Our newspapers daily report a decline in the number of initiatives taken in the business, financial, and political arenas. According to these reports there are:

- fewer initial public stock offerings
- fewer people running for public office
- fewer households participating in the stock market
- fewer family businesses succeeding to the second generation
- fewer homeowners "trading up" their smaller residences to larger ones
- fewer children taking over the family farm

Whatever the situation, such initiatives entail rational decision-making based on an evaluation of the risks and rewards involved. What are the reasons for the declining number of "go-ahead" decisions?

One view is that the maturing age of the baby boom leads naturally to more conservative behavior. Another is that the lessening of risk-taking behavior is simply due to the recent recession's impact on the psychology of decision-makers. A third view is presented here: that there is an increasing perception that the risks inherent in business and financial decisions overwhelm the rewards.

Faced with unreasonable levels of risk, investors and potential businesspeople may simply choose to dismiss the opportunities without further analysis. A sort of decision paralysis results which may keep worthwhile opportunities forever out of the decision-maker's reach.

A clear understanding of the measures available to lessen investment risk might encourage more people to explore the available opportunities. The following discussion presents a few of the tried-and-true remedies for investment risk.

**Risk Basics:**

A risky situation is one which exposed a person to a chance of injury or loss. Risk is present when there is: (1) lack of control, (2) lack of information, or (3) lack of time (MacCrimon, 14). Methods used to manage and, hopefully, lessen risk aim at improving the picture with respect to these three elements.
What are the Risks?

The first step in managing risk is to be aware of the risks which exist. We each hold items of value, nonmonetary and monetary, which might be lost or injured by negative outcomes.

Nonmonetary assets are involved in most business and financial decisions. They include a person's health, job security, chance for promotion, reputation, credit rating, personal and business relationships, and personal freedom. Risk is involved in any situation which poses a threat of loss or harm to any of these valued items.

Most obviously, risk is involved in decisions where a loss of value to monetary assets may result. Assets such as bonds, stock, real estate, or cash will be affected by an individual's investment decisions.

Investment risks may be classified into four categories: opportunity, emotional, systematic, and unsystematic. Opportunity risk is present when a decision-maker has a number of investment choices. The rates of return, as well as other performance measures, are usually investigated to guard against making the wrong investment choice.

Emotional risk is the "sleep-at-night" factor. A person's comfort level with a particular investment will be affected by such factors as their current financial position, emotional state, and stage of life.

Systematic risks are reflected in the daily ups and downs of the financial markets. They can't be lessened by switching investments within a particular market (say, switching one stock for another), but may be reduced by spreading investments between markets, for example, by selling stocks and buying bonds.

Unsystematic risks exist for individual investments: a particular company may not have the cash flow to pay off its debt, or keep its operations going. These risks are effectively handled by diversifying investments over at least 5-10 individual companies.

Remedies for Risk:

Risk pervades every moment of our lives. Some tried-and-true, and very effective, methods for managing financial risk are offered here. Each one will in some way compensate for the lack of time, lack of information, and lack of control present in many investment decisions.

PLAN AHEAD

*Chance favors the mind that is prepared.*
- Louis Pasteur
The purpose of financial planning is to reduce the chances of loss to monetary assets and by so doing, put the funds to more effective use in achieving personal and business objectives.

Planning ahead affords greater time to gain influence over factors affecting financial decisions. The financial planning process involves these five steps:

SETTING GOALS
ASSESSING CURRENT POSITION
DEVELOPING PROGRAMS
IMPLEMENTING PROGRAMS
EVALUATING PROGRAMS

Goal-setting is the first step. If, for example parents desire to save enough for their child's higher education in ten years' time, then a specific monetary goal will be set based upon assumptions about tax rates, rates of return on investments, what school the child might attend, and the trend of school fees projected over the period.

Comparing the parents' current financial position with their savings goal will indicate clearly what amount is needed to make up the difference. A program may then be developed and implemented to build the savings and have the money available at the time the child enters school.

Modifications will be made to the parents' investment program as time passes and conditions change. It's important to recognize that no plan is perfect, nor is it written in stone. Its sole purpose is to reduce the uncertainty faced by the parents by making, acting upon, and monitoring the best possible guesses.

Having financial plans firmly in place protects an investor against traps such as panicking during short-term dips in the financial markets and over-responding to the "golden egg" investments touted in the daily, weekly, and monthly media.

