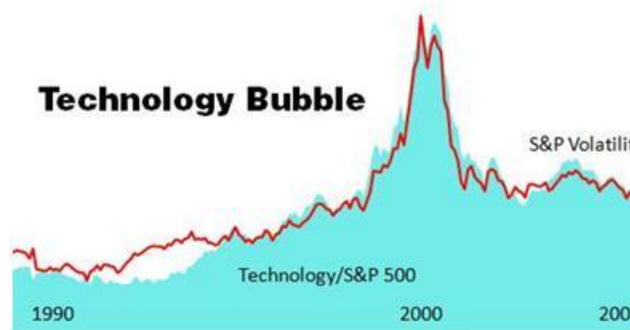
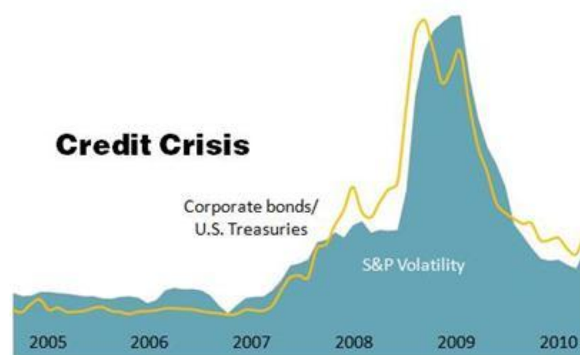
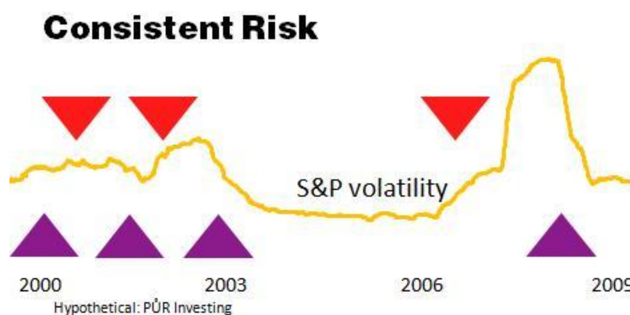


The technology sector’s weight in the S&P 500 from 1990 to 2004 is shown as the shaded blue area. The smoothed volatility of the S&P 500 (252 day moving average of standard deviation) is represented by the red line. The Technology Bubble is clearly seen. This parallels the “Nortel” effect in Canada. Most investment managers of balanced portfolios have a policy asset mix and rebalance to it. As the stock market moved sharply higher, managers were selling stocks and buying other assets. While intuitively correct (selling high), the result was that portfolios had the same asset mix at the top of the bubble as they did before it started. However, the risk in the market was clearly different. For pension mandates with long duration liabilities, this approach could be defended (although not entirely). Mutual fund managers have a perpetual mandate so the responsibility to maintain consistent risk in portfolios falls upon individual investors and their advisors who may or may not have the appropriate tools to monitor and manage to this growingly important factor. Similarly during the credit crisis, risk reflected the imbalance shown here as the spread of corporate bonds over U.S. Treasuries.



We suggest that markets seem friendlier to investments when volatility is stable or falling and less friendly when it is rising.



	Risk-based	S&P 500
Return	7.0	1.2
Risk	6.2	21.5
Worst 12 months	-6.4	-47.5

A simple stock-cash example showed that returns were better by 5.8% annualized and risk was substantially lower. Importantly for advisors, the worst 12 month performance of the consistent risk portfolio was substantially better than the S&P 500 alone.