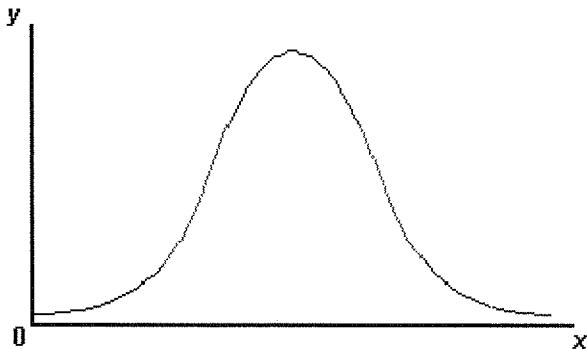


PROTECTING THE DOWNSIDE

By Andy Guzzetti, Managing Director DLG Wealth Management

AS ADVISORS WE ARE SPENDING MORE TIME TALKING TO CLIENTS ABOUT PROTECTING ASSETS RATHER THAN GROWING ASSETS. WE HAVE TO BE PREPARED TO OFFER OUR CLIENTS THE ABILITY TO HANDLE THE POSSIBILITY OF ANOTHER 2007-2008. CLIENTS CAN'T HANDLE ANOTHER 45% MELT DOWN. THEY NEVER HEARD ABOUT "TAIL RISK" OR "BLACK SWAN". NOW IT IS A PART OF MOST EVERY INVESTOR'S VOCABULARY.

WHAT IS 'TAIL RISK', ESPECIALLY "LEFT TAIL RISK". IF YOU LOOK AT THE STATISTICAL BELL SHAPED CURVE BELOW WE ALL KNOW FROM OUR STATISTIC CLASSES THAT STATISTICALLY 95% OF ALL RESULTS FALL IN THE CURVE. MONEY MANAGERS, HEDGE FUNDS BASE MOST OF THEIR DECISIONS ON THE CURVE. THEY ARE PREPARED TO HANDLE ANY EVENT WHERE RESULTS ARE INSIDE THE CURVE. WHAT HAPPENS IF RESULTS ARE IN THOSE LITTLE TAILS AT EACH END? IF IT IS ON THE RIGHT SIDE THAT WOULD BE POSITIVE, BUT THE LEFT SIDE TAIL RISK CREATES A NEGATIVE PROBLEM. WHEN THESE EVENTS HAPPEN THE CONTAGIOUS EFFECTS TAKE OVER CAUSING MASSIVE LOSSES IN DIFFERENT AREAS. WHEN THESE OCCURRENCES HAPPEN THEY ARE USUALLY CALLED "BLACK SWAN" EVENTS. EVERYONE THOUGHT ALL SWANS WERE WHITE AND NEVER EXPECTED TO SEE A "BLACK SWAN".



WHAT ARE SOME SOLUTIONS:

1. **VARIABLE ANNUITIES** can be used to protect investors in a number of ways. Two specific ways (there are approx 1600 versions) that variable annuities can help protect the downside are
 - a. In a deferred variable annuity, negative returns are possible, but the industry has created various options to put investors at ease, such as riders that guarantee certain levels of income upon retirement. This guarantee of a certain income level has become a very key feature, especially for the retired or close to retirement baby boomers. Thus even if there is a "black swan event" your retirement income is guaranteed. In this era of companies getting away from defined benefit plans this guarantee allows an investor to set up their own "defined benefit plan"
 - b. Guaranteed minimum death benefits can also protect the downside. Most deferred variable annuities sold include the basic kind: a guarantee that, if the account value has lost value when the investor dies, heirs will get the full amount initially invested. There are many variations of the minimum death benefit, such as "stepups" which are guarantees that heirs get the highest value the account hit on one of its anniversaries. Between 2001 and

2003, variable annuity beneficiaries received \$2.8 billion more than the account value when policy holders died earlier than expected, according to the Insured Retirement Institute.

2. **MANAGED FUTURES** can be used to protect the downside. Investors who want to be ready for a “Black Swan” event must have something in their portfolio that can make money not only on the upside but when values are falling. The values may be falling in equities, bonds or commodities and a managed futures program can make money in those falling markets, thus protecting some or all of your portfolio. The futures(commodity) markets have been built to hedge, although many investors try to speculate in these markets. The futures market is very complicated that is why we do not recommend a “do it yourself” futures portfolio. Let the professional with proven track records do it.
3. **DIVERSIFICATION/ASSET ALLOCATION** can be used to lessen downside risk. However in the events we are discussing especially in the last melt down nothing was safe. However diversification will protect you from being in one asset class that gets hammered.
4. **FDIC CD'S/ MONEY MARKETS** can be used to protect the downside, however with interest rates at record lows the returns may not even keep up with inflation. Having said that, we have all learned that cash is an asset class. Many investors forgot that fact and portfolios did not factor in cash while building diversified portfolios. Nothing wrong with having a portion of your investment assets in cash.

MANY ADVISORS HAVE SPECIFIC PROGRAMS THAT CAN HELP WITH PROTECTING THE DOWNSIDE.....COVERED CALL WRITING, MARRIED PUTS, STOP LOSS STRATEGIES TO NAME A FEW. EACH INVESTOR HAS TO DETERMINE THEIR FINANCIAL GOALS & THEIR RISK TOLERANCE AND THEN WORK WITH AN ADVISOR TO COME UP WITH A PROGRAM TO ‘HELP PROTECT THE DOWNSIDE ‘

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