#WiseWithEdelweiss

An Investor Education Initiative

Edelweiss MUTUAL FUND

Ideas create, values protect

Insights

Enjoy the ride

Don't let market swings spoil the party

In capital markets, investors can lose money in a heartbeat. The adage, "What goes up, must come down" seems to have been coined for capital markets. However, it does not really stop there. The cycle of up and down is literally perpetual and can have a strong impact on investor behaviour.

What is volatility?

Market volatility is basically the range of uncertainty associated with the rate of change in investment value. An investment with high volatility is one which experiences significant variation in its value during a specific time frame. This move can be an upwards or downwards. Such an investment can witness sharp price fluctuations which might not always reflect its underlying fundamentals. Assets with a high volatility are generally considered high risk as there is more uncertainty regarding the future outcome of such an investment. On the other hand, an investment with low volatility would experience minimal price fluctuations during a specific period. Due to minimal variation in prices, these investments are generally considered low risk.

Why should I be aware of this concept?

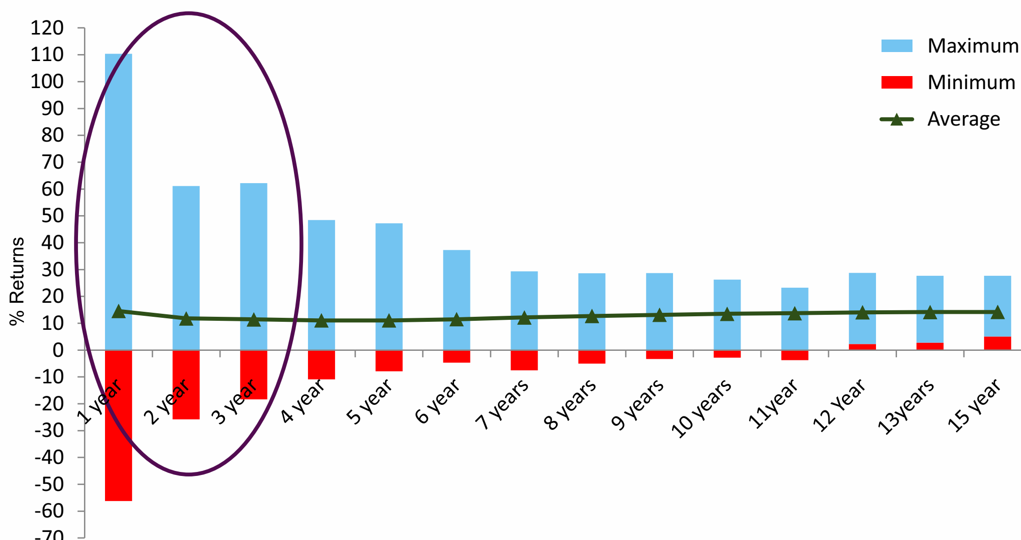
Volatility can have a strong influence on investor behaviour and can impact his/her ability to make rational investment decisions. Various studies have concluded that market volatility, investment prices and associated risk have a strong correlation. Generally, higher volatility is associated with falling markets while lower volatility is associated with steady and growing markets. It has been observed that in volatile market conditions investors often panic and withdraw investments in an attempt to avoid risk, only to return as active investors closer to peaks, when markets are trending and therefore less volatile. Consequently, they end up making losses.

Therefore, it is imperative to be aware of the inconsistent and unpredictable nature of markets and make investment decisions in a rational and disciplined manner.

How can I mitigate this risk?

One way investors can mitigate the risk associated with volatility is to diversify their portfolio and invest in a mix of assets that have a low correlation with each other. This will ensure that higher volatility of one asset class is neutralised by lower volatility in another asset class. Balanced and Dynamic funds aim to do just that. These funds construct a portfolio that switch between fixed income and equity assets in order to reap the benefits of equity while at the same time dampen the impact of volatility.

Another great way to combat the negative impact of volatility is by staying invested for the long-term. Long-term investing can smoothen the impact of the ebbs and flows of the markets and help investors reap the true potential of their investments. As you can see from the chart below, in the short term (1, 2, 3 and 4-year periods) average returns from equity investments witnessed sharp swings and went as high as +110% to as low as -55%. However, over the long-term, these swings smoothen out to generate returns of +20% with minimal negative returns.



Source: Acord Ace MF. Equities have been represented by Sensex Index. Data from May 1997 to May 2017.
This is only for illustration purpose. Past performance may or may not be sustain in future.

So, the next time you pick up the paper and read things like "volatility plagued the markets" or "volatility to the fore", don't panic. Stay calm and stick to your asset allocation strategy.

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MUTUAL FUND INVESTMENTS ARE SUBJECT TO MARKET RISKS, READ ALL SCHEME RELATED DOCUMENTS CAREFULLY.