

# WHY YOU SHOULD UNDERSTAND THE RELATIONSHIP BETWEEN RISK AND VOLATILITY



A lot of investors are confused about the relationship between risk and volatility (price fluctuation), with many believing them to be the same thing.

Warren Buffet says it's not just the man on the street who's unclear on this distinction, but many business and financial professionals are confused as well.

In a recent shareholder letter he wrote that many business schools teach that volatility can simply be used as a proxy for risk.

"Though this pedagogic assumption makes for easy teaching, it is dead wrong: Volatility is far from synonymous with risk. Popular formulas that equate the two terms lead students, investors, and CEOs astray."<sup>1</sup>

## So What Is The Difference?

Risk, according to London Business School professor Elroy Dimson, "means more things can happen than will happen."<sup>2</sup>

In other words, it's the chance you'll get the outcome you least desire. For investors that's the possibility that they will lose some or all of their initial capital.

Volatility, on the other hand, is the variation in the value of a security, index, or even a market of securities. It's the measure of how widely a price varies over a given period of time.

According to Howard Marks, founder of Oaktree Capital Management, because volatility can be reduced to a number, it's much easier to quantify than risk and so makes an easy stand-in.

## How Risk And Volatility Relate To Each Other

Risk and volatility mean different things to different kinds of investors.

For investors who are interested in short-term price movement, such as bond traders, volatility and risk often go hand-in-hand. A sudden price swing, up or down, could spell immediate disaster.

But for long-term investors, there is far less correlation between the two.

As Mr. Buffet points out, "Stock prices will always be far more volatile than cash-equivalent holdings. Over the long term, however, currency-denominated instruments are riskier investments—far riskier investments—than widely-diversified stock portfolios that are bought over time and that are owned in a manner invoking only token fees and commissions."

However, there is one type of long-term investor for whom volatility is closely tied to risk. And that's the person who reacts to sudden market swings. By moving his/her assets unnecessarily, s/he increases the risk of causing his portfolio to underperform and not meet his/her retirement goal.

Price fluctuation (volatility) is part of the implied risk a long-term investor must endure in pursuit of returns that would outpace inflation or cash. We often refer to the phenomenon as: "No Free Lunch." Our own behavior as investors is perhaps the greatest determinant because acting on fear or greed can turn short-term volatility in to a much bigger long-term risk.

Understanding the relationship between risk and volatility can make you a more prudent and less worried investor. Talk to us about what you should (or should not) do next time volatility strikes.

Have a great weekend!

Source: Efficient Advisors

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## Golf Tip of the Week



### Remove Choppiness in Your Swing

A good swing requires the ability to focus and hit with precision and power. As you swing, it's important to remove any choppiness. To get it right, imagine driving a spike into a log. Here's how to practice:

- **Envision chopping wood:** Imagine a log in front of you. Now, pretend to chop the wood, which most likely will cause you to swing at an abrupt angle. This is the angle that causes choppiness in your swing.
- **Pretend to drive a spike into the log instead:** Now, rather than chop wood, pretend you're driving a spike into the log. When you swing, imagine you need to hit level with the spike's head.

Hitting head on, instead of at an angle, will help dial in your swing. If you can act like you are driving a spike, you can gain control in your swing.

Tip adapted from PGA<sup>i</sup>

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## Recipe of the Week



### Mustard-Crusted Mini Meatloves

**Serves 4**

#### **Ingredients:**

1 ¼ pound ground meat, beef or dark-meat turkey  
1 small zucchini, grated  
⅓ cup seasoned bread crumbs  
Kosher salt  
Black pepper, freshly ground  
2 tablespoons Dijon mustard  
3 small Gala or Empire apples, cored and sliced into 8 pieces  
1 teaspoon fresh rosemary, chopped  
¼ teaspoon cayenne pepper, ground  
1 tablespoon extra-virgin olive oil  
chopped chives

#### **Directions:**

##### **Meatloaf**

1. Mix ground meat, zucchini, bread crumbs, and ½ teaspoon each salt and pepper in a large bowl.
2. Divvy up meat into 4 mini meatloaves and place on baking sheet lined with foil.
3. Brush each loaf with Dijon mustard.

##### **Apples**

4. Toss apple wedges with rosemary, cayenne, olive oil, and a pinch of salt until coated.
5. Place them around the meatloaves on the baking sheet, and bake at 425°F until thoroughly cooked, either for 30 minutes or until meatloaf heats to 165°F.

##### **Serve**

6. Garnish meatloaf and apples with chopped chives, and serve.

Recipe adapted from Good Housekeeping<sup>ii</sup>

## Health Tip of the Week



### Understand Sinusitis

Sinusitis causes your hollow sinus cavities to become infected or swell, most commonly around your eyes and cheeks. The result can be a painful, mucous-ridden sickness.

#### What causes sinusitis?

A variety of triggers can cause sinusitis, such as:

- Existing cold or viral infections
- Atmospheric conditions like air pollution and smog
- Allergens that become airborne

#### What symptoms occur?

Infected sinus cavities can develop mucus and trap air, creating a painful sinus headache in places like your forehead, eyes, neck, and ears. You also can develop additional symptoms including:

- Mucus that is thick and green or yellow in color
- Postnasal drip with a bad taste
- Sore throat and a cough

Further, if you have asthma, sinusitis can make controlling your asthma more difficult. Be sure to consult your doctor if you think you may be developing sinusitis.

Tips adapted from WebMD<sup>iii</sup>

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**Sources:**

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2. <http://go.efficientadvisors.com/e/91522/our-house-is-not-an-investment/4rld3/280983368>
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<sup>i</sup> <http://www.pga.com/golf-instruction/golf-tip-day/fundamentals/dont-chop-wood-drive-spike>

<sup>ii</sup> <http://www.goodhousekeeping.com/food-recipes/a41235/mustard-crust-ed-mini-meatloaves-with-roasted-apples-recipe/>

<sup>iii</sup> <https://www.webmd.com/asthma/guide/sinusitis-and-asthma#1-2>