

## Assessing Investor Risk Tolerance

**“Risk comes from not knowing what you're doing.”**

~ Warren Buffett

I recently attended the annual fi360 ([www.fi360.com](http://www.fi360.com)) conference in Orlando, Florida which gathers fiduciary investment experts from around the country to discuss investment best practices. In a market environment where many investors are questioning the benefits of taking any financial risk at all, my best take-away from this conference was learning more about FinaMetrica's financial risk profiling system.

Accurately assessing an investor's financial risk tolerance is critical to building an appropriate investment portfolio for them. To assess risk tolerance, most investment advisors ask simple risk-assessment questions to determine where an investor lies on the conservative-to aggressive risk preference scale. Unfortunately, when a financial crisis like we recently went through occurs, this simplistic approach can prove to be inaccurate as financial markets swoon and investors learn what their risk tolerance really is. At this point it may be too late to adjust their portfolios to more accurately reflect their real risk tolerance without incurring investment losses that may have been avoided with a more accurate risk tolerance assessment before their portfolios were constructed.

To more objectively and accurately assess investor financial risk tolerance, FinaMetrica - an Australian firm founded by Geoff Davey - has developed a best-in-class, scientific process for measuring risk tolerance that is backed by years of research. To ensure reliability and validity, FinaMetrica's process uses a 25-question psychometric survey which takes only a few minutes to complete. Psychometrics is a method of survey construction that uses psychology and statistics. The FinaMetrica system is now available in six languages and is used by leading financial advisers in 16 countries. More than 360,000 risk profiles have been completed with FinaMetrica's system since 1999.

The FinaMetrica assessment measures investor financial risk tolerance along three dimensions:

- 1) Perceived Risk - How much risk an investor prefers to take.
- 2) Risk Capacity - How much risk an investor can afford to take.
- 3) Required Risk - How much risk an investor needs to take.

All three dimensions are critical to arriving at an accurate investor risk profile. Once an investor's risk profile is understood, a financial advisor is better able to construct a financial plan and investment portfolio that an investor can remain comfortable with and committed to – without too much anxiety - no matter what the financial markets may do.

FinaMetrica risk profile results also provide a catalyst for a healthy discussion about financial risk management between an investor and their financial advisor. Therefore, we believe that all investors may benefit from reflecting upon their comfort level with their investment portfolio during the recent financial crisis and resulting financial market volatility. Investors should discuss any discomfort they may have regarding their portfolio with their financial advisor to conclude if any adjustments should be made.

If you would like to learn more about FinaMetrica's risk profiling tool or have questions about assessing your own risk tolerance and the appropriate management of investment risk, please contact me. I'd enjoy the opportunity to answer your questions and share more about how we assess investor financial risk tolerance to construct portfolios that meet investor needs while also helping them sleep well at night.

Stephen C. Schulmerich, CFP, CEA, AIF

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# FinaMetrica Questionnaire

## Name :

In the risk tolerance questionnaire which follows, you will be asked 25 questions about your attitudes, values and experiences with regard to financial risk. The questionnaire takes about 15 minutes to complete. Your answers are scored in the FinaMetricaPro system's database, by way of an objective statistical comparison against the answers given by a sample of the adult population to produce a detailed Risk Profile report.

Why are 25 questions needed? A person's answer to a specific question may be influenced by a particular experience they have had, or their mood at the time. Or they may have misinterpreted the question. Or they may simply have made a mistake.

Statistical studies are used to determine the number of questions needed to provide a scientifically acceptable level of accuracy in an assessment. The accuracy of a questionnaire is a function, in part, of the square of the number of questions. Because of the nature of risk tolerance, more than just a few questions are needed. Twenty would be a minimum. Statistical studies of this questionnaire show that its accuracy exceeds internationally accepted standards.

What if the situation described in a question has never happened to me, or will never happen to me? There are a number of questions that ask you to assume or imagine you are in a certain situation. These questions are designed to gain a picture of what you would do in such circumstances, regardless of whether you have ever been in them or are ever likely to be in them. Please answer as best you can on the available information.

What if a question asks about a situation where, in real life, I would have (or would seek) more information than is given in the question? Some questions require you to make a decision based on limited information. While, in real life, you may wish to obtain more information before making your final decision, these questions are designed to gain an idea of what you would do given the limited information. Please answer as best you can on the available information.

What if none of the choices in a multiple-choice question is my preferred answer? Some questions give you a limited choice of responses and may not include what would be your preferred answer. These are designed to obtain a picture of what you would do given the choices available. Please answer as best you can on the available choices.

You answer a question by selecting one of the options. You select an option by filling in the circle in front of it. Please answer all 25 questions. If none of the options is exactly right for you, choose the option that is closest.

