

Explaining Risk to Clients: The View From Two Advisors

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The Evolution of Risk Management

WHERE RISK LURKS

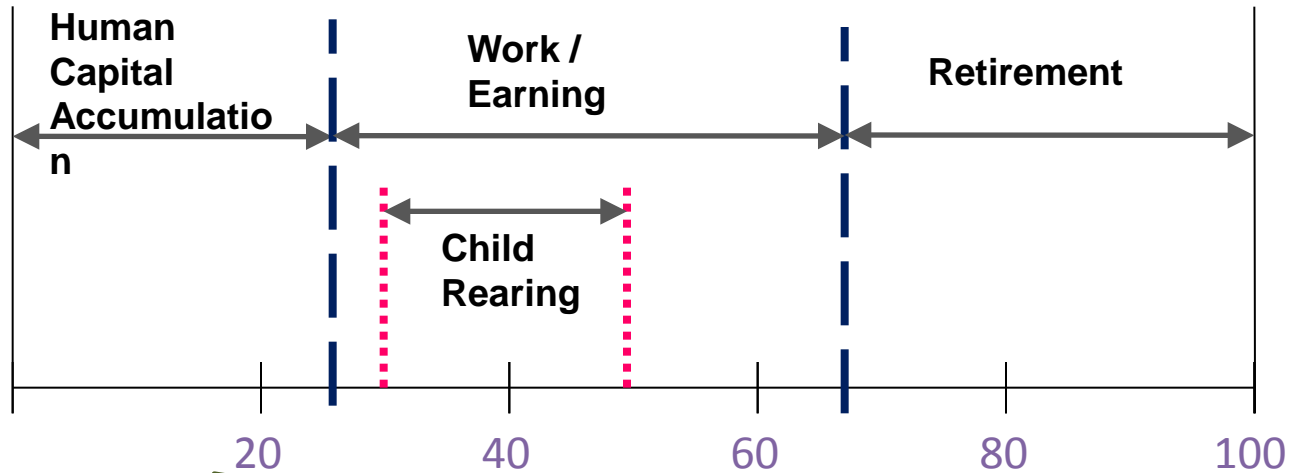
- Traditional View: in the portfolio
- Life Cycle Economics: in the human capital
- Behavioral Finance: in perception, communication, & anticipation
- View from the Trenches: above, plus: data input, implementation, and personal change, and when the client is a couple

TOOLS FOR MANAGING RISK

- Precautionary Saving
Diversified Investing
- Hedging & Insuring
- Better Language & Envisioning
- Facilitation of Personal Change, Alignment of financial habits with values

We are Shifting From Product through Policy To Process

Risks over the life cycle



Human capital

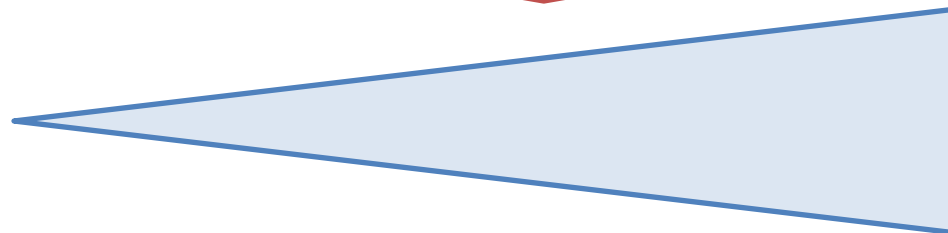
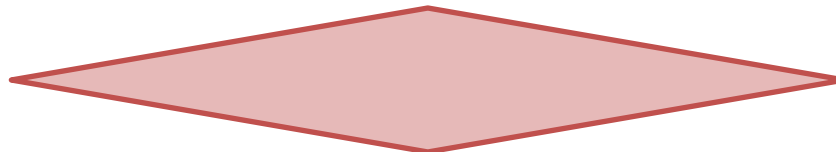
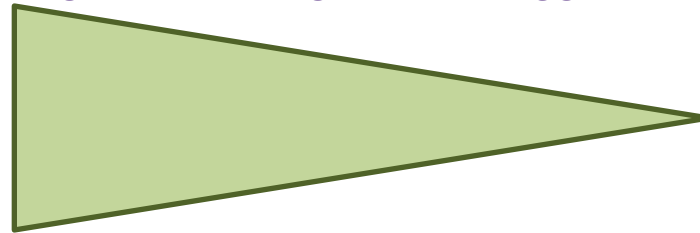
- Career choice
- Earnings
- Unemployment

