How to Find Stability in Times of Heightened Market Volatility

Speaker Key:

DP	David Pett
JC	John Christofilos
KM	Kevin McCreadie
BD	Bill DeRoche

Time code	Speaker	Text
00:00:00	DP	Welcome to AGF Inside Perspectives. All right, welcome. John, Kevin, how's it going?
	KM	Morning, David.
	JC	Morning.
	DP	This is Episode four of Season five. We're doing pretty good. We've got a nice little cadence going, once a month. And we haven't really been doing that up until now, so let's keep it going. John, are you all back to normal after your big trip to Augusta and the Masters?
00:00:31	JC	Yes. I've come back to earth a little bit. It was a great experience, once-in-a-lifetime opportunity to get down there for a day. Had a lot of fun. I will tell you, people have asked me what was it like, and I split it into two components. The first component is from a sporting event perspective. It's golf. You're 15 deep, looking at somebody hitting a ball 300 yards, so it's tough to see the actual event, although I did sit in the Amen Corner for a couple of hours, which was kind of nice.
00:01:01		So from a sporting event perspective, it's good. From an experience perspective, it's off the charts. The venue, the efficiency, the people, the etiquette, the grounds, everything was over the top. So very fortunate and honoured to be able to spend a day there, and it was a lot of fun, yes.
	DP	So which day were you there? Where you there on the…?

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	JC	There on the Thursday.
	DP	Which day?
	JC	Which was the first day of the tournament.
	DP	So there was a rain delay that day.
00:01:27	JC	There was a rain delay for a couple of hours, and we had to wait in some rain, but it was well worth the wait. And once we got on, it was an experience of a lifetime.
	DP	And so for listeners who may not know, Amen Corner is…
	JC	11 and 12.
	DP	11 and 12.
	JC	Right. So long par four into 11 and then a short par three over the creek and some sand traps. And it's a very famous hole. So we got to see both holes, and it was really special.
	DP	And who were you there to watch mostly?
00:01:54	JC	I watched mostly the Canadians. I actually followed Mike Weir around a little bit, past Masters champion. Corey Conners, I followed. Nick Taylor, I followed. I tried to stay Canadiana through the day. But it was a lot of fun.
	DP	And Kevin, have you ever been down to it? Oh, you have?
	KM	I have, yes. Actually, to John's point, it's a terrific experience. And you can't appreciate, watching on TV, how hilly things are. And it's always called a long walk. That is a long, hilly walk. So yes, it's a terrific event, probably my favourite golf event to watch.
00:02:26	DP	And if you were… So obviously, this is a sport that there's a bit of sports event tourism, if you will. I don't know if that's the right term. But are there any other events that either of you would have been to or would like to go to?
	KM	I've been to the Kentucky Derby, which is an interesting… I'll use the word interesting. It's one of those, it's the Indy 500 of maybe racehorses. But no, it's different, right? History, culture. It's a little different than the Masters, but…

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	DP	And that's coming up. I think it's always the first Saturday of May.
	KM	Yes. I think it's lost its allure a bit, but it's still…
00:02:59	DP	A little bit, yes.
	KM	Once upon a time, it was probably one of those things you wanted to see.
	DP	And what about you, John?
	JC	Yes.
	DP	F1 I know, because a lot of [overtalking] support that.
	JC	So I've been fortunate enough to have been to Super Bowls and Game 7 of the NHL championship. The one thing I have not done is a World Cup of soccer event. And whether that's later in the tournament, like a semi-final or a final, I think it would be off the charts.
	DP	Well, maybe you'll get a chance as I think they'll be in North America the next one. Is that right?
	JC	Yes, in 26, I think it comes to North America. So there might be an opportunity there, but that would be…
	KM	It comes to Canada.
00:03:29	JC	Yes, Canada and the US. Yes. So it'll be a lot of fun.
	DP	Okay, let's… Maybe it's time to introduce our guest. We have the pleasure of having one of our own. He's a Bostonian through and through. He's a former fighter jet pilot with the US Navy and a highly accomplished investor, who has carved a name for himself as a specialist in hedging strategies that have the potential to improve portfolio performance through reduced volatility and enhanced returns.
00:03:57		And the person I'm talking about, of course, is Bill DeRoche, Head of Quantitative Investing at AGF Investments, LLC. So if you guys are ready, let's get into it. Bill, welcome.
	BD	Thank you.

