Protecting Your Investments– August 31, 2021

There is much you can do to minimize your investment risk and maximise your returns.

Leading international financial institutions offer conflicting opinions on the direction of the world's major economies and interest rates. How can you better protect your own investments? How can you best position yourself in the current capital markets?

Remember that a large investment manager does not guarantee good investment performance. It is a good idea to do some of your own homework and monitor your investment performance.

If during regular meetings with your investment adviser you feel that your investment objectives are no longer being met and no attempt has been made to re-align your investments with your objectives, you should seek another adviser.

If you believe that either negligence or fraud has occurred, you should go to the Securities and Futures Commission immediately.

Statements

Clear, legible and comprehensive statements are an important means to effectively monitor your investments. You should keep a good record of your statements. With the aid of clear statements, you will be in a better position to follow your adviser's explanations as to how your portfolio is reacting to prevailing market conditions and how your investments are expected to perform in the coming 12 to 18 months.

Statements of investment accounts will vary from one type of adviser to another. Mutual fund statements will include all the assets of the fund. While your investment adviser should be able to answer any questions you may have about the performance of the fund, it is unlikely that he or she will be in frequent contact with the manager of the fund.

Mutual fund statements will be different from those of a bank, a brokerage house, or a discretionary manager. It is also likely that statements from advisers within the same category will vary. For example, some international stock brokers and private banks may have accounts for holdings in different foreign currencies, whereas others may just convert everything back to one base currency. Furthermore, market prices of some of the securities may be approximate or not current.

You should ask to see a sample statement when you are doing your initial due diligence. This should include a portfolio statement as well as a transactions statement. You should check to see whether these statements are audited by a reputable third party.

Good Positioning

International financial markets are constantly changing. Many investors try to time the markets in order to optimize gains. It is highly unlikely that anyone can successfully time the market over an extended period. How does one position an investment portfolio to get the best returns according to one's investment objectives?

If you were a collector of French wines, you would stock your cellar with wines from Bordeaux, Burgundy and perhaps the Rhone Valley. You would allocate a certain percentage of cases to each region, much like asset classes. You would have a diversified collection, with a number of different chateaux and vintages from each region.

The major investment asset classes are cash, bonds (fixed-income) and equities. Real estate, another important asset class, will be addressed in a separate article. After you have determined your asset allocation, you should then choose any number of different securities in each asset class. Each asset class has different risk and reward characteristics. Individual securities should be selected according to individual investment acumen and method.

Asset Allocation

Often market increases occur over a very brief period, sometimes a matter of weeks. If you wait until the market has made a large advance and then make investments, you run the risk of having missed out on most of the returns.

How do you determine what is the best asset allocation to achieve your investment objectives?

Different financial advisers have different approaches. Your local stock broker cannot advise you on asset allocation because he or she works in one asset class - equity - and in only one market, the Hong Kong Stock Exchange.

Asset allocation advice is generally included in the services provided by discretionary investment managers and private bankers.

In addition, there are advisers who will only provide asset allocation advice, leaving you to find the appropriate manager.

What is Diversification?

Diversification is often explained using the adage “don't put all your eggs in one basket”. Diversification helps decrease one's market risk. There are many methods of diversification. You can diversify between asset classes and within asset classes.

However, you must choose the method which best suits your objectives. For example, if you already have numerous assets such as business, real estate and regional stocks, in Hong Kong and elsewhere in Asia, you may wish to diversify into other international markets.

In diversifying among different security positions, you should try to find a balance which offers the best protection while achieving the best return. This is a matter of style and method.

For any equity portfolio, there should be no fewer than 30 positions in order to benefit from diversification and if the portfolio is smaller than $1,000,000 then probably no more than 40 to 50 positions. For a larger portfolio, for example US$10 million, then the number of positions could increase to even above 60.

Note that the number of positions does not increase in proportion to the total dollar value.

Managing as many as 60 positions becomes a job for a professional. If you wish to manage a portfolio of between US$300,000 and US$1 million without the help of a professional adviser, you will need to possess the professional skills necessary to undertake such a task.

Once you have determined your asset allocation you can also choose to use either discretionary portfolio managers or mutual funds. Both will provide you with the necessary level of diversification.

However, you should be careful not to over-diversify both because you will find that it will take a great deal of time to monitor your portfolio properly and over-diversification can actually lead to poor investment returns.

As an investor, protecting yourself against loss should always be a primary consideration. A clear investment account statement is fundamental to protecting your investments and is a tool of empowerment, facilitating your ability to monitor your investments and your investment manager's performance.

Asset allocation and portfolio diversification provide protection against rapidly changing market conditions by spreading your risk and allowing you to benefit from different market cycles.

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