Investing Risk in Your Investment Club

& the New myICLUB Portfolio Beta Report!

DOUG GERLACH • MYICLUB.COM • MAY 2024

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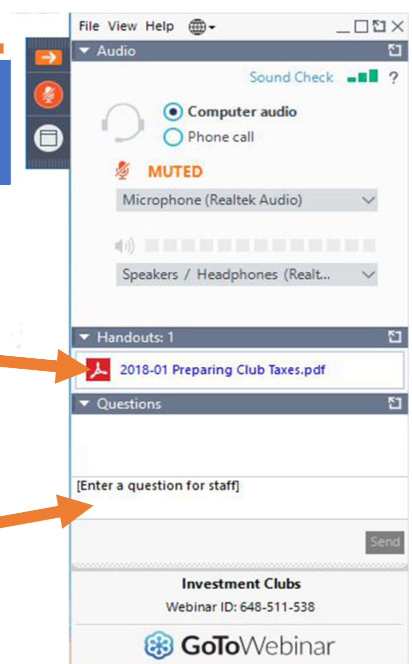
Handout & Questions

Handout in PDF format is available in Handouts tab.

Type questions in Questions box.



BASICS OF RISK, RETURN, VOLATILITY

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What Is Risk?

- Risk is any *uncertainty* that has potential to negatively affect your financial situation, such as:
- **Market risk**: How do market conditions affect your investment?
- **Business risk**: How do decisions made by management (such as to expand or merge) affect value of your investment?
- **Political risk & currency risk**: How do events or operations in foreign country affect your investment?
- **Liquidity risk**: Is it easy or hard to cash out your investment?
- **Concentration risk**: Are all your eggs in one basket?

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3 Primary Types of Investing Risk

1. Systematic.
2. Non-Systematic.
3. Company-specific.

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Systematic Risk

- Also known as "non-diversifiable risk," "volatility," or "market risk."
- Affects overall market, not just particular stock or industry.
- Unpredictable & **impossible to completely avoid**.
- **Cannot** be mitigated through diversification.
  - Can be *reduced* through hedging or by asset allocation.
- ***Beta*** measures how volatile investment is compared to overall market.

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Non-Systematic Risk

- Also known as "diversifiable risk," "unsystematic risk," "specific risk," or "residual risk."
- **Can** be reduced through diversification.
- Examples:
  - New competitor.
  - Regulatory change.
  - Management change.
  - Product recall.
- Can also *reduce* by adding **uncorrelated holdings** to portfolio.

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Company Risk

- Financial uncertainty faced when owning specific business & exposed to ups & downs of single company's performance.
- Can be managed by:
  - Diversification.
  - Owning additional companies.
  - Owning uncorrelated assets.

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Investment Returns Always Bring Risk

- Level of **risk** associated with particular investment or asset class correlates with level of **return** investment might achieve.
  - Investors willing to take on risky investments & potentially lose money should be rewarded for their risk.
- Tradeoff is always that **higher return** always brings **greater risk**.
  - Stocks are "riskier" than corporate bonds.
  - Corporate bonds are "riskier" than Treasury bonds or bank savings products.

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Average Returns of Various Asset Classes

- **Stocks** have most robust average annual returns over long term (just over 10% per year)
- **Corporate bonds** (around 6% annually).
- **Treasury bonds** (5.5% per year).
- **Cash/cash equivalents** such as short-term Treasury bills (3.5% per year).

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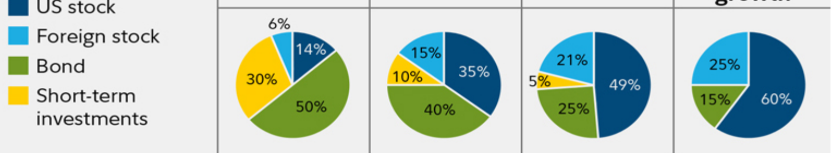
Returns & Risk in Various Portfolio Mixes



Annual return %	Conservative	Balanced	Growth	Aggressive growth
Average annual return	5.96%	7.96%	8.97%	9.65%
Worst 12-month return	–17.67%	–40.64%	–52.92%	–60.78%
Best 12-month return	31.06%	76.57%	109.55%	136.07%
Worst 20-year return (annualized)	2.92%	3.43%	3.10%	2.66%
Best 20-year return (annualized)	10.98%	13.83%	15.34%	16.49%
Historical volatility	4.50%	9.56%	13.06%	15.75%

Source: Fidelity

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How Clubs Should Approach Asset Allocation

- Clubs should aim to be fully invested in equities (US, foreign).
  - Emulate approach of equity mutual funds.
- Clubs should **not** aim to be self-standing investing vehicle with multiple asset classes.
  - This makes it harder for individuals to match their club holding to their personal portfolio.
  - For instance, younger members may not desire/require bond holdings personally, so if club holds them it may unnecessarily decrease returns of those members.

