Why risk-focused investing is a better way to build a portfolio

Speaking at Hubbis' Investment Solutions Forum 2017 in HK – Harold Kim of Neo Risk Investment Advisors how a focus on dynamically managing risk can greatly improve returns.

Successful investing involves the trade-off of risk versus return, according to Harold Kim, founder and chief executive officer of Neo Risk Investment Advisors. Yet most investors focus on return, despite it being unpredictable.

Instead, he believes that a focus on risk – which is predictable, variable and manageable – improves investment outcomes. In classic portfolio investment theory, the interaction of risk and return define the investment opportunity set.

Changing the risk – or return – assumption can dramatically impact the efficient frontier and the optimal portfolio allocation, explains Kim.

At the same time, the ex-post efficient frontier has changed dramatically over time as risk and return have changed.

In general, the difficulty with returns is that they are unpredictable, says Kim, which is well-established in academic literature and evidenced by the under-performance of active managers versus the index.

A better way to invest, he urges, is to focus on risk. Unlike returns, risk is persistent, and therefore predictable.

Other characteristics of risk include the fact that it varies greatly through market cycles and it can be managed. As a result, Kim says that focusing on risk is particularly effective in 'risky' markets.

For example, 'low risk' is generally followed by 'low risk'; whereas 'high risk' tends to be followed by 'high risk' – a well-established empirical result, according to Kim.

Risk-focused investment management, therefore, involves investing with an emphasis on managing risk to acceptable (optimal) levels. The tools available include dynamic asset allocation, diversification, hedging and derivatives. ■

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