



Capital Ideas

Say No To Risk

Say no to risk. Don't you like the sound of that? It is like Nancy Reagan's "Say no to drugs." It sounds good but means nothing. Worse, it does nothing.

There is a local "Financial Advisor" running ads on CNBC. His byline is "Say no to risk." In these times that is truly the song of the Sirens. So of course I went to his web site to see what he had to offer. I looked at the content and then pulled up his Form ADV, Part II. This is the same sort of cursory review that my friend Todd at the SEC would do. (By the way, I occasionally make reference to Todd because he was our SEC examiner. I am well aware that he has access to our web site and these newsletters that are posted on the web site). There was nothing on the site or in the Form ADV to indicate that this advisor had found the Holy Grail.

I must admit that it bothers me to see advisors imply that there is a riskless financial product. THEY DO NOT EXIST! There are no riskless financial products. Don't believe me? Let's look at a few.

Cash. Cash is riskless. Isn't it? If you take a thousand dollars and put it under the mattress for ten years, it will still be a thousand dollars when you pull it out. Right? Of course not. Inflation reduces the purchasing power of cash over time. Even at a modest 3% inflation rate you will need an additional \$344 to buy what that \$1,000 would buy today. Now, what would that \$1,000 be worth if all this money

the government is printing leads to even higher inflation?

Well, what about certificates of deposit? A CD is safe. What is the risk there? Well, if they were riskless, why would they need FDIC protection? And, since the FDIC is a government agency, you (through your tax dollars) are really protecting your own money. Besides, the banks as a group have not made a stellar showing the last few years. Some of our largest banks would not exist today if they were not bailed out with our tax dollars. Let's not forget Stanford Financial. Allen—I was not running a Ponzi scheme—Stanford's group offered above average CD rates. I guess there was no risk in pumping up those rates.

Money market accounts are surely riskless. Well, not really. Just ask owners of The Reserve Fund. You may recall that was the money market fund that broke the buck last fall in the wake of Lehman's failure. That led to the government using your money, again, to guarantee that money market funds would be able to maintain the dollar.

How about real estate? They just aren't making any more land. OK, we are all too aware of the risks in real estate.

Annuities. Step-ups. Guaranteed Minimum Income Benefits. Guaranteed Withdrawal Benefits. Guarantee this. Guarantee that. We love insurance products as they are not subject to the prohibition against using the word "guarantee." Well, those guarantees have put a number of insurance companies in a bind. They are raising the cost of the riders to a point

where there is limited upside potential on the contract at best. There is also the fact that you must read the contract to understand exactly what you bought.

Wow! None of these sound safe. At least I will have my Social Security. Maybe. The SSA recently announced that there will be no cost-of-living adjustment next year and perhaps not in 2011. The SSA also announced last week that the trust fund will be gone in 2037. If that happens, the payments will not disappear. They will drop to 76% of the promised levels. Medicare will go bust in 2017—only eight years from now. The long-term shortfall in Medicare can be cured by an immediate 53% reduction in benefits.

So you can say no to risk if you like. Just let me know when you find the Holy Grail. If it is real, I will move all our clients' money to that product. I do not care what it is. If it can avoid market risk, interest rate risk, inflation risk, fraud risk, and every other risk, I want it!

It just does not exist. Period. End of discussion.

I think it is better to embrace risk. Learn about it. Understand it. Use it to your advantage.

Every product and program discussed above has risk. Each one also has a bene-

fit that can be useful in someone's life.

We can't live without cash. Sure you can barter for goods and services, but your lifestyle will not be what it is today.

CDs and money market funds are suitable investments for short-term funds. They are low risk, not no risk. Still you can't be foolish when looking at these products. If the stated rate is too good to be true, assume that it is. That is a truism in financial markets. (AIG's Financial Products division was claiming last September that there was no risk of loss from the credit default swaps. I guess they were wrong.) There is no way an individual is going to be able to break down a CD or money market fund to determine the risk. Just don't try to squeeze an extra nickel in interest.

Real estate is a great investment. But, like any other investment it is subject to irrational exuberance. When people are buying property to flip, be very careful. If you are buying a home that you intend to live in for the foreseeable future, that is a different dynamic. Even if you overpay by ten to twenty percent, you can recover over time.

Annuities provide an income you cannot outlive (provided that the insurance company is not trying to outdo its competitors to such an extent that it puts the company in jeopardy.) But the insur-

ance companies that write the annuity contracts have to invest your money somewhere. They buy stocks, bonds, derivative instruments, real estate, and so on. They, and their investments (which provide the growth and guarantees in your contract), are not immune to the ups and downs of the markets. Once again, read the contract to see what remedies they have when times get tough (raising fees, freezing/changing benefits, etc.)

Do our accounts have risk? You betcha (where is Sarah Palin?) We try to moderate the risk according to your risk tolerance, but the risk remains. Without risk you would not be able to outpace inflation with your savings. You would be doomed to financial failure.

So don't fear risk. Embrace it. Risk will enable you to meet your financial goals.



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