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	DP	As you probably have been listening, we were just talking a little golf. Are you a golfer?
	BD	I try to play, not very well, though. But yes, love the game.
	DP	And any trips to the Masters, like these two have, or…?
00:04:30	BD	So as I was listening to you two discuss it, no, I've never been. My dad, who is now 95, almost 96, went two years ago. My sister, he went with my sister, who never takes no for an answer, was able to negotiate him to drive right up to the front gate. She convinced them he was handicapped. He proceeded to walk the entire course all day long. He actually got interviewed. Someone saw him and they did an interview with him.
00:05:00		The Georgia State Police saw the interview, and they were like, hey, you're not handicapped. But they loved it. And every day, he pulled up to the same spot, made a lot of friends down there. Definitely a trip of a lifetime for him.
	DP	Oh, that's super cool. Okay, we want to get into obviously the markets and investing and stop talking sports, although I think we could probably do that all day. But I do have one question. So as many of you know, the Boston Bruins are playing the Toronto Maple Leafs in the first round. This is one of the great hockey rivalries.
00:05:31		Boston, Bill, I understand you're a huge Bruins fan. Game three was last night. Bruins are up two-one. How are you feeling about the series so far?
	BD	Well, it's been as even as you could imagine. So it looks like, in my mind, it's going to go seven. To your point, I absolutely love the Bruins, grew up worshipping Bobby Orr. So yes, I want the Bruins to win. But it's funny, I have connections to the Leafs too. When I played in college, our assistant coach was a gentleman named Kent Douglas.
00:06:02		He was on the last Leafs team to win the cup. His other claim to fame was he was the oldest person to win the Calder Trophy, the rookie of the year. So I actually like the Leafs quite a bit, but I'm all in on the Bruins, for sure.
	DP	There you go. So I hate to admit this, but Boston's a pretty solid sports town.

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	JC	Yes.
	DP	Across the board, if you look at the four professional sports. I was looking up a stat, and Boston has 39 titles. And that's second place behind New York.
00:06:34		But New York's a bit of a cheat, because they have multiple teams. And I think 35 of their championships are the Yankees. Toronto has 16 championships. But Toronto doesn't play in the NFL. So if we add the CFL…
	BD	That's a bit of a cheat.
	DP	Which we have 18 titles…
	BD	Yes.
	DP	We come up with 34. So we're neck and neck with Boston. And the strange thing is that Baltimore has eight titles.
00:07:05		But if you add the CFL, they have an extra one, because there was a small, little error of the US team playing…
	BD	Baltimore Stallions, the Stallions in Baltimore. That's right, David, yes.
	DP	That's right, yes. That's right. I think they only lasted a couple of years.
	JC	Could I add one thing here real quick on this Toronto-Boston series? I think it's important. Anytime you get two Original Six teams playing against each other, whether it's on a Tuesday night in November or it's a play-off, there's something special that goes on. It's fascinating.
00:07:35		You walk downtown Toronto, and I'm sure the same thing in Boston, when Original Six teams are playing, it's a different evening. And what we're seeing so far through three games has been real special. The intensity, the passion is just off the charts. It's different than watching Colorado play Dallas. There is a different perspective.
	KM	And the other thing I'd add to that, I 100% agree, is it's a little different up here. By far, the Maple Leafs are Toronto's team, off the charts, where it's pretty evenly split in Boston between the Patriots, the Red Sox, the Celtics and the Bruins.

