Portfolio Day Special: A Clearer View of Risk

Knowing what you own is half the battle.

by Brian Portnoy, Senior Fund Analyst | 02-04-03

Perhaps the hardest investing concept to wrap one's brain around is risk. For many folks, it certainly meant something different a few years ago than it does today. When the bull market was raging in the late 1990s, risk was shorthand for missed opportunity. Risk meant not owning that hot stock or fund and foregoing those champagne dreams and caviar wishes.

Today, obviously, things are different. After a three-year drubbing, most investors have been rudely reacquainted with the true meaning of risk: losing your shirt when things don't go as expected and failing to meet your investment goals. Friendly neighborhood finance Ph.D.'s teach us that the statistical manifestation of risk is volatility, typically measured by an investment's standard deviation. But in managing one's own investments, it's important to rise above the stats and ask this simple question: How could things go wrong here? In other words, how might you fail to meet your investment objectives?

Thinking about risk in the abstract and actually managing it are two different exercises. Fortunately, investors do have tools to identify what bets they're taking, and that knowledge can lead to constructive changes to their portfolios. At the very least, knowing what risks are embedded in your portfolio helps you manage your own personal expectations so that when things go wrong, you're not surprised. Losing money sure doesn't feel good, but it feels even worse when you've been blindsided.