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MEASURING RISK

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What Is Volatility?

- Volatility is statistical measure of dispersion of returns for given security (or index).
- Volatility can either be measured by using **standard deviation** or **variance** between returns from that same security or market index.
- Higher volatility means "riskier" security in **short-term** (not as useful long-term).

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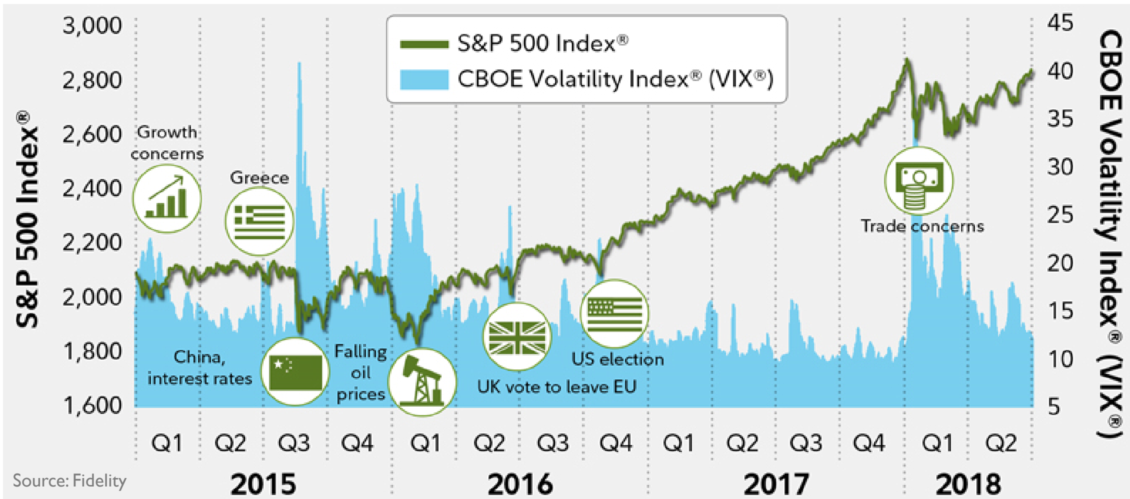
Volatility Is Normal Part of Investing



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Measuring Risk with *Beta*

- *Beta* measures how *volatile* investment has been compared to overall market.
  - Beta > 1.0 means investment has **more** systematic risk than market but with more potential return in rising market.
  - Beta < 1.0 means **less** systematic risk than market but with more potential return in falling market.
  - Beta = 1.0 means **same** systematic risk as market, so tends to move with market.
  - Beta = negative means security is inversely correlated with market (tends to move in opposite direction).

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Measuring Risk with Standard Deviation

- Often used as measure of volatility.
- Mathematical calculation that shows how price of asset deviates from its average price:
  - Calculate mean of each price in period.
  - Calculate difference between each price in period & mean price ("deviation").
  - Calculate typical ("standard") deviation of any price to any other in period.

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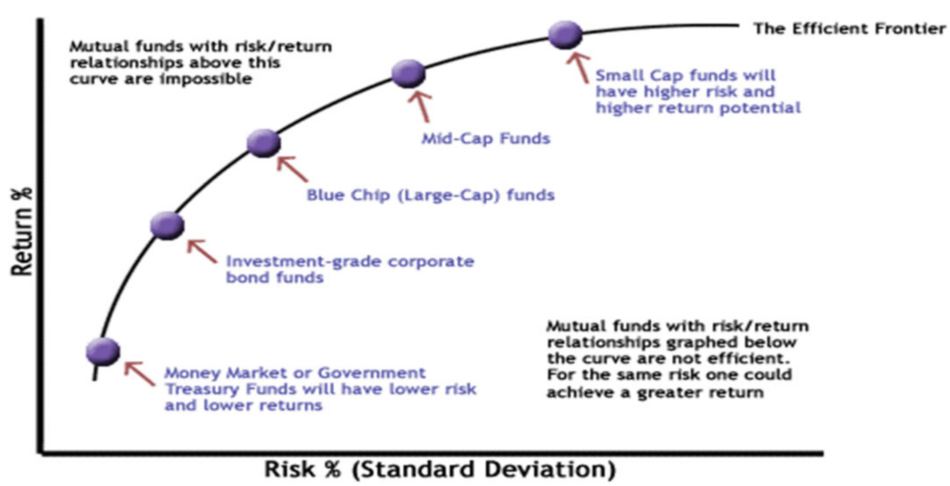
Risk & Return on the Efficient Frontier



