

# APPLYING RISK MANAGEMENT TO STOCK MARKET INVESTING (ISO- 31000)

Rob Chen | ASQ Presentation  
October 2020





# POOR RISK MANAGEMENT

Just not thinking it all the way through



# ISO- 31000 DEFINITION

- ISO 31000, *Risk management – Guidelines*, provides principles, a framework and a process for managing risk. It can be used by any organization regardless of its size, activity or sector.
- Using ISO 31000 can help organizations increase the likelihood of achieving objectives, improve the identification of opportunities and threats and effectively allocate and use resources for risk treatment.



# ISO- 31000 FRAMEWORK/PROCESS

- Framework – Governance, Program Design, Implementation, Monitoring, Continual Improvement
- *Process – Active communication, Process Execution, Oversight (not covered today)*



# BENEFITS OF EFFECTIVE RM

- Enables a strategy to identify and mitigate risks to enhance likelihood of achieving objectives and increase protection of assets
- Provides for a process of monitoring
- Allows you to see both the positive opportunities and negative consequences associated with risk, and allows for more informed, and thus more effective, decision making



# WHAT HAPPENS IF YOU DON'T

## Example #1 – Subprime Mortgage Meltdown

The subprime mortgage meltdown in 2007 that helped trigger the **Great Recession** stemmed from **bad risk-management decisions**, such as lenders who extended mortgages to individuals with poor credit; investment firms who bought, packaged, and resold these mortgages; and funds that invested excessively in the repackaged, but still risky, mortgage-backed securities (MBS).



# WHAT HAPPENS IF YOU DON'T

## Example #2– Wells Fargo Scandal

Wells Fargo paid \$185 million in penalties – the highest fine levied by the Consumer Financial Protection Bureau (CFPB) since it began operations in 2011 – for inappropriate sales practices. Millions of accounts were set up without customer consent, in many instances generating overdraft charges and other fees. The CFPB referred to the Wells Fargo activities as “widespread,” and 5,300 employees were been fired. Their CEO said this was unnoticed at his level for 5 years! **Where were the risk management and assessment processes?**



# ISO 31000 - FRAMEWORK



# APPLICATION TO INVESTING

- Start with a Framework (Plan)

- *As Chinese military general Sun Tzu's famously said: "Every battle is won before it is fought."*
- *In finance, risk management is the process of assessing, managing and mitigating losses.*
- *Start with an objective:*
  - *Example: I want to invest and create a nest egg for retirement*





# FRAMEWORK

- Program Design

- Risk Identification
  - Preventable – Improper allocation due to lack of understanding of asset classes. Not diversifying properly
  - Strategic - Accepting risk to generate superior returns, i.e. options trading
  - External – Political or social factors outside our control (pandemic, election uncertainty, etc.)
- Risk Management Processes
  - Self Assessment – How are you doing against your goals?
  - **Key indicators** – Overall stock or index resistance/support levels, Dollars loss/profit, 1% rule
  - Loss Events – What adjustments if any are made if a loss occurs
- Risk Reporting
  - Format and communication protocol for reporting on indicators and risks
- Risk Scenarios
  - Model if/then scenarios with your portfolio
- Risk Tolerance
  - What are you willing to lose before triggering action

# FRAMEWORK

- Program Design - Outcomes

Asset Class	Risk/Vol	Outcome*	Allocation*
Options/Derivatives	HIGH	-50% to +50%	10%
Stocks/Equities	MED/HIGH	-10% to +10%	70%
Bonds/Insurance	LOW/MED	2-3%	10%
Cash	LOWEST	0-1%	5%

*\*represents example of high-risk tolerance portfolio*

# FRAMEWORK

- Investment Risk Indicators

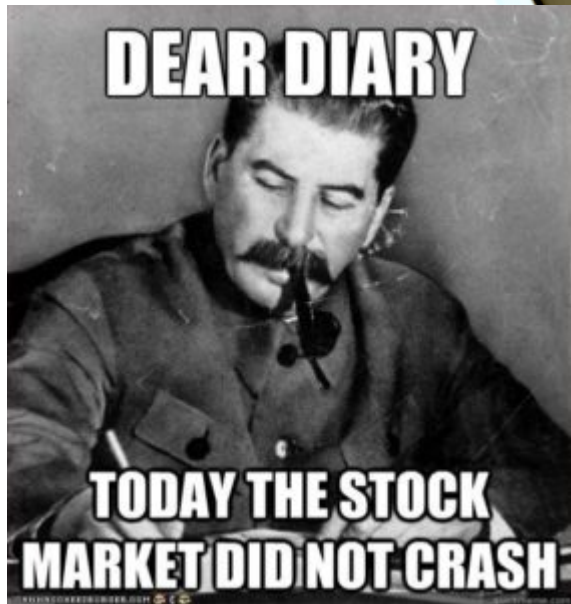
- Diversity in Sectors – Example Financial, Healthcare, Tech, Utilities
- Earnings surprises – Under covered stocks, new company
- Consistency in financials – Year over year performance (earnings, revenue)
- Volatility of stocks – Correlation to the overall stock market
  - Young, high growth stocks can be extremely volatile (TSLA, BYND)



# FRAMEWORK

- Governance/Monitoring
  - Consolidate accounts (multiple platforms)
  - Automated alerts at key price points
    - Profit goals (ex: +/- 30%)
    - Support/Resistance (trading range)
  - Rebalance rules to maintain allocations in asset classes and sectors (dependent on risk tolerance)
  - Loss triggers – cut losses, don't look back!
    - Rationale: Opportunity cost





# FRAMEWORK

- Implementation
  - Resourcing
    - Who will implement – you or a 3<sup>rd</sup> party advisor?
  - Reviewing your plan
  - Reporting on results
    - Outcomes determine if effective risk management took place

# FRAMEWORK

- Continual Improvement
  - Reviewing the risk management plan regularly
    - Define time period for portfolio review (ex: quarterly)
    - Compare actual performance against benchmarks
      - Own Profit Goals
      - Other Stock Market Indices (ex: S&P 500)
    - Adjust allocations, positions, risk tolerance as necessary





QUESTIONS?