Risk: 7 Ways to make Risk work for you

By Ken Breivik, President
Nehemiah Communications

Subtitles: Why you need it and how to be smarter when taking it. Bitcoin and options my biggest gain and biggest loss.

I think the oldest of the adage I was raised with was the phrase, "Nothing ventured, nothing gained." I really believe that what has made America a great country from an economic standpoint is the free market and people being encouraged to take chances, but then allowing them to reap the reward for those chances when they paid off and knowing that often many failures would occur before success. From America's early days both in the professional and innovative arenas we see people or things that were failures that eventually led to success. Examples on the professional side, are people like Walt Disney who were fired because he "lacked imagination and had no good ideas" and on the invention side, things like WD-40 (the number 40 comes from the complete failures of the first 39 versions).

If you go on the internet and read about risk, you get the general idea that winning in risk involves nothing more than keep running into a wall until eventually the wall will fall. In other words, repetition is the only way to make risk work. Another adage that makes this point is, "If at first you don't succeed try, try again." Certainly, repetition can help you achieve things that seem impossible. I am getting closer to having a silver ring that I have made through tapping a spoon on the edge of a silver half dollar for years, but could I have gotten a silver ring cheaper and easier through other means? Certainly! I believe I could run into a brick wall every day for the rest of my life and it is unlikely that the wall will fall down. So, the real question is how do you know risks that will eventually pay off versus risks that will never pay off?

What got me interested in writing this paper was two things: 1) the recent mania over bitcoin and 2) two people who I care about, one of which defined me as very financially conservative and one describing me as a big risk taker. I think both of these people are right. I do take a lot of risk, but I think that I have gotten smart in the risks that I take. So my risks are, well….. less risky.

Here is how I evaluate risks before I take them.

Measure Risk-Reward

Risk needs to measure against the reward. You should have a good idea of what you are risking and have an idea how this could pay out. Warren Buffett pointed out that since he has been investing for about 50 years the stock market has gone up an average annual rate of 9.8%. Over his life, he has had many investments that have not paid out for him, but he is one of the richest men on the planet and there have been many years that the stock market has lost money. Often the key is what can you do to lessen the risk. He does this by buying when the market is heavily sold off and when the market feels extended, he starts to build cash up, so he can buy when others are selling. If a business or investment is a high-risk proposition that is o.k. if there is a very very high opportunity for returns and your investment is very very small.

Minimize risk through diversification.

Anyone giving good investment advice will tell you that you should diversify your portfolio to minimize your risk. I historically try to never have more than 12% of my money in any one investment and my money is scattered between real estate, stock/bond market and my business. In the above point, I mentioned that it was o.k. to have some high-risk investments if they generated high returns, but I would recommend that these investments be the smallest part of your portfolio. In my business I am constantly looking for new products that I can develop that will help my customers succeed and that they would be willing to pay for. My first year of owning Nehemiah Communications the bulk of our money was being made through T.V., radio and newspapers ads. I was really intrigued with the idea of websites and we started working to add that to our mix. Last year we did a large number of websites and I did not sell a single T.V., radio or newspaper ad. Diversifying our mix of services has allowed us to continue to grow and find new opportunities as others have closed. Some people know my photography work and that has really developed as an outgrowth of expanding our services to help our customers. You can get overextended, but I would always recommend a business or investment be diversified to at least six to eight different sources.

Do your own homework and be careful of experts.

In my early days of investing I lost some money listening to experts both in person and on tv who “knew” what the next big investment was. Generally doing homework has led me to avoid more risk than it has led me to take. I honestly cannot think of a time when I did my homework and an investment looked bad that it actually paid off. If the risk is a business you want to start, you really need to understand as much as you can about that business. Talk with people that run similar companies or even better go to work for one until you learn the business (let someone else take the risk for you). In financial investing. start with investing in companies you understand.

Set Limits (Time and Monetary) on your risk.

