GETTING ADDITIONAL INSIGHT INTO PORTFOLIO RISK

Apart from short-term Government of Canada treasury bills – which as of February 4th, 2021 offer a mere 0.06% yield* – all investments carry some element of risk. In the previous article of this three-part series, we noted that volatility had become investors' preferred measure of risk and laid out some of the drawbacks of using volatility alone as a risk measure.

In this article, we will describe some tools investors can also use to understand the risks they are taking, to mitigate unintended and/or unrewarded risks, and to better understand whether the risks they are taking intentionally are scaled appropriately.

*Source: https://www.bankofcanada.ca/rates/interest-rates/t-bill-yields/

FOUR WAYS TO IDENTIFY PORTFOLIO RISKS

1

Adjusting volatility using statistical techniques

Many statistical techniques exist for adjusting volatility to account for skew, kurtosis or autocorrelation. For example, sharpe ratios can be adjusted by incorporating a penalty factor for negative skewness and positive kurtosis. Similarly, when annualizing standard deviations, statistical methods can be used that adjust for autocorrelation. Using these methods can give a clearer understanding of portfolio risk than simply using the traditional volatility risk metric.

2

Risk factor models

"Risk factors" are broad persistent drivers of returns that help explain the variations in the way different investments perform. Constructing a risk factor model of a portfolio allows for a better understanding of the underlying risks that may be driving the portfolio's returns.

3

Scenario analysis

Scenario analysis helps investors better understand how portfolios might perform in different market and economic environments. Considering the changes in the volatility and correlation of different investments during extreme events can be helpful in providing more realistic expectations of anticipated drawdowns.

4

Conditional analysis

Considering how assets and strategies have performed in different market regimes can provide valuable guidance. For example, for fixed income strategies, historical performance may differ during periods when interest rates are rising or falling, or when credit spreads are widening or tightening.

FORTIFYING PORTFOLIOS

Each of these tools looks at risk in a different way. Combining them can provide a fuller understanding of portfolio risk and offer insights to fortify a portfolio by constructing it so that it has the potential to perform well across a broader range of economic and market scenarios.

HOW CAN WE HELP?

PORTFOLIO CONSTRUCTION CONSULTATION SERVICE (PCCS)

We believe that portfolio construction is one of the great differentiators in the Canadian investment industry. Through PCCS , advisors get access to unique data, analytics and insights to help design portfolios that aim to achieve better outcomes and help clients stay invested in all market conditions.

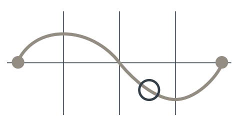
Your Model Portfolio + **Our Risk Factor, Stress Testing & Scenario Analysis** = **Risk Awareness & Insights**

We help advisors clearly define their investment goals, diagnose unintended risks, and design portfolios that offer the potential to more efficiently and consistently achieve desired outcomes.

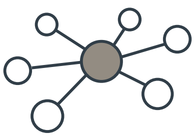
Our experienced portfolio consulting professionals are a multi-disciplinary team with backgrounds in asset allocation, risk management, quantitative research and portfolio management.

Our analytics focus on four key areas:

Strategic asset allocation



Tactical asset allocation



Factor analysis

Evaluation for alpha sources

GET STARTED.

Contact Robert Wilson to request a review.

ROBERT WILSON, CFA, CAIA, CIM
Vice President, Retail Sales &
Portfolio Construction Consultation Service
Rwilson@pictonmahoney.com

PICTON MAHONEY
Asset Management

pccs.pictonmahoney.com

DISCLAIMER