

Weathering market volatility

During times of volatility, it's wise to remain calm.

Times of market volatility can often trigger emotional responses in investors, responses that can impact judgement and potentially affect long-term plans. Too often, investor emotion follows the ups and downs of the market. While market volatility is largely out of our hands, understanding how it occurs and the role of your long-term financial plan can help you weather the storm.

Though often stressful, periods of volatility are an opportunity to connect with your advisor, enabling them to act as a sounding board for the concerns you may have. By talking about current events in light of your overall financial plan, your advisor can provide reassuring perspective to help you stay the course or readjust if your plan no longer aligns with your goals. Above all, maintaining perspective and investing intelligently are critical.

KEY TAKEAWAYS

- ▶ Volatility is the product of uncertainty in the financial markets.
- ▶ Effective asset allocation and diversification can help protect your portfolio.
- ▶ Maintain perspective. Despite periodic pullbacks, returns over multi-year periods are generally positive.
- ▶ Your financial plan is in place for a reason.
- ▶ Periodic check-ins with your advisor and rebalancing as necessary can help keep your portfolio on track.

DEFINING VOLATILITY

Understanding what volatility means in the financial markets is key to weathering periods of ups and downs. At a basic level, when stock prices fluctuate dramatically, the markets are in a period of high volatility. So why do these periods of instability occur? While the specific causes are countless, the root of nearly all volatility is uncertainty. Certainty induces confidence in financial markets and produces a greater degree of predictability when pricing assets. On the other hand, when previously unforeseen

risks become visible to investors, they may react with anxiety and confusion. Often, in an attempt to avert losses or gain profit, investors frantically buy or sell, causing asset prices to swing wildly.

To explore uncertainty, you should understand that most uncertainty comes from four main categories of risk: market risk, liquidity risk, credit risk and operational risk. In most cases, market risk is responsible for volatility in asset prices.

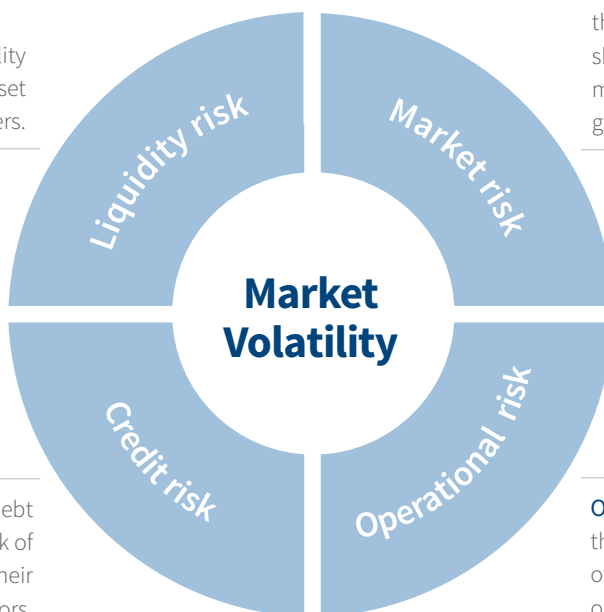
To put the concepts of risk and uncertainty into a little more context, suppose a company earns most of its revenue from international sales. The company receives payment in foreign currencies, which are exchanged to U.S. dollars. Say the value of the U.S. dollar fluctuates relative to foreign currencies and the trend is expected to continue in the future. It is therefore more difficult to value the future revenues of the company with the same degree of certainty due to the presence of additional currency risk. As a result, investors sell shares of the company, causing its stock price to decline. The result? Heightened volatility.

The root of nearly all volatility is uncertainty.

Four categories of risk

Liquidity risk The inability to sell a particular asset due to a lack of buyers.

Credit risk Specific to debt investments, the risk of debtors defaulting on their obligations to creditors.



Market risk Generally the most common cause of uncertainty, this includes external price shocks, currency or interest rate movements, natural disasters and geopolitical tensions.

Operational risk Risks inherent in the management of a business or other entity, including fraud and other illegal activities.

MEASURING VOLATILITY

Volatility is a valuable gauge for investor sentiment and the level of uncertainty present in the markets.

