Revealed: 1 Portfolio Management Strategy Used by Super Rich Investors

Description

The biggest difference between beginner and high-net-worth investors is their approach to risk management. For beginners, the thought of getting rich quickly steers them toward riskier assets that may be too much for them to handle given their risk tolerances. Wealthier investors, on the other hand, seek to obtain the highest returns when adjusted for the risk they'll take on through the help of professional high-net-worth portfolio managers.

One does not simply jump into the stock market on the assumption that stocks will continue to go up in a straight line, as they have most recently. Oftentimes, investing based on momentum is a sure-fire way to scare oneself out of the market for good.

Investing with the goal of achieving the highest returns possible seems like an obvious choice for beginners, but there's a world of difference between trying to score the highest return and trying to obtain the highest risk-adjusted return.

It's the neglect of risk management that causes many beginner investors to fall behind, as high-net-worth investors gain a leg up over the crowd. While the risk tolerances of investors are unique to themselves, most beginners who chase the "sexiest" of growth stocks at any given time are likely wandering outside of their risk comfort zones without realizing it, at least not until the declines begin.

With that in mind, a more prudent approach to constructing a portfolio would be to start with a foundation of blue chip dividend-paying stocks with a low degree of correlation relative to other constituents in the portfolio as well as the broader market indices. This lower degree of correlation allows investors to better prepare themselves for a volatile storm that could easily wipe out most other portfolios that focus on upside potential.

You see, the wealthiest of clients don't want to take on excessive risks for a chance to get rich quickly. They don't treat their portfolio as a lottery ticket and neither should beginners, most of whom are risk-averse by their very nature. So, instead of trying to chase returns, investors should focus on finding the perfect balance between minimizing downside risk and maximizing upside potential, rather than focusing solely on the upside.

Given that we're in the late innings of the market cycle, it would only be prudent to balance a portfolio that considers the minimization of downside risk. Although such a conservative strategy may seem like a huge dampener of returns in an up market, consider how the **BMO Low Volatility Canadian Equity ETF** (TSX:ZLB) has fared since its inception. As a lower-risk, one-stop-shop low volatility play, you'd think that the index consistently underperformed the TSX or **S&P 500** over the years, but this hasn't been the case, as I've highlighted in a prior piece.

"Since the ETF's inception, ZLB has clocked in greater total returns that both the S&P 500 and the TSX Index," I said. "Not only are you taking on less volatility, but you're also not compromising on the return front. And as the waters become rougher, one has to think that the outperformance exhibited by the ZLB will become even more pronounced."

Foolish takeaway

There's no shame in buying a low-volatility ETF like the ZLB. The smart-active, low-beta ETF is a new line of low-priced (0.4% MER) investment products that can help today's beginners invest like the super rich with minimal effort. Given that we're in the latter stages of a decade-long market cycle, I consider the ZLB to be the quintessential basket of stocks to own as the road ahead becomes that much rockier.

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