

Why You Need Forward-Looking Stress Testing



Investors get into the market to build a financial future that enables the life they dream of. As a financial advisor, it's your job to help clients reach their goals.

But because every person approaches investing differently and with unique outcomes in mind, there is no such thing as a one-size-fits-all portfolio.

With so much variation in risk tolerance and stated goals, forward-looking portfolio stress testing software helps advisors guide conversations with each prospect and client. When you can present a picture of potential outcomes, rather than assessments based purely on past performance, you can help your clients move forward with their investing journey.

Here are three reasons why forward-looking portfolio stress testing is so beneficial.

1. Portfolio Stress Testing Helps Separate Uncertainty from Risk

Uncertainty is a part of life, and while the idea of uncertainty is connected to risk, it's not the same thing.

Consider your decision to get behind the wheel of your car each morning. There is uncertainty and risk involved in any commute — there are millions of accidents on the road each year.

While you can't guarantee you'll reach your destination without an accident, you

can take steps to mitigate your risk, like buckling your seatbelt and resisting the urge to text until you've reached your destination.

As a fiduciary financial advisor, forward-looking stress testing can help you educate your clients on the difference between uncertainty and risk in their financial decisions.

First, there's the education piece: forward-looking stress testing helps you teach clients about potential impacts of uncertainty and risk on their portfolios. Uncertainty is inherent in a global economy — unpredictable macro events will happen in the world, and they will lead to reactions in the market.

Once your clients understand where the uncertainty lies, then you can show how your fiduciary work addresses risk. Stress testing allows you to demonstrate your hedging techniques in action, and investors can see what you're doing to help mitigate risk in the face of an uncertain future.

2. Stress Testing Showcases Potential Upside, Too

When you talk about stress testing, risk is central to the conversation. But the flip side of any potential risk is a possible reward.

Clients with a longer time horizon may build portfolios that accept a greater risk because they wish to chase the bigger upside. Others — like those in their retirement years — are willing to forego potentially sizable returns in exchange for relative security.

As a financial advisor, it's your job to align a client's portfolio with their risk tolerance. Forward-looking portfolio stress testing software allows you to run the investment strategy you've created through hypothetical scenarios, showing your client how you've accounted for potential upside and downside in their portfolio.

For those clients with longer time horizons, forward-looking stress testing scenarios are an opportunity to show how greater short-term risks may result in long-term returns that align with their goals.

For your more conservative clients, stress testing software can showcase how you aim to insulate against short-term risk while still delivering an attractive hypothetical upside.

3. Stress Testing in Risk Management Shows the Big Picture

The global economy is like a giant ecosystem. One seemingly distant fluctuation can have ripple effects in unexpected places. With forward-looking stress testing, you can better see these surprising knock-on effects and illustrate them for clients.

Orion Risk Intelligence incorporates a parametric regression model into its stress testing software. It considers 60 to 70 economic indicators and regresses each one against each security in a portfolio. When one lever moves, they all react. The model is designed to consider those inextricable links in our global economy.

As you swap different asset classes and holdings in and out, your client can see the potential effects of each action in real-time. Visualizing these impacts on their holdings with real scenarios helps your client consider the future of their portfolio. And it makes it easy for you to demonstrate the proactive thinking behind your proposed investment approach.

Most advisors today rely on stress testing built on historical scenarios. While past information is helpful to a point, forward-looking stress testing helps clients understand potential risks and rewards in a whole new way. When you can visualize real-world impacts on a portfolio, you can better assist clients in building the financial future they want.

Tune into our on-demand webinar to see how the powerful combination of Orion Risk Intelligence model management and stress testing capabilities can give you a competitive edge in any market.

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