The Impact of Volatility

Impact on a Hypothetical $100,000 Portfolio

	Year 1 Return	Year 2 Return	Average Return	Compound Return	Value at End of Year 2
Portfolio #1	50%	-50%	0%	-13.4%	$75,000
Portfolio #2	10%	-10%	0%	-0.5%	$99,000

For illustrative purposes only.

Investors should design portfolios to experience less fluctuation in returns. Lower volatility can result in a higher compound return and greater terminal wealth.

Although Portfolio 1 experiences a strong gain in the first year, this gain is more than eliminated in year two. Portfolio 2 experiences a much smaller gain and loss during the two-year period.

The lower volatility of returns produces a higher compound return and preserves more portfolio value. Managing volatility is particularly crucial during a market downturn. After experiencing a loss, a portfolio must earn an even higher return in future periods to fully recover to its previous level.