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Oxford Financial Group, Ltd.™

Jeffrey H. Thomasson, CFP®

Robert W. Hauswirth, MBA, CFA®, CFP®, CPA, PFS

Charles L. Heekin

“How do I assess my risk tolerance when it comes to investing?”

By Jeffrey Thomasson, Robert Hauswirth and Charles Heekin

Many investors do not completely understand the risks they are taking in their portfolios, nor do they have a satisfying method of evaluating how much risk is too much. Moreover, industry jargon and terms such as “the standard deviation of returns” are not very helpful to most individual investors, and may actually increase confusion and frustration. Fortunately, there is another way to think about it.

Typically, an investor’s overall risk tolerance has two components: the capacity for risk and the appetite for risk.

The capacity for risk is usually determined by objective factors, such as the size of the investment portfolio, the investor’s time horizon, spending or liquidity needs, and any special planning objectives, such as philanthropic or wealth transfer goals. Generally speaking, the longer the time horizon and the smaller the spending requirements relative to the portfolio size, the greater the capacity for risk. Indeed, several methods quantify a portfolio’s capacity for risk and can produce a workable framework.

An investor’s appetite for risk, however, is much more subjective. It is often driven by individual character and behavior traits, and often measured by the willingness to endure volatility in asset values. Moreover, the appetite for risk is usually dynamic—it can change from one period to the next—making it much more difficult to quantify than an investor’s capacity for risk. The dynamic aspects of risk appetite have been the subject of much research in the field of behavioral finance.

Potential conflicts may arise if an individual investor’s appetite for risk exceeds that person’s overall capacity. The individual may be tempted to overreach, and the result can lead to financial disaster. Excessive risk can come from a variety of sources: an inappropriate asset allocation, a liquidity squeeze, the improper use of leverage, efforts at market timing, portfolio or security concentration, etc.

Ideally, investors will understand themselves, their personal biases, and their financial situations well enough to find a balance between their appetite and their capacity for risk. This balance is essential for constructing a portfolio that achieves long-term objectives without creating too much anxiety. Creating—and following—a thoughtful investment policy statement will help reveal and articulate this balance, and provide a context for disciplined portfolio rebalancing going forward. However, few of us live in an ideal world.

A good advisor will help an investor understand how a portfolio is constructed, where the risks are embedded, and how it fits into an overall financial plan. Looking at the traditional asset allocation between stocks, bonds and other investments is only the starting point. A truly detailed analysis will study other factors, such as economic exposure, portfolio liquidity, tax exposure and the likelihood of permanent capital loss for any of the underlying investments. ☺

BEHAVIORAL BIASES THAT CAN AFFECT RISK APPETITE

All investors are subject to behavioral biases that affect the way we process information and make decisions. Even when we are aware these biases exist, they can be extraordinarily difficult to overcome. These biases include:

Recency effect—the tendency to focus more on recent events and information and less on historical context

Anchoring and adjustment—the tendency to place too much emphasis on a specific reference point and failing to adjust properly to new information

Confirmation bias—the tendency to favor information that confirms a preconceived view or position, regardless of whether the information is true

These biases can cause many investors to abandon long-term strategies and hinder their ability to make rational decisions. Remaining detached or emotionally ambivalent to investments—and events that affect the financial markets—is important. A good advisor will help you remain objective.

“An investor’s overall risk tolerance has two components: the capacity for risk and the appetite for risk.”

– Oxford Financial Group, Ltd.

How to reach Oxford Financial Group, Ltd.

To reach Oxford Financial Group, call 317.843.5678 for Jeffrey H. Thomasson or 312.846.6000 for Robert W. Hauswirth and Charles L. Heekin.

MY AREAS OF CHARITY AND COMMUNITY INVOLVEMENT INCLUDE...

Jeffrey: Youth services, humanitarian activities, museums, education, arts and culture

Robert: Education, health and human services, arts and culture

Charles: Arts and education, children’s charities and environmental causes

MY HOBBIES ARE...

