

Risk, Quality and Confidence

In February of 2007 we introduced our updated website and our “Live Your Dream” theme. At Madison Wealth Management our clients rely on our advice to help them secure their financial futures so that they can live their dreams. To this end, we must work to understand our clients’ financial objectives and uncover the risks that could take them off track. We are told that our focus on the latter makes Madison unique and especially valuable as an advisor to our clients.

Time and time again we are reminded of the value of planning ahead. Natural disasters like the tsunami that hit Thailand, the hurricane that devastated New Orleans or the recent earthquake in China remind us of the consequences of not planning or limited planning. While these events were surprises, it is not surprising that they occurred. The risks were evident to those who chose to look at them. Other risks might not be so obvious – for example, the cute and cuddly panda pictured to the right almost killed the Australian photographer who snapped this photo.



Cute and cuddly? Yes, but very dangerous!

As unpredictable as life can be, many of its aspects are quite predictable as we go through life’s various stages. While individuals might see certain events occurring once or just a few times in their lifetimes, as advisors we see many of these events play out over and over again in our growing base of clients. Examples of infrequent events include retirement, the sale of a family business, the loss of a spouse, the loss of a job, or education spending for kids heading off to college. At some point all of our clients will face many of these common events and, as advisors, we are in a position to help them prepare for them and address potential financial risks.

To this end, Madison has developed a method for helping our clients identify the vulnerabilities in their current financial situation. We call it our “**Risk, Quality and Confidence**” review. Our process examines the risks that may be present in an existing portfolio, the quality of an existing advisory relationship and the degree of confidence in one’s financial position and plan. Our process is designed to identify risks and determine those that are most acute. In so doing we build a “heat map” so that it’s easy to see what needs immediate attention.

Portfolio Risk: In many cases, prospective clients we speak with are aware of the risks being taken and have well constructed portfolios that are appropriate for their current and future needs. However, more often, just the opposite is the case. It’s not that we would recommend reconstructing their portfolio, as there are many appropriate ways to build a portfolio, but perhaps the level of risk present is underappreciated or even unnecessary. Why drive 90 miles per hour, when you are more likely to arrive safely and timely at your destination by driving much more slowly? If you don’t have to risk life and limb, why do it?

“He who is not aware of his ignorance will only be misled by his knowledge,”

Richard Whatley

“There are risks and costs to a program of action. But they are far less than the long-range risks and costs of comfortable inaction.”
John F. Kennedy

In designing a portfolio, our view is that one should only take the risks that are needed. If the reward for taking additional risk isn't obvious or required, then why take it? This doesn't mean that all investors should be "conservative." In investing, risks are required in order to earn a return. Sometimes a conservative approach results in what is likely to be a poor outcome, and is therefore quite risky. An example of this would be someone who holds 100% of their portfolio in cash, only to see its purchasing power steadily diminish over time from the effects of inflation. This approach can be quite risky for someone who needs their money to maintain its purchasing power over the rest of their lifetime. So sometimes, risk exists where seemingly no risk was taken! Of course, risks come in many forms and our review is designed to uncover the most relevant ones.

Relationship Quality: Determining the risk status of a portfolio is certainly integral to our review, but it is not necessarily the most important part. Someone might have a suitable portfolio, but if their advisor isn't responsive to their needs or doesn't co-ordinate with their other professional advisors, the quality of the relationship could be low. Like any relationship, one that is not functioning at a desired level presents risks. If communication is poor or the reports received aren't clear, things may be overlooked. Just as in planning for natural disasters, issues overlooked tend to become major problems down the road. It's always best to identify the type of relationship, the level of communication and the desired reporting detail upfront or early on in a relationship with a professional advisor. Our review helps clients and prospective clients do this.

Financial Confidence: The third aspect of the review develops an understanding of the degree of confidence each client has in their own financial situation. For example, if you have a financial plan, how confident are you with that plan? Are you on track to meet your retirement goals? If so, how confident are you in your assessment? When it comes to trust and estate documents are you confident that you have the proper documents in place and your documents are current? Questions regarding insurance, tax issues and other areas are also included. Within this aspect of the review it is important to identify areas where confidence is low and address those areas first. By addressing the areas of low confidence the overall level of confidence in one's financial situation will quickly rise.

Confidence Level (Legend):		Good	Some	None	Key Issues
Financial Planning					
14	Do you have a financial plan?	Yes	Good		
15	Are you on track to meet your financial goals?	No		Some	Reduce risk!
16	Aware of how much or little risk needed to succeed?	No		None	
17	Does your portfolio support your financial plan?	Yes	Good		
Trust and Estate Documents					
22	Working with a trust and estate attorney?	Yes	Good		
23	Are the proper documents current and in place?	Yes		Some	Verify
24	Beneficiary designations current and appropriate?	Yes		None	
Insurance Needs					
30	Working with an insurance professional?	Yes		Some	
31	Are proper coverages in place?	No		None	
Tax Issues					
41	Working with a tax professional?	Yes	Good		

Sample view from the Financial Confidence review

The output of the **Risk, Quality and Confidence** review is a three page summary that visually displays the areas that need attention (sample view at left). Our goal with this process is to help our clients avoid the foreseeable risks so they stay on track to meet their financial goals. So, next time you are living your dream on that trip to China, you'll know to take photos of panda bears from a safe distance!

Important Note: Please do not assume that any information contained in this Insight serves as the receipt of, or as a substitute for, personalized investment advice from Madison Wealth Management. Please remember that while we are informed about many tax, legal and insurance issues, we are NOT in the business of providing tax advice, legal advice or selling insurance. We strongly encourage you to consult with a trusted tax advisor, attorney and insurance professional. Madison can help coordinate the efforts of your other advisors and help ensure that their work is consistent with your financial planning needs.