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00:08:08		When you come here, it's like people live, breathe, die Leafs, for sure.
	DP	Absolutely. Okay, we should get to the markets. We'll start, as we always do, Kevin, with maybe just a rundown of what's been going on in markets since the last time we spoke at the end of March.
	KM	Yes, perfect. Listen, we're sitting here toward the end of April now. The market, usually the S&P is a proxy. It's up 6.5%, so a pretty good start to the year.
00:08:35		But we've given back, since we last met, 3.5% of that, and as we talked. You were going to move into April more seasonally challenged. You had a really strong start. If we actually go back to the end of March, 9%, probably one of the best quarters we've had of all time. Part of the softness we've seen here, again, seasonality that we've talked about, but also, you've had central bank speakers basically now starting to move in different places. And the one that's really, I think, been aggravating the situation, if I have to use that word, has been the US Fed.
00:09:03		Coming out of the last meeting, they seemed a little bit more dovish, saying, you know what, we're… They reset how many times they think they're going to cut rates. And the market cheered for the fact that they came out, and on their little mechanism they use, this dot plot, showed that they would cut rates three times this year. And so as we moved through the last four weeks or so, the data that they look at post that meeting has come in a little hotter on certain fronts, really the inflation front, some of it higher jobs as well in the employment report, but really around inflation.
00:09:35		So now you've seen this idea that, maybe not so much three times. We're down to, it looks like, pricing in only one cut, and now much later in the year, well out past the election. And I think that's what the market has adjusted to, that if you push things out later and you reduce rates fewer times, the odds of you making a mistake and sending the economy into a harder landing from this soft landing, i.e. maybe even a recession, go up.
00:10:06		And that means profits probably go down. And so you've seen this adjustment mechanism across the board really

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		over this last five or six weeks of getting used to later and not so many.
	JC	So let me get real technical here on what's happening in April. Because people ask me all the time, what's happening in April? And it's really simple. The market's doing what it's supposed to do. The run-up that we had in the first three months of the year, again, just didn't feel normal. It was too aggressive, too quick.
00:10:36		So anytime you get that sort of experience in the market, you get a pullback. And that's what we're seeing in April. So a little bit too much froth. We saw that when we looked at our retail trading numbers, and we will look at that on a daily basis. They were elevated, so more people participating. You look at the call volumes in the options markets, over the top. So we had to pull back a little bit, and it's okay. We're fine. We're going to be in decent shape here.
00:11:00	KM	And one of the interesting things we talked about last time, if you remember the start of the year, the market was pricing in seven rate cuts, so almost, call it, 1.75% from here by the end of the year. And the market kept powering through as that was priced out, now to… We said seven became three, and we cheered and the markets were okay, pretty orderly. And now we're saying, I don't know, three just quickly went to one and, well, late [?], maybe there's none.
00:11:29		And I've even heard people start to say, I don't know, maybe they even put one rate hike back in. That would be… If you want to talk about volatility, that would create a lot of volatility. So anyway, I think that we actually repriced things well from January to March. And now, I think we are struggling with that, how do we adjust to where rates are going, and how soon?
	DP	I hate to give you guys compliments, but I do believe both of you called the softness that we have seen over the last three weeks.
00:11:59	JC	That only tells you one thing, David, that we've been around for a long, long time, and we've seen this softness. So again, it's what markets do. When it gets too frothy, people get pushed back down and you lose some of that froth. And that's what we're seeing.

