# Focusing on risk – to build a more robust investment portfolio

*Dr Harold Kim, founder and CEO of Neo Risk Investment Advisors, believes that Asia's wealth management community needs to move beyond traditional static theories of portfolio allocation and to focus instead on the ever-changing nature of real-world risks in order to improve investment performance.*

Link to Article on website
Link to Event Homepage
Link to Content Summary page
Link to Photos
Link to Video Highlights

## Executive summary

Dr Harold Kim, founder and CEO of Neo Risk Investment Advisors, believes that investors should build and manage their portfolios with a keen eye towards the changing nature of market risk. Kim and his colleagues stress the need for dynamic risk management to optimize investment performance; that is, as the risk environment changes, investors should be systematically changing their portfolio allocations in response.

Kim presented a challenging and insightful Workshop at the Hubbis Investment Solutions Forum demonstrating the need for a risk-focused investment approach in the real world where returns are difficult to forecast and where risk varies continuously.

HAROLD KIM
Neo Risk Investment Advisors


**KIM BEGAN BY NOTING** that traditional investment models require estimates of expected returns, risk and correlations in order to determine the best, or optimal, portfolio allocation for a given investor.

However, he observed that the history of financial markets shows that return and risk change significantly and continuously through time, resulting in efficient portfolio frontiers that also change through time, often dramatically. "If an investor does not respond to changes in either expected return or expected risk, then the investor's portfolio will be suboptimal; that is, the portfolio will not be the best portfolio possible."

Kim continued: "The challenge is that we know from academic research and practitioner experience that returns are extremely difficult to predict, with an eminent professor once noting that a monkey throwing darts at a list of stocks will choose a portfolio that will perform just as well as or better than one chosen by a professional investor. It is very, very hard to predict returns."

At the same time, Kim noted that risk is an equally important input into the investment process, but one that is often neglected. "As you think about the investment equation, risk is just as important as return; in fact, investing is a trade-off between risk and return."

Furthermore, what makes risk interesting, he explained, is that risk is persistent and therefore predictable. "What do I mean by persistent? If market risk is low today, market risk tomorrow will most likely be low. If market risk is high today, then most probably market risk will be high tomorrow. That is persistence. Contrast that with returns. If returns are positive today, does that mean returns will be positive tomorrow? Since we believe markets are efficient, most likely the answer is that we do not know – perhaps the chance is 50-50 that markets will be up."

He continued: "If you have two important inputs to an investing model, one of which is unpredictable, and of one of which is predictable, which input should you focus on? Of course, you should focus on the predictable input. That input is risk."

## Changing the investor paradigm

Given this predictability of risk, Kim therefore wants to change the way people approach investment and the way wealth managers provide advice to their clients.

Armed with over twenty years of experience following degrees earned from Harvard and Princeton universities in the US, he explained that his work has led him to the conclusion that as risk changes, an investor must respond by changing portfolio allocations in order to maintain an optimal portfolio.

Kim elaborated: "We know that certain portfolio allocations do better in low-risk environments, and others do better in high-risk environments. Understanding that risk is persistent should allow an investor, by understanding the current outlook, to improve their portfolio allocation and therefore investment performance."

"For example, market risk was extremely low in 2017, with Asian equities realizing an extremely low level of risk below 10% (as measured by volatility). In this benign environment, a high allocation to a risky asset such as Asian equities would have been appropriate, and such an allocation would have been well-rewarded. However, towards the end of January and early February 2018, market risk increased significantly. A risk-focused portfolio would therefore have reduced allocations to Asian equities, with resulting outperformance as markets fell thereafter."

He continued: "My mission today is to convince you that investors need to manage their risk dynamically" in order to improve investment performance. "Since risk can be predicted, reacting to changes in risk will result in a better, more optimal portfolio and over the long-term, better performance."

Kim ended the session by characterizing the investment approach used by Neo Risk. "We stress dynamic risk management. We forecast market risk on an on-going basis, and then use this information to actively manage the risk in our portfolios. The end result is investment performance that is smoother and more robust, particularly when markets are weak, versus a more standard, static investment approach. " ■