

Back to normality: How to adapt as volatility re-emerges

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I once read that life is like a toilet roll: the closer it gets to the end, the faster it goes. One can be forgiven for feeling that changes occurring today are greater, faster and more dramatic than at any time in the past – though perhaps that is simply my age playing tricks on me.

In sharp contrast, equity markets have looked anything but excitable. Since 2022, they have enjoyed an unusually long calm spell, with market volatility well contained bar a brief spasm in April 2025.

However, signs are emerging that market conditions are once again beginning to reflect economic, geopolitical and technological changes – playing to the strengths of investors with a strong valuation discipline and a focus on consistent compounding.

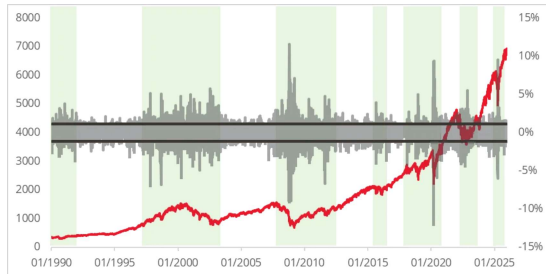
Benign markets aren't normal

The US exceptionalism narrative, underpinned by a conviction in an AI-driven utopia and dominated by a narrow cohort of companies, has allowed markets to take almost any change in their stride, as if the only plausible outcome were an upward-only low-volatility return path.

However, when one looks back across history, as shown in Chart 1, periods of low volatility are never permanent. There are prolonged

periods where volatility remains elevated, irrespective of the ultimate direction of the market. The chart spans my investment career, starting in 1991, and shows that volatility in markets is simply a normal state of affairs.

Chart 1: S&P 500 – Price return and % daily moves since 1990.



Source: Bloomberg, March 1990 – December 2025. Price return LHS, % daily moves RHS. Past performance is not a guide to the future. The information shown above is for illustrative purposes.

Signs of normalising volatility

There are signs that a return to normality could be under way. And that matters for investors.

First, inflation – one of the most important variables that affects volatility across many asset classes. When looking at year-on-year percentage changes (Chart 2) and the rolling 4-

year volatility in US CPI (Chart 3), one can see clear signs that inflation volatility is returning.

The last period of prolonged inflation volatility was during the 1970s oil price shock caused by Middle Eastern wars. This led to meaningful volatility in equity prices over that decade, even though the world equity market rose in nominal terms over that period.

Chart 2: US CPI – Year on year % change



Source: Bloomberg, September 1960 – 31 January 2026. The information shown above is for illustrative purposes.

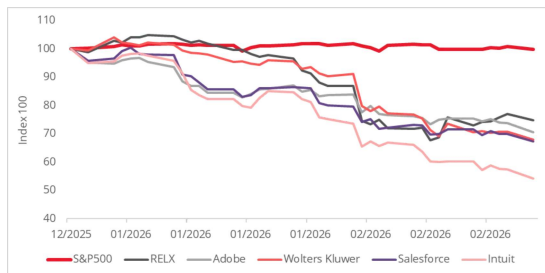
Chart 3: US CPI – Rolling 4-year volatility of YoY % change



Source: Bloomberg, September 1960 – 31 January 2026. The information shown above is for illustrative purposes.

Second, disruption from the AI revolution is showing evidence of moving from promises of future nirvana to real world implications. Take February's sell-off in software companies in the wake of Anthropic's launch of AI co-worker agents across differing tasks – see Chart 4. Over that period, the S&P 500 barely flinched, but beneath the calm, investors were questioning the future of companies previously regarded as AI winners.

Chart 4: Impacted software stocks vs S&P500 – Performance, January to February 2026.



Source: Bloomberg, 23 February 2026. USD. Past performance is not a guide to the future. The information shown above is for illustrative purposes only and is not intended to be, and should not be interpreted as, recommendations or advice. This

information should not be construed as a recommendation to purchase or sell any security.

