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Managing Portfolio Volatility In An Uncertain World

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An Interview With Greg Rodger, CFA, Chief Investment Officer

HighView Financial Group

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Overview:

The global debt crisis, particularly for governments in Europe & the United States, has created an environment of uncertainty that has led to a period of extreme capital markets volatility around the world.

At HighView Financial Group, our view remains that it will take many years to address these debt excesses – which were created over more than two decades. As a result, we continue to believe that global capital markets volatility will unfortunately remain a part of investing for the foreseeable future.

For this reason, we recently sat down with Greg Rodger, Chief Investment Officer of HighView Financial Group to discuss how he and the investment team at HighView design client portfolios to successfully navigate the global turbulence and mitigate portfolio volatility.

MB: **Greg, thanks for taking the time to chat with me today about a topic that I know is on the minds of so many investors nowadays. The first question I have for you is how does HighView manage portfolio volatility for clients?**

GR: The first thing I believe people need to understand is that portfolio volatility is a reality of investing in nearly all securities but that an investor's tolerance for given levels of portfolio volatility are very personalized. I strongly believe that the key role of any investment advisor should be to architect a portfolio structure for each client that balances the pursuit of their investment goals (ie: short, medium & long-term) with their tolerance for risk & portfolio volatility so that they can remain committed to their investment plan, in both good & bad capital market conditions.

To do so, HighView uses a three-step process of **Attitudinal Risk Assessment, Portfolio Design & Stewardship** with all of our clients.

MB: Can you please describe the first part of the process – Attitudinal Risk Assessment?

GR: This element of our client profiling has been developed over many years, by the partners at HighView, in collaboration with behavioural psychologists. Through this interview process we are attempting to assess 4 dimensions that will affect the Attitudinal Risk Profile of a client: Capacity, Knowledge, Experience and Willingness.

We have not designed this risk assessment process with a separate section for each attribute but rather score the results of the entire interview against each of the attributes to ascertain the overall Attitudinal Risk Profile. From this score, we then structure a portfolio that is anticipated to behave in a manner that is consistent with what we believe the client will be comfortable with. This portfolio must then be compared to the portfolio that will best match their investment goals in order to ascertain if there are any gaps between the two that need to be addressed.

MB: Greg, how does HighView design client portfolios to match their unique levels of risk?

GR: It is our firm belief that the manner in which an investor's portfolio behaves over time, and through various market cycles, is at least as important as the longer term returns that it generates. The foundation for this belief stems from our direct experience with investors and their demonstrated lack of comfort with significant drawdowns in their portfolios. While a particular portfolio structure may prove beneficial over time, if the investor is not able to accept the shorter term volatility then they are likely to force liquidation at an inopportune time. To effectively address this, when structuring a portfolio one must recognize how the various components are expected to function together so as to create a portfolio that will perform in a way that not only meets the investor's needs and goals, but also behaves in a way that is comfortable for them over time. To accomplish this, a rigorous focus on risk, as opposed to returns, is the key. To do so, we construct client portfolios according to four levels, in a 'top-down' process:

- **Asset Class:**
  What asset classes will be included in the portfolio (ie: equity, fixed income, real estate, cash, etc.)?
- **Investment Mandates:**
  What investment mandates will comprise the portfolio (ie: Canadian equity, US mid-cap, Canadian Laddered Bond, Canadian Corporate Bond, etc.)?
- **Investment Managers:**
  What investment managers will be employed to satisfy the investment mandates?

- **Investment Vehicles:**
  Will the Investment Managers appear in client portfolios through the use of Investment Funds or individual securities (ie: stocks and/or bonds)?

We then perform an in-depth analysis as to how this type of portfolio is anticipated to perform during extreme market events and fully discuss this with the client prior to investing. As a result, when we enter periods of increased market volatility, such as we have experienced recently, there really are no surprises for our clients.

MB: What do you mean by 'Stewardship'?

GR: At HighView, the word 'stewardship' means how we oversee & govern the management of client wealth – as an investment fiduciary - in partnership with the client & their other professional advisors, all in the diligent pursuit of their financial objectives.

As we've already discussed, at the outset of our engagement with a client, we will spend a great deal of time understanding the specific needs and goals they are expecting to achieve aligned against various time horizons. In addition, we will explore with them their past experiences with various forms of risk, how they planned for and reacted to it, and how those experiences have shaped their attitudes towards risk and uncertainty. These needs, goals and attitudes form the basis for how portfolios should be constructed and serve as the benchmark against which the portfolio results must be measured from time-to-time. As result, on at least a quarterly basis we will review with each client the following:

- Are the short-term cash flow needs being met. This is a critical component. If the short-term needs are not being met, then the longer term plans are of little value.
- Do the portfolios remain on-track to meet the medium and longer term goals and aspirations
- Are the portfolios 'behaving' in a way that was anticipated

This process of stewardship is so critical – especially in today's global capital markets – as clients goals & attitudes to risk can change over time. If we as Investment Counsellors do not capture these changes in our regular discussions with clients, it will be very challenging for us to be successful in helping our clients diligently pursue their financial goals.

MB: Thanks Greg for taking the time to share your experiences & insights in effectively managing portfolio volatility for investors.