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	DP	So Bill, what's your take on what we've seen?
	BD	Well I guess I'd ask Kevin. I don't think not having any rate cuts is a bad thing. If we're cutting, it's probably because something is bad in the economy.
00:12:28		So I don't think we're in a bad situation. And as long as things continue to look good in the economy, I think we can move higher in the market. All the things that were said about things getting too frothy are true. I think people were thinking cuts in terms of getting back to a more neutral rate, which is great. But I just don't think the Fed… They're going to make sure inflation's dead. It is such a pernicious thing. It really hurts everybody.
00:13:03		They're going to wait probably too long. The whole type one/type two error. So I think if we just stay here longer, higher for longer, not a bad thing.
	KM	So the narrative is about to change, which is growth's been great, first quarter was a 3% growth in the US, and to Bill's point, nothing felt like you should be stimulating a world where you're growing at 3%.
00:13:29		Today, we found out US GDP, which may get revised, came in with a one handle on it, high ones but still 1%, lower than where what you'd say is the economic track for growth, which is typically targeted around two-ish and change. And at the same time, one of the inflation gauges that the Fed looks at, which is the personal consumption expenditure index, their version of inflation, came in higher. Still a three handle on it. So two things moving the wrong way.
00:13:58		You could accept that little bit of higher inflation as long as the growth was there. Now, you're looking at maybe a scenario where people are starting to say, wow, we have a slowing economic growth and we still have this stubborn inflation. And the inflation argument, to the average consumer, is not the economic argument we talk about, which is this rate of change. It's only going up 3%, and it's decelerating to 2%. This is about the base level of things.
00:14:25		So if you go back to where we were in pre-COVID, things like food, North America, and Canada, US kind of the same, up almost 30%. Gasoline prices, from where we started the year, up fairly significantly in both countries. And so these are things, the average consumer doesn't

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		concern themselves, well, it's only going up X. They feel like, wow, the price of this is still elevated. So the level of things is what's pinching consumers.
00:14:56		And you see it in the polling data in the US with Joe Biden. Probably one of the top things that people are concerned about is, even though the economy seems to be doing well, people are struggling with, as Bill said, the inflation that has pushed prices to these levels. And they probably don't come back for certain things.
	DP	And is it that disparity, that in terms of that economic data, GDP's saying this and consumer data's saying something a little differently? Is that what creates that volatility and that uncertainty in investors?
00:15:25	KM	Yes. So now you have a scenario where, if growth is slowing, you want to start to ease rates off so you can avoid a recession. But you're now in the camp of, how do I do that with inflation well away from where I want it to be? You put yourself in a box. That's the situation Canada has found itself in as well, slower economic growth but stubborn inflation. And so if you're the central bankers in these two countries, your job just got harder.
00:15:55	JC	So the Fed's got a dual mandate. So the economy's the one side, but employment's the other. And employment seems to be still very vibrant. People are hiring. When does that start to roll?
	KM	We've been surprised by the fact that… Every Thursday, we get a look at people who claim new unemployment benefits. They should be going up by now, and they're stuck at this level which is in the low 200,000. And that's frictional. People just… Jobs close, new jobs get started, so it's not elevated. And that's been surprising to people, John.
00:16:26		And the pace of job creation in the monthly data we get has been stubbornly high for the Fed. And so I would argue that they still have the checkbox on full employment, but they're not getting to the inflation rate that they want.
	JC	And then from the corporate side of things, how are CEOs thinking about their employment bases? Because we got into a situation where we didn't want to lay anybody off or cut jobs because we may not be able to find people

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		when we need people. Are we still in that mindset, Kevin, or is that starting to shift a little bit?
00:16:58	KM	In the ideal world, you kill, if you will, open requisitions for people looking for employees. If everyone stops looking for more employees, there's not this wage race to pay people, and we're all looking for the same thing. And so if somebody pays up, that creates wage inflation. So if you can get rid of the demand for incremental labour and keep the workforce working, that's a great scenario. And that's what we have literally been seeing a little bit of.
00:17:26		I suspect now, John, if economic weakness really starts to bear, companies start to actually pull back actual workers.
	JC	Yes.
	KM	And that's the delay. That's what we have not seen. And that actually starts to… Because you're defending your profits there. And that becomes a spiral. You lay people off, they stop buying jeans and sunglasses and going out to dinner, especially with these higher prices, and companies' profits that make those things go down, and they lay off more people. And that's how the cycle goes the other way on you.
00:17:54	BD	And there's been a lot of differences within the labour market, right? The higher end of the labour market has been probably stagnant if you look at some of the statistics for kids coming out of college and all. So a lot of the growth has been in areas that are different. There's definitely a huge story to be told if you dig into underneath the covers there, for sure. I think the US Fed's been very fortunate in that a lot of the largest companies that have done well, a lot of them are self-funded.
00:18:27		They don't need to go to the capital markets. They're not getting impacted by these higher rates. Then this whole AI story has really helped juice the economy, so the Fed has been able to raise rates as high as they have to combat inflation but still have good growth. I think they've been fortunate. I think, to Kevin's point though, it's going to start getting harder now.
	KM	The other thing I'd… And Bill makes a great point about all jobs aren't equal in the way they've been added. The