Historical volatility is measured by observing changes in asset prices over time. Standard deviation, a statistical measure of variability, indicates the degree to which an asset has 'deviated' from its average price. Investment professionals regard standard deviation as a proxy for risk and use it to calculate a wide array of financial measures. Often, they'll also compare a stock's

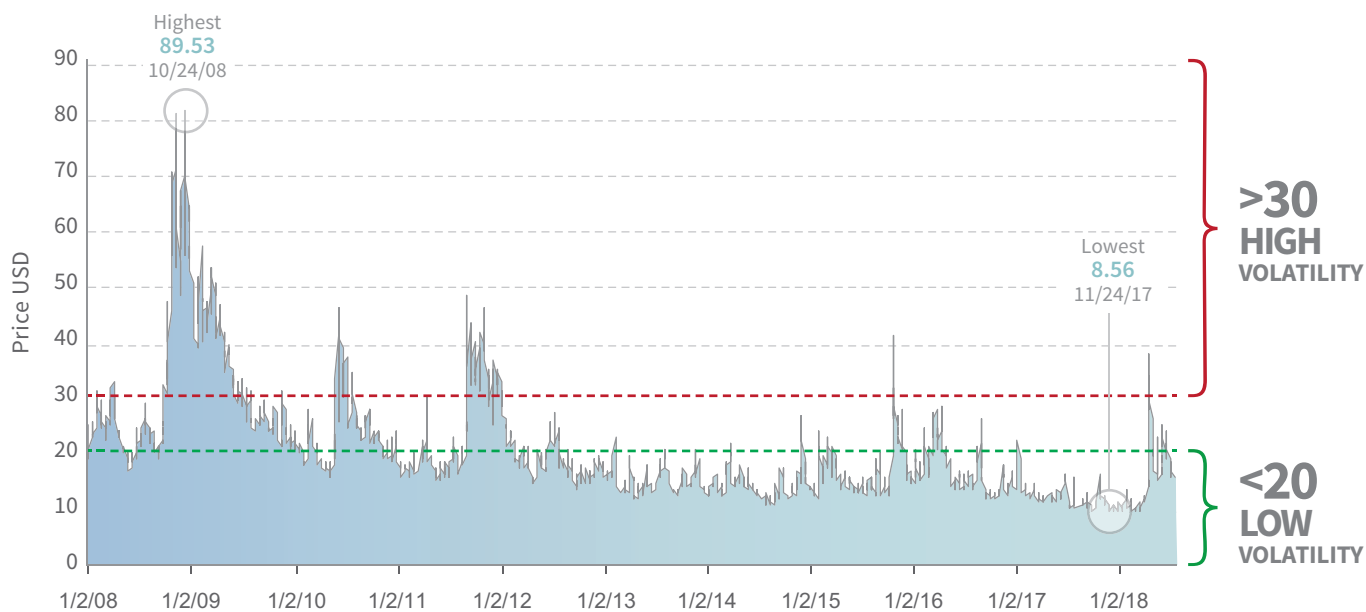
current value to its average price over a preceding time period, known as a simple moving average, to help identify trends and signals.

Implied volatility, conversely, is a helpful gauge in anticipating future volatility. Implied volatility is derived from prices on option contracts. These contracts allow investors to buy or sell assets at a given price at a predetermined point in the future. Therefore, their prices are largely determined by the expectation of future price fluctuations on the underlying asset.

It is important to remember that the stock market is cyclical. Patient, committed investors – those who view their investment strategy with a long-term perspective – often experience stock market resilience firsthand.

Investment professionals often look to the **Chicago Board Options Exchange Volatility Index (VIX)**, which aggregates the pricing on an array of options contracts on the S&P 500. The VIX – also known as the “fear index” – is one of the leading gauges of market risk and a frequent estimate for volatility levels over the next 30 days.

The fear index



Source: Bloomberg, January 2, 2008 to April 30, 2018

PLAYING THE LONG GAME

While market volatility is inevitable, there are a variety of strategies that may help mitigate its negative impact on your portfolio.

