Worried About Market Volatility? Take a P.A.U.S.E.

It may seem like there is a lot of news about the stock market being volatile. If that's got you concerned, here is an easy way to consider how you perceive the stock market and its fluctuations. Try taking a pause. Here are five things to remember about volatility that can help you position yourself appropriately and reduce your concerns.

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P is for Potentially Positive: If the news you've been hearing about market volatility has a doom and gloom aspect to it, it makes sense that you might worry. The negative aspects of volatility don't paint a full portrait. Sometimes market volatility can create situations where investors find an advantage. "Quality companies with strong fundamentals generally do better when economic conditions slow down or market volatility increases… As prices fluctuate, this provides opportunities for investors to invest in a growing company at a discounted price and then wait for [the potential] cumulative growth down the road."[1]

A is for Accuracy: If market volatility concerns you, accuracy about volatility may help. What exactly is volatility? Volatility is a measure of the increase or decrease of a stock over a period of time. On an individual stock, higher volatility can relate to the risk of investing in that company as it can predict fluctuations over time. On a market-wide basis, volatility refers to the aggregate of the stock prices moving up or down. Volatility is driven by many factors, including political, economic industry and sector factors. "Volatility is a reflection of investor sentiment, therefore any factor that can influence investor behavior will affect market volatility."[2] Market volatility is measured by indexes, the best known of them is called the Chicago Board Options Exchange Volatility Index (VIX). "The VIX … gauges investors' expectations about the movement of stock prices over the next 30 days based on S&P 500 options trading. The VIX charts how much traders expect S&P 500 prices to change, up or down, in the next month."[3]

It's important to distinguish volatility from other concepts. For example, volatility does not necessarily mean risk – though they are related. It's also important to distinguish a volatile market from a recession. According to the Federal Reserve, a recession is a measure of economic growth, where widespread, significant lack of growth (or shrinkage) happens over two or more quarters. That usually includes job growth, profitability, housing market statistics and other measures. Stock market volatility can be related to recessions but in a way that might not be obvious. "First, the level of volatility does not predict financial crises, but prolonged periods of low volatility do…., we examine in more detail how low volatility causes financial crisis. We find that low volatility is followed by credit build-up, indicating that economic agents take more risk in periods of low financial risk,

[1]https://www.fidelity.com.sg/beginners/your-guide-to-stock-investing/understanding-stock-market-volatility-and-how-it-could-help-you
[2]https://public.com/learn/what-causes-market-volatility
[3]https://www.forbes.com/advisor/investing/what-is-volatility/#:~:text=Market%20volatility%20is%20the%20frequency,market%20is%20said%20to%20be.

which in turn endogenously increases the likelihood of future crises”[4]

U is for Unexpected: What most investors fear is that unexpected events will negatively impact their investments. However, there are some investments that can weather unexpected changes in the market better than others, just as there are some investors who can weather fluctuations in their investments better. A financial advisor can help you make the right choices in selecting both individual investments as well as a long-term investment strategy that will suit your specific needs. Think of it as expecting the unexpected.

S is for Skill: Understanding market fluctuations and perceived volatility in the market or individual stocks, is an investing skill. Some investors may have these skills through their education, close relationships, or career focus. Others may not. Understanding markets, their timing, and setting expectations is something you can improve upon. If your perception of market volatility is causing you concern about your investments, a financial advisor may be able to help you understand market events and trends. That understanding may help you make the best decisions.

E is for Expectations: Market fluctuations are usually responses to events. Some of those events may have global impact, like the war in Ukraine, or may be more domestic, like a short-term shortage of dry ice impacting food shipping. But whatever causes the market to fluctuate or become more volatile, some volatility is to be expected. In fact, some experts say to expect a volatile year every five years[5], whereas others might shorten or lengthen that time period. In addition to improving your understanding of market fluctuations, a financial advisor may be able to help you set realistic expectations for how the market may respond to global events. Many investors may have concerns when the market behaves differently than their expectations. Setting, and adjusting, expectations for market behavior that are realistic can help you make the best decisions to accomplish your investing goals. “From 1979 to 2020, the S&P 500 Index returned an average of 12.35% per year, and investors may have expected similar 12% returns in any individual year. However, there were only three years in which the Index returned between 9% and 12% during this period. Volatility is much easier to tolerate when you expect it.”[6] For those who can’t tolerate market volatility or large fluctuations in the market, they may need to focus more on liquid investments, for example, fixed annuities.

E may also be for an Emergency Fund.

If you are unsure of your skill level or your expectations when it comes to market volatility, have a conversation with your financial advisor.

[4]*https://www.federalreserve.gov/econresdata/feds/2016/files/2016093pap.pdf*
[5]*https://www.forbes.com/advisor/investing/whatis volatility*
[6]*https://www.hartfordfunds.com/practice-management/client-conversations/managing-volatility/10-things-you-should-know-about-volatility.html*

IM-MU0211 (Sept. 22)