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		higher end of the economy, tech, finance, have suffered losses.
00:19:01		Where we've had big gaps coming out of COVID was at the service end of the economy, so hospitality, leisure, retail. And very unpopular, but I'll state it. Immigration in the US, which is a big political argument right now, has helped contain some of the labour force issues, because a lot of those folks have taken jobs in the lower part of the economy that have been tough to fill. And one could argue that they've actually helped prolong this economic cycle so far.
00:19:30		More research will be done on that over time, but there's been a couple million people that entered the US that have actually legally entered and have taken some of those jobs. But there is differences in the labour force, as Bill said. And I'd bring it back, one last thing, David, there are differences because of that in the consumer. I'll flip this over. The high end is still doing okay, consumption wise. I think the low- and middle-income consumer, with these higher inflation prices, is really starting to struggle.
00:19:58		We see it in credit card data. We see it in delinquencies in credit card data from the various companies. So when we put it back together, it looks great. And when we start to separate them via income quartile, it looks a little different. And that's where I think the softness starts to show.
	DP	Bill, a question for you. I know your team does a lot of modelling in terms of the macro regime, if you will. Where are we right now in terms of that regime? How would you articulate that?
00:20:27	BD	Yes, it's interesting in that we're in what we would describe as a reflationary scenario, where inflation is going up as well as growth. But the reality is, if we think about quadrants and we're looking at the rate of change of both growth as well as inflation, we're pretty close to right in the centre. So small changes could cause growth to go up or down, and very small changes could cause inflation to go up and down.
00:21:00		And I think that's causing some of the uncertainty we're seeing right now. If we were squarely in one of the quadrants right in the middle, I think it would be a little more clear for people. But again, because we're so close

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		to the middle of the plot, it makes just minor things really increase what's going to happen.
	DP	So clearly, a tenuous environment. And maybe that brings me to my next line of questioning. And it's that concept of volatility.
00:21:31		If I am watching BNN, every single day, there will be a segment on how to mitigate volatility in the markets. It just seems to be a synonymous term with investing. But it means maybe different things to different people. So I just want to get into your heads a little bit about how you think about volatility and what it means to you in terms of investing.
	KM	So volatility goes both ways. It goes up and it goes down, and we tend to only focus on the one on the downside.
00:22:00		We're okay as a society and market participants on the stuff that just goes up. We get a little more freaked out on the stuff that goes down. So I…
	DP	Yes, volatility is almost associated with a correction as opposed to the up and down, right?
	KM	So one of my favourite phrases actually comes from Bill, about how markets react with escalators and elevators, right, Bill?
	BD	Yes. They tend to go up like an escalator and drop like an elevator, for sure. Yes.
	KM	That's volatility.
00:22:27	DP	So, John…
	JC	Yes.
	DP	From your standpoint, from a trading standpoint, how do you gauge volatility? What are some of maybe the important metrics or indicators where you say, okay, we're in a heightened volatile period, if you will?
	JC	Yes. Just keep in mind, my perspective is much shorter. It could be daily or hourly. And when I look at or think about volatility, I put, equals opportunity. So if we're a buyer of something and there's some volatility, I can take