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### Privacy

You agree that FinaMetrica may use the risk tolerance and demographic data you supply for FinaMetricaPro for research and to further develop the system and may combine this data with similar data from other people PROVIDED THAT any information which could identify you personally has been removed from the data by PIE. The full FinaMetricaPro Privacy Statement is available at [www.risk-profiling.com/privacypolicy.htm](http://www.risk-profiling.com/privacypolicy.htm).

## ACCEPTANCE OF TERMS AND CONDITIONS OF USE

By signing this declaration, I acknowledge I have read and understood and hereby accept the above Terms and Conditions of Use.

Date Completed: \_\_\_\_\_

First Name: \_\_\_\_\_

Middle Initial: \_\_\_\_\_

Last Name: \_\_\_\_\_

Email Address (if any): \_\_\_\_\_

Signature: \_\_\_\_\_

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# FinaMetrica Questionnaire

## Name :

1. Compared to others, how do you rate your willingness to take financial risks?
  - Extremely low risk taker.
  - Very low risk taker.
  - Low risk taker.
  - Average risk taker.
  - High risk taker.
  - Very high risk taker.
  - Extremely high risk taker.
2. How easily do you adapt when things go wrong financially?
  - Very uneasily.
  - Somewhat uneasily.
  - Somewhat easily.
  - Very easily.
3. When you think of the word "risk" in a financial context, which of the following words comes to mind first?
  - Danger.
  - Uncertainty.
  - Opportunity.
  - Thrill.
4. Have you ever invested a large sum in a risky investment mainly for the "thrill" of seeing whether it went up or down in value?
  - No.
  - Yes, very rarely.
  - Yes, somewhat rarely.
  - Yes, somewhat frequently.
  - Yes, very frequently.
5. If you had to choose between more job security with a small pay increase and less job security with a big pay increase, which would you pick?
  - Definitely more job security with a small pay increase.
  - Probably more job security with a small pay increase.
  - Not sure.
  - Probably less job security with a big pay increase.
  - Definitely less job security with a big pay increase.
6. When faced with a major financial decision, are you more concerned about the possible losses or the possible gains?
  - Always the possible losses.
  - Usually the possible losses.
  - Usually the possible gains.
  - Always the possible gains.
7. How do you usually feel about your major financial decisions after you make them?
  - Very pessimistic.
  - Somewhat pessimistic.
  - Somewhat optimistic.
  - Very optimistic.
8. Imagine you were in a job where you could choose whether to be paid salary, commission or a mix of both. Which would you pick?
  - All salary.
  - Mainly salary.
  - Equal mix of salary and commission.
  - Mainly commission.
  - All commission.
9. What degree of risk have you taken with your financial decisions in the past?
  - Very small.
  - Small.
  - Medium.
  - Large.
  - Very Large.

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# FinaMetrica Questionnaire

## Name :

10. What degree of risk are you currently prepared to take with your financial decisions?
- Very small.
  - Small.
  - Medium.
  - Large.
  - Very large.
11. Have you ever borrowed money to make an investment (other than for your home)?
- No.
  - Yes.
12. How much confidence do you have in your ability to make good financial decisions?
- None.
  - A little.
  - A reasonable amount.
  - A great deal.
  - Complete.
13. Suppose that 5 years ago you bought stock in a highly regarded company. That same year the company experienced a severe decline in sales due to poor management. The price of the stock dropped drastically and you sold at a substantial loss.
- The company has been restructured under new management, and most experts now expect it to produce better than average returns. Given your bad past experience with this company, would you buy stock now?
- Definitely not.
  - Probably not.
  - Not sure.
  - Probably.
  - Definitely.
14. Investments can go up or down in value, and experts often say you should be prepared to weather a downturn. By how much could the total value of all your investments go down before you would begin to feel uncomfortable?
- Any fall would make me feel uncomfortable.
  - 10%.
  - 20%.
  - 33%.
  - 50%.
  - More than 50%.
15. Assume that a long-lost relative dies and leaves you a house which is in poor condition but is located in a suburb that's becoming popular.
- As is, the house would probably sell for \$300,000, but if you were to spend about \$100,000 on renovations, the selling price would be around \$600,000. However, there is some talk of constructing a major highway next to the house, and this would lower its value considerably.
- Which of the following options would you take?
- Sell it as is.
  - Keep it as is, but rent it out.
  - Take out a \$100,000 mortgage and do the renovations.

# FinaMetrica Questionnaire

**Name :**

16. Most investment portfolios have a mix of investments - some of the investments may have high expected returns but with high risk, some may have medium expected returns and medium risk, and some may be low-risk/low-return. (For example, stocks and real estate would be high-risk/high-return whereas cash and CDs (certificates of deposit) would be low-risk/low-return.)

