



# Investment Insights

Kevin Kennedy

## Living In A World Full Of Risk

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Life today is full of risks. Whether it is the risk of terrorist attacks, losing your job, an earthquake, or risk in your investments, recent events around the world have highlighted just how risky life can be. It is difficult, if not impossible, to eliminate risk from our lives: the best we can do is find ways to limit risk to levels we find acceptable.

When it comes to your investments, it is always important to know the risks you assume in investing, and to explore ways of limiting the risk to match your comfort level. Just like in life, there are few ways to completely eliminate risk in investing, but there are ways you can invest that will manage or reduce risk based on your needs.

A good example of managing risk can be seen in how you likely use insurance to limit your risk in driving your car. Every time you get behind the wheel of your car, you assume the risk that you might be in an accident, causing harm to another vehicle or another person. The risk of liability you might have in these situations is lessened by automobile insurance, which assumes risk for you beyond a certain level (your deductible). By having insurance on your auto, you are in effect transferring risk from yourself to the insurer, so that you can operate your vehicle without the possibility that an accident could result in you losing a substantial amount of money in the event that you cause an accident. Without insurance, you expose yourself to an unlimited amount of risk. The other option to managing this risk is to stop driving your car altogether, which probably isn't a feasible option.

This scenario also exists in investing. Most all investments carry some degree of risk. Be it the stock market, housing market, or bank CD's, most all investments have an element of risk. As in the case of driving your car, eliminating investment risk by simply not investing at all usually isn't a feasible option for most people: to meet goals of retirement, funding college education, or buying a home, people need to save an invest to accumulate wealth. Given that we all need to invest in some way to meet these goals, the issue becomes one of managing and reducing risk to levels we feel comfortable assuming.

In my method of investment planning, I work to achieve two major goals for my clients. First, I manage money to achieve goals of desired and needed returns. Obviously, people invest to make their money grow over time, so this is always a primary goal. Secondly, I

manage money to reduce risk, constantly looking for ways to achieve our return goals with the least possible amount of risk. This goal was not nearly as pressing in most people's minds when investments were steadily rising during the huge economic expansion of the 1990's, but it has moved to the forefront of concerns as the investing world has become less kind to all investors. Risk management has become as important as seeking high returns in the environment we're in now, and it has exposed many flawed investment strategies that never addressed this issue when it was less obvious.

There are many ways to manage risk in investing. A simple technique is diversification, or spreading your investments over a wide variety of assets. The risk of getting caught in an Enron or Worldcom debacle is lessened greatly if only a fraction of your investment dollars are involved in those securities.

Another technique is investing in insured investments, whereby you can use the design of insurance to transfer risk in your investments to the insuring company. With the increased awareness of the risks inherent in investing, insurance companies have become active in finding ways to incorporate insurance into investing so as to minimize investor's risk.

A third technique is hedging, which incorporates the idea of offsetting or transferring risk. Major institutions have used hedging techniques for decades to manage risk, but it can also be utilized by individuals in many situations to reduce investment risk.

The bottom line is this: we live in a risky world, and realistically there is no way to completely avoid all risk in our lives. The solution is finding ways to manage risk, in your life and your investments. Swearing off driving your car in an effort to avoid risk altogether is not a feasible option. Neither is swearing off investing in stocks and bonds to avoid those risks. Always be aware of risk in your life, and look for ways to transfer unacceptable risks to others. It will help you sleep better at night, and hopefully make you a better investor.

*Kevin Kennedy is president of Kevin Kennedy, LLC, a registered investment advisor firm in Alameda. Reach him at 510-748-1898 or [Kevin@KevinKennedyLLC.com](mailto:Kevin@KevinKennedyLLC.com). Stocks, bonds, and mutual funds involve risk, including loss of principal. Past performance is no guarantee of future results.*