If you want to explore a new business or new investment decide before you get too deep into the process how long and how much capital you are willing to commit. This may be the hardest of the points to balance. Often business owners, including myself, during the start-up phase trade a salary to buy more time. You may decide to stay in longer than your original limit, but it should be a warning sign if you are both well over budget and have made little progress toward your goals. Investment limits might be that once you make “x” amount of money you will get out of the investment. Picking good investments is easier than knowing when to take profits.

The most money is made doing the opposite of the crowd.

A great way to go broke is to do what everyone else is doing. Both the dot.com and housing bubbles hurt many people who had no experience in investing in internet companies or remodeling or houses for the purposes of flipping them. Following a trend can be smart, but once everyone is talking about the investment and it seems like the "crowd" is all wanting to invest that is generally a good time to get out. The investment still might work for a while, but it is better to start looking for a new opportunity. My first major investment in the stock market came a few weeks after the dot.com bubble crash. The crash caused all stocks to go down and I reasoned that it was crazy to think this changed the value of some of the large stable companies. I borrowed some money from my mother and invested in the broad market. Sure enough, the market rebounded. I returned her money with interest and had a nice war chest to invest with.

If something is getting too good be the first to get out.

Sometimes you get it right. You take a risk and it really pays off for you and as above more people are joining you in your investment. As you reap the rewards of your risk taking you need to review two of the previous items and ask yourself a question, "Have I made the money that I wanted to make and now that the crowd is in what is my new risk-reward?" You will rarely regret taking profits but will hate yourself if you made lots of money only to lose it all.

Only risk what you can afford to lose (and still sleep at night).

I sometimes take "a flyer" on a high-risk investment, but generally, I invest no more than 1 to 5% of my investible money on these high-risk investments. I won't love it, but I will not lose sleep over a one to five percent loss. If I lost 20% of my money to a single investment and knew I would not get it back, that would be too painful for me. What your personal pain tolerance is should be a factor of your net worth and age. The nearer to retirement and the more strained your finances the less risk you should take.

A real-life success and failure from the investment world of evaluating risk.

So just to make this practical I wanted to look at my worst and best financial investments of the last two years. My worst was what I will call a lazy investment. I had bought some options on the general market that were to expire near the end of January. This was a trade I had done many times before and made money, but this time I went over my normal cap of any one investment being over 10-15% of my money. I did not do my homework and had failed to notice that the market was looking overextended and failed to catch things early when the investment was going south. I then saw that everyone was exiting and the "experts" were telling people to get out. I went against my normal risk-taking strategies and followed the crowd out of the investment and lost a good deal of money only to see the market rebound in just a few days.

My best investment was investing about 2% in bitcoin at a little over $4,000 per coin. In a few months, it was worth $17,000 per coin. Everyone was talking about it and it had gone from being a 2% flyer to jumping to almost 10% of my investment money. It was really hard to start exiting the trade when everyone was talking about it. Both the experts and the crowd, but it was suddenly worth more than I wanted to risk and I knew that if the crowd was entering it would just get riskier. While bitcoin would go briefly over $19,000 a share it has dropped since then. Can it go up from here? Certainly, but I am looking for something else that the crowd is not looking at and I made more money then I originally projected. I can walk away having made money and not worry about the wild swings it is now going through.

Closing Thoughts.

I am in no way trying to encourage people about what they should or should not invest in or what types of businesses they should or should not go into. The main point I want to get across is that you cannot make risk work for you just by continuing to do risky things. Risk has to be measured against reward and against your personal situation and passions that you have. But only a fool takes needless risks without looking for ways to minimize the risk and giving oneself the best opportunity to benefit from the risks that are being taken. I think risk is important, but I think many Americans are not only risking adverse but also think that others and the government should bail them out from their risks. The way I have learned from my risks has always been through my failures. When you waste a lot of time or money on a bad choice you won't forget it. Failure is often a critical component to future success and if others take that pain away then they are taking away our future success.

I am wishing all of you future success, even if it is a little risky!