Preparing Your Portfolio for the Unexpected

**Trying to Reason With Hurricane Season?**

**What would you do?** Imagine you lived on the coast and read the below quotes in your local newspaper:

> “On balance, it is not likely that the United States will experience a hurricane in 2008.”

> “My arithmetic says if there’s a one-third probability of a hurricane, then there’s a two-thirds probability there won’t be a hurricane.”

> “[One expert] puts the chance of a hurricane in 2007 at about 25 percent, up from a 10 percent chance a few months ago. But others ... say the chance of a hurricane next year is pretty slim.”

Would you cancel your flood and wind damage insurance? Of course not. Even if the probability of a hurricane is low, the potential for damage is too high to leave yourself unprotected.

The quotes above were actually printed in the media¹ in 2006 and 2007, with one important difference. In place of the word “hurricane,” the real quotes used the word “recession.” And in that environment, many investors left their financial house unprotected. They avoided assets, such as long-term government bonds and cash, that have historically held up during recessions. Instead, they positioned their portfolios for continued economic growth through stocks and other equity-like investments.

And their portfolios were severely damaged when the economy slipped into recession and the markets plunged.

**Probability versus impact**

The problem is that many investors disconnected the probability of a recession from the impact of a recession. They absorbed the consensus message that the probability was low, so they didn’t prepare.
Does this sound familiar?

"If I’m not fully invested in equities, I might miss out on market highs." Lower risk assets may come with lower return potential, and including these assets in your portfolio when times are good may mean missing out on some gains you might have earned with higher risk assets. Remember that your goal isn’t simply to make the highest possible returns at all times. You have a concrete financial goal – retirement, home ownership, sending your children to college – and getting there means appropriately managing risk.

"I’ll get out before the market tanks." Your mortgage company wouldn’t allow you to repeatedly cancel and reinstate your insurance policies from year to year. But in the financial world, you can buy and sell assets whenever you want. The problem is, economic predictions are unreliable. And historically, the market’s best performing and worst performing days have typically fallen in close proximity to each other, leaving little room for error.

"I can make up the loss in the next bull market." Some investors don’t worry too much about losses, because they believe the next bull market will cure all ills. What they overlook, however, is that the impact of losses isn’t easy to erase. If your portfolio falls 20% in value, you need a 25% gain to get back to where you were. Each generation of investors has seen a market downturn take half their portfolio value at least once. If this happens to you at an inopportune time - say, as you’re approaching retirement – chances are you’ll have to scale back your plans, or possibly delay retiring altogether.

Talk to your advisor

Prudent risk management means being prepared for all three broad economic environments:

- **Recessions** can bring steep losses that are difficult to overcome.
- **Inflation** can eat away at your portfolio value and erode your buying power.
- **Missing out on potential gains during low-inflationary growth environments** could leave you vulnerable to shortfalls in retirement.

The ideal asset allocation varies from investor to investor. Your financial advisor can help you construct an asset allocation that’s right for you, and monitor your strategy so that your portfolio’s always prepared for the unexpected.

Your challenge as an investor is to create a financial plan that’s built to meet your needs no matter what the markets are doing. Meeting that challenge requires thoughtful planning, deliberate action and a financial partner who’s dedicated to your success – that’s what Intentional Investing® is all about.

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