Asset allocation and diversification

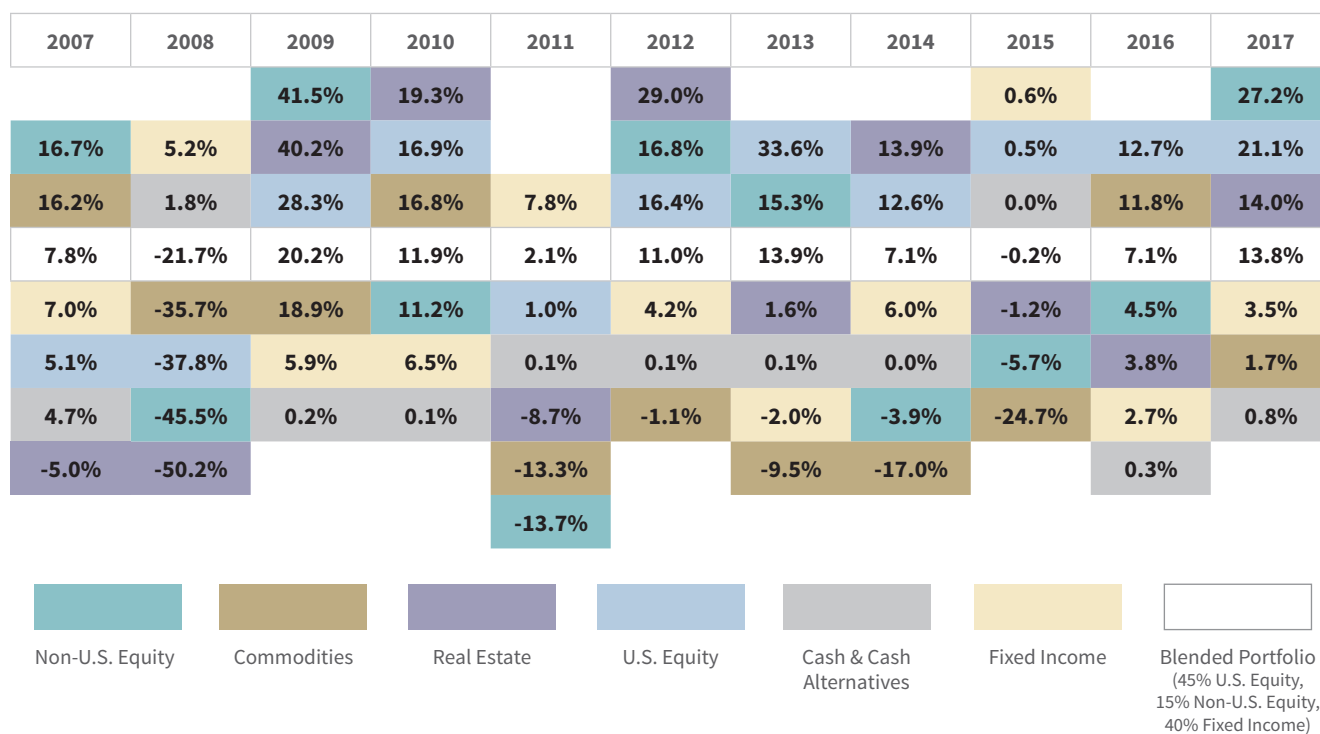
Your first defense against volatility is working with your advisor to craft and maintain a balanced portfolio. Effective asset allocation and diversification can broaden your reach in the market and provide a wider safety net during periods of turbulence. Volatility often affects individual sectors and asset classes differently, so diversifying across various classes, sectors, and securities reduces the chance of one narrow decline devastating your overall portfolio. Additionally, paying attention to how your assets are correlated – how much they tend to move in the same direction – may help insulate your returns from the negative effects of volatility.

A key aspect of maintaining your portfolio through any market is having a clear understanding of your tolerance for market movements. Working with your advisor to determine your risk tolerance – over the long term, not how you feel when the market is soaring or skidding – can provide perspective when creating an asset allocation model that can see you through the market’s ebbs and flows.

A key aspect of maintaining your portfolio through any market is having a clear understanding of your tolerance for market movements.

Investment returns, ranked best to worst

Asset classes cycle in and out of favor. Here’s a look at how each major asset class performed compared to a diversified portfolio over the past 11 years.



