WHAT IS RISK?

Many of us use the word “risk” so often, we rarely think of what “risk” really means. We need to understand how important it is from an intellectual point of view, but an emotional point of view as well. I write of risk from not only a financial point of view, but from a “life” point of view as well. Let us then define risk further as any possibility of loss, no matter what type.

We as a society try to reduce risk through a number of different methods. We use insurance to try to reduce risk when it comes to potential liability, such as car insurance, or an umbrella policy. We try to reduce the risk of loss of personal property, such as wind insurance on the house, or the loss of a car being stolen.

In our current economic environment, with market volatility higher, risks are greater now than they have been in the past number of years. Of course, with the Dow Industrial average reaching a high of just over 14000 in October of 2007 to its current level, just under 7900 (as of March 26, 2009)equities have become inherently more risky.. Certainly the same applies to real estate. In both cases, the volatility is substantially greater.

Without a doubt, both equities and real estate have done well over the long run, but over the short run, these asset classes have historically not shown consistent results. The question then, from a financial planning point of view, is “how do we balance risk against its potential rewards, or gains?”

When it comes to investing, one has to consistently evaluate whether the risks applicable to particular investments are still appropriate, considering we now know that risk still means that we could lose principal as well as create gains. Each investor should have a good understanding of the particulars of any potential investment and what the risks associated with that investment are, while also considering the level of risk that is appropriate given personal economic circumstances, other investments they have, and cash flow needs currently and over the long term. Without knowledge and understanding of each investment, its inherent risks, and consideration of personal circumstances, the investor could expose themselves to a greater degree of risk than is appropriate based on those aforementioned factors. For these reasons, it is important to seek professional guidance in order to create a “team” approach among you, your financial advisor, accountant, and estate attorney.

Of course, this brief article is no substitute for a careful examination of all of the advantages and disadvantages of this matter in light of your unique personal financial circumstances. Before implementing any estate planning strategy, contact and consult with your Financial Advisor, estate planning attorney or tax professional.

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