to monitor how much of a return from our investments we have been getting from the market risk taken. This ratio was developed by Nobel laureate William F. Sharpe, and is a popular measure used by many portfolio managers.

While ratios can seem intimidating to some, the ratio can be obtained by dividing the risk of a portfolio into the portfolio's adjusted return. The number we use for the risk is known as the standard deviation which is a measure that indicates how much the portfolio can vary around its mean. A high standard deviation would suggest that the portfolio is significantly affected by market swings. To obtain the adjusted return, we subtract a market risk-free return (usually the 10-year Treasury Bond) from the portfolio's gross return. This adjustment allows us to use a return that is in excess of a return we would have received from a risk-free investment. The higher the Sharpe Ratio, the more return we are getting from the market risk we are taking.

The formula looks like this: (Total Return – Risk Free Rate) / Standard Deviation.

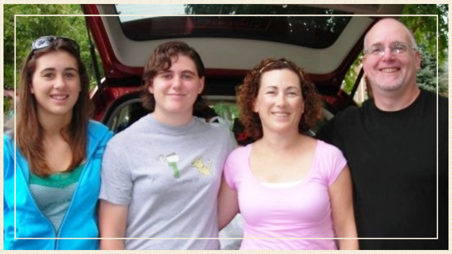
INTEREST RATE RISK

Next we will discuss interest rate risk, which is a timely risk to understand. As we know, interest rates are very low, and as the economy improves we will probably see these rates begin to rise. This will have an important impact on the returns of most investments holding bonds. As interest rates rise, the prices of existing bonds will drop in order to make yields competitive with the current yields being offered in the market. Interest rates have been moving generally lower for over twenty years, so it is important to know investments comprised mainly of interest-sensitive bonds may not perform as well as they have in the past. For more information on this topic, please see our November, 2010 issue of Vantage Point written by David Grant entitled, "Rising Interest Rates and Fixed Income".

Given the high amount of equity and bond exposure in most portfolios, you can understand the importance of monitoring these risks. One way we have attempted to lower both of these risks is to use alternative investment asset classes and strategies when appropriate. It is important to know, however, that these investments carry unique risks of their own, although we will not discuss them here. Understanding the risks carried within a portfolio is extremely important and will not only help to better evaluate a portfolio, but will also assist toward keeping a portfolio performing well. For additional information or questions you may have regarding managing risk within your portfolio please contact your Relationship Manager.

VANTAGE NEWS

Please join us in welcoming Anne Yates, our new Financial Planning Associate. Anne started in January and will support the planning team as they continue to grow with new clients. Anne is a CPA and will take the CFP® exam in March. Anne decided to make a career transition to help others plan for college and retirement. She and her husband, Kevin, are happily moving towards the tail end of funding college for their own two daughters. Anne enjoys working with both numbers and people, and is looking forward to working with our team and meeting you.



Morgan, Carolyn, Anne & Kevin

With the launch of NAPFA Genesis, Dave has been featured in various media outlets over the past few weeks. While mostly industry magazines, Dave's exposure to the planning community has increased and helped grow this networking group to 50 members within one month. He was most recently interviewed by the CFP® board for an upcoming piece in their monthly newsletter.

Mike and Kim had an exciting start to February. As avid Packer's fans, they enjoyed seeing their beloved team win the Superbowl and lift the Lombardi trophy. However, being outnumbered by Bears fans in the office has meant that the age-old rivalry just got a little more intense.