Diversification does not ensure a profit or protect against loss.

The process of rebalancing may result in tax consequences. Every investor’s situation is unique and you should consider your investment goals, risk tolerance and time horizon before making any investment. Investing involves risk and you may incur a profit or loss regardless of strategy selected.

VOLATILITY MAY PRESENT OPPORTUNITIES

The good news is that market volatility isn't always bad news. Though it may be tempting to concentrate on losses caused by price fluctuations, it's important to remember that volatility – and changing price trends – may offer opportunity for gains.

One way to potentially use volatility to your advantage is through dollar-cost averaging, the practice of investing a set amount every month or quarter. Although engaging the strategy takes discipline – you'll be putting money into the market when the headlines (and likely your

friends and colleagues) are full of doom and gloom – price declines often afford investors the opportunity to purchase assets at better valuations.

It's also good to keep in mind that, in the right situation, selling assets at a loss, a practice called tax loss harvesting, may prove beneficial. This strategy can help offset the taxes on your investment gains. At the same time, you free up capital to reinvest at lower prices.

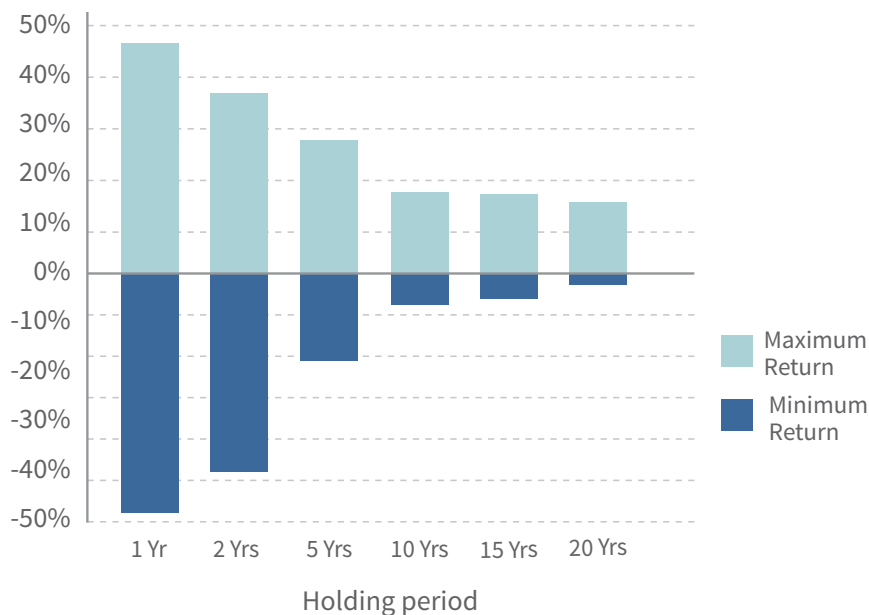
Although it may be difficult, try to stay focused on your financial goals when markets are volatile.

If you're contributing money to a company 401(k) plan, perhaps biweekly or monthly, you're already practicing dollar-cost averaging.

Range of best and worst annual returns

Historically, the market has tended to deliver more consistent, positive returns the longer the investment is held.

The chart below looks at rolling returns over various holding periods.



As of 12/31/2017. Source: Morningstar and PGIM Investments, S&P 500 TR USD Index. This example is for illustrative purposes only and is not indicative of the performance of any investment. It does not reflect the impact of taxes, management fees, or sales charges. The S&P is a weighted, unmanaged index composed of 500 stocks believed to be a broad indicator of stock price movements. Investors cannot buy or invest directly in market indexes or averages. Past performance is no guarantee of future results.



