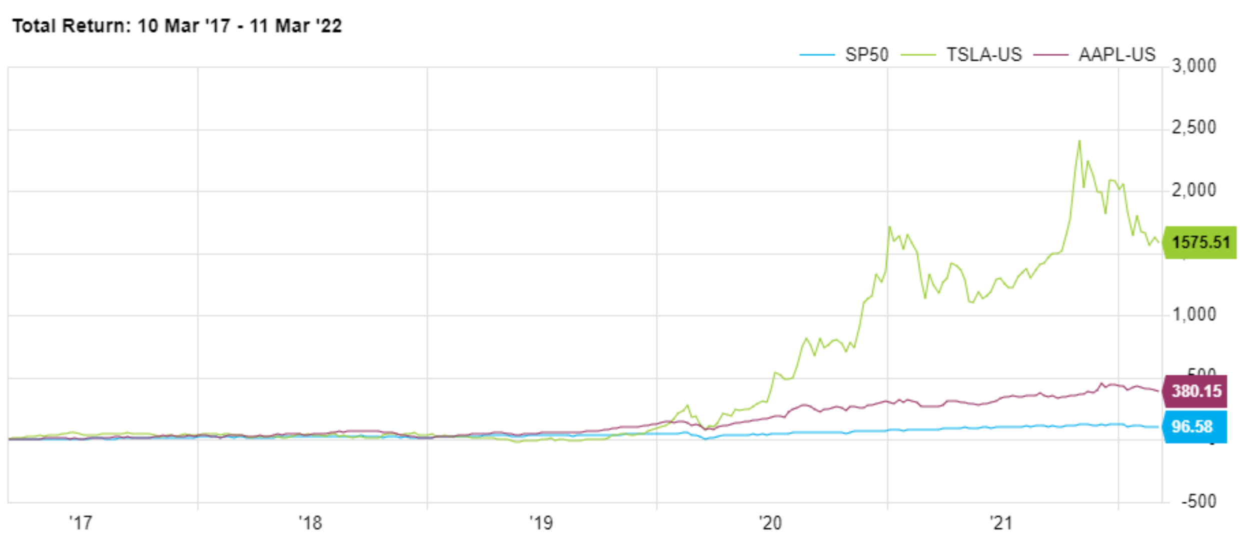
This has been another volatile week in the markets with Monday and Tuesday both being down days. After a sharp rebound on Wednesday, it looks like the S&P 500 is going to close the week down about 1.6%. With the current market behavior, we thought this would be a good time to discuss the difference between risk vs volatility.

Volatility often refers to unpredictable price swings. There are multiple ways this can be measured but, more common measures include standard deviation and beta. This will get a little technical, but it is important. Standard deviation is a statistical measure of how much an investment is likely to deviate (both positive and negative) around it's average return. This can provide good insight for some investments but, what if a stock often has more positive upswings than downswings? This would increase standard deviation, and, thus, the measure of risk. Most investors would agree having big upswings above the expected return is good because that means more money is being made. As a result of this shortcoming in standard deviation, measures like beta can be useful. Beta is a measure of volatility relative to the market's volatility. These tend to be useful measures of risk when comparing investments or portfolios. It provides a way of standardizing risk and return expectations.

With these measures of volatility defined, it begs the question if they're a good measure of risk. The short answer is that they are useful, but they do have shortcomings. Volatility metrics are important for determining risk, but that is not how we would define risk. Let's take a look at two stocks: Apple (AAPL) and Tesla (TSLA).



As you can see, both Apple and Tesla are exhibiting more volatility than the S&P 500, meaning they have more up and downswings. However, as you start look at longer timeframes you can see that these stocks have outperformed. But this is not always the case, there are periods of significant underperformance. This leads us to ask the question of volatility being an adequate measure of risk? In the case of Tesla and Apple, we believe volatility presents an opportunity rather than a risk.

Let’s take a look at our definition of risk. We view risk as the permanent impairment of capital; in other words, losing all of your principal. When the investment committee analyzes a company and stock, we look at the underlying fundamentals, like how fast the company is growing revenue, the health of the balance sheet, etc. We also look at the company’s business strategy and how viable we think it will be in the current and future environment; in addition, we look at the quality of management to gauge if they will be able to deliver on the strategy. If all of this checks out, we then do a discount cash flow analysis to provide us a value per share of the company and compare it to the market price. If we believe the value is high enough to compensate us for the risk of being wrong, we then decide to buy the stock. We finally overlay technical analysis, which focuses on price action and price patterns to help us determine a good entry point. Finally, we continuously monitor the company and if the fundamentals remain strong and we continue to see value per share above price per share, we hold the stock.

As you can see from our process, we do not put too much weight on current market sell offs that are based on short-term events. When investors get scared and everything is being sold, we look for opportunities; we are glad to buy a good company stock from someone who is scared and willing to sell it to us for cheap. The reason most investors panic is because they do not have an investment framework and don’t know if the current events are affecting the company they own. We understand very well why we own the stocks in our portfolio and if the fundamental deteriorates, we don’t have issue selling, but if the fundamentals are intact, we welcome the opportunity to buy more of the stock at a discount.

We understand volatile markets can be scary for investors. This is why we use a data driven approach to portfolio management and financial planning. This ensures emotion, and the risk of panic selling, is taken out of the decision-making process. We appreciate the trust our clients place in us as stewards of their wealth as we continue to evaluate the market for opportunities.