Key to Educated Investing—Manage Risk

There are things we can control and others we cannot. Financial risk adheres to this actuality—there are controllable and uncontrollable risks. Successful physician-investors must be able to identify the difference between the two types before they can take advantage of the opportunities presented by learning to manage risk well. Learning to recognize the differences enables physician-investors to maximize investment opportunities and eliminate concern regarding events that are uncontrollable. It is important to understand both aspects of risk to ensure sound investment decision-making as well as weather today's turbulent markets.

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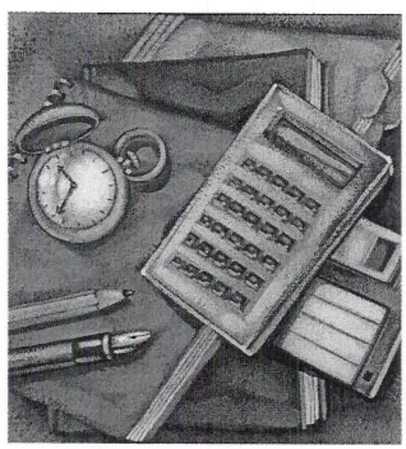
IN AND OUT OF CONTROL

Systemic or market risk is the uncontrollable variable for investors. It is risk created by major events, such as the war in Afghanistan and the Russian financial crisis of 1998. Unsystemic risk is the controllable factor. It's just like giving yourself 30 minutes extra to get to an appointment so that the probability of arriving on time is greater. When it comes to investing, it's doing your homework and understanding the intrinsic value of your holdings so you can make educated decisions regarding your investments, rather than relying on diversification and hoping that everything turns out okay.

The market volatility that we have experienced over the past 18 months is a product of what we as investors can (unsystemic risk) and cannot (systemic risk) control. Uncontrollable risk causes investors to act irresponsibly by hastily selling valuable stocks without careful evaluation. Uninformed investors tend to broad-brush the market due to an urgent need to take action to temporarily minimize losses. However, investors must not generalize the market based on general perceptions because you don't ever invest in the market—you invest in individual companies.

Generalizations would cause you to believe all New Yorkers are curt or all Californians are lackadaisical. When, on the contrary, recent events have shown New Yorkers to be quite generous, and Californian inventiveness has given rise to revolutionary businesses, including Cisco, Oracle, and Sun Microsystems.

Evaluating the market is no different. We must avoid generalizations to minimize losses. For example, if Microsoft was a buy at $55, then, assuming all unsystemic factors are constant, it is definitely a buy at $20. We all wait for the $500 shoes to go on sale before we buy them. The quality of the shoe is the same, but the value we get for the shoe increases because we purchased it at a lower price, the same applies to Microsoft.



The ability to recognize the fact that systemic selling of stocks occurs and having the ability to take advantage of those situations can provide you with greater leverage. Using risk management as a tool, you can evaluate companies for their true value and identify bargains in the market.

KEY RISK FACTORS

The following steps can help you invest with a greater awareness of what you can and cannot realistically control:

- Never act on your investments when you might make an irrational decision.
- Manage your own expectations of the market, and remember that you invest in individual companies, not "the market."
- Do your homework and research companies before you have any money at stake.
- Continue to monitor the progress of your investments and remember that investing means ongoing research.

I always say that if you cannot accept risk or at least temporary market fluctuations as part of your investment strategy, you shouldn't be investing in public companies. Managing risk is the key to educated investing. The first step is to develop a keenness for identifying uncontrollable (systemic) vs. controllable (unsystemic) risk and making smart decisions on the evaluation of both.