

Embracing market volatility: A path to portfolio resilience and rational investing

PROFESSIONAL OPINION



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In the realm of finance, volatility often carries a negative connotation, evoking images of tumultuous markets, panicked investors, and turbulent economic conditions. However, amidst the chaos lies opportunity for those willing to embrace it. Contrary to popular belief, market volatility can serve as a catalyst for rational decision-making, and long-term wealth accumulation. By understanding the positive aspects of volatility and adopting strategies to harness its potential, investors can navigate the ups and downs of the market with confidence and resilience.

The positive side of market volatility

At its core, volatility measures the frequency and magnitude of price fluctuations in financial markets. While elevated volatility may ignite investor anxieties, it often reveals opportunity. Volatility is a natural characteristic of dynamic markets, reflecting the interplay of supply and demand, investor sentiment, and macroeconomic factors. One of the primary benefits of market volatility is its role in driving price discovery and efficient allocation of capital. Rapid price movements enable markets to quickly adjust to new information, facilitating the fair valuation of assets, resulting in greater market efficiency. Moreover, volatility promotes liquidity, allowing investors to buy and sell assets with ease, thereby reducing transaction friction and enhancing market transparency.

From a strategic standpoint, market volatility presents opportunities for investors to capitalize

on price fluctuations by actively rebalancing assets with sturdy prices against those that are exhibiting deviant price behavior. Simply stated, investors can benefit by executing on the time-honored axiom of buy-low and sell-high. Market volatility provides that exact opportunity for disciplined investors with a well minded investment strategy.

Portfolio diversification and asset allocation

While market volatility may induce investor anxiety, it is at the core of portfolio diversification. Diversification is the practice of spreading investments across different asset classes, sectors, and geographical regions to reduce risk and enhance risk-adjusted returns. At the core, it's the proverbial "don't put all your eggs in one basket" strategy.

Asset Allocation builds on the foundational elements of portfolio diversification by employing correlation coefficients and mean-variance optimization to build portfolios that are efficient for a given level of risk or a desired level of return. Although neither can be predicted with absolute precision, asset allocation is a significant move forward beyond traditional diversification strategies. By allocating capital strategically across a diverse range of assets with low or negative correlations, investors can achieve a more resilient portfolio and capitalize on upside potential.

Emotions and investing

Money and emotions just don't mix. Unfortunately, we are all human and we need to recognize our own shortcomings when it comes to emotions and our investments – to some degree fear and greed are at play in all of us. Market gyrations can often trigger releases of dopamine and feelings of euphoria in our limbic system which oversees our most basic survival instincts (fight or flight). Emotions cloud rational decision making and can lead us to chase return and buy high, at or near market peaks, or sell low during corrections fueled by fear, both are a surefire recipe for diminished outcomes.

Accept that volatility will come and so will your emotions – and stick to your plan. A good investment strategy should be connected to a larger financial plan to guide decision making through periods of market volatility and to ensure appropriate diversification during periods of low volatility and growth. Ultimately, investment planning and moreover, financial planning is about increasing the probability of success. Having an investment plan that connects to financial plans and long-term goals can help investors navigate market volatility with confidence and discipline, avoiding the missteps of emotional decision making and impulsive behaviors that may

compromise their financial security.

The media is not your friend

In today's hyperconnected world, investors are inundated with a constant stream of news, opinions, and market commentary from various media sources. While staying informed can be beneficial, it's essential to distinguish between meaningful insights and hearsay that can distort perception and fuel emotional reactions. Be discriminating and recognize that what is being covered by business media outlets is intended to capture your attention and imagination. Don't think so? What was the best performing stock in the S&P 500 for the prior 30 years ending July 2023? Did you guess Monster Beverage (MNST)? When was the last time you heard that name in the financial media?

To navigate the media's incessant noise investors should adopt a hyper selective and discerning approach to information consumption. Focus on reputable sources that are data oriented when the hyperbole of opinion starts – mute the sound, change the channel, or turn the page. Sensationalism only serves to stir emotions and increase the probability of poor decision making.

Practicing mindful consumption from diverse and balanced sources can lead to improved outcomes and a stronger financial plan. Properly practiced, this framework reduces confirmation bias by providing investors with the information needed to build a robust thesis that is refined by the frictions of dissenting opinion to make good investment decisions.

In conclusion, market volatility is a double-edged sword that presents both challenges and opportunities for investors. By understanding the positive and negative aspects of volatility investors can harness the power of diversification and asset allocation to avoid emotional decision making and tune out the media noise affording the opportunity for investors to navigate turbulent market conditions with confidence and resilience. For more information on market volatility and investor behavior please visit our website at: www.prenticewealth.com/investor-resources/

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