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“How do I keep risk at an acceptable level and also create a dynamic portfolio?”

By Matthew J. Miller

The process of creating a dynamic portfolio begins with determining the level of risk you find acceptable, and then working to maximize return based on your tolerance for risk. The weakness in this approach is that it makes maximum return the focal point. A better strategy is to focus first on the rate of return it will take to reach your investment goals—then determine how to achieve it with minimal risk.

That said, you will still need to determine what minimal risk you find acceptable, and that process begins with understanding the various elements that make up risk.

UNDERSTAND THE ELEMENTS OF RISK

One aspect of risk is purely psychological and basically comes down to how you respond emotionally to taking a risk: What is your perception of risk?

The term “perceived risk” says it all. If you perceive something as a risk, for you it is. In short, how you are wired determines your capacity for risk, but your portfolio itself has a capacity for risk as well. That capacity is measured not by emotions, but by the numbers. Your portfolio’s capacity for risk is basically how much you

can lose before you jeopardize its ability to meet your goals.

No portfolio is risk free—even the most conservative. And there is an amount of risk that is simply necessary to produce the return you need to achieve your financial objectives. The goal is to keep that risk level inside your comfort zone.

So, how do you stay inside that comfort zone during the ups and downs of the investment process? The key is to control the volatility of your portfolio, and, in turn, your emotions. Understandably, clients experience volatility through the fluctuations in their monthly account statements. And market volatility, like that experienced during the most recent recession, can cause many clients to make short-term decisions that may negatively affect their long-term goals.

CREATE A PORTFOLIO THAT KEEPS YOU ON PLAN


The key to creating a portfolio that effectively keeps volatility low is to structure it so you avoid the temptation to veer from your plan.

Begin by making sure the various elements in your portfolio address the extremes of the economy, which include inflation (gold, precious metals,

TIPS); deflation (bonds); prosperity (stocks); and recession (cash). By strategically allocating your investment dollars to address these extremes you should reduce the overall correlation of your portfolio and control the volatility.

As American economist Harry Markowitz, winner of the Prize in Economic Sciences in Memory of Alfred Nobel, put it, “To reduce risk, it is necessary to avoid a portfolio whose securities are all highly correlated with each other.”

Another way to minimize volatility is to maximize the tax efficiency of your portfolio by using new cash inflow to achieve an annual rebalance. Also, to continue to work towards long-term success, use no-load and institutional share class funds to keep your costs as low as possible. And finally, what should be the primary focus of your portfolio construction is to protect the downside in order to achieve the minimal acceptable rate of return.

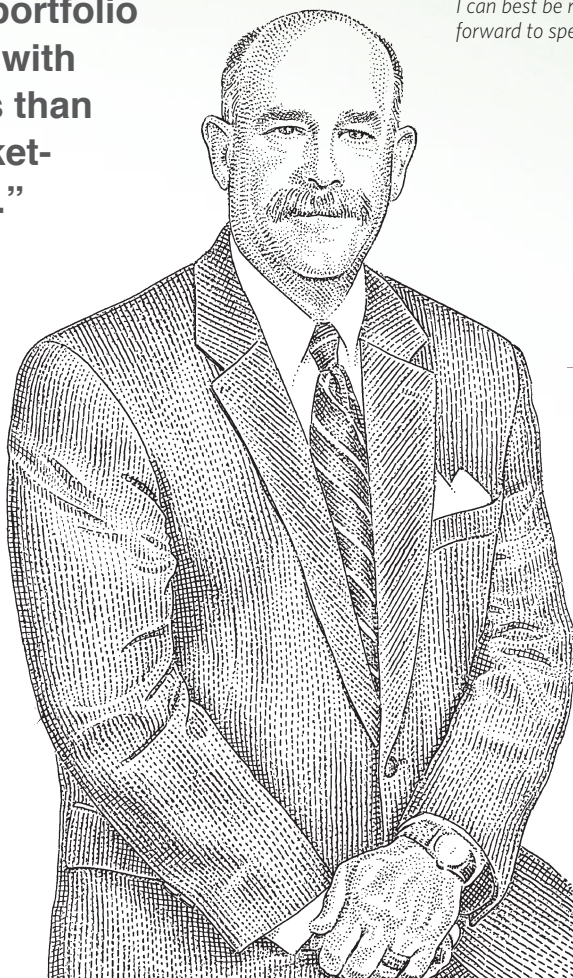
In short, achieving strong, long-run returns from a dynamic portfolio has more to do with controlling risk and avoiding losses than producing market-beating returns during the bull runs. 

“Achieving long-run returns from a portfolio has more to do with avoiding losses than producing market-beating returns.”

– Matthew J. Miller

How to reach Matthew J. Miller

I can best be reached at 630.705.2047, and I look forward to speaking with you.



IF I WEREN'T A WEALTH ADVISOR, I'D BE...

A landscape architect. I enjoy being outside and working with my hands to create things I can enjoy while sitting on the patio after a long day at the office.

MY HOBBIES ARE...

Golfing and gardening. Both require patience and planning, skills that transfer well to wealth management.

WHAT'S ON MY DESK...

Numerous inspiring books, including Cowboy Ethics—What Wall Street Can Learn from the Code of the West, by James P. Owen.

About Matthew J. Miller

Matthew J. Miller is a managing director in Mesirow Financial's Investment Advisory group. He is a seasoned industry professional with more than 35 years of experience. Mr. Miller specializes in developing sound financial strategies for affluent families, individuals and business owners. He holds a bachelor's degree from John Carroll University in Ohio. Mr. Miller is a Certified Investment Management Analyst professional and an Accredited Investment Fiduciary designee. He and his family live in Oak Brook, Ill., where he is a member of the Oak Brook Chamber of Commerce Development Council and a member and a past president of the Oak Park Country Club.

Assets Under Management
\$300 million (The Miller Team)
\$25.3 billion (Mesirow Financial)

Minimum Fee for Initial Meeting
None required

Minimum Net Worth Requirement
\$1 million

Largest Client Net Worth
Confidential

Financial Services Experience
37 years

Compensation Method
Asset-based fees

Primary Custodian for Investor Assets
Mesirow Financial, Inc. (plus multiple secondary)

Professional Services Provided
Financial planning, investment advisory and money management services

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