

Yes Another Investment Risk

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The market goes up. People feel good. The market goes down. People feel bad. Does the common man, Joe Blow, have any influence on either of these conditions?

Not unless Joe Blow is an alias for Jerome Kerviel, France's Societe Generale bank employee, recently in the news. He is blamed for starting a series of events that lead to a \$7 billion bank loss. This, in turn, may have been what sent the market so sour on 1-21-08 in Europe (that's Dr. Martin Luther King Day here) and resulted in a dramatic downturn in US futures. Societe Generale was reportedly unwinding positions into a down market.

There are lots of uncontrollable risks (see below) for stock market participants like the one above technically called market risk. When it occurs and results in an unexpected downturn, the investing public feels helpless because there is nothing they can do to influence market direction. In other words, market participants have little or no control over market risk and other investing risks as well such as inflation, business and currency (see below).

Another Risk

Now we can add a new risk to the list for stock investors. It's holding a large account at E-Trade. This is because the E-Trade bank division was heavy in mortgage-backed securities, which they have yet to totally get off their books. This means the whole company is financially fragile, and, in the worse possible case, could go under.

The difference between this new risk and more traditional investment risks (again, see below) is that it is controllable. This concept is important to physician-investors who have to manage risk and essential to those with large E-Trade accounts. This is why.

Holders of large accounts at E-Trade can choose to transfer them to a more stable brokerage firm. In this way, they can rid themselves of this added investing risk that they can control. In a previous column I reviewed the reasons I kept my account at E-trade in spite of a Citibank prediction in November that there was a 15% chance that E-trade might file for bankruptcy. More recently, I have reconsidered this position.

If E-Trade fails due to its bank division mortgage backed securities fiasco, one of two things is likely to happen. It will be taken over by another firm or it will declare bankruptcy. The stimulus for another firm to buy E-Trade is to acquire its book of business. But, other firms are already gaining its business because E-trade account holders are transferring their accounts. This suggests that there is less stimulus for a competing firm to acquire E-Trade because it is already getting what it wants—new account transfers. Additionally, with the stock market taking significant dives, an acquiring firm may feel less comfortable about taking on new debt.

Will a bankruptcy happen? Certainly, everyone hopes not. However, if it does, accounts may be frozen for quite some time. This is incapacitating for the client, especially for the investor who has most of his/her money at E-Trade. Frozen accounts cannot be traded, and in an increasingly fragile market where opportunities abound, this could mean inability to trade the account in a favorable timely fashion.

Take Control

Acknowledging this controllable risk is what I am doing when I transfer the most vulnerable portion of my E-Trade portfolio, the cash and bond segment. If they were frozen, I would be unable to trade and could miss market opportunities. I include the bonds because they are all short term and will turn into cash at some time in the near future.

Although I am generally happy with my interactions with E-Trade and my Platinum representative in particular, it is time to diminish the one controllable investable risk over which I do have power—the brokerage firm that holds my account.

Risk Defined

- **Inflation Risk**—A dollar buys less than it used to. Solution: Earn more dollars at your job so that you can continue to buy good and services, or make more money on your investable dollars. Stocks, rather than bonds, are usually a good choice for inflation risk because they are more likely to keep up with inflation.
- **Business Risk**—A promising business you invest in may unexpectedly fail (think Enron). Solution: Invest in many businesses (diversification) so that all your eggs aren't in one basket.
- **Currency Risk**—There is an increased risk when investing abroad because US dollars may or may not be highly valued compared to other currencies at the time the purchase is made. For example, today the dollar is weak. This means it buys less in other currencies than normal. Solution: There is no way to avoid this risk, but using asset allocation and keeping 20% or more in a diversified international fund that is purchased at different times can help attenuate it.

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