Investor Insight

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Volatility and Opportunity

During turbulent times, it is sometimes difficult to remember that volatility in the marketplace is, in fact, the norm. Seasoned investors accept it as a reality of the markets and embrace volatility for the opportunity it can offer.

Volatile markets are characterized by wide price fluctuations and heavy trading. Various underlying factors cause an imbalance of trading pressure in one direction, either selling or buying.

The volatility can often be attributed to a variety of reasons, including investor reactions to disappointing economic news and geopolitical friction, as well as nervous investors who may have be prompted by the sell-off after experiencing a lengthy bull market.

Consider this historical perspective on volatility. Since 1970, over two thirds of the annual returns of the S&P/TSX Composite Index* (with dividends reinvested) have been year-over-year changes (either gains or losses) of greater than 10 percent. Over one-third of the annual returns have been year-over-year changes of greater than 20 percent. Yet, over this period the index has had an annualized return of 9.4 percent.

As uncomfortable as the ups and downs may be, volatility provides opportunity for the investor. Historically, equity markets have provided some of the best returns to investors and in today's world of low interest rates this still has been the case. However, with the rewards offered by the equity markets come the volatility associated with the ability to buy and sell the shares of a company.

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During temporary periods of downward volatility, the resulting price movements of most quality company shares are not usually related to their long-term operational performance. Since the fundamentals of quality stocks often haven’t changed during these times, such volatility can provide a short-term opportunity to purchase good investments at a lower price.

At the same time, remember that the decision to sell shares should not be an emotional reaction to volatile markets, as this may mean selling at a lower price. Over the longer term, a portfolio that emphasizes quality and diversification is often largely unaffected by these short-term periods of volatility.

As difficult as it may be in practice, embrace volatility for its opportunity, because, at the end of the day, just like death and taxes, volatility remains one of life’s certainties.

*Source: S&P/TSX Composite Total Return Index annual returns from 1970 to 2014, using closing data from Dec. 31 (or relevant last day of trading for calendar year).