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Volatility - The Price You Pay

One can almost say that, **by design, prices of equities are volatile**. Investors in any asset, but especially financial assets with an active and deep two-way market, must expect price volatility as the norm and not the exception.

However, on certain days, price volatility seems extreme, and this fact scares off many investors. Monday was one of those days. It started with the Japanese stock market index ending down 12.4%. The very next day, it bounced up 10.2%

To gain perspective of volatility at a micro level, look at the price movements of the top-performing US stock, Nvidia. Conceptually, it seems inconceivable that the "value" of a company could move, not by millions or even billions, but hundreds of billions of dollars within a single day. But this is exactly with what happened on Monday. Triggered by the Japanese market decline, the $2.5 trillion US chip designer and supplier saw its price fall over 14% at Monday's opening, only to rise by some 14% two days later – representing over $300 billion dollar moves in the market valuation for one company.

There are numerous factors that contribute to price volatility, **making it difficult to predict** which one or which combination will impact market sentiment and prices next. What might seem insignificant to most market participants one day can quickly become a major deciding factor the next.

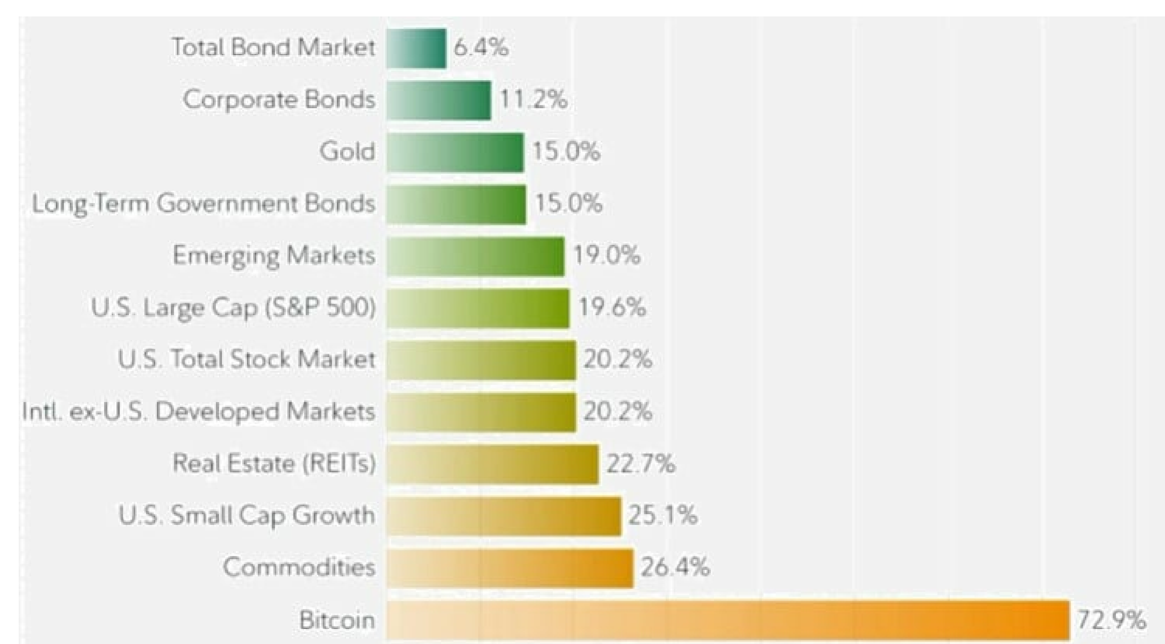
So, What is Volatility?

In traditional finance, volatility is synonymous with "risk." Higher price volatility typically corresponds to higher actual or perceived risk because it makes future returns less predictable.

Volatility usually refers to standard deviation, a statistical measure of dispersion of returns. Volatility can be either "bad" (when measuring negative returns) or "good" (when measuring positive returns).

Different asset classes are expected to have different levels of volatility, which can and does differ depending on the measurement period. The table below reflects the average volatility of a range of asset classes, from "lower risk" bonds to "higher risk" bitcoin over a 4-year period.

Table 1: Annualised Volatility of a Range of Asset Classes (February 2020 – February 2024)



Source/s: Bloomberg, February 2020 - February 2024.

The volatility of an asset class itself has been shown to be more predictable than returns themselves. Understanding this assists with portfolio construction across multiple asset classes.

In Conclusion

All investors seek maximum returns, **but not all can tolerate** higher levels of price volatility. Investors should recognise that price fluctuations are not only normal, but essential for achieving superior long term returns.

Ultimately while the quest for maximum returns drives investment decisions, managing and understanding volatility is crucial for achieving sustainable financial success.

Volatility is often perceived as a daunting aspect of investing. However, with a shift in mindset, **perhaps it should be seen as the price paid for superior returns.**

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If you have any questions, Ian and our team would love to hear from you on global@seedinvestments.co.za.

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