Volatility revisited: where calm meets opportunity

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I wrote earlier this year about volatility, explaining why it should not necessarily cause investors to panic. Since market ups and downs have continued since then, further underlining the notion that this is a "new normal", it seems apt to revisit the topic.

I would like to take the argument a step further on this occasion. Having previously stressed that volatility need not be a cause for alarm, I believe it is useful to explore in more detail why there might even be instances when the phenomenon should be embraced.

We first ought to remind ourselves of the basics, the most important of which is to understand why volatility can appear so rife. Broadly speaking, the spark usually comes from the unforeseen.

Perhaps most obviously, this might assume the form of conflict. By way of manifest illustration, take the hostilities between Israel and Iran, which negatively impacted a number of markets while prompting a spike in oil prices[1].

Geopolitical and geoeconomic uncertainty is another likely trigger, as are controversial policies. The fallout from President Trump's "Liberation Day" announcement on trade tariffs reflected both.

We can also include in the list pandemics, more localised upheaval and – much less widely appreciated – the far-reaching repercussions of short-termism among the investment analyst community. I discussed the last of these at length in my earlier article.

There are a number of significant hurdles to sensible decision-making when confronted by such challenges. One of the toughest to overcome is recency bias, which is a cognitive bias that results in undue emphasis being placed on recent events.

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Let us say, for example, that an investor notices a particular company's share price has fallen because of developments in the Middle East. The temptation might be to extrapolate the present turmoil far into the future, inferring that the impact on the business will prove permanent.

Consequently, the investor's knee-jerk reaction could be to sell the stock. Yet it is far from guaranteed that a situation that applies today will still apply tomorrow, next week, in six months or even further down the line – so such a move might turn out to be precipitous, to say the least.

In circumstances like these, even though instinct might well lean towards dramatic action, calm is almost always the optimum response. The long-term view is what really matters. There is little merit in trying to jump in and out of markets, which are practically impossible to "time".

Composure is not the same as inertia

That all said, there is a big difference between remaining commendably composed and becoming completely blind to opportunity. After all, see-sawing share prices offer irrefutable evidence that markets are inherently inefficient – and inefficiencies can be an investor's dear friend.

To reiterate: volatility occurs because no-one is all-seeing and all-knowing. Accordingly, while it should be respected, it should not be hidden from – since it is in many ways there to be exploited.

This brings us to the distinction between strategic and tactical investing. The former is about having a long-term plan, while the latter is about being prepared to tweak that plan in light of shorter-term twists and turns.

Volatility is the principal catalyst for tactical investing. The fundamental purpose of regularly rebalancing the assets in a portfolio is to capture gains from market fluctuations.

This does not mean thrashing around and randomly juggling holdings in the hope of getting lucky. Rather, it means applying a critical lens, drawing on all the data and insights available and arriving at fully informed investment decisions.

As you may recall, I consider myself a student of military history. Last year, while walking the Via Francigena from Canterbury to Rome, I passed through Reims, France, where General George S Patton established his headquarters during the Third Army's rapid advance across Europe in 1944.

"The time to take counsel of your fears is before you make an important battle decision," Patton once declared. "That's the time to listen to every fear you can imagine! When you have collected all the facts and fears and made your decision, turn off all your fears and go ahead!"

Patton was absolutely relentless, of course. His motto was "Go forward!". He had no truck whatsoever with the notion of retreat. So I do not pretend he can serve as an wonderful role model for investors in every conceivable respect, as successful investing is seldom an unwaveringly gung-ho affair.

Nonetheless, despite the typically strident tone, the above remark neatly captures the essence of tactical asset allocation in the face of volatility. It is a question of risk and reward – a matter of carefully weighing up an opportunity and then seizing it if you have good reason to believe you can profit from it.

Ultimately, the point is this: it is very easy to believe volatility requires investors to adopt a purely defensive posture – a kind of "brace for impact" mindset – but this is not true. Even in the midst of tumult, while caution is invariably advisable, there is scope to prosper.

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1. See, for example, Al-Jazeera: "Oil prices spike, US stocks fall on Israel-Iran crisis", June 18 2025 – https://www.aljazeera.com/economy/2025/6/18/oil-prices-spike-us-stocks-fall-on-israel-iran-crisis.

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