Jeffrey: Antiques, art collecting, film, painting, opera, music and theater

Robert: Golfing, racquetball, running, biking, theater and film

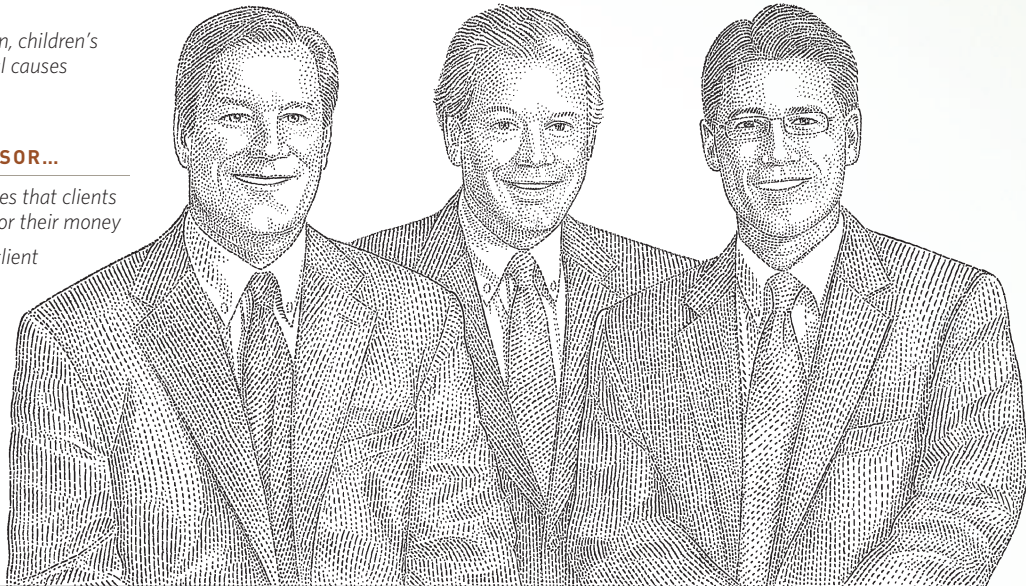
Charles: Sports, scuba diving, hiking, travel, historical literature and live music

A GOOD WEALTH ADVISOR...

Jeffrey: Sincerely appreciates that clients expect and demand value for their money

Robert: Understands that client relationships are truly the foundation of the business

Charles: Is committed to delivering consistent and unbiased advice



Left to right: Charles L. Heekin, Jeffrey H. Thomasson and Robert W. Hauswirth

About Oxford Financial Group, Ltd.

Founder Jeffrey H. Thomasson is CEO and managing director of Oxford Financial Group, Ltd. He is committed to serving clients’ financial and investment planning needs and has been doing so for more than 25 years. He obtained the Certified Financial Planner designation through study in the fields of investment, insurance and retirement and estate planning. He received the Indiana University Kelley School of Business Distinguished Entrepreneur Award. Robert W. Hauswirth is a director in Oxford’s Chicago office, where his focus is providing clients with comprehensive investment and financial advice, which he has been doing for more than 15 years. He earned his MBA from Northwestern University’s Kellogg School of Management. Charles L. Heekin is a director in Oxford’s Chicago office, focusing on business development and advising clients. His experience includes 10 years on Wall Street working in capital markets, advising professional money managers, financial institutions, charities and endowments.

Assets Under Management
\$8.4 billion (globally)

Minimum Fee for Initial Meeting
None required

Minimum Net Worth Requirement
**\$5 million (planning services)
\$2 million (investment services)**

Largest Client Net Worth
Confidential

Financial Services Experience
64 years (combined)

Compensation Method

Fixed fees (planning services) and asset-based fees (investment services)

Primary Custodian for Investor Assets

The Trust Company of Oxford, Fidelity and Schwab

Professional Services Provided

Planning and investment advisory services

Website www.ofgltd.com

Email jthomasson@ofgltd.com
rhauswirth@ofgltd.com
cheekin@ofgltd.com

Oxford Financial Group, Ltd.

980 North Michigan Avenue, Suite 1080, Chicago, IL 60611
11711 North Meridian Street, Suite 600, Carmel, IN 46032

312.846.6000
317.843.5678



Jeffrey H. Thomasson, CFP®

Robert W. Hauswirth, MBA, CFA®, CFP®, CPA, PFS

Charles L. Heekin

Oxford Financial Group Ltd.™
980 North Michigan Avenue, Suite 1080
Chicago, IL 60611
Tel. 312.846.6000

11711 North Meridian Street, Suite 600
Carmel, IN 46032
Tel. 317.843.5678

Email: jthomasson@ofgltd.com
rhauswirth@ofgltd.com
cheekin@ofgltd.com
www.ofgltd.com

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