focus

Turning market volatility to your advantage

It is understandable that investors are reluctant to invest new money when markets are volatile. However, it is possible to take advantage of such volatility.

Regular Investing

Trying to get the timing of investments right is very difficult. The aim is to buy when the market is low and sell when the market is high but this is almost impossible when markets are volatile. One effective way of dealing with this problem is to drip-feed money into the market over time rather than invest a single lump sum.

This strategy might result in a larger accumulated total compared to the lump sum route but it might also result in a smaller fund. Even if the latter result is achieved, the build up over time would certainly be smoother and therefore less worrying. Also, the regular investor does not lose the use of the initial lump sum for the entire period.

Pound-cost averaging

Regular investing also has another benefit, known as “pound-cost averaging”. Say an investor invests a set amount on a monthly basis, then in a month when the market falls, they will get more shares for their money. If the market rises, they will of course purchase fewer shares, but their existing shares will also be worth more.

Rising Market

	Investment	Share price	No. of shares purchased
Month one	£100	£1.00	100
Month two	£100	£2.00	50
Month three	£100	£3.00	33.3
Total	**£300**	**£6.00**	**183.3**

Average price of shares bought: £300/183.3 = £1.64

Average share price: £6.00/3 = £2.00

Falling Market

	Investment	Share price	No. of shares purchased
Month one	£100	£1.00	100
Month two	£100	£0.67	149.3
Month three	£100	£0.33	303.0
Total	**£300**	**£2.00**	**552.3**

Average price of shares bought: £300/552.3 = £0.54

Average share price: £2.00/3 = ££0.67

Over the long-term, this means that the average price of the shares an investor holds may in fact be lower than the average of the share price for the investment period, since they have bought more shares when the price is lower and fewer when it is high.

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Splitting a lump sum investment

The same principle applies to a large lump sum as this can be split and invested over several weeks or months to remove the risk of investing everything when the market is at its peak.

Absolute return funds and Structured Products

In addition to how you invest, there are also products that try to take advantage of such volatility.

"Absolute Return" funds tend to be predominately share based, and use a variety of techniques that aim to produce positive returns even when markets are generally falling. These techniques generally thrive on volatility and therefore can potentially produce greater returns in more uncertain times.

"Structured Products" use derivatives to guarantee at least a return of capital but hopefully a fixed positive return, subject to certain criteria being met over a fixed period of time. Depending on the pricing of the derivatives, which is affected by market volatility, such arrangements can provide valuable protection and attractive positive returns in volatile times.

Reducing risk

We strongly believe that a diversified portfolio is important and will become increasingly important given the uncertainty surrounding the changed prospects for world economies and in turn investment returns over the next few years.

A reduction in risk can be achieved by using some of the techniques and products described above. If you require further information on any of the issues discussed in this document, please contact your adviser.

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