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		advantage of that volatility for our portfolio managers and get a better price obviously.
00:22:56		So when I look at volatility, I look less at the VIX versus individual stock volatility.
	DP	And by VIX, we're talking about the Volatility Index. Yes.
	JC	The Volatility Index, right, which everybody talks about and quotes and whatever. I would actually argue that VIX is less of an indicator today than it ever has been. There is so much financial engineering and derivative overlays that happen inside of VIX that actually suppresses. I got asked this morning by somebody, why is VIX only at 16 when we're seeing markets do what they do?
00:23:26		And it's because of some of the overlays and some of the derivative work that goes on in the background. So I look less at VIX and look at more individual stock volatility, and especially the names that we're trading that particular day. So my perspective is much shorter than a portfolio manager or a CIO's perspective.
	DP	And then, Bill, how do you look at volatility?
	BD	Yes, volatility is a ubiquitous term that's used. When I think about it, I'm trying to focus on probably one of two things.
00:23:56		One is just uncertainty, which causes prices to fluctuate quite a bit. We talked about some of the uncertainty that's picked up over the course of the last, say, month or so. And that has to do with, say, monetary policy. So we're seeing elevated fluctuations. The other side is the risk component. A lot of times, when people think volatility, volatility tends to spike when the market goes down, so people have that elevator mindset.
00:24:26		So the other element that I'm constantly thinking about with volatility is, conditionally, what are the factors that we can see today that may increase the probability of a large drawdown? And we can look at them. Some of them are macro-related. Some of them could be the market trading at higher multiples. So you look at all of those components, and together, you're trying to say, is this a heightened risk environment or is it not?
00:24:55	KM	Yes, let me say, it may be an extension of what Bill said, if we all had perfect certainty about everything, perfect certainty, true certainty about when central banks were

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		going to cut rates to sustain the economies, we can position and make investment decisions with great clarity. We don't, and this is what makes a market. There's someone out there who says they're going to cut rates X. There's somebody who says they're going to be Y. That uncertainty creates volatility. That's just monetary policy.
00:25:24		We're also living in a world that for many years we haven't dealt with, which is geopolitical uncertainty, which is basically two shooting wars on different fronts, geopolitical in the terms of electoral uncertainty, whether it be the US election, what either the US Congress is going to do and has done now with giving aid finally to… There's a whole host of things that are creating this idea that if we can't figure it out, how do I position for that event that may be the one I don't want?
00:25:56		And so there's not just monetary and what bankers do to stimulate the economy. It's the adverse thing of you do something really bad in the Middle East and energy goes to $100 a barrel, oil goes to $100 a barrel, the consumer's going to feel the pain at the pump pretty quick. And again, we're probably living in more fog around things that are in front of us than we have in quite some time.
	JC	Maybe just to touch on something I mentioned earlier about VIX being less of a gauge than in the past, I'll give an example.
00:26:29		If you sit in my seat in the morning and you're watching the screens pre-market and you see VIX higher and the futures higher, that doesn't correlate very well. So typically, one of the two is going to reverse. Either the market's going to come back in or VIX will continue to move. You know what I'm saying? So VIX is less of an indicator for us on the trading side than it ever has been. As I mentioned, single stock volatility is much more important.
	DP	To that point, is it fair to say that volatility is a feeling as much as it is a tangible thing that you can track?
00:27:04	KM	Yes, it's fully an expectation. If you think about it, I look at things like ratios of people who buy puts, which is I'm getting nervous and I want to protect myself, versus people who buy calls, which is saying, I think this market's going up and I want to put a call right now for the future. And when those things flip around, that's a feeling or

