

# UN-MEASURED IS UN-MANAGED

## A Story About UNCOMPENSATED RISK

### Part One

Through Investment Policy Statements or advisers' strategies to arrive at an asset allocation, a portfolio's Compensated Risk (CR) is usually well managed, while the management of Uncompensated Risk is usually ignored and remains Un-Measured. The result has been Un-Management of Uncompensated Risk (UCR) along with a substantial amount of money being left on the table.

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We have examined hundreds of ADVs and especially Section 8 – Investment Strategies and Risk of Loss. One adviser got it right when describing in their ADV: “*Our investment philosophy is that asset allocation and diversification protects portfolios.*” However, like many advisers they assume the mean-variance compensated risk process has simultaneously created a well-diversified portfolio. BUT - - - - -

Envision this: You start out with an inheritance or court award and all in U.S. T-Bills. At that point there is no Compensated Risk or Uncompensated Risk (UCR). But, during the asset allocation process, including Mean-Variance Optimization, UCR is created and even made worse by constraints on one or more investments or sectors.

The law says you must prudently reduce UCR and in order to do so *a second step has to be measuring the amount of UCR* in the newly created and constrained portfolio and to identify those assets that carry the *UCR plague*. In order to comply and also enhance the portfolios returns with less risk you must take out the “bad apple” investments and replace them with non-closely-correlated assets that also contain low semi-deviations peppered with a small weighting for momentum. It takes an algorithm like ours to do this and usually has the effect of a higher Sharpe Ratio when these seemingly minor but significant changes are made.

See the dissimilarity between CR and UCR - <http://precisionfiduciary.com/PrudentRisk/>

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Watch for Part Two of Un-Measured is Un-Managed next week.

and

Save the date for our AICPA webinar at 12:45 pm EDT on June 19, 2019

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