Standard Deviation (Volatility)

- Standard deviation, also referred to as volatility, measures the variation from average performance.
- If all else is equal, including returns, rational investors would select investments with lower volatility.
- Within the context of a diverse portfolio, allocations to riskier assets can make sense even for conservative investors, as these allocations can actually reduce a portfolio’s overall volatility.

Impact of Standard Deviation on Investment Decisions

Consider two similar mutual funds, A from the prior example and B, which has an average return of 10% and standard deviation of 15%. Given these two similar options and a mandate to choose only one, a rational investor would be expected to always choose A because it offers the same return as B but with a more consistent, less-volatile return pattern. However, in practice it’s not usually that simple. There is often a trade-off between returns and volatility; therefore investors are generally forced to decide between higher return, higher-risk assets and relatively lower return, lower-risk assets.

What Does This Mean for Investors?

Investors have many options to choose from based on their particular desire for returns and the amount of risk they are willing to take in order to achieve those returns. Investors who are risk conscious may choose to purchase a mutual fund that focuses on investment-grade bonds rather than a small-company equity fund. In doing so, they would also be expecting lower long-term returns to correspond with the lower expected volatility of bonds as compared to equities. Perhaps an investor may desire equity-like returns but with lower volatility and thus may choose a managed-volatility equity fund.

It’s important to note that many different types of assets often have a place within the context of an overall portfolio. Even for risk-averse investors, more volatile investments can make sense within a diverse portfolio. In fact if the higher volatility and lower-volatility assets have low correlations, the overall volatility of the portfolio may actually be lower than either individual investment. This is a potential benefit of diversification, and why even in relatively conservative SEI strategies you will often find modest allocations to equities and other riskier assets, such as high-yield bonds.
Glossary of Financial Terms

- High-yield bonds: High-yield bonds are rated below investment grade and are considered to be riskier.

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Important Information

Diversification may not protect against market risk. There is no assurance the goals of the strategies discussed will be met.

Important Information:

Past performance is not a guarantee of future performance. Investments in SEI Funds are generally medium to long term investments. The value of an investment and any income from it can go down as well as up. Investors may not get back the original amount invested. Additionally, this investment may not be suitable for everyone. If you should have any doubt whether it is suitable for you, you should obtain expert advice.

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