

## Client and Investment Risk Methodology

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Designed to promote confidence through a clear, accurate, and objective process

# A Clear Risk Analysis Process

The assessment and application of risk is foundational to the portfolio design and implementation process. Risk often serves as an overarching guide to identify client investment goals and expectations, select appropriate investment options to support those goals and expectations, and manage an investment experience that is comfortable and productive for the client.

We provide advisors and their clients access to a process that identifies risk in relation to a well-diversified, global equity portfolio—through a clear risk analysis process—to help facilitate an investment process that is aligned to client expectations and long-term investment objectives.

## **Identifying Client Risk**

Our risk assessment uses objective and subjective questions to evaluate and identify client risk profiles.

#### **Considerations**

- Investment objective
- Time horizon
- Income stability
- Risk/return attitudes

- Emotional capacity for bearing risk
- Market volatility tolerance
- Ability to handle financial emergencies

Client and strategy/security risk scores are expressed as a percentage of risk of an Equity Baseline Portfolio (EBP)—our baseline diversified equity portfolio. The EBP is comprised of a blend of domestic and international market index benchmarks. We use 60% Morningstar U.S. Market Index for our domestic weighting and 40% Morningstar Global ex-U.S. Large-Mid Index for our international weighting.

This means a risk score of 50 would exhibit approximately 50% of the risk of the EBP.

#### Why Global?

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Studies have shown that an international allocation of 40%—50% may be optimal for long-term risk reduction\*. The use of global benchmarks as a point of reference for portfolio risk may be more appropriate for well-diversified investment portfolios.

\*Global equity investing: The benefits of diversification and sizing your allocation - Vanguard, February 2019

## **Identifying Investment Risk**

We use a proprietary combination of measures to create a comprehensive evaluation of strategy or security risk, as compared to our Equity Baseline Portfolio (EBP).

#### **Risk Score**

Our risk score considers two risk measures: 33% Relative Risk\* and 67% Beta

Those two risk measures are considered, equally, across four time frames: 1-Year, 3-Year, 5-Year, and 10-Year



If an investment does not have sufficient history, a benchmark comprised of a cluster of similar securities (determined by a third-party data provider) will be used to complete the remainder of the historical data. The benchmark returns are risk-adjusted based on the behavior of the investment compared to its benchmark. Why Risk is So Important

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We believe investors who are placed in portfolios appropriate to their individual risk tolerance and market participation attitudes are more likely to stay invested, allowing more time for the portfolio strategy to succeed, and ultimately bringing them closer to their financial goals.

## **Risk Bands**

Client risk scores are segmented into five, standardized risk bands—designed to assist portfolio management and design.

Aggressive Growth: 81 - 100 Growth: 61 - 80

- Growth & Income: 41 60
- Income & Growth: 21 40

Conservative Income: 0 - 20



### **Factors of Consideration**

#### **Relative Risk (Standard Deviation)**

Standard deviation is a measure of absolute risk, and in our opinion, the best tool to gauge an asset's impact on a portfolio, regardless of good or bad performance on its own. However, diversification impact is not considered in standard deviation. Bonds were highly volatile compared to stocks in 2007 and 2008. But they gained in price as stocks faltered. This dynamic actually reduced portfolio volatility, though standard deviation was high.

#### Beta

Beta is a measure of correlated risk, and commonly used in risk measurement. We measure one-year beta to capture short-term market changes, and 10-year beta for a long-term perspective. The 3- and 5-year time periods capture intermediate-term changes in the market environment.

When evaluating beta, we look at how much risk a particular asset is adding, relative to movement in the EBP. When an asset is highly correlated with the EBP, it will have a high beta. However, when an asset has a low correlation, seen in alternative investments like commodities, beta will be lower.

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