Financial capital

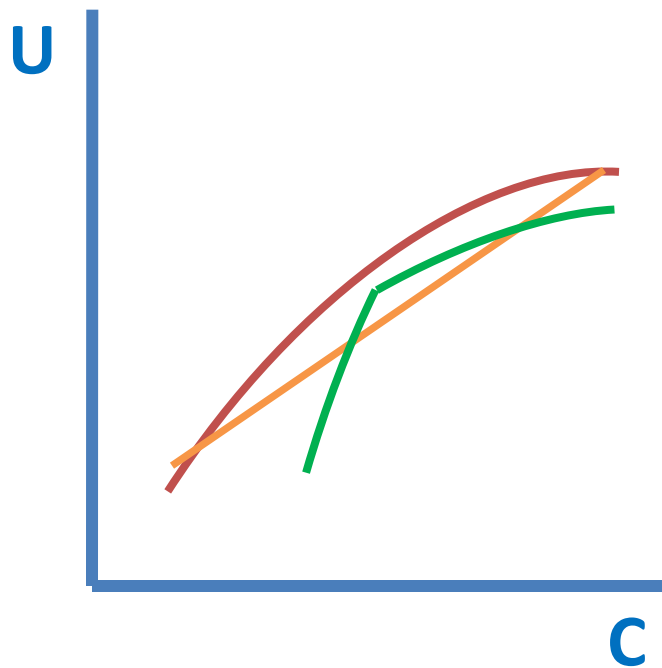
- Inflation
- Equity and credit

Health

- Disability
- Long Term Care
- Longevity/ Death



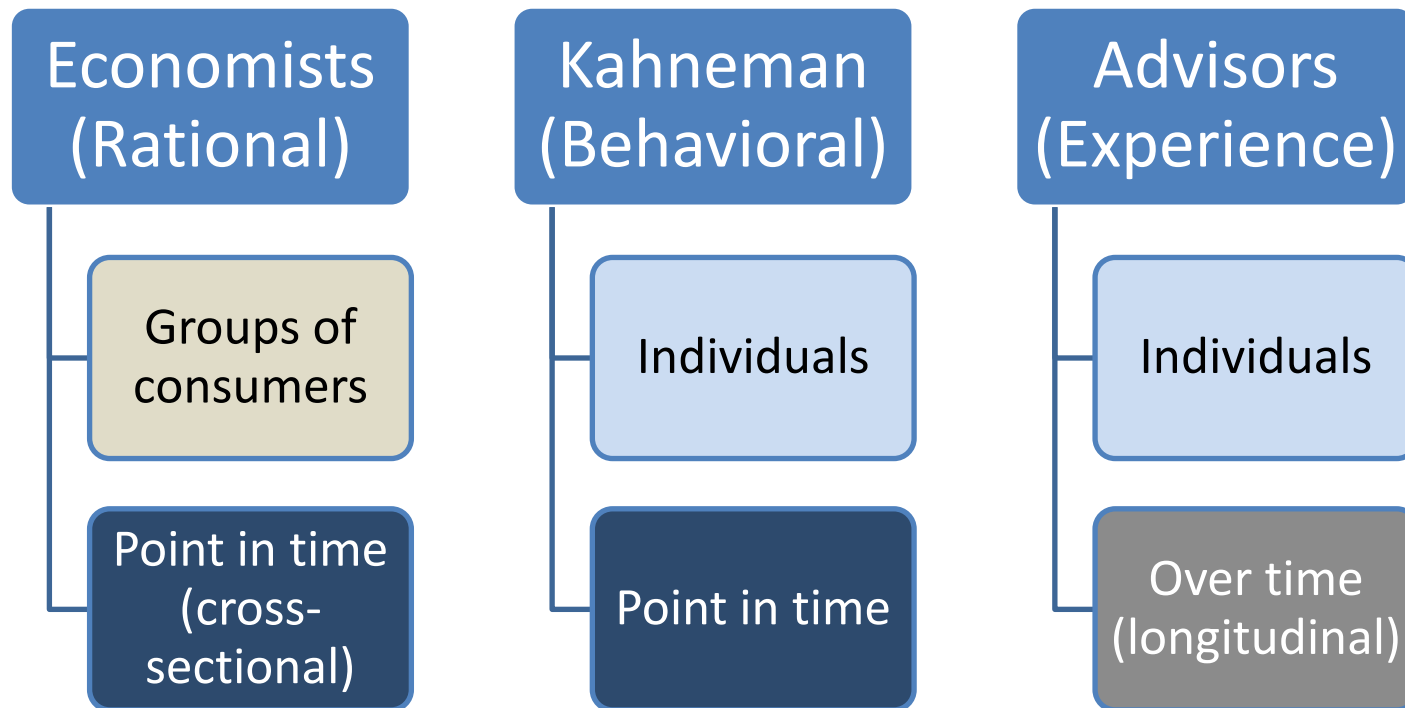
Utility function is central



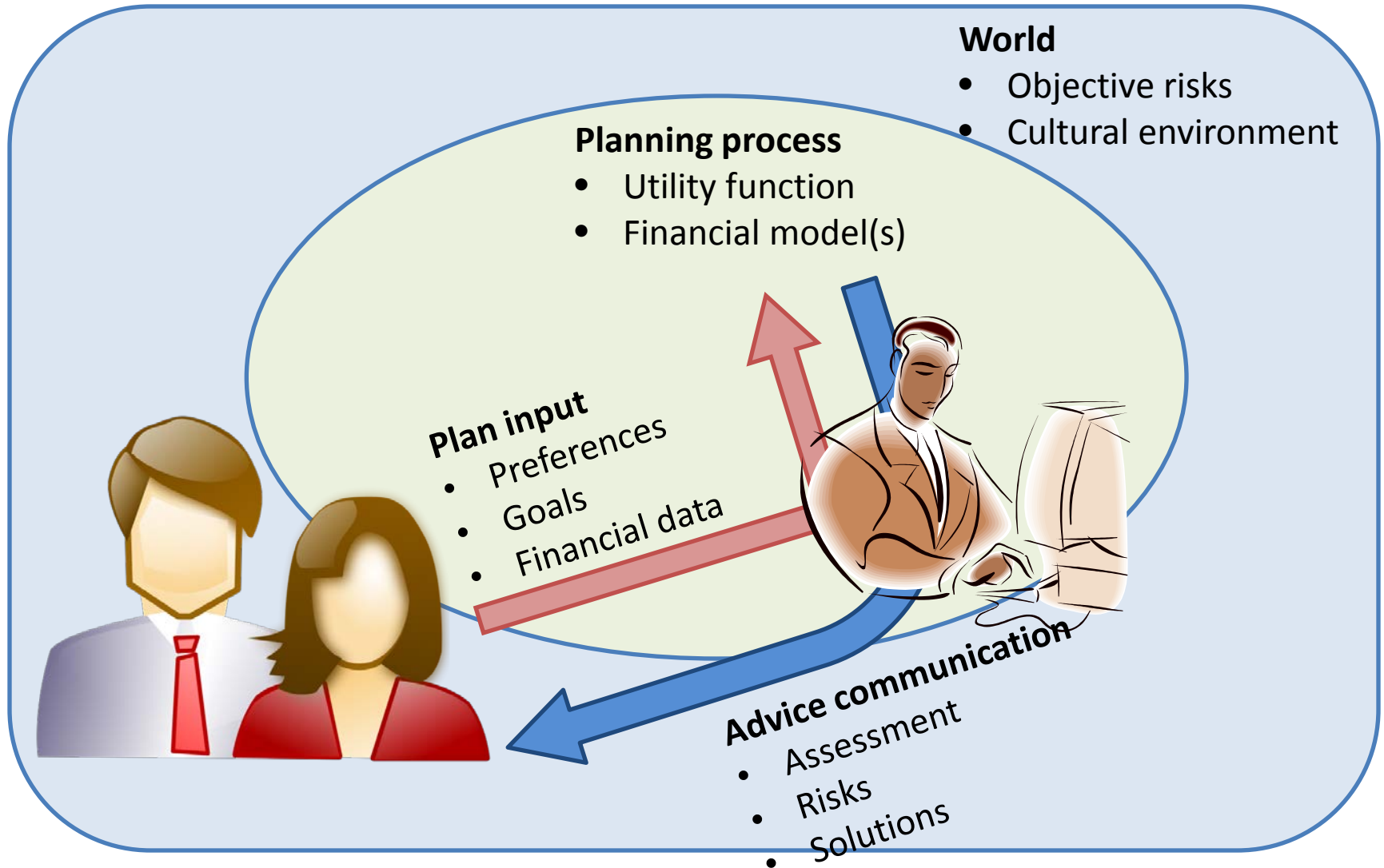
Traditional
Rational
Behavioral

- Specifies (minimally):
 - Time preference
 - Risk aversion
 - Reference levels
 - Consumption / leisure substitution
 - Experienced vs remembered
- Each parameter has **major** practical planning implications

Evaluating utility specifications – perspective matters!



Planning process embodies own risks



Research agenda

Resource allocation

- Human capital risks
- Managing investment risk (standard of care)
- Resource use in retirement

Client humanity

- Life-cycle behavior
- Recognizing and managing biases
- Advisor humanity
- Planning for couples