FUSION
CAPITAL MANAGEMENT

The Importance of Managing Risk

A fundamental idea in finance is the relationship between risk and return. The greater the amount of risk that an investor is willing to take on, the greater the potential return. The reason for this is that investors need to be compensated for taking on additional risk.

For example, a U.S. Treasury bond is considered to be one of the safest investments and, when compared to a corporate bond, provides a lower rate of return. The reason for this is that a corporation is much more likely to go bankrupt than the U.S. government. Because the risk of investing in a corporate bond is higher, investors are offered a higher rate of return. However, a U.S. Treasury bond is exposed to different types of risk which could include inflation or purchasing power risk, and political risk.

Since every investment is exposed to some form of risk, working with an expert who manages those risks is important. The three primary systematic risks are Market risk, Interest rate risk, and Inflation or purchasing power risk. There are also four primary unsystematic risks, they are business risk, liquidity risk, political risk, and regulatory risk. Fusion Capital Management focuses on building values-based investment strategies for our clients focusing on what is important to our clients, and then implanting a plan that aims to achieve a sound risk-adjusted return

How do we measure risk-adjusted returns?

One measure of risk adjusted returns is Sharpe Ratio. The Sharpe ratio tells us whether a portfolio's returns are due to smart investment decisions or a result of excess risk. This measurement is very useful because although one portfolio or fund can reap higher returns than its peers, it is only a good investment if those higher returns do not come with too much additional risk. The greater a portfolio's Sharpe ratio, the better its risk-adjusted performance has been. A negative Sharpe ratio indicates that a risk-less asset would perform better than the security being analyzed.

The two portfolios detailed below have an almost identical stock-to-bond ratio, yet have wildly different risk characteristics. Fusion believes that the best way to manage risk is to actually measure it. This provides an optimal starting point for portfolio analysis and maximizes precision in Fusions' client suitability recommendations.

	Portfolio A *30/70 Stock to Bond Ratio*	Portfolio B *30/70 Stock to Bond Ratio*
3 Yr. Standard Deviation	12.73	16.57
3 Yr. Sharpe Ratio	0.23	0.03
Best 3 Yr. Return	11.14%	14.75%
Worst 3 Yr. Return	-2.98%	-8.03%
3 Yr. Avg. Return	4.41%	1.30%

Contact us:

9111 Cypress Waters Blvd, Suite 140
Dallas TX 75019

P: 866.254.4235
F: 888.607.8601
E: info@fusioncm.com
www.fusioncm.com