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Nobel Laureates Agree - It's Time For A New Approach

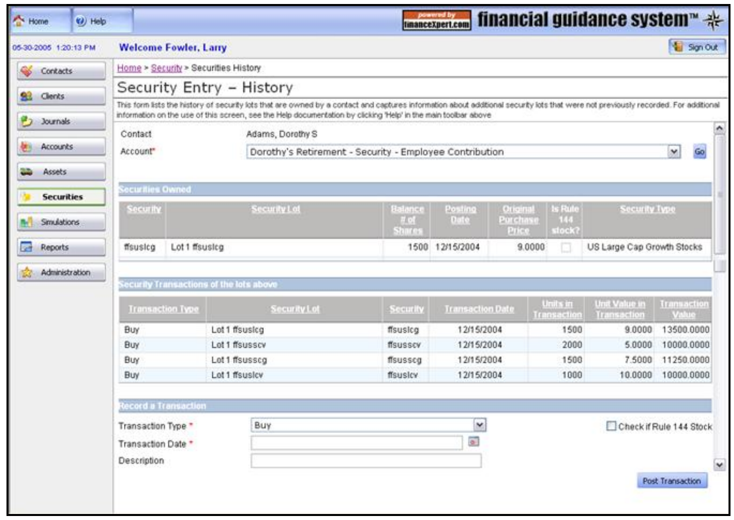
Daniel Kahneman won the **Nobel Prize** for economics in 2002 for observing that Modern Portfolio Theory does not explain how individuals make investment decisions. He recommends that financial advisors guide client behaviors, rather than attempt to predict market returns.

So what can you do for clients who need to spend money when markets aren't producing expected returns?

"While risk statistics work well for estimating risk during normal market conditions, they cannot predict the occasional, unexpected crises that result in extreme market shocks. To address this issue, we recommend ***stress testing****." (RiskMetrics Group 2005)*

More than anything, clients want to know they will have enough liquidity to do the things they want to do when they want to do them. To guide clients effectively, financial advisors must focus on **event risk management**. This requires advisors to understand two critical issues. First, the sequence and timing of financial events have a profound effect on the persistence of wealth. Second, the best way to comprehend how clients are likely to respond to financial events is through **"event simulation"**.

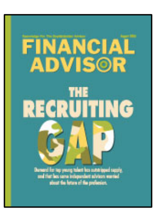
One of the fathers of Modern Portfolio Theory is also having a change of heart, according to an article by Rick Miller in *Investment News* (May 9, 2005):*"William F. Sharpe, the Nobel laureate in economics whose capital asset pricing model set the framework for optimizing investment portfolios, is researching how baby boomers can optimize their income streams in retirement."*



Quoting from the article: *"With scant academic research in the area, several academics who work on retirement income strategies welcome Mr. Sharpe's entry into the field."* What is telling about the fact that Bill Sharpe is working on this is that he is essentially saying that the tools that have been developed over the last 30 years - that he had a major part in developing, that are applicable to the savings side of the life cycle - are not applicable to the dis-savings side of the life cycle," said Moshe Milevsky, an associate professor of finance at the Schulich School of Business at York University in Toronto.

"So what he is essentially saying is, new thinking is required," added Mr. Milevesky, author of the upcoming book "The Calculus of Retirement Income" (Cambridge University, 2005).

financeXpert founder Larry Fowler joined Jeffrey Rattiner for an insightful article on "Averting Disaster" published in the August 2005 issue of Financial Advisor magazine. http://www.fa-mag.com/issues.php?id_content=2&idArticle=1027



financeXpert

1420 NW Gilman Boulevard #2656, Issaquah, Washington 98027

Phone and Fax 425-458-4998

www.financexpert.com