I have but one system of ethics for men and for nations. To be grateful, to be faithful to all engagements and under all circumstances, to be open and generous, promotes in the long run even the interests of both: and I am sure it promotes their happiness. - Thomas Jefferson

The View From Here

March 2016

Dear Clients and Friends: The wonders of modern technology, the experience and attention of our very able staff, and Gordon Thompson's wise leadership give me the opportunity to concentrate my efforts where we think they are of the most value. While it's true that I'm not in the office as much as I used to be, it's not true that I have any less interest in our portfolio work and our focus on financial integration for all our clients. For something like 30 years now, I've been thinking about, studying about, and trying to build portfolios attentive to the general idea of managing risk. That remains my focus and the controlling characteristic of our client portfolios.

I will write my future communications to you under this banner of ***The View from Here****. The idea is to adhere to the simple maxim that the quality of management is a function of the clarity of communication. I will do my best to communicate with you regularly, clearly and appropriately whether in the office, holed-up in my home study, or traveling around. The focus will always be on you and your well-being. We welcome your thoughts and visits – call or come see us when you can.*

Thank you and God Bless,
Doug

Managing Risks: A Framework

The word risk derives from the early Italian *risicare*, which means to dare. In this sense, risk is a choice rather than a fate. So, since, particularly in the portfolio and financial integration sense, we have available choice, risk becomes an opportunity, not a fate, and dominates our work on behalf of our clients.

The author Charles Caleb Colton wrote that "Imitation is the sincerest form of flattery." In that sense I have extracted a framework for risk management from a recent Harvard Business Review (HBR) article[1] and offer my plagiarism and flattery here along with my own adoption to our client work.

The HBR article distinguishes between three types or categories of risk.

Preventable Risks

Preventable risks are characterized as internal, controllable, and subject to being eliminated or avoided. Our work seeks to avoid / eliminate preventable risks in portfolios via our continuing focus on:

- Diversification
- Appropriate cash-flow provision
- Cost Control
- Tax Efficiency
- Internal Processes and Client Service

Avoidance / elimination of preventable risks is appropriate because these type risks have no strategic benefit – e.g. diversification does not reduce long-term expected returns, etc.

[1] Kaplan, R. S., & Mikes, A. (2012, June). Managing Risks: A New Framework. *Harvard Business Review*, pp. 1-19.

The HBR article suggests that the notion of avoiding / eliminating preventable risks is best accomplished via active prevention: monitoring operational processes, and guiding our work through well thought out practices and portfolio models.

Strategy Risks

In the portfolio context, it is necessary to voluntarily accept some risk in order to generate superior returns from portfolio strategies.

> *You want a valve that doesn't leak and you try everything possible to develop one. But the real world provides you with a leaky valve. You have to determine how much leaking you can tolerate.*
>
> - *From the obituary of Arthur Randolph, the scientist who developed the Saturn 5 rocket.*

Strategy risks are quite different from preventable risks because they (strategy risks) are not inherently undesirable – e.g. long-term exposure to diversified equities increases expected return versus cash and fixed income, albeit at the expense (risk) of short-term volatility (e.g. stomach aches as the portfolio bounces around in value).

External Risks

Some risks simply arise from events outside our portfolios and remain beyond our influence or control. Sources of these risks can be natural and political disasters, major macroeconomic shifts, etc. Because none of us can prevent such events, our portfolio work must focus on mitigation of their impact. Once again diversification, planned provision of appropriate cash-flows, and internal processes / client service become effective tools for managing exposure to these external risks.

We hope this discussion of a risk management framework is useful to you. With all sincerity, it dominates our research, work and thought. However, none of this matters without our clients' input – we are only part of a team; our work, the various markets and, most importantly, our clients' needs, objectives and desires trump all other considerations.

> *Any decision relating to risk involves two distinct and yet inseparable elements: the objective facts and a subjective view about the desirability of what is to be gained, or lost, by the decision.*
>
> - *Peter Bernstein*

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