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The impact analysis of financial risk management on ordinary investors' asset allocation

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Abstract: The development of financial market usually makes ordinary investors burst into a new round of vitality, but it should be noted that ordinary investors often lag behind professional investors in terms of professional knowledge. Especially in the financial market where the corresponding system is still being improved, it is more important to guide the investment behavior of ordinary investors. Therefore, taking ordinary investors as the object, expounding the types of financial risks briefly, analyzes all kinds of financial risks by using the risk management theory, and points out the importance of fully managing corresponding financial risks for ordinary investors to effectively allocate assets. Also for the financial industry group of ordinary investors recognize the financial risk management operation affect the efficient allocation of assets, begin to pay close attention to financial risk management, learning financial risk management, and gradually to professional investors, thereby realizing the rational and effective investment enlightenment and reasonable suggestions are put forward.

1. Introduction

In recent years, with the improvement of China's comprehensive financial strength, China's financial industry has gradually embarked on the road of vigorous development. However, we should pay more attention to the coexistence of opportunities and challenges, and the positive correlation between income and risk. Investors who have promoted the development of the financial industry generally have some ideas that selectively ignore risks, are not prepared or believe that risks will not happen to us. When they happen, they may have caused us to suffer more serious losses. Therefore, it is increasingly important to truly understand, predict and effectively manage the changing financial risks in today's uncertain world.

2. Theoretical Overview of Financial Risk Management

2.1. Definition of Financial Risk

Risk generally refers to the uncertainty of future results caused by internal and external factors directly or indirectly. Scholars at home and abroad have expressed and defined this concept in different forms. At the same time, financial risks are divided into risk behaviors of multiple levels, categories and categories. At the same time, risks are divided into systematic and unsystematic risks according to whether they can be decentralized, and the two together constitute the total risk; According to the drivers of risk, it can be divided into major financial risks (operational risk, liquidity risk, market risk and credit risk) and other financial risks (strategic risk, reputation risk, legal and compliance risk and country risk) [1].

2.2. Financial Risk Management Theory

The core of financial language usually refers to financial risk management, which involves the identification, quantification and control of financial risks. At the moment when the development of economic globalization promotes the process of financial integration, financial risks become more multifaceted and multi-level, and their complexity is different from that of the past. The influence and interaction between risks are also increasingly strengthened. At this time, the necessity of effective management of financial risks becomes more and more prominent. At the same time, from the perspective of historical events, financial risk management has experienced three major development processes since its emergence.

The first aspect is the constant mutual penetration between the economy and the financial market. The financial market frequently fluctuates greatly, and the world economic trends and rules have also undergone tremendous changes, which has promoted the industry's growing demand for relevant theories and tools such as technical methods for managing financial risks. After World War II, the process of world economic integration also promoted the development of economic openness. Secondly, in the early 1970s, as the dollar crisis rose to the frequent outbreak of the American economic crisis, and with the contradiction that the system itself was difficult to adjust, the Bretton Woods system finally declared a formal collapse, which also represented the decline of the fixed exchange rate system worldwide. After that, companies and individuals have to face various financial risks such as exchange rate risk and country risk in the process of investment. Especially in the past ten years, there have been many financial crisis events that have swept the world with surprising destructive power, such as the "Black Monday" that swept the global stock market in 1987, the Asian financial storm in 1997, the U.S. subprime mortgage crisis in 2007-2009, and so on. The outbreak of financial crisis events again and again has caused enormous obstacles and damage to the healthy development of financial markets and the world economy, prompting people to recognize financial risk management, thus realizing the necessity and urgency of financial risk management [2].

Second, the progress of economics has driven the development of financial theory and provided the corresponding theoretical basis for the development of financial risk management. After the 1960s, finance began to establish its status as an independent discipline and derived a large number of classical financial theories and models that were widely accepted and used by the broad financial theory and practice circles. For example, "CAPM Capital Asset Pricing Model" designed by William Sharp and John Lintner, etc., "Efficient Market Hypothesis" theory proposed by famous American economist Eugene Fama, "Option Pricing Model" of Black Scholes, "Arbitrage Pricing Model" of Stephen Ross, etc. After the 1970s, neo classical economics began to establish a set of economic analysis framework based on information and risk, which occupied the mainstream

position of economic research in the economics circle at that time, prompting people to re-examine the traditional economic development theory model.

