HSBC

Mutual Fund

Here's how you can make the most of market volatility

What exactly is market volatility?

Market volatility is the range of price change in a given period of time. If price of an asset does not change or fluctuate frequently, that asset is considered as less volatile. Similarly, a highly volatile asset experiences rapid increase and decrease in prices.

Does Volatility = Risk?

"Volatility is far from synonymous with risk. Risk comes from not knowing what you're doing." - Warren Buffett

Risk refers to the possibility of **suffering capital loss**. It is a **subjective** phenomenon which depicts an investor's willingness and **ability to withstand any loss**. Risk as a perception could also arise from low awareness or wrong understanding.

Volatility, on the other hand, is **objective** in nature and does not always mean capital loss. It denotes the **asset's tendency to move up and down**. If embraced & optimised rightly, volatility can be great for long-term investors.

To summarise – Volatility is relative to the price movement of any asset and is universal whereas Risk is based on individual perception and is a subjective term.

Volatility & Investing

You can ride volatility by choosing right asset allocation. As different asset classes carry different volatility profile, investing across non correlated assets can help you achieve effective portfolio diversification and manage portfolio risk and volatility.

Asset classes variation in volatility and performance

	Debt Low	Gold Moderate	Equity High
Relative volatility	15, 10, 5, 0	60%, 40%, 20%, 0%, -20%	100, 50, 0, -50, -100
Min returns(%)	4.71	-5.39	-51.18
Max returns(%)	9.96	42.70	77.59
AVG Returns	**7.45%**	**13.03%**	**20.24%**

Returns given above represent Compound Annual Growth Rate (CAGR) of the respective asset classes as on 31 October 2020 calculated on a 1 year rolling performance basis for the rolling period 01 Jan 2003 to 31 October 2020 | Debt: CRISIL Ultra Short Term Debt Index | Gold: Pure gold rates 24K | Equity: NIFTY 50 TRI | Performance of mutual fund schemes may not be in line with the performance of Index on account of expense charges and performance of individual security held by the scheme.

Source: HSBC Asset Management, Bank Bazaar, ACE MF | Past performance may or may not sustain, it does not guarantee the future performance | These are for illustration purpose only.

The higher the volatility, better the probability of generating higher returns! As we can see despite carrying the highest volatility, equity has outperformed all other assets over a long period of time.

If you stay invested for long term with equity, the probability of you losing money goes down dramatically.

S&P BSE Sensex	(Rolling returns)				
	3 years	5 years	7 years	10 years	15 years
Average rolling period returns	**16.38%**	**16.00%**	**15.67%**	**15.59%**	**15.02%**
Positive investment periods*	88%	92%	94%	99%	100%

Source: BSE, CRISIL Research, Past performance may or may not sustain, past performance does not guarantee future performance. Data as on October 2020

Daily rolling returns for respective holding periods since 1979.
For instance, in case of 15-year monthly rolling returns, there will be 9468 return periods. The first return period will be June 1979 to June 1994 and last return period will be Oct 2005 to Oct 2020. * Positive returns – The number of investment periods during which returns have been positive. For example, where investment returns have been computed for a 15-year rolling period46, 9621 out of 9621 days offered positive returns. These are for illustration purpose only

Thus, if you want to make the most of market volatility choose the right asset class and aim for long-term wealth creation.

How can you ride volatility?

1. Look at the bigger picture/ Focus on long-term investments

Although inevitable, volatility is a temporary hiccup that has insignificant impact on your long-term wealth creation journey. In order to achieve goals easily, it is important to focus on long-term goals and avoid paying attention to short-term volatility.

2. Stay patient throughout the investment journey

When market is volatile, exiting the market may seem like a sound strategy. But as Nick Murray said, 'Time in the market is your greatest natural advantage'; it is wiser to stay patient and wait for the correction. In fact, reacting to volatility rather than riding it can lead to lasting consequences.

3. Opt for disciplined investment option

Investing fixed small amount on a periodic basis via Systematic Investment Plan not only spreads out your investment over different market cycles but also helps in mitigating short term volatility and benefit from it.

4. Stick to your asset allocation strategy

While it is prudent to review the strategy once every year, having a biased allocation towards a single asset may not be the right approach. You should build an asset allocation strategy that aligns with your goals and risk appetite and sustain that strategy.

The right way to deal with volatility is to ride through it and not react to it.

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