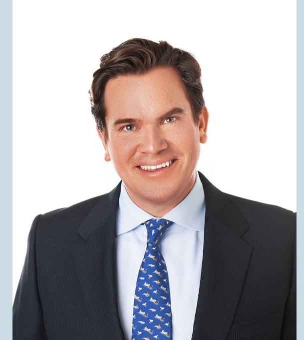
INCLINE
Investment Advisors, LLC

# How Risky Is Your Portfolio?

## Do You Even Know?

For the last several months our team at Incline Investment Advisors has been offering a complimentary portfolio analysis. In this paper we report on what we have learned. We try to help investors to assess their own risks and how they are handling them. We next provide some advice for the confirmed "Do-It-Yourself" investor.
Finally, we ask you to consider the alternative – very wise for most people – of bringing in some expert help.



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## Our Method

At IIA we have two contrasting approaches. Our quant guru and CIO, Todd Hurlbut, uses statistical measures to examine every holding. Jeff Miller, as the lead value manager, is the team member who focuses on fundamental valuation methods.

Our Quantitative approach:

- Initial assessment to determine risk tolerance, including behavioral finance questions
- Quantitative risk assessment of each holding including volatility and correlation
- Risk / Reward heatmap that helps identify outlier holdings
- Determine efficiency of portfolio from a risk standpoint. Is the investor being compensated in proportion to the risk that they are taking?
- Stress test portfolios to determine how they will perform in times of crisis

Our Value approach. We use fundamental methods to analyze and classify each position as one of the following:

- Solid long-term holding
- Mildly over-valued
- Significantly over-valued
- Reasonable valuation but little upside
- Speculation
- Solid Income holding
- Aggressive reach for yield

We have had over 100 requests and have analyzed most of them. Without revealing any confidential information, we are in a position to highlight some important trends.

1. Investors are riding winners, no matter how high they move.
2. Investors who need income are switching from low-return choices to higher-yielding ideas, no matter how speculative.

Remarkably, this happens even for investors who state that they want to preserve capital. Todd provides and analyzes a risk assessment test to determine the investor's risk tolerance. Our data-based conclusions are alarming:

***There is a wide disparity between what they seek and what they own.***

## How Can This Happen?

How can an intelligent, careful, and successful investor create such an unsuitable portfolio?
We have observed several reasons:

- It is hard to quarrel with their own success.
- They fall in love with their stocks.
- They do not want to pay taxes.
- They have no rebalancing discipline.
- They lack an overall plan for reaching their goals.

Let us emphasize. These are very smart, very successful investors who have accumulated significant wealth. They have enjoyed a decade with significant gains regardless of specific allocations. It has been especially rewarding to those simply going with the crowd.

Few are asking whether this is likely to continue, and for how long.

## Signs of Trouble

Do you see these signs of trouble?

- No time to enjoy life because you are working on your portfolio. This is by far the most important warning bell because it reveals a serious error in judgment (unless reading stock news is your hobby). When you need to have a room painted or plumbing fixed, do you hire an expert? Is your time is better spent elsewhere?
- You are worried about the constant avalanche of headlines – the pandemic, the natural disasters, the protests, the election. Do these events matter? Should you act?
- You are worried about someone else in your family taking over. You need a planned succession but might wait too long.
- You feel indecisive, locked into inaction even when it seems like a move is called for.

If any of these signs sound familiar, you have a choice of actions. You can study even harder, gain sophistication in recognizing market moves, and jettison holdings that are not working.

If, like most people, that is an impossible dream, you might consider bringing in an expert. If you are really confident in your own plan, feel free to stop here. This is designed as a helpful paper, but sometimes the best help comes when you bring in the A-Team.

## What A Financial Advisor Can Do?

Advisors can help in many ways.

**Discipline.** The advisor has great experience with many situations. Policies like eliminating high-risk positions and rebalancing are absolutely routine.

**Unemotional.** Like anyone, the advisor has favorite stocks. That does not imply a large and permanent allocation. Great companies are not always great stocks. Price, valuation, and the market environment are all factors. A cool head is required.

**The best tools.** An advisor has tools to help with asset allocation, the investor's overall plan, deciding how to balance tax considerations, and formal risk management. It is essential to have the tools, know how to use them, and effectively implement the findings.

**Knowing when to sell.** The reasons vary. Over-valuation, better opportunities, stock-specific problems. It may be right to dump losers but is often more important to declare victory and sell winners.

## Advisor Fees

Investors considering professional advice often begin by asking about fees. We understand the reason. They are experienced consumers and price is an important factor in most purchases. If you are going to choose an advisor with a sales and marketing penchant, price may well be relevant. If the advisor is going to plug you into a computer-generated box and sell investment products with another layer of fees, you should expect a rock-bottom fee.

A valuable advisor understands you. He or she understands markets, recognizing the difference between the many bogus threats and what might be serious. The advisor is a fiduciary, always acting in your best interest – not what generates a commission.

Let us offer two quick examples. Right before oil prices cratered, MLPs were the rage. The claim was that they collected like a toll road, so prices did not matter. We had a client who wanted to place his entire portfolio in this sector. At that time Jeff wrote a special analysis for the client explaining the consequences. When this group crashed, he saved more than twenty years' worth of fees in a couple of weeks.

Another client was getting a sales pitch from a *former* stockbroker (always check their record with FINRA). He recommended a blind BDC that owned a building hosting conventions and weddings. It was a "can't miss" proposition. The minimum was $250,000. Jeff researched the project, consulted some real estate experts about the prospectus price, did some research on the sales guy, and advised against it. The sales guy told her that he was objecting only because we did not want to lose her fees! We do not know for sure how this one played out, since the BDC does not provide public reports. But we do know that the wedding and convention business was especially vulnerable compared to other BDCs.

***The fees paid to a poor advisor are usually far too high; the cost of a great advisor can be repaid many times over.***

## Conclusion

We hope this paper has been useful for everyone. Many readers have told us that they get ideas when we describe our approach.

If you are still in doubt about how risky your portfolio is, feel free to contact us. It never hurts to get a second opinion. If you are starting to think that professional help is a good idea, we are happy to start with a conversation. We will show how to match your asset allocation to your goals, especially in these turbulent times. And of course, we will build around your favorite positions keeping tax consequences in mind.