2.3. Current Situation of Financial Risk Management

Since the reform and opening up, China's financial system has entered the track of rapid development, especially after becoming a member of the WTO World Trade Organization and gradually entering the international market, it has officially entered the right track, which also makes China's financial industry and financial institutions begin to grow in order. Whether from the perspective of system, concept or investor awareness, the two regulations of the State Council's Decision on Amending the Regulations of the People's Republic of China on the Administration of Foreign funded Insurance Companies and the Regulations of the People's Republic of China on the Administration of Foreign funded Banks have been continuously improved, which has enhanced the people's confidence in the development of the domestic financial industry while opening up the new financial structure. Ordinary people began to gradually participate in the financial industry and invest through reasonable asset allocation as ordinary investors and professional investors, among which professional investors played a leading role in financial investment asset allocation with their professional knowledge. Therefore, more and more scholars began to study the positive and negative effects of financial risk management on investors' investment strategies to a certain extent.

As for the research and analysis of the domestic status quo of financial risk management, Cao Xiaoqing and Luo Ying and other predecessors generally recognized the development of the domestic financial industry, found the hidden seeds of financial risk, and expounded the current situation of domestic financial risk: they believed that under the current financial environment, there were still insufficient awareness of financial risk prevention, imperfect financial risk management system, and low transparency of market information, Among them, Mr. Luo Ying believes that the current downturn of the real economy has also led to the accumulation of risks to some extent, which has a linkage effect on the financial economy [3]. In this regard, we should analyze the causes of risks and propose corresponding solutions. Only by constantly improving the financial system and cultivating the idea that the public, as ordinary investors, will gradually move closer to professional investors, does investment risk not mean that we should be cautious, but recognize risks to a certain extent, learn risk management, apply risk management, and cultivate a positive and rational investment awareness; However, Mr. Wang Jue believes that the reasons for the risks arising from financial activities under the new situation include the lack of stability in the online financial market and the lag in international financial trade. He hopes to prevent and resolve financial risks by constantly strengthening financial management of enterprises, strengthening capital management, improving the efficiency of capital utilization, strengthening investment management, and ensuring scientific investment, The pioneers drive the latecomers and individual investors, so as to continuously improve the investment literacy of investors and lay a good foundation for the orderly progress of personal finance and effective asset allocation in the future. This is also an extension of Mr. Deng Xiaoping's thought of "getting rich first, driving wealth later, and ultimately achieving common prosperity".

3. Overview of Asset Allocation Theory

3.1. Asset Allocation Theory

Asset allocation theory is to allocate and convert self owned assets among different asset categories. Simply put, "Don't put all your eggs in one basket". For example, the real estate we own is the only asset type of a family. However, if the real estate market price fluctuates greatly due to

other factors at this time, it will have a great impact on the value and status of family assets. Investors under asset allocation can often obtain good returns while effectively reducing the volatility of asset risk. For gold, real estate, stocks, bonds, bulk commodities, etc. that are widely circulated in the current market. Investors allocate their assets in proportion to multiple planned asset investment strategies in these major asset categories, which is called asset allocation [4].

For those investors who prefer long-term investment, asset allocation mainly has three central elements: first, the cyclical nature of the economy. The cyclical nature of the economy usually shows a spiral upward trend, rather than a straight line. Therefore, the economy is always experiencing economic overheating, economic stagflation, and economic recession. With the stimulus of monetary and fiscal policies, a new round of economic recovery will begin. second, for a single asset, it is generally exposed to the risk of large price fluctuations in the market. In history, A-shares have experienced a huge drop of 75%. However, investors need up to 300% of capital gains if they want to earn back the principal in the face of 75% asset shrinkage, which is extremely difficult. Investors who prefer long-term capital should be more alert to the impact of a single asset. Third, most investors are loss averse in nature. From the perspective of behavioral finance theory, this feature will encourage investors to add more gambling to their rationality in the process of investment. But when they are faced with profit, they become more conservative instead. In this case, investors often lose more during the economic cycle, giving investors a bad investment experience.

