APRIL 17, 2023

PHILEQUITY CORNER

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Risk and safety

Is balancing the risk in your investment portfolio like a dim sum meal? Some diners can take chicken feet and even drool. (Oh, those ligaments that stick between your teeth!) Others stick to the familiar pork buns and turnip cakes, or mix the whole menu—a little of each please. And don't forget the fried rice.

Is this dim sum theory of investment applicable to the real world?

Investment options vary according to the risk one is willing to assume. Investment advisers want to know the client's investment philosophy to evaluate her risk appetite. If the goal is just to conserve capital and perhaps get a modest return for income enhancement, the portfolio recommendation will favor corporate bonds or even time deposit and money market funds.

If the risk appetite is hearty (adventurous culinary types that sip bone marrow through a straw), the mix may go for aggressive approaches like cyber currency which Charles Munger of Berkshire Hathaway calls "rat poison squared".

Here are some things to consider with risks.

There is a mistaken belief that cash is the safest form of investment. This conviction disregards inflation and the effect of currency depreciation. Cash is seldom kept under the pillow, as this will make it too lumpy to allow sleep. (We're not even counting the coins.) Still, interest from even a special deposit account may not cover the twin effects of inflation and foreign exchange risk. So, "parked cash" is not entirely risk-free.

Opportunity cost needs to be considered. Keeping investments in one form necessarily means giving up potential yields of the alternatives, especially if the present cash hoard is the result of liquidating a position in equities by taking profits or limiting losses. Waiting in the sidelines too long may mean missing the parade.

Even the most conservative investor does not keep all her assets in cash. Part is invested in real property, as in the house or condo she lives in.

Investment decisions can be delegated to the professionals. It is helpful to track personal portfolio picking (try a small portfolio), especially the crucial matter of timing when to buy or sell, against professionally run funds with research teams tracking corporate performance. Can the individual investor outperform the professional? Even with insider knowledge, the odds go against the unaccompanied soloist.

The equities market with its volatility, as in the recent uncertainties about bank runs and "tip of the iceberg" fears of the unknown, have invited comparisons to gambling in casinos. The gambling paradigm is too simplistic even if the results in terms of gains and losses can seem to be identical. Bets in a casino are decided by the luck of the draw as there are no underlying fundamentals to give a perspective on the risks being taken.

Even after a balanced mix of risks, there is the option of using borrowed funds for investing. The use of margins or loans to buy stocks can exacerbate steep declines in value. It is possible to lose more than the investible funds. Margin calls and redemptions of panicky mutual fund investors can accelerate the selling pressure on the market and trigger corrections.

Dips in the composite index price are often considered temporary and perceived as a window of buying opportunities. Warren Buffett famously said, "You can't outperform unless you have both cash and courage". And the acknowledged wizard of investment strategy has practiced what he has preached.

Still, the issue of risk and safety, and the appetite for either or both has to apply only to "investible funds". These should not include money intended for such things as electric bills, tuition for the kids, and home amortizations.

What about savings towards a Mediterranean cruise or the purchase of a new hybrid car—can these be considered investible funds? This compartmentalization of cash is called "mental accounting" by the behavioral economist Richard Thaler. This subconscious allocation of cash balances compartmentalizes the intended use for the cash on hand. The money for revenge travel is not mixed with the cash set aside for contingencies like hospitalization and loss of a job.

The risk appetite needs to apply only to future investments, not the ones that resulted in buyer's remorse, or even selling too soon. It is good to remember that it's not what you lost but what you now still have that really counts.

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