Financial Planning

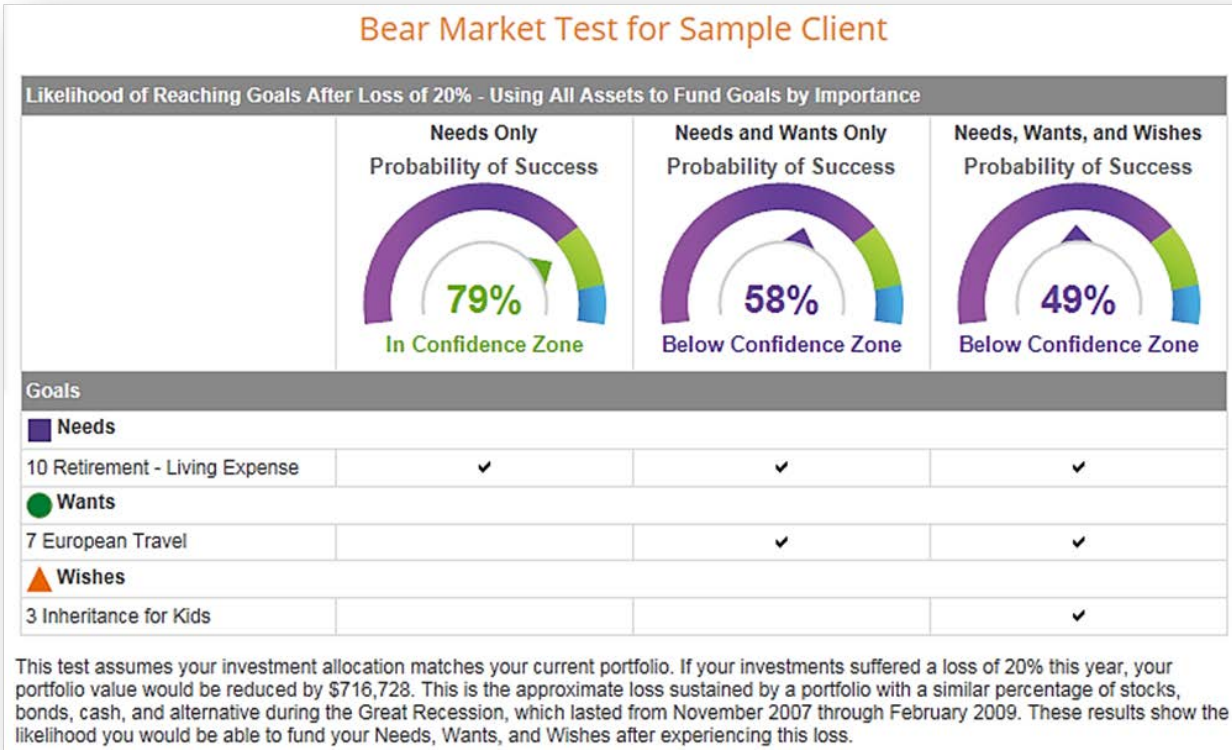
Do You Know Your Risk Capacity?

Markets react to information quickly these days, which can mean significant changes in your portfolio value in very short periods of time. Those changes can naturally cause concern about your plans for the future. If a severe bear market event occurs in the first year of retirement, for example, the impact may be such that you are unable to recover to fund all of your retirement goals during your lifetime. Determining your risk capacity in addition to your risk tolerance can help you and your financial advisor develop a plan that helps you to meet your financial goals and worry less about volatile markets.

Tolerance vs Capacity

Risk tolerance is the amount of risk you are comfortable taking with your investments. Your risk tolerance can be determined in several ways, and will typically fluctuate with age, income need, time horizon and ability to tolerate market volatility. Questionnaires, for example, allow you to answer a series of questions that help you arrive at a risk level you can accept without losing sleep over your investments. Having an understanding of your risk tolerance is a necessary step in determining the appropriate mix of investments or asset allocation. But will the mix of investments dictated by your risk tolerance generate the return you need to meet your goals? If the amount of risk you are comfortable taking is less than necessary, your investments may not generate the return needed to meet some or all of your financial goals. Conversely, if you have a high threshold for risk, you may be taking on unnecessary risk which may also have an impact on your plan. Having an understanding of your risk capacity can help with these types of issues.

Risk capacity is the amount of risk necessary to meet your goals. To determine your risk capacity, you need to consider factors like the timing and amount of your goals and the availability and size of your assets. This approach will give you more insight into how your risk tolerance, goals, assets and investment mix all work together to meet your needs over your lifetime. It is also important that consideration of risk capacity incorporate various market conditions, especially down markets. At Benjamin F. Edwards, we have access to a tool called the Bear Market Test that examines the risk to your plan if a historically severe bear market event occurred this year. Bear market testing can help you gain an understanding of your "worst case" loss capacity – an answer to the question of 'how much is too much' for you to lose in a severe market decline and still remain on target with your financial goals.



Bear Market Test for Sample Client

Likelihood of Reaching Goals After Loss of 20% - Using All Assets to Fund Goals by Importance	Needs Only Probability of Success	Needs and Wants Only Probability of Success	Needs, Wants, and Wishes Probability of Success
	79% In Confidence Zone	58% Below Confidence Zone	49% Below Confidence Zone
Goals			
Needs			
10 Retirement - Living Expense	✔	✔	✔
Wants			
7 European Travel		✔	✔
Wishes			
3 Inheritance for Kids			✔

This test assumes your investment allocation matches your current portfolio. If your investments suffered a loss of 20% this year, your portfolio value would be reduced by $716,728. This is the approximate loss sustained by a portfolio with a similar percentage of stocks, bonds, cash, and alternative during the Great Recession, which lasted from November 2007 through February 2009. These results show the likelihood you would be able to fund your Needs, Wants, and Wishes after experiencing this loss.

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**The Bear Market Test results shown above are based on inputs and assumptions for a hypothetical client using the MoneyGuidePro® financial planning system (MGP). The projections or other information generated by MGP regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results.*

These and other analysis tools can help ensure that you have a plan for your investments that is tailored to you and your family. Talk with your BFEC Financial Advisor to identify gaps and opportunities in your planning and seek solutions to ensure your risk capacity is in line with your goals. ■