For these three problems that often occur to investors in the financial industry, investors can often use the asset allocation theory to diversify their own assets, reduce the volatility of the entire asset value, achieve benign interpenetration of economic cycle changes, avoid unnecessary losses caused by cyclicity, and even can effectively match the risk and return, so as to achieve higher returns at the lowest risk.

3.2. Analysis of the Relationship between Financial Risk Management and Asset Allocation

For systematic and unsystematic risks, investors' management means are mainly to minimize risks and maximize expected returns by avoiding systematic risks as much as possible and achieving quantitative reduction of unsystematic risks through portfolio management. Therefore, portfolio management is also called a kind of financial risk management behavior. In this development process, a variety of portfolio management methods have gradually emerged. In Markowitz's theory, the asset portfolio should not only have a single risky asset, but only by adding risk-free assets can a complete portfolio be formed.

Thus, CAL (capital allocation lines) is extended. CAL can well reflect expected return E (r) and total risk α Linear relationship of. It also enables investors to more clearly analyze the allocation of capital between risk-free and risky asset portfolios; in the effective frontier theory, the tangency between asset allocation line and effective frontier produces the optimal asset allocation line under the current situation, which is called the capital market line. The above two theories are mainly applicable to asset allocation portfolio under total risk. In the capital market line CML, the total risk represented by the horizontal axis is divided into systems risk and unsystematic risk, which can reduce risk by forming a portfolio through asset diversification investment, and even obtain risk-free returns through arbitrage. Then the system risk becomes the only risk that investors need to worry about. Further analysis of the correlation coefficient between systematic risk and expectation leads us to the securities market line SML. We usually use The vertical axis remains unchanged, while the horizontal axis is determined by the total risk turn into system risk ， The coordinate axis of SML is obtained. In this way, we can conduct an adequate asset allocation to manage unsystematic risks and achieve the goal of managing risks and diversifying risks [5].

4. The Impact of Major Financial Risk Management on Asset Allocation

4.1. Credit Risk Management

Credit risk management refers to the identification and evaluation of credit by the credit provider according to credit rating and relevant information. Then adjust the investment behavior according to the credit risk that you will bear and the economic loss caused by the credit risk. When ordinary investors are faced with investment activities, they often start to judge whether the project can be trusted, to what extent is the credit risk of the project, how much is the impact of the degree, and what is the role of other investment activities or asset allocation matching, and then consider the value of the investment. Therefore, when allocating assets, it is of great significance for investors to adopt more effective credit risk management, screen asset allocation projects, match asset portfolios more effectively and determine asset allocation portfolio strategies faster and better [6].

4.2. Operational Risk Management

Operational risk mainly refers to the risk of loss caused by imperfect, error or even failure of internal and external factors, including program system and staff. The operational risks are divided into seven categories (internal fraud, external fraud, risk events caused by customers, products and commercial behaviors, risk events caused by employment contract problems or work conditions, system errors and business interruption, risk events involving execution, delivery or transaction process management, loss of tangible assets, etc.). As the operational risk has a very wide range of impacts, from the perspective of coverage, the management of operational risk needs to cover almost all kinds of risks in all aspects of the bank's operation (including daily businesses with high frequency of occurrence and relatively low loss; natural disasters with low frequency of occurrence and large general loss, etc.).

For investors, professional requirements and the complexity of some related operations often lead to huge operational risks for ordinary investors, which is easy to cause huge amounts and greater losses. Therefore, only by paying more attention to the learning of operating system expertise, or paying more attention to professional institutions, can we better reduce or even avoid operational risks. It enables ordinary investors to better convert portfolio investment strategies into actual investment asset targets in the process of asset allocation in investment activities, and achieve effective asset allocation through operational risk management.

4.3. Liquidity Risk Management

Liquidity risk management refers to the risk that when an investor invests in a project in a certain period, the implementation of its asset allocation strategy focuses too much on assets or businesses, resulting in a fund flow gap, or when the stock of investment funds is insufficient, the capital chain is disconnected due to the early termination of the contract by the counterparty.

