CAN YOU EMBRACE THE VOLATILITY?

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High volatility and sharp losses in equity markets around the world in the past few weeks caused much anxiety among investors and advisors. I understand why; they see the value of their portfolio going down and they start thinking about even worse losses or even permanent loss of their capital.

Why is that? Is it the first time they have experienced volatility? Does volatility tell them anything about the future? And is higher volatility necessarily all bad?

VOLATILITY IS AN IMMUNE SYSTEM

Volatility in equity markets is essential and very healthy; it works like an immune system. It pushes out "weak" hands in the market and helps prevent risks from accumulating for too long. It breaks the back of excessive leverage in the system before it becomes too big and a real threat to market stability.

We see it time and time again, for example, the blow-up of volatility sellers in Exchange Traded Notes (ETNs). These speculators thought that falling volatility in equity markets would continue as the norm.

High volatility wakes investors up and reminds them that there are actual risks in markets and in investing. It makes them start asking questions like maybe the market is overvalued after all? Maybe we underestimated the effect of a trade war with China? Maybe cycles still do exist? And am I able to benefit from these events? They obviously can't answer these questions (and probably no one can), but investors are then more engaged. It's an excellent opportunity for them to test their investment thesis and evaluate the hidden risks in their portfolios.

FINANCIAL MEDIA IS OVERRATED

The higher the volatility, the more you should avoid financial media. There's so much noise coming from the media. It's amazing how bad it is for investors to rely on the media for the real picture. It most often distorts reality and gets investors to make the wrong decisions. The media will report only the anecdotal, dramatic news, not what really matters, which gives investors the wrong impression of the real risks and opportunities.

Investors who rely only on financial media for their decision-making process will find themselves in an illusion. They only think they understand the world. With an overwhelming amount of information, there has to be a thought-out process of screening and rationalizing the information we receive.

THE MOST IMPORTANT QUESTION YOU CAN ASK

If this spike in volatility gets you nervous, ask your advisor the "what-if" questions. With a robust intentional process behind structuring your portfolio, you and your advisor will be able to see beyond a certain stressful event. You should know what your actions will be after the "if" happens, whether it's a recession, a sharp drop in equity markets or higher interest rates. Understand how you can take advantage of such events. Sounds trivial, but these questions are rarely asked.

So, go ahead and ask the most critical question: WHAT IF? What if equity markets drop 40% and what if bonds and stocks fall at the same time? And you better have a good answer. Most events are tough to predict and extreme, or "tail," events are just unpredictable. So focus on your process and the resilience of your portfolio. It's the only thing you can control before the uncontrollable strikes.

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