



Checking Your Risk Tolerance

What is the maximum percentage you would be willing to lose in any one year in your portfolio? Suppose that an investment you held for one year lost 15 percent of its value but its performance was similar to other investments of that type. What would you do?

What would cause you more stress – not owning stocks when the market rises or owning stocks when it drops? Of course, all investments involve risk. Identifying and recognizing your personal risk tolerance is critical to choosing a portfolio and is an important first step in any investment decision.

There are many types of investment risk. Depending on your goals and time frame, you may be able to tolerate some forms more than others. For example, how exposed is your portfolio to the following general risks?

- Market risk: the possibility that the value of your portfolio will fall as a result of broad stock price declines.
- Inflation risk: portfolio returns that don't outpace the rising cost of living.
- Shortfall risk: the chance that a chosen investment strategy won't provide the return needed to achieve a particular goal.
- Interest rate risk: the losing end of the seesaw effect in which interest rates rise while bond prices typically fall, and vice versa.
- The better you understand these and other risks, the better prepared you may be to assess your overall risk tolerance.

Risk tolerance is not easily measured. It depends on a host of individual, sometimes intangible, factors, including emotional reactions and past experiences. However, the process of measuring risk tolerance has come a long way. Decades ago, it may have been gauged by asking investors if they had ever considered perilous activities, like hang gliding or mountain climbing. Today, surveys and questionnaires have been designed to help measure investors' risk tolerance relative to other investors, depending on the score achieved. An investor might fall on the "risk averse" end of a scale, the "risk tolerant" end or somewhere in between. Risk tolerance tools are also being advanced through the use of psychometrics, a field of study that incorporates psychology and statistics.

More important than tools, perhaps, is the input of an experienced professional who knows how to make the most of a risk tolerance assessment. Risk tolerance should be compared with an investor's risk requirement – the level of risk needed in order to pursue a particular financial objective. An individual with limited risk tolerance but aggressive goals, for example, may need assistance structuring a portfolio that can potentially bridge the gap.

Part of our service includes reviewing your risk tolerance. Together we can conduct a risk tolerance assessment and then crosscheck the results against your current portfolio. This interactive process will help determine if you need to change your investment policy or modify your goals.

It also will help you sleep better.

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