# Why Volatility Matters (Part One)

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According to Merriam-Webster, the word “volatility” comes from the Latin, *vol?tilis*, meaning *flying*. Any investor who has remotely been paying attention to market events over the past several weeks can appreciate that etymological derivation.

Even this community grown accustomed to wild swings of value over the past seven years was taken aback by the gyrations on display in the public equity markets, first overseas, then in the US. The Dow plummeted some 2000 points in the one week beginning August 18th, but has recovered almost half of that ground through this week.

What caused these dramatic moves is unclear. Ostensibly the slowdown in growth coming out of China was a contributing factor, despite the fact that this trend had been developing and trumpeted for months.

Or it could have been the general uncertainty on interest rates, despite the fact that the Fed has been telegraphing an increase all year.

Whatever the reason, after the worrisome headlines last month, investors reassessed the situation and determined that things weren’t quite as bad as they looked – at least, in the equity markets.

Meanwhile in the public credit markets, volatility lived up to its name’s origins as flying to quality manifested itself in heady outflows from retail bond funds. The final week of August saw $1.6 billion depart from bond funds, according to Lipper FMI.

With risk off, this seemed a reasonable response for investors in the junk asset class. As our *Chart of the Week* depicts, the high-yield premium and volatility index have moved in concert for ten years, demonstrating almost perfect correlation.

What made less sense was the equally dizzying $800 million of retail cash that exited loan funds that same week. While certainly some of that money went to CDs and Treasuries, the result was a puzzle, as one friend of ours highlighted:

“l get the bond outflows,” he told us. “It’s all about rates and risk. But loan outflows? Don’t investors know what loans are? They’re secured, unlike bonds. They’re floating rate so perfect hedges against a Fed move. And there’s little exposure to Asia. What gives?”

It was instructional to witness as well, in contrast to major zig-zags in public equity valuations, loan prices in the secondary market barely budging over the same period. Per S&P LCD, the aggregate price for the most liquid loans softened only 1 point, from around 99 to just over 98 (with par issuance being 100).

Over the next few weeks, we’ll explore the questions raised by market movements in the current environment. In particular, we’ll examine the role volatility plays in the credit markets, and how experienced investors are looking for opportunities amid what looks like an extended period of general uncertainty.