Which mix of investments do you find most appealing? Would you prefer all low-risk/low-return, all high-risk/high-return, or somewhere in between?

Mix of Investments in Portfolio

|                                   | High        | Medium      | Low         |
|-----------------------------------|-------------|-------------|-------------|
|                                   | Risk/Return | Risk/Return | Risk/Return |
| <input type="radio"/> Portfolio 1 | 0 %         | 0 %         | 100 %       |
| <input type="radio"/> Portfolio 2 | 0 %         | 30 %        | 70 %        |
| <input type="radio"/> Portfolio 3 | 10 %        | 40 %        | 50 %        |
| <input type="radio"/> Portfolio 4 | 30 %        | 40 %        | 30 %        |
| <input type="radio"/> Portfolio 5 | 50 %        | 40 %        | 10 %        |
| <input type="radio"/> Portfolio 6 | 70 %        | 30 %        | 0 %         |
| <input type="radio"/> Portfolio 7 | 100 %       | 0 %         | 0 %         |

17. You are considering placing one-quarter of your investment funds into a single investment. This investment is expected to earn about twice the CD (certificate of deposit) rate. However, unlike a CD, this investment is not protected against loss of the money invested.

How low would the chance of a loss have to be for you to make the investment?

- Zero, i.e. no chance of any loss.
- Very low chance of loss.
- Moderately low chance of loss.
- 50% chance of loss.

18. With some types of investment, such as cash and CDs (certificates of deposit), the value of the investment is fixed. However inflation will cause the purchasing power of this value to decrease.

With other types of investment, such as stocks and real estate, the value is not fixed. It will vary. In the short term it may even fall below the purchase price. However over the long term, the value of the stocks and real estate should certainly increase by more than the rate of inflation.

With this in mind, which is more important to you - that the value of your investments does not fall or that it retains its purchasing power?

- Much more important that the value does not fall.
- Somewhat more important that the value does not fall.
- Somewhat more important that the value retains its purchasing power.
- Much more important that the value retains its purchasing power.

19. In recent years, how have your personal investments changed?

- Always toward lower risk.
- Mostly toward lower risk.
- No changes or changes with no clear direction.
- Mostly toward higher risk.
- Always toward higher risk.

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# FinaMetrica Questionnaire

## Name :

20. When making an investment, return and risk usually go hand-in-hand. Investments which produce above-average returns are usually of above-average risk. With this in mind, how much of the funds you have available to invest would you be willing to place in investments where both returns and risks are expected to be above average?
- None.
  - 10%.
  - 20%.
  - 30%.
  - 40%.
  - 50%.
  - 60%.
  - 70%.
  - 80%.
  - 90%.
  - 100%.
21. Think of the average rate of return you would expect to earn on an investment portfolio over the next ten years. How does this compare with what you think you would earn if you invested the money in one-year CDs (certificates of deposit)?
- About the same rate as from CDs.
  - About one and a half times the rate from CDs.
  - About twice the rate from CDs.
  - About two and a half times the rate from CDs.
  - About three times the rate from CDs.
  - More than three times the rate from CDs.
22. People often arrange their financial affairs to qualify for a government benefit or obtain a tax advantage. However a change in legislation can leave them worse off than if they'd done nothing.
- With this in mind, would you take a risk in arranging your affairs to qualify for a government benefit or obtain a tax advantage?
- I would not take a risk if there was any chance I could finish up worse off.
  - I would take a risk if there was only a small chance I could finish up worse off.
  - I would take a risk as long as there was more than a 50% chance that I would finish up better off.
23. Imagine that you are borrowing a large sum of money at some time in the future. It's not clear which way interest rates are going to move - they might go up, they might go down, no one seems to know.
- You could take a variable interest rate that will rise and fall as the market rate changes. Or you could take a fixed interest rate which is 1% more than the current variable rate but which won't change as the market rate changes. Or you could take a mix of both.
- How would you prefer your loan to be made up?
- 100% variable.
  - 75% variable, 25% fixed.
  - 50% variable, 50% fixed.
  - 25% variable, 75% fixed.
  - 100% fixed.
24. Insurance can cover a wide variety of life's major risks - theft, fire, accident, illness, death etc. How much coverage do you have?
- Very little.
  - Some.
  - Considerable.
  - Complete.

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**Name :**

25. This questionnaire is scored on a scale of 0 to 100. When the scores are graphed they follow the familiar bell-curve of the Normal distribution shown below. The average score is 50. Two-thirds of all scores are within 10 points of the average. Only 1 in 1000 is less than 20 or more than 80.

What do you think your score will be?