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		people's expectations about where things are going. So I do think there's an expectations element to volatility.
00:27:30	BD	Absolutely. So you can look at realised vol, which is always going to be backward-looking, and it's actually been pretty low. And that was the whole pause environment. People were in agreement the Fed had paused. If you look at realised vol over, say, the last year, it's down around 10%. That's pretty low. But I think, to Kevin's point, everybody realises that spikes in vol tend to be episodic, and they tend to be around macro events.
00:28:00		And I think we're seeing a little bit of that now, because there's more uncertainty around where we're going in the future.
	KM	And then I'll throw one more, when you have had asset classes that run this hard this fast and you get a curve ball, like earnings and the expectations we've built into the stock prices that have gone up, and somebody does something that disappoints, or even something that's not even related or kind of related to it disappoints.
00:28:26		We had an event last Friday which I haven't seen in years, where we had drawdown in the markets, parts of the markets, the darling names that people have loved. Some of them were down 10% in a day, and nothing that had to do with them, yet the rest of the market showed real breadth. It went up. And those are, again, creating volatility for investors who've crowded into things. And all of a sudden, everybody says, wait a minute, something… And people don't understand what's going on and they panic.
00:28:54	BD	And I would just add, if you try to oversimplify things, say, look at a Gordon Growth Model for the market, you end up with two levers. One is multiple expansion, the other's earnings growth. If you look at last year, basically last year was a multiple expansion, for the most part, that drove the market up. So we're at elevated levels to start the year. It was going to be hard for that lever to be able to generate any returns going forward. So everybody's eyes are focused, laser, on the earnings growth and what's coming in.
00:29:27	JC	So if you looked at my father's portfolio, he wouldn't think it's been volatile at all. It really depends on what you hold. If you're high growth and high-octane stuff, yes, you're

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		probably going to feel that volatility a lot more in your portfolio and in your PA, personal account, than you would if you owned a bunch of other instruments that weren't as volatile. So it really depends on what you hold and when you hold them to make you really feel if it is volatile or not.
	DP	I want to pick up on something you mentioned earlier, John.
	JC	Yes.
00:29:54	DP	It related to the market structure perhaps having changed with high frequency, and how that may be distorting… Or maybe distorting's not the right word, but it's changed that level of volatility in the market, just generally speaking, from ten or 20 years ago.
	JC	Yes. I think market structure and market participants. So we have a much greater number of retail or self-directed investors sitting in their basements, trading the market, than we have for a long, long time, other than obviously during COVID, which were really elevated.
00:30:28		But we're still at elevated levels. And they have less patience than a long-term investor, so they're adding volatility as they look at their portfolios churning and moving higher and lower all day, every day. So they're adding volatility just by being overly active in the market. High frequency trading, depending on what numbers you look at, it could be 50%, 60%, 70% of daily volume, the algorithms that are working every single day. So there's different participants in the market today than there were ten, 15, 20 years ago, when you could really rely on volatility indexes being more accurate than they are today.
00:31:02	BD	There's lots of academic papers that have been written on the sources of volatility. And if anyone has insomnia, I'm more than happy to share them with them. But at the end of the day, there's basically two sources, the source that John described, which is due to trading… And most academic papers come out on the view that there's too much volatility due to trading. We're trading too much and so forth. The more important source, though, is news coming into the market. And right now, those are the trading…

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00:31:32	DP	The unexpected.
	BD	Yes, the trading aspect is pretty consistent. We could argue it's too high, but it's the new information coming in that causes the uncertainty. That's what we try to focus on at the end of the day.
	DP	So the sheer volume of it, but also that idea that we don't know what's to come in terms of that news flow. The unexpected, right?
	KM	I just feel like we've been… And I think COVID was an event, for sure, that changed a lot of things, which we've spent a lot of time talking about.
00:32:02		I think now, we're in a place that there are many things external to the market, external to a specific company that affect companies, that affect markets, that I think, when I look at… To John 's point, the VIX doesn't really reflect the potential volatility around us for the uncertainty, for the thing we're not planning for.
	DP	So Kevin, you mentioned earlier that when people think about volatility, they think negatively, but there's a positive side to volatility.
00:32:33		So maybe we can wrap a bow on this conversation and talk a little bit about how the three of you think investors should be managing heightened volatility to the downside but also to the upside.
	KM	So this is going to sound perverse. We all want markets to go up. I think the thing that you would try to have in addition to that, maybe the second priority, is to avoid the large loss.
00:33:01		And I always think of the compound effect, and we always think of it positively. I always say the worst thing for you is the compound effect of a negative return. So take a manager. If a manager someplace in life went down 50% in a given year and you started out with $100, you end the year with $50. It happens. I've seen people in our industry famously blow up like this. So that investor has $50. If that manager goes up 50% the next year, guess what? You now only have $75. You don't have your $100 back.
00:33:31		So if you can dampen what the market gives you from that volatile uncertainty by reducing the effect of a loss,

