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WEALTH MANAGEMENT

Volatility

Keeping Perspective & Staying Proactive

March 2024

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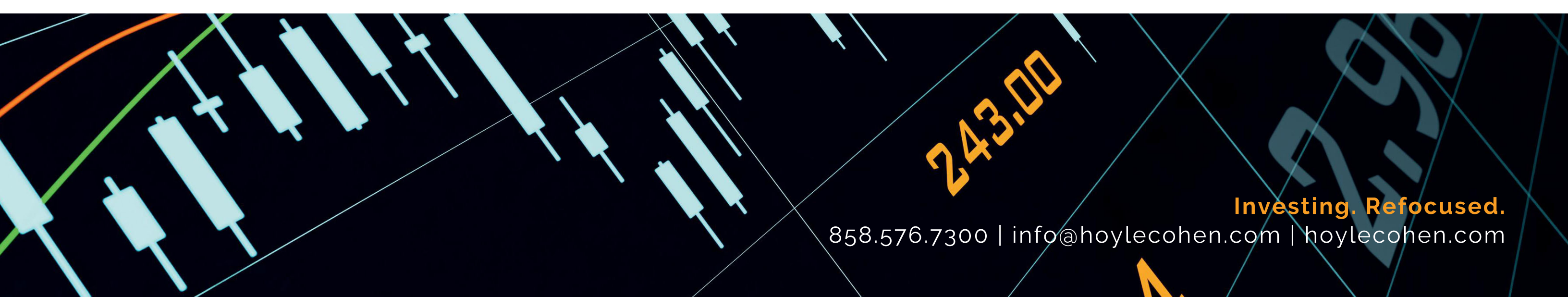
Volatility in financial markets can be unnerving, occasionally prompting some investors to make hasty decisions. In reality, it's not volatility that is our greatest threat, but rather our reaction to it. Resisting emotional urges and maintaining perspective and discipline is vital to achieving your financial goals.

Maintaining Perspective

When discussing the concept of perspective, many pseudo scientists reference the claim that if you shrunk the earth to a diameter of 2.25" and held it in your hand, it would feel smooth like a newly manufactured cue ball. While they have since calculated that it would feel more like fine sandpaper, the thought is surprising nonetheless. Consider for a moment the vertical distance between the Mariana Trench and Mount Everest. At the deepest part of the ocean, the Mariana Trench measures 35,000 feet below sea level, while Mount Everest, at its tallest peak, measures 29,000 feet above sea level. That's approximately 10 miles between the lowest and highest points on earth. While that distance seems quite significant at first glance, is it really? Investors fear a Mariana Trench equivalent market downturn and are jovial as we approach a Mount Everest size market upturn, but if they zoom out for a bird's eye view, the entire experience appears relatively steady. Why? Because **perspective is everything, and volatility is only temporary.**

Defining Volatility

The term volatility derives from the Latin word volatilis, or fleeting. It is here today, gone tomorrow. That meaning holds true, particularly with regard to financial markets. Investor sentiment is ever changing with the constant inflow of new information. New information tells a story and investors prefer that story be predictable. When that information is status quo, volatility is minimal. When it is uncertain or unexpected, volatility rises. Macro examples of this include economic data such as inflation measures, jobless claims, or upcoming presidential election results. Micro examples include non-public company specific information that alters investor perception of a company's long-term viability, such as information related to earnings, new product releases, acquisitions, key departures, or fraud. When new information is unexpected, fear of other potential unknown factors can cause volatility to compound.



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Avoiding Market Timing

Markets shocked by new information often experience high volatility and downturns. When a decline exceeds 10 percent, but is less than 20 percent from a previous high, it is called a correction. While painful in the short term, it is important to remember this is normal. In fact, markets have been correcting annually since 1928. When a **correction occurs, fear sets in and the urge to sell becomes overwhelming**. Most investors fall prey to this urge, exacerbating volatility. Research suggests, however, that **investors should remain steadfast and fight this urge**, as recovery of losses typically occurs within an average of 4-6 months post correction and 12-18 months following a 20%+ decline, or bear market. The greatest risk to achieving your financial goals is inactivity during a recovery. A Bank of America study, using data as far back as 1930, found that **investors who sat out during the 10 best return days of each decade, achieved a return of 28%, compared to the 17,715% return for investors who resisted the urge to sell during rough patches**. While the research affirms that avoiding market timing is key, that doesn't mean you should be inactive.

Preparing for Market Declines

Preparation is key to mitigating the risks of market downturns. Connecting regularly with your advisor to assess expectations and discuss your risk tolerance can be crucial to mentally and financially preparing for the inevitability of volatility and market declines. While **staying invested is key, it's equally important to stay proactive.** Through activities like portfolio rebalancing, dollar cost averaging, sector/security rotations, and making alternative investment allocations, investors can position themselves to take advantage of the opportunities that may arise during a market recovery.

Investing can be stressful, and market volatility undoubtedly exacerbates that stress. It can feel like you're at the bottom of the ocean with the mountain summit as your destination. But if you stay proactive, and keep sight of the big picture, that 10-mile hike looks a lot more like a walk in the park.

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