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EDITION 03 | 2019

Q:

What are the best strategies for managing volatility?

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▸ **All investments experience volatility.** Even seemingly stable investments like cash in your home country's currency can experience fluctuation. Viewed from the perspective of a foreign investor or an economist studying inflation, that domestic cash investment will show changes in value with surprising regularity.

Illiquid investments like real estate or hedge funds appear similarly stable; however, just because an asset is not priced daily does not mean its value is static. If you received an offer to purchase your home every day, the range of prices would be startling.

Changes in value can be slow or fast, but one thing to keep in mind is that volatility is difficult to predict, especially in the short term. So how do you manage such changes when they do arise? We typically recommend a couple of approaches, which can work together to maximize your return while you live with uncertainty.

The first approach involves supervising investments. The best managers do not ignore information, but they recognize which information is essential and which information is a distraction. They learn the history and characteristics of the people or instruments they are managing and use knowledge and experience to avoid making unnecessary or harmful changes.

As a student studying electrical engineering, I learned the concept of the signal-to-noise ratio. Noise is everywhere, and it can overwhelm signals that are sent and received if not filtered effectively. Through experience and training, investment managers can tune in to the signal and ignore the noise.

One caution is always to ask if the historical conditions and assumptions remain valid when tuning to a signal. This oversight was a critical mistake made by many in the 2007–08 financial crisis. If the signal is now on a different frequency, you may need to change the channel to understand what's really happening.

Study and experience also help to conquer the fear that is sometimes generated by volatility, as it is human nature to become alarmed by sudden and unexpected change. However, such concerns can be calmed by installing the proper tools to accommodate these events before they occur.

Valuable tools in managing volatility involve written expectations for upside and downside possibilities and maintaining diversification in your portfolio. If all your money is in a single investment, industry or asset class, it all becomes subject to the same factors causing fluctuation in that segment. By building a diversified portfolio, the whole is less volatile than the individual parts.

Finally, understanding the correlations among investments can further reduce the effects of volatility while preserving expected returns. For example, investing in a company that is a consumer of energy along with a company that is a producer can often help the risk-return metrics of a portfolio.

A mixture of stocks and bonds (regardless of the short-term outlook for each) has historically been a good strategy to maximize return with decreased risk. Options can also be employed as a tool, but they are usually expensive. They can be used to either increase or decrease the volatility of your portfolio depending on the strategies employed, so proceed cautiously if taking this path.

The second approach to management is judicious use of means to accomplish an end. Volatility is a necessary means to achieve the desired result in an investment. Put another way: If there were no volatility in your investment, you would never make any money. It would always stay the same. So put the tools and knowledge to use to minimize downside volatility and enjoy the upside volatility when it comes. ●

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ABOUT RICHARD P. SLAUGHTER ASSOCIATES, INC.

Richard P. Slaughter Associates is a leading wealth management firm specializing in delivering tailored strategies as a fiduciary and advocate for high net worth individuals, families and businesses. Slaughter Associates constructs a comprehensive financial relationship with its clients by delivering expertise in financial planning and asset management and coordinating with tax, insurance and estate professionals. The result is a holistic approach—unique in the financial industry—that generates a clear path to the individual financial goals of the client. Founded in 1991 in Austin, Texas, Slaughter Associates was among the first fee-based firms in the nation, a fiduciary status that allows it the freedom to provide advice that is always in the best interest of the client. Slaughter Associates is a NABCAP Premier Advisor, recognized for its commitment to maintaining top business standards, first-class financial management capabilities and dedication to preserving transparency in the financial services industry.

EXPERTISE

Areas of Expertise	Assets Under Management	Other Interesting Fact
Specialization in comprehensive wealth management services for families with over $1 million in net worth	$550M (as of 2/01/2019)	One of the first fee-only advisor firms in the United States

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