Perpetual Equity Investment Company Limited

Perpetual knowledge bank series: volatility

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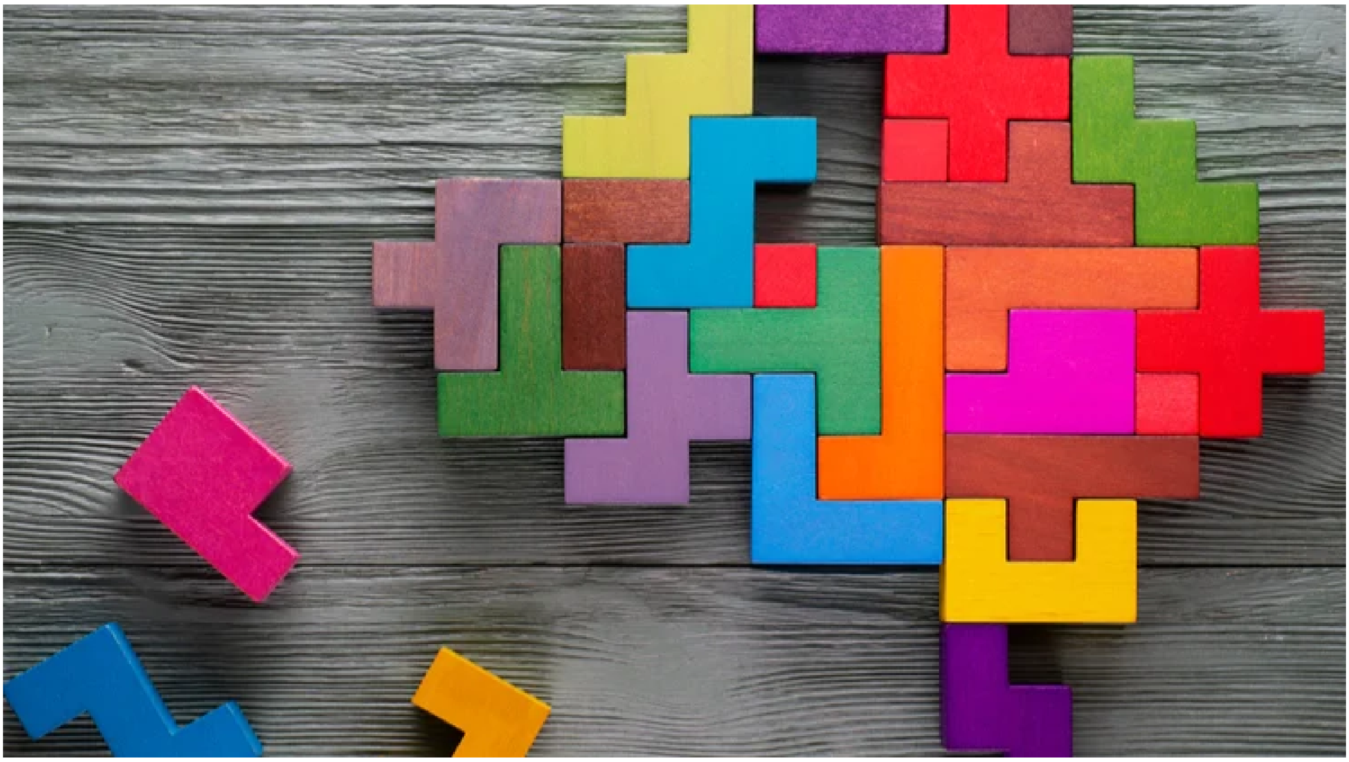

Volatility in the context of financial markets refers to rapid stock price fluctuations and swings. But while investors often only associate volatility with the downside volatility that comes with spectacular market crashes, the more likely outcome is that the market – and individual listed stocks – will experience both good days and bad. Historically the market has produced some of its highest returns in the wake of memorable downturns with both the 2008 financial crisis and the recovery from the Covid-19 pandemic in 2020 being recent examples. While neither of these events were much fun for investors watching their portfolios diminish at the time, those who stayed in the market or who took the opportunity to realign their portfolios were often rewarded down the track.

A good example of this would be the ASX 200's performance in 2020 and 2021. In 2020, ASX 200 shares fell by 32.5% between mid-February and mid-March due to the onset of Covid-19, only to rebound 36.7% by the end of the year. After such a high volatility year for ASX 200 shares, 2021 was relatively benign, appreciating by 13.02% over the calendar year with no significant market corrections or crashes. Periods of increased market volatility should therefore be seen as inevitable, and investors should accept volatility as a normal and necessary part of investing. However, rapid market falls can make even seasoned investors nervous especially when the sell-off is being driven by big macroeconomic themes like wars or pandemics. Another way to think about volatility is that it creates opportunities for savvy investors who invest for the long haul.

As a general rule, shares that fall into the growth shares category tend to display higher levels of volatility than value shares or ASX blue chips. This typically means outperforming the index during bull markets and underperformance during bear markets. By contrast, companies that tend to have resilient and predictable cash flows, like utilities or infrastructure providers, tend to be low volatility shares. These might underperform during bull markets but might also provide higher levels of capital protection during bear markets. Investors handle volatility in different way and engaging with a financial adviser can assist in determining your investment goals, risk profile and appetite for volatility compared to the broader market.