

THE PROTECTED INVESTOR

“There are two kinds of investors, be they large or small: those who don’t know where the market is headed, and those who don’t know that they don’t know. *Then again, there is a third type of investor—the investment professional, who indeed knows that he or she doesn’t know, but whose livelihood depends upon appearing to know.*”

William Bernstein, *The Intelligent Asset Allocator* (New York: McGraw-Hill, 2001)

The market may be the absolute best place to invest over the next few years or the absolute worst. The fact is we cannot predict what the future will bring.

Risk Management – The Traditional Approach

Stock market risk is conventionally dealt with by an attempt to minimize and control it through diversification, asset allocation and having a long-term time horizon. The problems associated with this means of risk management for stocks/mutual funds are well documented and give investors a false sense of security.

Asset allocation, diversifying investment funds between stocks, bonds, cash and other areas (such as real estate), helps to reduce risk but does not protect the investor from dramatic downturns in the market.

The Protected Investor Approach

The primary objective of an intelligent investment strategy should be to preserve capital and build upon it at a consistent, moderate rate in both bull and bear markets.

So what do we do about market risk? There are four things we can do: avoid it, attempt to control or minimize it, retain it or transfer it.

Avoiding Risk

If we are concerned about a plane crash we don’t fly.

If we’re concerned about stock market risk we don’t invest.

Controlling Risk

If we are concerned about our health we watch our diet and exercise.

We try to minimize market risk by asset allocation and diversification.

Retaining Risk

We decide to take the risk that our \$50 lawn ornament will be stolen.

We decide to invest all of our 401-k in our employer’s stock.

Transferring Risk

We buy a homeowners policy to transfer our risk of loss by fire to an Insurance company.

We buy a market-linked investment to transfer the risk of loss in the market to the issuer.

The majority of people who have money to invest put a substantial portion into the stock market. The minority chooses to deal with stock market risk by complete avoidance. But there is an opportunity cost in missing out on the sometimes-exceptional gains that investing in the market can provide. **The answer to this dilemma is to transfer the risk of being in the market to a third party.**

When you transfer the risk of loss of your house to a third party you pay a premium, even though you hope you never have to submit a claim. When you transfer the risk of market ups and downs to a third party you continue to hope that the market goes up in the long run even though you may not receive 100% of the increase. The fact that you may not get a return as high as the overall market is the “premium” you pay for the guarantee that your principal and account balance can never go down due to market downturns.

Tools of Risk Management

There are a variety of tools that can be utilized to intelligently design an investment strategy that creates protection from the usual risk inherent in investing in the market, while allowing for potential growth that is tied to market performance.

Each person who has saved and accumulated wealth and invested has had to choose between these two options:

1. Give up a degree of safety in return for greater opportunity for growth, or;
2. Sacrifice growth opportunity in return for a higher degree of safety.

Now you can have the best of both worlds; guarantee of principal and the potential of market-linked growth with no risk due to market downturns. **Equity Index Linked accounts provide the power of money in the market with the comfort of money in the bank.**

Protected Growth Planning