 By Susan Carr-Templeton / 05/18/11 RSS feed Like

Can You Protect Your Investment Portfolio From Risk?

I recently moderated a panel of experts whose job is to research investments for financial advisors and individual investors. This particular panel presented the results of its research on how to manage portfolio risk and in particular, tail risk. Tail risk means the holdings in a portfolio fall in value more than two standard deviations from the average. In simpler terms, tail risk happened to most of us in the fall of 2008.

The presenters discussed the research and they agreed that there is no easy or perfect way to reduce investment portfolio risk.

Some of the strategies included using options to protect on the downside. This approach does work, but at a cost to a portfolio's return that most investors would not be willing to sacrifice. It was suggested that on average, an investment portfolio will underperform by 3 percent a year to protect the holdings from more than a 13 percent decline.

A whole new group of investments tracks market volatility, such as the VIX, and these can be blended into a portfolio. The VIX is an Exchange Traded Note that tracks the volatility of the S&P 500 option prices. Due to its performance behavior in relation to an equity portfolio, this may be costly in terms of limiting ones returns at the expense of protection.

Another way to protect a portfolio from risk involves hedge funds, as most of these did outperform the market in 2008. Hedge fund investments, in my opinion, serve as a good diversifier, but the best ones are only available by investing directly in a partnership, rather than a mutual fund structure. Under these partnerships, the minimum investment usually starts at $100,000 and liquidity is poor. Typically it takes 90 days or longer to redeem shares. Some hedge funds come in a mutual fund format, so they are more easily accessible. However, if you read the research, due to the restrictions on trading and liquidity, the mutual fund structure tends to hinder the performance.

And finally, our most seasoned panelist put it quite simply: There is no magic investment to protect your portfolio. One should follow these simple rules: Understand what you are investing in, be sure to diversify, and be willing to ride out volatility without pulling your money out of the market.

As a side note, if you were invested in the S&P 500 index three years ago and did not remove your money during the decline, you would be ahead by 1.78 percent today.

Share:

Susan Carr-Templeton is a personal wealth advisor with more than 20 years of investing experience. In addition to managing Stafford Wells Advisors, Ms. Carr-Templeton volunteers on the investment committee for the Advocate Foundation. She offers personal finance on investing, saving, retirement and more in "Making the Most of Your Money."

Comments (0)

Add your comment

Name (required)

Email Address (required)

Website

Comment

More by Susan Carr-Templeton

Are ETFs Better Investments?
Find out about the elemets behind an ETF More »

Taxes For 2011: Pay Less Starting Now
Tips on how to keep the money you earn in 2011 More »

5 Important Tax Savings Tips To Use...
Tax saving tips you won't want to miss! More »

Tsunami In Japan: A Lesson To Keep...
How will the aftermath in Japan effect the U.S. economy? More »

Facebook: How to Buy Stock in a Private...
Get in on your share of the Facebook fad More »

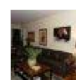
Related Blogs | Most Commented

Are ETFs Better Investments?
By Susan Carr-Templeton

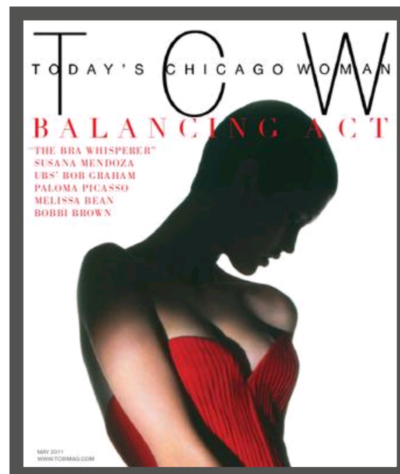
Tsunami In Japan: A Lesson To Keep Investments Diversified
By Susan Carr-Templeton

Taxes For 2011: Pay Less Starting Now
By Susan Carr-Templeton

Rentals Rule the Chicago Market as Housing Sales Stall
By Terri Ryan


Is Now a Good Time to Sell Your Home?
By Terri Ryan

PURCHASE DIGITAL ISSUES



Advertising

For information regarding advertising, please contact us

Download the 2011 Media Kit Our Advertisers