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		you're going to be so much better off over time. So we may think about it as upside. I always say the second thing to worry about is minimise the negative compound effect, because you'll end up better off, longer term, if you do that.
00:33:56	BD	And David, you and I have talked about this in that there are specific points in people's lives where that risk is even higher. So we call it sequence risk. But if you're right around retirement, where your nest egg is at its highest level, and you experience a big drawdown event, all of a sudden, you're not going to have enough money for retirement. So there are points in the cycle where you have to be extremely focused on how much risk you have, because a bad event like that you may never come back from.
00:34:29	DP	And so to mitigate that, guys, people know about asset allocation, I'm sure, the listeners, but is there something more direct that people need to be doing that maybe they're not doing?
	KM	Yes. So I think it is asset allocation. I think it's using instruments in your portfolio that are available to minimise that drawdown. I think it's if you're uncertain about the future and you know you've got a liability in front of you, like your next kid's college payment, pull that cash out, park it in front if you're uncertain.
00:34:58		If you think about fixed income, it's actually given you income now. There's a point in time where bad news will rally the bond side of it to offset some of your equity declines, which has not been the case more recently but will be. I think of things like instruments, whether it be a specific product that hedges the beta in the market. We have one in-house that's up 12% this year. That is going to give you a lot of defence in this. So you've got to package it all together now. Think of things like energy if you can find places for real assets in your portfolio.
00:35:28		Now, if the geopolitical side gets a little bit out of hand in the Middle East, oil goes through 100, that portion of your portfolio is going to go up probably with that. Gold is probably in there too, will go up with that and help you. You put it all together, you can minimise that drawdown by just using instruments differently to cushion some of the negative effects of the uncertain event.

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	DP	And Bill, there's no shortage of options now that Kevin's describing for investors, end investors, if we will.
00:36:00	BD	Yes, for sure. Of course, the engineer in the group is going to look towards some of the more interesting ways to do it. But I'd go back to both your points, Kevin, and you, David, that first and foremost, start with the easy stuff. Keep it simple. Asset allocation and diversification are your best friends. I do think the fixed income comment was right on the money.
00:36:25		But the only other thing I'd add, though, is over the last, say, 15 years, you really hadn't had to worry about inflation, so fixed income and equities probably worked great. You may want to add a third leg to the stool to be there to help combat inflation. Especially if you're retired, inflation is very pernicious, as I said earlier. So those would be the three things I'd be trying to combat at the end of the day.
00:36:55	JC	Not that a trader can give a portfolio manager or a CIO any advice on asset allocation, but I will say this. The proper asset allocation will allow you to tweak that portfolio without having to time the market every day and being in and out and in and out and so forth. So timing the market is a losing strategy, because you're going to make two mistakes. You're going to get out at the wrong time, and you'll never get back in at the right time. So proper allocation is important, and then being able to tweak that asset allocation from time to time without having to be all in or all out of the market.
	KM	And I think this all goes back to what we've said for the last couple years.
00:37:29		We're in an adjustment phase as, to Bill's point, we've been 15 years with near-zero rates that we've all somehow forgotten was not normal and made it normal. We're going back to this adjustment of we are dealing with inflation, we are dealing with Fed policy that's trying to combat things that most younger investors haven't seen in 15 years. And so as we've worked through that adjustment, and I think we're getting through it, it's creating this volatility, which is going to create us to have to think differently, to Bill's point, about how to put things back in our portfolios and remember what our goals and

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		objectives are, to hedge against that, because we're not going to near-zero interest rates again.
00:38:05	DP	So certainly no guarantees in investing, but between the three of you, lots of food for thought for our listeners. I think we'll end it there. Thanks very much, Bill. A pleasure having you here. I'd love to wish the Bruins luck, but I'm not going to do that. And John and Kevin, we'll see you next time.
	KM	Thank you, David.
	JC	Thanks, David.
	BD	Thanks, David.
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