



MAKE

Ben Silverman on his new company, his time at NBC and what the future of television holds.

GROW

Stress-Testing Your Strategy: How did your investing approach fare during the recession?

LIVE

Are safe rooms really safe? Plus: Why wealthy kids should work.

Worth®

THE EVOLUTION OF FINANCIAL INTELLIGENCE



ANDREW ROSENFELD, GUGGENHEIM PARTNERS
As Featured in Worth Magazine

WORTH.COM

02

VOLUME 18 | EDITION 02



BEHAVIORAL INVESTING

What it is: A philosophy informed by the notion that it is simple human nature to make errors of judgment when investing due to our fear of loss and regret over missing gains, among other human idiosyncrasies—and that, rather than fighting these tendencies, investors can compensate for them.

Who swears by it: Guggenheim Partners, a wealth management firm that has incorporated behavioral principles into its investment philosophy.

The elegant financial models that have defined modern finance for decades have left many investors deeply unsatisfied. The assumption that markets are efficient and stocks accurately priced, these critics say, just doesn't stack up against the bubble and bust experience of past decades.

"In terms of building portfolios, the idea that markets are normal—that precipitous changes just never occur—that, I think, is clearly wrong," says Andrew Rosenfield, chief executive of Guggenheim Investment Advisors, the wealth management division of Chicago-based Guggenheim Partners, which oversees about \$40 billion. "Nobody believes in the perfection of pricing capital assets in such a way that you don't have inexplicable and massive changes in asset values."

This is a relatively recent view. Until the 1980s, the Efficient Markets Hypothesis was accepted as gospel. But in the '90s, two academic psychologists, Amos Tversky and Daniel Kahneman of Stanford and Princeton universities, respectively, began a series of groundbreaking experiments

examining how people make decisions involving risk. Their work culminated in Prospect Theory, which holds that, among other findings, people feel regret from financial loss more acutely than they feel the joy of gains, yielding a preference for "loss aversion." This work spawned an entirely new branch of economic and financial analysis called behavioral finance and won Kahneman the Nobel Prize in economics in 2002.

Perhaps more than any other firm, Guggenheim has taken these lessons of behavioral finance to heart. Not only has it aggressively integrated key concepts like loss aversion into its approach to managing wealth, the firm has also hired Kahneman as a consultant. The process that the Nobel laureate helped develop for the firm, dubbed Riskometry, uses a series of proprietary interview questions to uncover how much a client is willing

to put at risk in the pursuit of gains.

Untangling feelings about gain and loss lead to smarter investment decisions, says Rosenfield. The problem is that most people want to make a lot of money while never losing anything—two goals that are fundamentally in conflict and trigger all sorts of bad behavior, such as buying and selling investments at exactly the wrong time in order to chase performance in a rising market or sidestep losses in a falling one.

Guggenheim seeks to curb such bad behavior by splitting client assets into two distinct portfolios, one called "conservative," which is designed to preserve wealth by minimizing losses, and another called "bold," which takes additional risk with the aim of achieving higher returns. How each client defines "conservative" and "bold" is a function of their unique Riskometry profiles, which can vary widely. •

BOTTOM LINE:

Adopting simple behavioral principles such as segregating your portfolio according to the risks you're willing to take can save you from making bad decisions—and help you feel calmer about your investments.

OTHER NOTABLE INVESTMENT APPROACHES:

GROWTH INVESTING

Owning shares of companies that exhibit above-average rates of growth irrespective, to a certain degree at least, of how expensive the shares are based on common valuation metrics like the price-to-earnings ratio.

MOMENTUM INVESTING

Buying shares of companies with recent strong returns and selling those with poor returns, based on the notion that trends in the market often continue for a time and can be exploited. Instead of "buying low and selling high," momentum investors buy high with the aim of selling even higher.

HEDGING

This approach isn't always employed for its original purpose: cushioning a portfolio from the bumps and bruises of the market by maintaining a significant portion of the assets in a hedged structure at all times, typically achieved through short-selling. Today some hedge funds "hedge" only opportunistically; many tend to invest the overwhelming majority of their assets on the long side, leading to declines when the market is falling.