For ordinary investors, the so-called management of liquidity risk is not just a simple sentence "Don't put eggs in one basket", which can be summarized. Ordinary investors should view liquidity risk from two aspects of stock and flow, so as to properly control stock and adjust flow to manage liquidity risk and achieve effective asset allocation. In essence, it is to find the balance of capital revenue and expenditure against various factors that affect the supply and demand of capital. Adjust the fund position in a timely manner to avoid excessive concentration of funds in an investment project or industry, or make most of the funds in regular products unable to be used to meet the actual fund needs. In this way, we can achieve a better division of asset allocation proportion by managing liquidity risk, and ensure that there is still sufficient funds to ensure living consumption

in the process of asset allocation, and do not miss the opportunity of low risk asset appreciation when encountering bull market and other golden investment periods, so as to reduce the opportunity cost in a timely manner.

4.4. Market Risk Management

Market risk refers to the risk of losses caused by the uncertainty of future market prices, including stock prices, commodity prices, interest rates and exchange rates. It can be divided into stock price risk, commodity price risk, interest rate risk and exchange rate risk. The above factors have a direct impact on investors in the financial market, or they may have an indirect impact on counterparties, investors or even a part of the underlying asset allocation portfolio.

For ordinary investors, market risk is often one of the most difficult risks to distinguish and manage. However, in the face of market risks, investors can manage the market risks we encounter or will face in the following two ways to optimize asset allocation [7].

Risk avoidance. Risk and return are like two carriages tied together, and taking corresponding risks will gain considerable benefits. The complete avoidance of a type of market risk means that investors should completely withdraw from the market. Therefore, only when a certain industry or market is extremely depressed will this approach be adopted.

Risk transfer. Because market risk itself cannot be eliminated, investors can manage market risk through various financial derivatives. For example, investors can transfer risks through futures contracts, forward contracts, swap options and other derivative instruments in the derivatives market. The risk exposure can also be reduced to an acceptable level by means of hedging contracts.

5. Overview of the Impact of Other Financial Risk Management on Asset Allocation

5.1. Strategic Risk Management

Strategic risk, usually refers to the uncertainty of the company's overall loss, and is a factor affecting the overall development direction of the enterprise. In general, when business problems occur due to process errors in the business process, the operational risk turns into strategic risk. At this time, the business strategy of the enterprise needs to be adjusted and changed in a timely manner. However, when the products or services produced or provided by enterprises are less competitive than other substitutes in the market, the competitive risk will evolve into strategic risk.

Enterprises often use a variety of methods (including: testing the severity and timeliness of possible risks through risk identification and assessment; determining the degree of risk impact by quantifying risks; understanding the transformation of risks and opportunities through risk and opportunity identification to minimize the cost of opportunities; planning risk reduction programs through the establishment of risk management teams; adjusting capital decisions through capital allocation and capital structure, etc.) To control strategic risks. Investors can also analyze whether the strategic risk management of the company is effective by focusing on the strategic risk management of the enterprise companies under the asset allocation strategy, and make corresponding investment decisions to further effective asset allocation [8].

5.2. Reputation Risk Management

Reputation risk, as defined in the Guidelines on Reputation Risk Management of Commercial Banks issued by the CBRC in 2009, is the risk that the related parties' credit rating of commercial banks and other reputation categories will decline due to the operation management or external events of an enterprise institution. The impact of reputation risk is similar to that of operational risk,

which is difficult to quantify directly, and it is difficult to separate from other risks and deal with them independently.

In the process of investment, investors should focus on the reputation of the target company of investment allocation, so as to measure the reputation risk and associated impact they may suffer, so as to manage the reputation risk and achieve effective allocation of asset allocation. This is similar to strategic risk.

5.3. Legal and Compliance Risk Management

Legal and compliance risks in the financial industry are generally considered as the risk of being punished by administrative regulations, major reputation and financial losses due to investors' failure to comply with the Securities Law, the Company Law and other relevant laws and regulations in their investment behavior.

