



# Longbow Asset Management Company

## Quarterly Investment Note February 13, 2006

Events of the last decade, most notably the twin, indomitable forces of rapid technological progress and globalization have supercharged the pace at which today's financial markets operate. As cheap electronic memory and powerful computer processors have increased our ability to store and analyze data, globalization, coupled with high bandwidth communications, have exponentially expanded the amount of data to be analyzed. The result is a continually accelerating hyper information cycle.

This trend will continue as tomorrow's markets will contain greater complexity, be more competitive, and move at a faster pace than today's. Technology will allow developing economic powerhouses, such as Brazil, China, and India, to become central players in the global financial markets rather than merely sideline participants. In short, as our world increasingly becomes continuous and global, time and location will correspondingly become less important.

As in the past, challenging new problems will be solved with innovative solutions. Financial engineers proved their worth in the 1980s when they waved their securitization wand and turned masses of small, illiquid, and heterogeneous mortgages into investment grade bonds. The alchemy of securitization has now turned everything from credit card balances to intellectual property rights into marketable securities. Going forward, securitization will continue to crossover to new asset types.

History also demonstrates that new risks require new risk management tools. For example, the late 1990s witnessed explosive growth in the currency, interest rate, and credit default derivatives markets as a direct response to the demands of globalization. More recently, derivatives concerning weather conditions and economic reports have become available. Now, financial market participants can mitigate their risk exposures in these areas where appropriate.

How can investors be successful in today's multidimensional, highly amplified financial market environment? Our firm advocates adopting a back to basics approach.

Now, more than ever, it is critical for investors to clearly define their investment objectives and to come to realistic terms with their personal risk tolerances. In addition, investors should adopt a long-term, big picture perspective. Taking these steps will help tether an investor's wealth to their goals and keep them grounded whenever global financial storms blow across their continually diminishing horizon.

Rather than avoiding risk, investors should avoid taking poorly understood risks, unnecessary risks, or intolerable risks. It is noteworthy to point out that for financial purposes the standard English definition of risk is deficient. Merriam Webster's dictionary defines risk as: "*the possibility of loss or injury.*" By contrast, in Chinese, the symbols for risk are a combination of the symbols for "danger" and "opportunity," which is more reflective of financial risk.

Financial markets are complex and continually evolving. To gain clarity amid this backdrop of constant change our firm strives to help its clients distill what truly matters – namely their investment objectives and risk tolerance – and discard what does not. Thus, our antidote to complexity is simplicity.

Below is a highly instructive list of risk management rules established and promoted by RiskMetrics Group<sup>TM</sup>. The rules are concise, elegant, and powerful. They represent the steadfast logic necessary to tame today's financial market complexity.



## **9 RULES OF RISK MANAGEMENT**

by RiskMetrics Group™

- 1 **THERE IS NO RETURN WITHOUT RISK**  
Rewards go to those who take risks.
- 2 **BE TRANSPARENT**  
Risk should be fully understood.
- 3 **SEEK EXPERIENCE**  
Risk is measured and managed by people, not mathematical models.
- 4 **KNOW WHAT YOU DON'T KNOW**  
Question the assumptions you make.
- 5 **COMMUNICATE**  
Risk should be discussed openly.
- 6 **DIVERSIFY**  
Multiple risks will produce more consistent returns.
- 7 **SHOW DISCIPLINE**  
A consistent and rigorous approach will beat a constantly changing strategy.
- 8 **USE COMMON SENSE**  
It is better to be approximately right, than to be precisely wrong.
- 9 **RETURN IS ONLY HALF THE EQUATION**  
Decisions should be made only by considering the risk and return of the possibilities.

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Each of our firm's clients is unique and each has different investment goals. We work efficiently and in a disciplined manner to design investment solutions to meet our clients' needs. We invite you to call our office at (918) 295-9929 or send an e-mail message to [jakedollarhide@lbamc.com](mailto:jakedollarhide@lbamc.com) if you have any questions or need assistance anytime. We are always available to help and we appreciate your trust and confidence.