Is Volatility Dead? When you read this statement, for most of us, the first thing that goes through our heads is that is ridiculous. Yet when I meet with many people for the first time and I review their portfolios, many of them are invested as if they can either easily handle 30%+ volatility or, put another way, they falsely believe their portfolio could never drop 30%. This is typically caused by three possible scenarios; the first being the least likely and the last being the most common.

1. They think that volatility is dead.

2. They think they can sell out before the market drops.

3. They have no idea the amount of potential risk in their portfolio.

I always ask, “How much downside volatility can you handle before you get nervous?” And the answer is normally about 10%.

Over the past 50 years, numerous times, the stock market has had major and minor drops, 1987, 1998, 2002-2003, 2008 quickly come to my mind as examples. In each case, the market has since recovered and then achieved new highs. Thus, had one stayed fully invested through the downturn and subsequent recovery, they would be fine. That is easily said looking back in a rearview mirror. If fully invested during a downturn, it is tough and hard to wait for the recovery. For those approaching or in retirement, let’s call it 50 plus years of age, it may be difficult both financially and emotionally to handle a 30% drop in the value of a portfolio. One has to wonder if the portfolio will have time to recover if one is withdrawing currently or about to withdraw against the portfolio for income.

Everything I just stated, most of us know. Yet during periods of raging bull markets like what we have been experiencing over the past 9 years, many retail investors forget about all of this and have a false belief that they will be able to get out before the next drop or that the next drop won’t affect them.

Many people today are focused on chasing the highest returning assets with the least cost instead of being focused on the amount of risk and/or volatility an investment takes to achieve its return and the correlation the investment has to all the other investments in a portfolio. I have been asked to review many portfolios as of late that are, in my opinion, massively over concentrated in the stock market based on the assessed risk tolerance. If there is a stock market drop, these portfolios may drop far quicker and far more than the investor realizes or can stomach.

All this being said, portfolios heavily weighted in stocks have performed incredibly well since 2009. There as well has been very little volatility since 2009. Many have felt that this was because of Fed intervention. Over the prior 8 years it seemed that whenever the market pulled back, the Fed would make an announcement that created the perception of “lower for longer” for interest rates and
the market rallied back up. Well the Fed is no longer intervening and we still have not had any real volatility in markets to speak of. But let me clarify. The Fed rarely caused the market drops over the past 8 years instead it has been perceived that it helped pacify issues whenever they happened. I do not know what will cause the next market correction or when it will happen, but I do not think the Fed is going to step in this time and be able to create the “lower for longer” calming effect that the markets have gotten used to.

There are many current risks both known and unknown that could be the cause for a start in volatility and a market correction. Whatever it is that causes it and whenever it happens is unknown. But I, and I am sure you, do not think that “volatility is dead”, or believe that you can sell out fast enough as it begins to happen. On the other hand, if you are young and iron stomached you may be able to handle it. My experience is that for most that is not the case. Therefore, now may be the time to fully review your portfolio and risk test it for volatility and to make sure you are diversified correctly so that you may be able to handle the next downturn if and when it happens instead of being blindsided.

*Please feel free to forward this article to anyone that might benefit from reading it.*

Thank you,
Andrew Schultz

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**About the author:**

Andrew Schultz has been a Financial Advisor at Morgan Stanley and its predecessor firms for over 25 years. He is one of approximately 300 Private Wealth Advisors, a group within Morgan Stanley Wealth Management who focus on Ultra High Net Worth individuals, families and foundations. Andrew has recently been recognized by Barron’s as one of the Top 1200, by Forbes as one of the Top 200, and by the Financial Times as one of the top 400 Financial Advisors in the country.

If you would like to receive Andrew’s weekly commentary please email him Andrew.schultz@morganstanleypwm.com or visit https://fa.morganstanley.com/theschultzgroup.

If you are interested in scheduling a consultation with Andrew please contact Jen Todd at jennifer.todd1@morganstanleypwm.com or 305 695-6153.
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