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Ways of Managing Investment Risk

- **Asset Allocation:** Include different asset classes in portfolio (such as stocks, bonds, real estate, cash) to increase probability that some investments will provide satisfactory returns even if others are flat or losing value.
- **Diversification**: Divide money allocated to particular asset class, such as stocks, among various categories of investments in that class.
- **Hedging & Insurance**: Expensive & thus may reduce returns. May involve speculative, higher risk activity such as short selling or investing in illiquid securities.
- **Focus on Long-Term:** Target returns that are possible after next recession/bear market & ignore short-term gyrations of market or bear cycles.

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Another Way of Considering Risk

- Since volatility is short-term-focused & may not have much impact on long-term return in buy & hold portfolio, consider risk as **measure of how you might reach or miss long-term goals**.
- For example:
  - Holding cash in low-interest bank account may not earn enough to retire happily. (High risk.)
  - Trying & failing to guess near-term direction of market may cause losses & delay retirement. (High risk.)
  - Investing in broad-based all-equity portfolio in 401(k) may deliver long-term returns that allow you to retire early. (Low risk.)
  - Trying to avoid risk & thus earning below-average return on investments. (High risk.)

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MYICLUB.COM PORTFOLIO BETA REPORT

Where to Find Portfolio Beta Report

- In **myICLUB** > **Reports** at bottom of Portfolio Reports section.
- Also in left navigation column, under **Portfolio** header.

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Portfolio Beta

Portfolio Beta as of 5/13/2024 (generated on: 5/13/2024).

This report shows the beta (β) of each stock in the club portfolio, and the overall portfolio beta. Beta is a commonly-used measure of a security's volatility relative to the broader market.

Weighted Average Portfolio Beta: 0.91

Ticker	Security	Shares owned	Price/share	Market value	% of Total	5-year Beta	Weighted Beta
BABA	Alibaba Group Holdin	750.0	$80.04	$60,030.00	6.8%	0.45	0.03
BHP	BHP Billiton ADS	1,200.0	$57.19	$68,628.00	7.8%	1.01	0.08
BP	BP Plc	1,000.0	$37.84	$37,840.00	4.3%	0.68	0.03
DTEGY	Deutsche Telekom ADR	3,500.0	$23.63	$82,705.00	9.4%	0.68	0.06
LVMUY	LVMH Moet Hennessy L	2,000.0	$169.53	$339,060.00	38.6%	1.15	0.44
ORCL	Oracle Corp	1,300.0	$116.67	$151,671.00	17.3%	1.03	0.18
PETS	Petmed Express Inc	2,800.0	$4.08	$11,424.00	1.3%	0.72	0.01
TM	Toyota Motor Cp ADR	400.0	$218.78	$87,512.00	10.0%	0.71	0.07
Totals				**$838,870.00**			**0.91**

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myICLUB Report Definitions

- **Ticker, Company Name, Shares Owned**: As of date of report.
- **Price/Share, Market Value, % of Total**: From most recent closing prices (not from Valuation).
- **5-Year Beta**: As provided by Morningstar in data.
- **Beta Weight**: Calculation of how much security contributes to overall portfolio beta.

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myICLUB Beta Calculation Notes

- **5-Year Beta:**
  - Updated monthly in myICLUB data at month-end.
  - Only appears for common stocks & REITs (not for Funds, ETFs, other).
  - Only appears for securities with 60+ months of prices (otherwise "n/a").
- **Beta Weight:**
  - Based on % owned of each security.
  - Shows how much each position contributes to total portfolio beta.
  - Add all beta weights together to determine **portfolio beta**.
  - Will show as "n/a" if value is insignificant (near 0).

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Interpreting Portfolio Beta

- As with security beta, **Portfolio Beta** gives idea of overall volatility of entire portfolio.
  - **β= 1.0**: Portfolio sensitivity equivalent to market.
  - **β> 1.0:** More sensitive to volatility risk than market.
  - **β< 1.0**: Less sensitive to volatility risk than market.
  - **β< 0**: Inverse relationship between portfolio sensitivity & market (e.g. gold).

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What Beta Should Clubs Strive For?

