



Portfolio Risk Management: Beyond Avoiding Pain to Capturing Opportunity

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Effective portfolio risk management must balance downside protection with upside participation. While the industry often fixates on avoiding losses (selling high), true long-term success requires systematically buying low—turning temporary market weakness into compounding opportunities. A prime example is portfolio rebalancing: trimming overweight positions (selling high) and adding to underweight ones (buying low). Yet, too often, risk conversations begin and end with drawdowns, neglecting the wealth-building power of disciplined buying during dips.

Why the Industry Obsesses Over Drawdowns

Advisors and institutions prioritize downside risk for compelling reasons:

Recovery Math	Losses require disproportionately larger gains to break even.
Behavioral Bias	Clients feel losses 2x more than equivalent gains (prospect theory).
Historical Trauma	Bear markets like 2000–2002 and 2008 left deep psychological scars.
Sequence of Returns Risk	Drawdowns in early retirement force selling more shares, permanently impairing sustainability.
Regulatory & Fiduciary Duty	Advisors must demonstrate prudence; regulators scrutinize large losses.
Business Survival	Client retention hinges on trust—big drawdowns trigger outflows.

The Rarity of Meaningful Drawdowns

Despite the focus, severe drawdowns are statistically uncommon. 5% dips are noise—the cost of equity participation. 10% corrections are routine. True bear markets? Only 1 in 5 years (20% of time). Why devote 80% of your risk budget to events that occur just 20% of the time? Instead align effort with probability: commit 80% of strategy to the 80% of outcomes that drive returns.

*80% of market history is NOT a bear market.
Focus 80% of your strategy on the 80% of time markets are rising or recovering.*

Drawdown Level	Annual Probability	Frequency
≥5%	~96%	Nearly every year
≥10%	~57%	Every ~1.8 years
≥20% (Bear Market)	~20%	Once every ~5 years

Delayed Re-Entry Signals

FOMO (Fear Of Missing Out)

Conclusion

Rebalancing Triggers	Incorporate dynamic rebalancing triggers versus static rebalancing dates (quarterly, annual).
Treat 5-10% dips as noise	Avoids panic selling, reduces whipsaws. Treat as opportunities to rebalance and add new money.
Focus on entry signals and upside participation.	Incorporate techniques that focus on entry signals and upside participation versus only those that focus solely on exit signals and limiting drawdowns.

*Risk management isn't just
about eliminating pain; it's
about turning temporary
setbacks into permanent gains.*