Investment returns become more predictable over longer time periods, so the longer the time an investment is held, the more assurance there is that the investment will perform as planned. Relationships between different types of investments hold up well over the long-term, i.e., stocks outperform bonds, small stocks outperform larger ones, and venture capital outperforms them all - but these comparisons are much more reliable over 30-50 years than they are over three to five. So investors will experience less risk if they plan ahead and employ a buy-and-hold strategy, coupled with a close monitoring program.

EMPHASIZE EVALUATION

A forecast is never a statement of fact.
We know only what is behind us, never what is in front of us.
Sir Alex Cairncross

An important aspect of all good financial plans is a periodic progress evaluation. Only hindsight is 20/20, so in order to keep our feet solidly on the ground we need to regularly review the results of our plans and programs. Unfortunately, this final planning step is often missed in the hustle of attending to whatever problem next faces us.

Evaluations are most effective when based upon previously set performance criteria, established during the planning process. In a retirement planning situation, for example, monitoring should be done at least annually to see that savings are growing toward the retirement goal at the planned-for rate. Where plans are guesses, these evaluations provide facts. Future plans and adjustments should be based upon this solid information.

Here are some other steps which may be taken to assure that high-quality information is obtained for backing future decisions.

• Ask for comprehensive and readable reports from investment companies and advisors. If current market values of investments aren't given on the reports, ask for them.
  • Invest locally: it's easier to keep track of a business or real estate investment when it's located down the street.
  • Hire an advisor to watch over things and report to your on regular basis.
  • Choose investments which have an established track record (five years or longer).

• For each type of investment you hold, find an independent rating service or market index to compare its performance against. For example, the Weiss rating for life insurance companies or the Wilshire 5000 index for small-stock funds.

• Follow the advice of Barton Biggs, Morgan Stanley's director of global research and strategy. Ask the following questions about each type of investment you are considering:
  (1) What is the historical performance of the investment: (2) How do current conditions compare with past epochs? (3) What are the odds that future performance will deviate from the norm (Zipser)?

An investor who has established an ongoing monitoring process will have a greater sense of financial control, and will be able to make well-informed and timely changes in the original plan.

DEVELOP A SYSTEMATIC APPROACH

Thrift is the great fortune-maker. It draws the line between the savage and the civilized.
-Andrew Carnegie

There is a certain Buddhistic calm that comes from having . . . money in the bank.
-Tom Robbins
One of the best ways to gain financial control is, paradoxically, to put many decisions on "automatic." Creating positive habits for spending and saving allows more time for attending to unusual events.

An increasing number of people are participating in company retirement plans, taking advantage of these systematic and relatively painless savings programs, which also have significant tax benefits.

Any similar strategy which involves the setting aside of equal amounts of money at regular intervals will lower investment risk. This technique is known as dollar-cost averaging, and is illustrated in Figure 1.

An investor who regularly invests $1000 per month will purchase more shares when the market is low, and fewer shares when the market is high, thereby achieving an average purchase price which is lower than the market average.

In the illustration, 50 shares are purchased at $20, when the market is low, and only 33 shares are purchased at the high market price of $30. Over the two-month period, the investor spends an average of only $24.10 per share, while the average market price was $25. This example shows how a systematic approach to investing can benefit the saver.

Investors will also benefit from following a well-planned policy for spreading their savings between various types of investments, a strategy known as asset allocation. A recent study of 91 pension plans showed that 93 percent of their performance could be explained by the asset strategy which they selected (Dodson).

In asset allocation, a specific proportion of the total amount invested is assigned to stocks, bonds, cash, real estate, or other major asset categories. For example, a younger investor will generally allocate a higher proportion to stocks (see Figure 2), and an older one will emphasize bonds. This setup assures a certain amount of diversification across the various financial markets.

<table>
<thead>
<tr>
<th>Cash</th>
<th>15%</th>
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<tr>
<td>Stock</td>
<td>60%</td>
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<tr>
<td>Bonds</td>
<td>25%</td>
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Figure 2
Sample Asset Allocation for a Young, Moderately Aggressive Investor
The specific mix of investments in any portfolio must be individually determined and would depend upon the investor's age, financial goals, current financial position, life-style, and attitude toward risk, as well as upon the economic climate and other factors. Once set, the proportions should be changed only when a significant event alters the economic picture or the investor's own circumstances.

Dollar-cost averaging and asset allocation are two investment strategies which provide for automatic decision-making, lowering the costs and risks involved with investment choices.

Conclusion:

We face risky investment decisions when we have choices to make and we lack the time, information, or control needed to ensure the protection of our assets. By planning ahead, thoroughly evaluating our progress, and systematizing our financial decisions, we actively reduce the risks we face, making more investment options available and attractive.