- Given market dynamics (tendency of market to move upwards over long term), portfolio beta should be greater than 1.0 if goal is to outperform broad market.
- Portfolio beta much greater than 1.0 may cause discomfort when market reverses course.
- Portfolio beta below 1.0 will tend to deliver lower returns than market over time (though portfolio will see less decline during market reversals).

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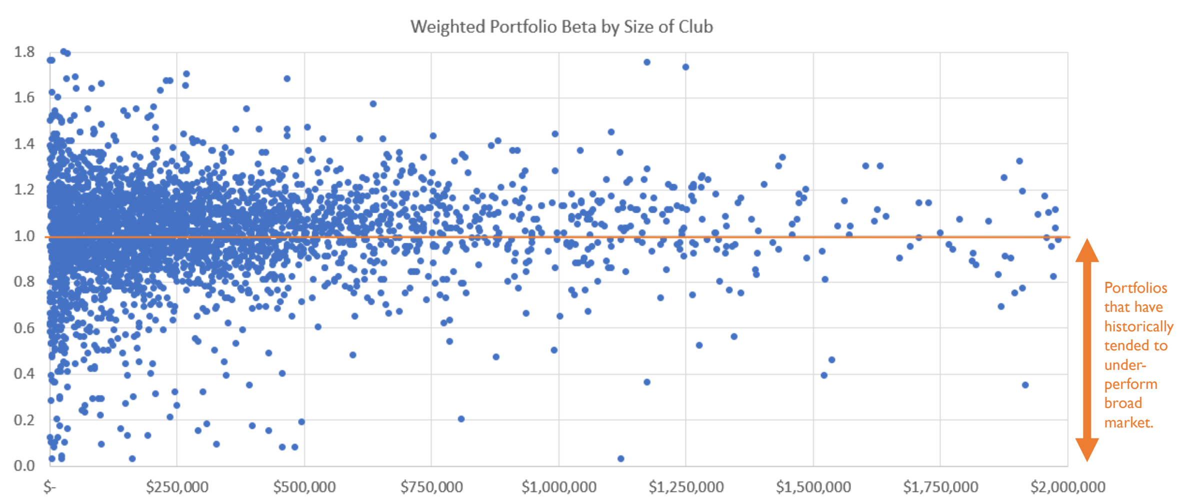
Too Many Clubs Favor Low-Beta Stocks



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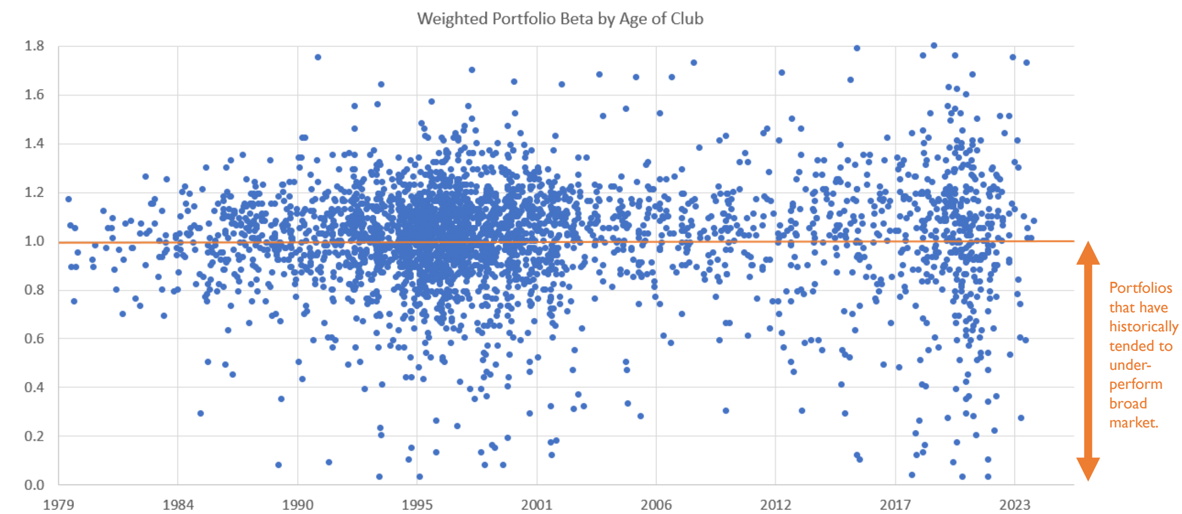

Downsides of Beta

- While beta provides some information about risk, is not effective measure of risk on own.
- Only looks at past performance relative to S&P 500 & does not provide forward guidance.
- Does not consider fundamentals of company or earnings & growth potential.

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More Questions?

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