

## DEFINING RISK AT THE PORTFOLIO LEVEL

There are numerous ways for investors to view and manage risk. In this two-part series we take a closer look at assessing and managing risk at the portfolio (Part I) and manager (Part II) levels.

If you simplified risk into a single portfolio metric, which one would you focus on?

**Pier Friend:** We think about portfolio risk in terms of the permanent loss of capital. We expect that there will always be volatility, but what matters most to us as investors is avoiding investments where capital is permanently impaired.

Knowing that investors typically view volatility negatively, could you discuss any positives that can come with volatility?

**PF:** Absolutely. While we are not saying volatility is irrelevant, we do value the opportunity it can create. As an example, at the beginning of the global pandemic we saw some public equity markets decline 30% or more. In our view, this was an opportunity to invest at distressed prices despite the enormous uncertainties that were roiling markets. We recognize that nobody enjoys market downturns, but like an earthquake, we view them as natural and unavoidable events that allow investors to rebuild their portfolios and benefit to a greater degree during the recovery.

When you build client portfolios, how do you engineer the portfolio in a consistent manner across multiple asset classes?

**PF:** One way we do this is to analyze each investment, regardless of the asset class, in terms of expected annualized return versus potential maximum drawdown. We aim to avoid investments that have an asymmetric risk/return ratio. The higher the max drawdown, the higher the expected return should be. At the portfolio level, we run a weighted return and weighted portfolio max drawdown analysis to confirm that the portfolio's risk level matches the client's risk profile. If so, we then confirm if the return expectation is aligned with the client's long-term profile. If either of these outputs do not match the client thresholds, we know we need to adjust portfolio holdings and weights to solve for the discrepancies. This is not just a pure math problem, it also utilizes some art, science, and history.

How do you manage portfolios for exogenous risks?

**PF:** It is important to remember that exogenous risks such as war, pandemics, political events, and severe financial crisis are not predictable and often occur with little advanced notice. Rather than trying to predict the timing of when to de-risk a portfolio, we find it more prudent to be mindful of the portfolio's strategic asset allocation targets and the ranges of exposure that its policy statement allows for. There is comfort in "sticking to the plan" in uncomfortable times. By utilizing an investment policy statement ("IPS") and operating within its guidelines, one can naturally take advantage of periods of market weakness and strength while eliminating the difficult task of "market timing".

The bottom line? There are a myriad of ways to analyze investment risks. Having a framework to navigate all of them is essential and working with an OCIO who has experience in this field can help match the return and risk profile of an institution with its optimal investment portfolio.



**PIER FRIEND**

*Chief Investment Officer,  
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As the Chief Investment Officer of Colony's Institutional Advisory Practices, Pier is responsible for all aspects of the investment process — from manager research to portfolio construction, asset allocation, and client communication. He also supports the needs of our institutional and ultra-high net worth clients.

Pier served as Chief Investment Officer at New Providence Asset Management prior to their merger with The Colony Group in 2021. Previously, Pier spent ten years at Goldman Sachs Asset Management where his responsibilities included Head of the U.S. Core Equity business. He began his career in Japan teaching English as a second language, then returned to NYC where he worked for Nihon Keizai Shimbun before joining Gabriel Capital Group as a research analyst responsible for risk arbitrage and long-short investments for a \$1 billion hedge fund. Pier has served on the Advisory Council for the Headmaster of St. Andrew's School.

Pier earned his Master in Business Administration from the New York University Leonard N. Stern School of Business, and his Bachelor of Science from Williams College.

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