Visualizing the Financial Crisis

By **Helen Yang**
ANDES WEALTH TECHNOLOGIES

We are at the end of the bull market. It still seems to be going strong - even volatility came and went - but people are definitely nervous, perhaps even more so after a strong 2019, like someone inching closer and closer to the inevitable cliff. Is it going to happen in 2020? If so, would it be deep and painful or shallow and swift?

Now throw in the presidential election -- remember how the Fed Funds Rate was kept low during the 2016 election season but climbed up steadily right after? Would the Fed continue to cut the rate in 2020?

Conflicting theories abound, but don't worry - we don't do predictions because we know you don't need another one. Instead, we focus on real-time risk monitoring to help you see the market dynamics in a new way, and monitor the financial crisis before, during and after. For financial advisors, it is a powerful tool to help you effectively reduce panic and protect your clients and yourself.

On this risk-return chart, each mini pie chart on the solid line represents a model portfolio based on its 30-year averages. This set of seven classic model portfolios, from the most conservative to the most aggressive, forms a classic efficient frontier. Higher risk, higher return.

However, the market often deviates from 30-year averages, sometimes dramatically. According to Dr. Andrew Lo from MIT and his Adaptive Markets theory, the risk and return relationship changes over time, hence it is important to monitor it closely, especially during times of uncertainty.

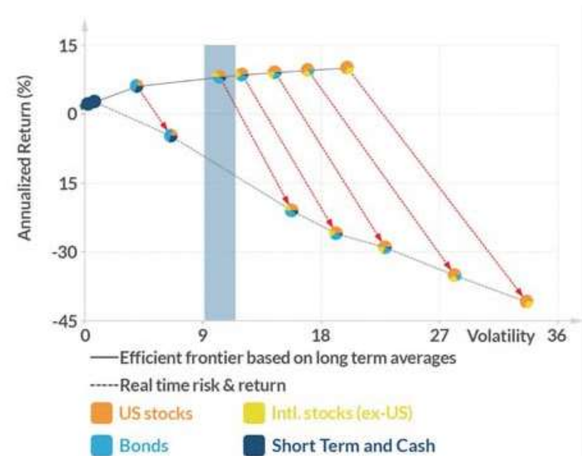
As an example, here the dotted line shows the actual risk and return for a given time period. Note how each model portfolio shifts to lower right, indicating higher risk comparing to its 30-year average and the return is well into the negatives. In this case, higher risk doesn't bring higher return.

On September 15, 2008, the day Lehman Brothers collapsed, the one-month risk and return looked similar to this. Take a look at the live data at live.andeswealth.com/portfolio-health-check. Select 1-month, and change the as-of-date to 2008/09/15.

Two months later, on 2008/11/14, at the height of the financial crisis, everything shifts much further into the lower right corner. As the market starts to recover in 2009, the chart looks decidedly different starting in late March.

The powerful visualization makes it easy for you to see market dynamics and communicate effectively with clients. It is especially powerful to use it in conjunction with our behavioral profiling to anticipate client behavior, and guide them through irrational fears.

Real-Time Risk Monitor



Source: Andes Wealth Technologies

But more importantly, use it to monitor the financial crisis to protect your clients and yourself. After all, if your clients' assets drop 40%, your revenue drops 40% too. Can you afford it?

But if you go in and out, how is it different from market timing? I used to commute to Boston and spend hours contemplating this while sitting in traffic. Marketing timing is like switching lanes frequently trying to get ahead, which usually doesn't work. But being aware of structural trends is different. When the Big Dig project was going on, I'd avoid I-93 and take Route 1 instead.

Helen Yang, CFA, is the Founder and CEO of Andes Wealth Technologies and winner of the 2011 Harry Markowitz Award.
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