Is Volatility So Bad? Think Again.

By Betsy Shelton, Director of Research/Senior Portfolio Manager

In my opinion volatility often gets a bum rap. One needs only to pick up a newspaper or listen to the talking heads to be made instantly aware of what the media makes out to be a pending disaster. But let's stop and take a moment to think this one over more carefully. Just as bread needs yeast in order to rise, so financial markets need some degree of volatility. Notice I said "some degree". That's because if there is too little of an activating agent the effect will be not only minimal but can also work against the process involved. Similarly if there is too much activation the outcome, be it baked goods or the securities market, can explode into a chaotic mess.

Over the past year, yields in the short end of the Treasury market (3 years and less) have backed up in anticipation of the Federal Reserve Bank raising rates while longer rates have actually declined over this same period. With the economy improving, albeit in fits and starts, it would appear that any action by the Fed has been pushed back to at least September. However, many investors have for many years now been living in the shadow of fear about rising interest rates and the prospect of market volatility that often accompanies such rises. Rather than being paralyzed by such events, we encourage investors to be proactive in advance of a potential meaningful rise in rates. Proactivity begins by recognizing and accepting several factors. First is that rising rates, in and of themselves, are not bad. They are simply an inherent part of the market cycle as reflected at any given time. It is the circumstances surrounding these changes that should be examined and acted upon. Secondly, the volatility that comes with changing rates provides opportunity. Despite the uncertain outlook, seasoned investors who have a clear picture of their own goals, objectives, and risk tolerance, take advantage of market changes to seek out opportunities not only to increase return, but also as avenues to improve portfolio characteristics, be it credit rating, sector, coupon, etc. (Continued on page 2)

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Our Mission

CFI is dedicated to the task of securing for each individual account the best possible after-tax performance net of fees. We accomplish this by actively managing tailored portfolios in strict adherence to the strategic objectives of each client. It is our responsibility to employ the most suitable fixed income assets and strategies in a manner most effective for every account. It is our duty to devote the resources, intensity and vigilance necessary to insure all clients consistent superior results.

Questions and comments are *always* welcome. Email susan@charlesfishinvestments.com with your comments. Thanks!

"Remember the turtle; to get anywhere it has to stick its neck out" James Bryan Conan

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Without volatility markets remain flat and as such provide little to no chance of increasing returns or improving one's holdings. In fact, a prolonged period devoid of volatility often leads to participants leaving the marketplace, reducing the acquisition options and increasing the potential for liquidity risk once rates do again begin to rise. Astute investors embrace the prospect of increasing rates rather than flee from them, even if it means more price volatility. Why? Because they have done their homework and understand the elements that can impact their holdings. The knowledgeable investor knows that the cost of waiting more than likely will exceed any loss incurred from volatile market valuations.

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Word of the month: **Volatility**

The modern definition of volatility comes from the Old French word meaning to "flying". Whether volatility is historic (that is based on past prices) or implied (as in what the future market value might be), certain character traits come to mind: unpredictability, varying often or widely, excitable, emotional. In other words, volatility refers to the amount of uncertainty or risk associated with the size of changes in a security's value. When it comes to the financial markets, the higher the volatility, the more dramatic the price change in either direction, compared to low volatility where changes are slow and steady over time.

FISH SCALES

		Scales for California names only					
NATIONAL AA RATED*	MAR	AA G.O.	A-rated COPs	Pre-Refunded	Non - Rated*	USTN	AA Txbl Muni
0.24	2016	0.35	0.54	0.22	0.91	0.23	+24
0.62	2017	0.65	0.88	0.55	1.36	0.57	+36
1.00	2018	0.99	1.23	0.91	1.74	0.90	+46
1.25	2019	1.23	1.52	1.13	2.05	1.23	+60
1.46	**2020**	**1.43**	**1.74**	**1.32**	**2.29**	**1.43**	**+64**
1.66	2021	1.62	1.96		2.53	1.66	+80
1.87	2022	1.81	2.17		2.75	1.79	+86
2.07	2023	1.98	2.35		2.92	1.87	+99
2.24	2024	2.18	2.51		3.05	1.96	+100
2.35	**2025**	**2.32**	**2.64**		**3.15**	**2.03**	**+110**
2.48	2026	2.48	2.80		3.31		
2.62	2027	2.66	3.03		3.45		
2.74	2028	2.79	3.18		3.57		
2.82	2029	2.93	3.34		3.64		
2.89	**2030**	**3.07**	**3.39**		**3.71**	**2.33**	**+124**
3.13	**2035**	**3.25**	**3.64**		**3.89**	**2.49**	**+133**
3.25	**2040**	**3.42**	**3.76**		**3.96**	**2.67**	**+142**
3.30	**2045**	**3.47**	**3.82**		**4.02**	**2.74**	**+151**

April 30, 2015
AS OF DATE

NOTE: The scales represent CFI's opinion of approximate bond values (offered side) at the close of business for the date shown and should be used as a general reference only. They are based on data from sources we believe to be reliable. CFI does not guarantee the above information for accuracy or changes due to shifting market conditions and other unforeseen reasons.

For example, suppose in 2012 an investor, out of fear of that interest rates would soon be rising, decided to invest $100,000 in a money market fund with a tax-free rate of 0.15% rather than invest in a 4 year AA-rate municipal bond yielding 1.50%. Fast forward three years to today's market. Having postponed investing for three years that same investor would have to earn an astounding 5.50% on a 1-year tax-free bond to catch up with the investor who bought a four-year bond in 2012. Furthermore, if that same investor decided to invest today in 4-year AA-rated California municipals he would likely earn, at best, 1.25%.

It is always good to remember that one's investments are like ships. Life can be treacherous on the high seas but protected in the harbor. Even large ships periodically get tossed in a storm but most still make it safely to their destination. And this is true of a well-constructed, actively managed bond portfolio. Yes, the storm clouds of higher rates and the potential for accompanying volatility may be brewing and yes, one should always be prepared to batten down the hatches, but there still needs to be a skipper at the helm. Investors need to neither fear the journey ahead nor bury their heads in the sand. Rather they need to follow the quintessential Boy Scout motto to "Be Prepared!" Now is the time to affirm one's goals and objectives, review each holding to ensure it is in sync with one's risk tolerance level, and evaluate the benefits (and costs) of potential strategic adjustments whether it is accumulating cash, swapping out of existing holdings, or shortening one's duration. CFI welcomes the opportunity to discuss with our readers just how to effectively execute any one of these strategies based on one's risk tolerance and portfolio composition.

1 Calculations based on simple interest only. If return is compounded, the breakeven yield would be that much higher.

For more information visit
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to schedule a private consultation.