In this regard, ordinary investors should correctly understand the definition of investment activities, conduct investment operations legally, and the investment operations and investment direction methods must comply with the Law of the People's Republic of China, the Securities Law and other relevant laws and regulations, and fraud, illegal operations, insider trading, operating the securities market and other acts are prohibited.

6. The Enlightenment of Financial Risk Management on the Asset Allocation of Ordinary Investors

6.1. Gradually Establish the Concept of Effective Asset Allocation and Cultivate the Awareness of Risk Management

With the rapid economic development in China, investment and financing behavior has gradually entered the period of people's life. More and more ordinary people have begun to participate in the financial market and become a member of ordinary investors, and gradually develop into professional investors. And investment and financing activities have gradually become the "necessities of life" of some people. When investors are faced with more and more types of investment assets with different proportions of risks and gains, they should more reasonably and effectively allocate their own assets. While satisfying their own living consumption, they should let some of their idle funds continue to increase in value. They cannot help but catch up with possible inflation, and more importantly, they should make investment and financing a great weapon to continuously improve their own quality of life.

In this regard, after learning the above risk categories and their definitions, properties and characteristics, as well as the asset allocation theory, I deeply understand the important impact of adequate financial risk management on the formulation of my own asset allocation strategy in the process of financial investment activities. It is suggested to go deep into the publicity and promotion activities of financial education activities, cultivate the awareness of risk management and conduct reasonable, appropriate and appropriate investment allocation while advocating compliance financing; As the largest part of investors in the financial market, ordinary investors should better learn relevant financial knowledge and laws, invest legally and manage risks in compliance with regulations, consciously shoulder financial market responsibilities, maintain the order of the financial market, and establish the image of qualified financial investors [9].

6.2. Gradually Improve the Financial Risk Management System

At present, under the rapid development of China's financial market, the financial system is still

constantly improving. While seeking to adapt to China's financial market conditions, we should ensure that the system can give all kinds of investors confidence in the surging vitality of the financial market. In this regard, the constantly improved financial risk management system has established a good foundation for the courage of ordinary people to enter the financial market and become ordinary investors, the confidence of ordinary investors in asset allocation and investment activities, and the steps and channels for ordinary investors to develop into professional investors. At the same time, it also plays a very important role in promoting investors to gradually establish the concept of effective asset allocation and cultivating the awareness of risk management [10].

6.3. Increase the Proportion of Risk Management in Asset Allocation

After entering the financial market, ordinary investors began to apply it after constantly understanding the relevant financial market system and gradually cultivating their financial risk management awareness. First of all, we should carry out investment activities on the premise of complying with various legal standards of the financial market, and constantly improve the proportion of our own application of risk management in the process of asset allocation. This is also one of the important steps for ordinary investors to transform into professional investors.

The second choice is to adopt corresponding management methods in the face of different financial risks to achieve the effect of effective asset allocation. Classify the main financial risks (credit risk, operational risk, liquidity risk, market risk) and other financial risks (strategic risk, reputation risk, legal and compliance risk, country risk), and take targeted measures to fully utilize resources to allocate funds. The management proportion of manageable risks should be focused on, the financial risks that are difficult to manage should be considered for treatment, and the unmanageable risks should be avoided, so as to achieve the goal of obtaining the maximum benefit under the minimum risk.

7. Conclusion

The revision of the two regulations, the Decision of the State Council on Amending the Regulations of the People's Republic of China on the Administration of Foreign funded Insurance Companies and the Regulations of the People's Republic of China on the Administration of Foreign funded Banks, has greatly helped China's financial industry to create a new pattern of opening up. The constant introduction of foreign capital has injected a dose of confidence into China's financial industry, and has also brought great confidence to individual investors and institutional investors in China's financial industry. In this regard, ordinary investors who begin to actively enter the financial industry to seek asset appreciation should seize the opportunity in the golden age of opportunities and challenges, fully learn financial risk management knowledge, cultivate risk awareness, and achieve effective asset allocation. The Greek sovereign debt crisis, which kicked off in 2009 and had a far-reaching impact, further elaborated the fact that understanding and managing risk is not only a problem that risk managers must pay attention to, but also a content that every investor in the financial system needs to understand and master, and more importantly, it should become a content that every economic entity needs to know well.

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