Why Six Months for a Portfolio's Probability Range?

As you know, Riskalyze empowers advisors to quantitatively determine a client's risk tolerance, and build a portfolio to fit.

At the end of the risk questionnaire, we turn the client's multi-dimensional Risk Fingerprint into a comfort zone... a certain amount of downside risk the client is comfortable taking over a six month timeframe, in exchange for the opportunity to achieve a certain amount of return.

Every time an advisor builds a portfolio, Riskalyze calculates a range (e.g. –7% to +12%) that constitutes a 95% probability for that portfolio's outcome, six months from then. A portfolio with a range that matches the client's comfort zone therefore has a 95% probability of staying within the client's risk tolerance.

Develop Long Term Thinking

Some advisors have questioned our decision to use a six month timeframe for this process. They worry that any discussion about a six month period will lead investors to invest on a short term basis.

We believe the opposite is true, and here is some data you can share with your clients to demonstrate why your approach as a Risk Aware Advisor is the correct one.

Research Tested

We've found that six months is a very effective period of time for assessing the risk of a portfolio, and comparing it to a client's risk tolerance. It's a period of time that clients have easily related to in our research. And it also happens to be a time period that allows us to build a much tighter probability range using standard deviation.

To keep clients focused on the long term, we recommend against discussing a portfolio's expected return, whether for six months or a year. We only need to look at the broader stock market to understand why.

Over the 25 years from 1988 to 2012, the stock market rose an average of 9.7% annually. But in all twenty five of those years, guess how many of them came within 100 basis points of that 9.7% average? Only one – 2004 with a 9% gain.

So while the markets average out to a nice number, they very rarely hit that average in any given year. The same will be true for a portfolio, so setting client expectations with expected average returns really sets an advisor up to fail.

That's why Risk Aware Advisors are shifting the focus of their client discussions to investing within a probability range, rather than investing for a particular targeted return. It increases the likelihood of success and keeps clients focused on what is really important – staying invested for the long term.

Still need help? Contact Us (/contact) *Last updated on April 11, 2016*

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