INVESTING WITH DISCIPLINE

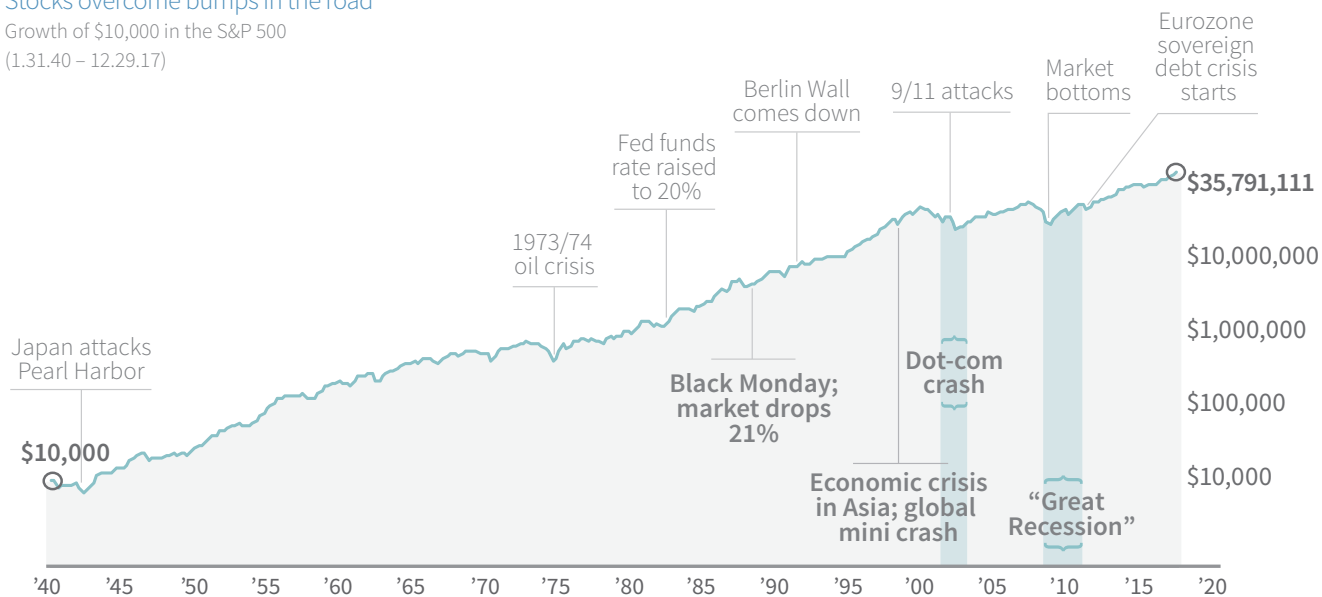
Volatility doesn't occur in a vacuum. It's influenced by human behavior and actions – or rather *reactions* – to events in the market, the global economy and politics, among other factors. And while current events can initiate fluctuations, it's the response of investors that fuels them.

rush out when everyone is selling. It can be difficult to ride out volatility without reacting irrationally, but it's important to maintain discipline and focus on your long-term goals and best interest.

While everyone wants to “buy low and sell high,” investors are often driven by emotion to do exactly the opposite. Excitement can cause investors to rush in when the market's rising and everyone else is buying, then panic and

Stocks overcome bumps in the road

Growth of \$10,000 in the S&P 500
(1.31.40 – 12.29.17)



Source: Morningstar; Past performance may not be indicative of future results. There is no assurance these trends will continue. The market value of securities fluctuates and you may incur a profit or a loss. This analysis does not include transaction costs which would reduce an investor's return. The S&P 500 is an unmanaged index of 500 widely held stocks. An investment cannot be made directly in this index.

MAINTAINING PERSPECTIVE

No matter the intensity of the market turbulence that may arise, don't underestimate the value and importance of time. The markets have proven remarkably resilient over the long term. In fact, while the financial markets can be quite volatile year-to-year, returns are generally positive over multi-year periods. By simply staying invested, you give your assets the chance to rebound in the wake of downturns.

Don't forget that you have a financial plan for a reason, and that it was carefully crafted by you and your advisor specifically with your objectives and risk tolerance in mind. Though it may be difficult, staying focused on your endgame is the best way to help achieve your long-term objectives. As always, your financial advisor is there as a trusted guide and resource to address any concerns and help you make progress toward your financial goals.

RAYMOND JAMES®

INTERNATIONAL HEADQUARTERS: THE RAYMOND JAMES FINANCIAL CENTER
880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // 800.248.8863
RAYMONDJAMES.COM