WILMINGTON TRUST

3 Portfolio Risks That Could Be Hazardous to Your Wealth

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In managing an investment portfolio aimed at both preserving and growing wealth, it's critical to periodically revisit the various forces that could present a threat to those goals. But before portfolio risks can be managed, they need to be identified. With that in mind, let's look at:

1 The risk of losing your money.

First, let's define terms. *Volatility*—up and down market movements—is a measure of the variability of an investment's returns. The industry standard for measuring volatility ("standard deviation") aims to assess the *risk* of a security, asset class, or portfolio, i.e., how much returns "bounce around" over a market cycle.

We prefer a complementary risk measure that focuses on *drawdown exposure,* which reveals the most you could likely lose in portfolio asset values, measured from where you are at any one point in time to the eventual bottom, or trough, of that cycle. This is a more tangible way of illustrating what could happen in a very bad market environment, because it is more consistent with what a person could actually experience. *In our experience, investors are typically less concerned with how much their portfolio returns are likely to fluctuate in a given year and far more concerned about the maximum capital loss they could withstand at any given time.*

2 The risk of outlasting your money.

Longevity risk exists when investors live longer than expected, or they start to withdraw money from principal at a rate that increases over time, and the rate of return their portfolio earns does not keep up with the increased rate. According to the Centers for Disease Control, in 2016, the overall life expectancy was 78.7 years.

Of course, when you talk about life expectancy in regard to portfolios, you're really talking about the need to structure your assets in such a way that creates sufficient cash income to fund expenses. Investors should think about living expenses as well as goals that require significant funding, such as college, retirement, or major purchases. And the planning often needs to extend beyond

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one's lifetime to include setting a target amount for passing on wealth to family or charitable endeavors. By incorporating such goals into the analysis, you can determine the probability of meeting those goals and select the appropriate investment strategy.

3 The risk of diluting your money.

Inflation poses yet another potential concern—the loss of future purchasing power—which might require needing to increase the value of invested assets just to maintain current purchasing power. For example, assuming a 2.5 % annual inflation rate, an investor with $10 million in investments today would need to have just over $21 million in 30 years in order to maintain their current purchasing power. This applies to cash outflows as well. For instance, those with a current level of expenses of $300,000 would see the level of those expenses increase to just over $629,000 in 30 years, assuming a 2.5% inflation rate. And many expenses—such as health care—typically grow at rates even higher than that of inflation.

Next steps

Our sophisticated planning software—Wilmington Trust's Paragon® *(Portfolio Analysis, Risk Assessment & Goals Optimization)*—puts current and hypothetical portfolios to the test in order to see how they would stand up to various market shocks and other "what-ifs."

Paragon can help evaluate expected return, volatility, and drawdown over a specified time horizon, while you select or optimize the best strategy for meeting your investment objectives, measured by projected wealth and probability of meeting goals. Paragon can also address other portfolio risks, such as the projected impact of inflation assumptions on purchasing power and the sustainability of spending, after folding in anticipated expenses, life expectancy, and other factors.

To learn more about Paragon's capabilities, reach out to a Relationship Manager. See how it can uncover the risks in your portfolio in an effort to help you fulfill your objectives in the timeframe you envision, while taking the degree of risk with which you feel most comfortable.