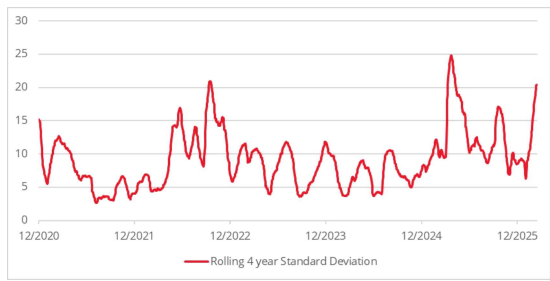
The latest fault line is in private equity and credit vehicles – Business Development Companies (BDC) – that offer public-market investors access to private investments. Here too, signs are emerging that volatility is returning as AI disruption throws long-held assumptions about business model valuations and durability into doubt. Charts 5 and 6 illustrate how this is starting to be reflected in both returns and rolling volatility.

Chart 5: S&P BDC – Total Return Index, December 2020 – March 2026.



Source: Bloomberg, December 2020 – 16 March 2026. The information shown above is for illustrative purposes.

Chart 6: Rolling 4-year volatility of the S&P BDC Index



Source: Bloomberg, December 2020 – 16 March 2026. The information shown above is for illustrative purposes

Volatility and the power of consistency

A return to normal market conditions with increased volatility matters. Simple math shows that when a return path becomes volatile, consistency counts far more than it used to.

Table 1 demonstrates this. During more normal volatile return pathways, not losing as much on the downdrafts matters most. In other words, downside capture becomes of greater importance than upside capture. As the table demonstrates, even a consistent return with a Beta below 1 over the three years can still generate a better compounded return than a volatile market return.

Table 1: Lower performance volatility compounds better

| | Yr 1 | Yr 2 | Yr 3 | Sum | Compound |
|--|------|------|------|-----|--------------|
| Consistent | 10 | 10 | 10 | 30 | 33.1% |
| Weak start | -20 | 10 | 40 | 30 | 23.2% |
| Strong start | 40 | -10 | 0 | 30 | 26.0% |
| Consistent but less than the market | 9 | 9 | 9 | 27 | 29.5% |

Source: Redwheel. The information shown above is for illustrative purposes only and is not intended to be, and should not be interpreted as, recommendations or advice.

Adapting to normality

The previous period of calm in the face of significant change has shaped investors' behaviour to focus on upside capture almost exclusively. The narrative of 'Buy the dip' encapsulates this perfectly. Yet a return to more normal market conditions requires a change in approach.

There are many ways to reduce downside risk, and within a long-only equity approach, valuation and durability of a company's cashflows becomes paramount. The durability of the cashflows enables companies to suffer disruption, whether that be macro or micro-driven. Having a process with a valuation discipline enables the investment strategy to tolerate volatility.

For it is valuation that can either offer protection or exposure to an increase in volatility. Remember that the valuation of an equity stock simply reflects expectations for the future. If it is high, then expectations are

high and confident. Such expectations are vulnerable to disappointment, leaving the stock less able to suffer volatility that will inevitably occur on the way to an outcome that may or may not be the one predicted. By contrast, a reasonable or even cheap valuation offers a margin of safety because it assumes that little will go right. A low valued investment is therefore better placed to suffer a range of outcomes and hence volatility.

Volatility can be an opportunity

At the time of writing, S&P 500 valuations show a P/E multiple of c.25x [1], high on historical measures. The same goes for the MSCI World, on c.22x. Maybe change isn't faster or greater now, maybe it is, or maybe it's just my age! What is clear to me is that markets have not been behaving in a normal way.

Normality in markets is characterised by more volatility than we've seen in recent years. And such a return to normality requires a return to some old-fashioned attributes: an insistence on starting yield, a focus on resilient cash flows and a valuation margin of safety that allows portfolios to welcome volatility as an opportunity, not a threat.

Key Information

No investment strategy or risk management technique can guarantee returns or eliminate

risks in any market environment. Past performance is not a guide to the future. The prices of investments and income from them may fall as well as rise and investors may not get back the full amount invested. Forecasts and estimates are based upon subjective assumptions about circumstances and events that may not yet have taken place and may never do so. The statements and opinions expressed in this article are those of the author as of the date of publication, and do not necessarily represent the view of Redwheel. This article does not constitute investment advice and the information shown is for illustrative purposes only.

References

[1] Bloomberg, 18 March 2026