Even Volatility Is Relative

View from the Observation Deck

1. Having endured two relatively deep bear markets since 2000, it is only natural that some investors would be keen on reducing the volatility of their stock portfolio.

2. One of the ways in which to assess volatility is standard deviation. It measures the dispersion of returns, in this case relative to the mean (average) of a respective index, over a chosen period of time.

3. The higher the standard deviation, the greater the amount of volatility. As you can see in the chart, volatility can accompany successful as well as disappointing outcomes.

4. The 5-year standard deviation on the S&P 500 (as of 4/26/13) was 18.8%, with a 5-year average annual total return of 4.82%. It represents the broader market.

5. The S&P 500 Consumer Discretionary Index’s standard deviation was 22.7%, with a 5-year average annual total return of 13.00%. A little more volatility, but significantly more return.

6. The S&P 500 Energy Index’s standard deviation was 23.2%, with a 5-year average annual total return of 0.30%. Almost the same volatility as the S&P 500 Consumer Discretionary Index, but far less return.

7. Standard deviation is just one of many tools that has the potential to help investors strike a better balance between risk and return.

This chart is for illustrative purposes only and not indicative of any actual investment. The illustration excludes the effects of taxes and brokerage commissions or other expenses incurred when investing. Investors cannot invest directly in an index. The S&P 500 is a capitalization-weighted index comprised of 500 stocks used to measure large-cap U.S. stock market performance, while the S&P Sector Indices are capitalization-weighted and comprised of S&P 500 constituents representing a specific sector.