Volatility Is Not Risk

Imagine your home was listed on the NASDAQ.

The Fed hints at rate hikes, your house drops 4% in an hour because the pool of buyers who can afford the monthly payment just shrank. A TikTok goes viral showing a package thief two blocks away, down another 2% as traders price in "rising crime in the area." The S&P sells off on tariff news, your house falls in sympathy because "risk assets" are down and buyer confidence is shaky. It rained on Saturday, open house traffic was low, and your ticker gaps down Monday morning.

None of this changed anything real about your home. The roof didn't leak. The schools didn't get worse. Your commute didn't get longer. But if you had a ticker, you'd feel like your wealth was evaporating in real time.

The "stability" of real estate isn't because homes are actually stable. It's because you don't have a price feed making you watch the noise. Ignorance feels like safety. Stocks don't have that luxury. Every twitch is visible. And because the twitches are visible, we've convinced ourselves they're meaningful.

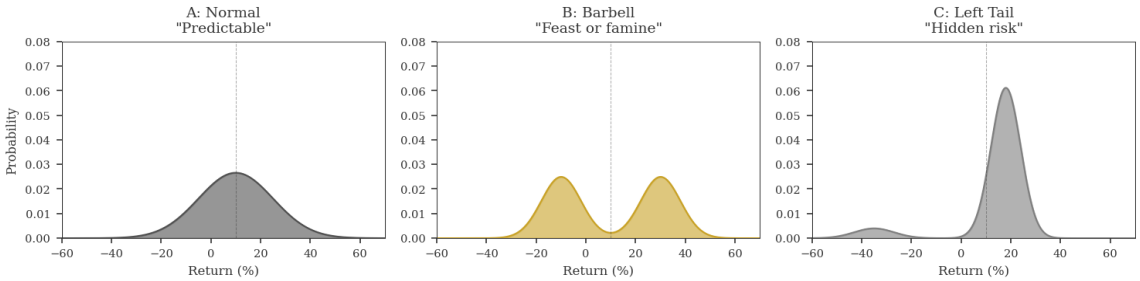
The Problem With "Risk" Scores

Open any brokerage app and you'll see stocks labeled with risk scores. These scores are almost always based on volatility: how much the price bounces around, measured by standard deviation. The logic: if a stock moves a lot, it's risky. If it moves calmly, it's safe. This framework has a few deep problems.

First, volatility is a two-sided measure. Standard deviation penalizes any deviation from the average, including positive ones. A stock that returns +5%, +40%, +8%, +35%, +12% gets tagged as "volatile" because the returns vary widely, even though you're winning every single period. Upside surprise is treated identically to downside disaster. The math doesn't care that you're variably getting rich.

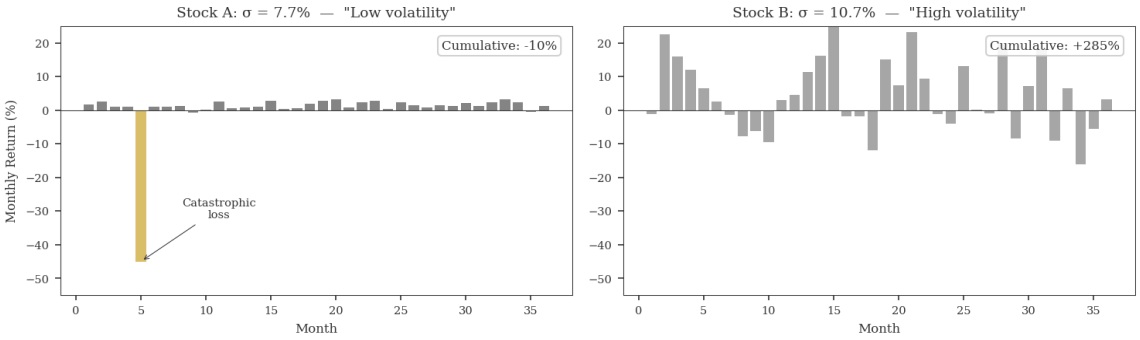
Second, standard deviation tells you nothing about the shape of the distribution. Two stocks can have identical standard deviations but completely different risk profiles (Figure 1). Panel A shows steady, predictable returns clustered around the mean. Panel B is a barbell: you either win big or lose big, with nothing in between. Panel C looks calm on the surface but carries rare catastrophic losses lurking in the left tail.

Figure 1: Same Standard Deviation, Different Risk Profiles



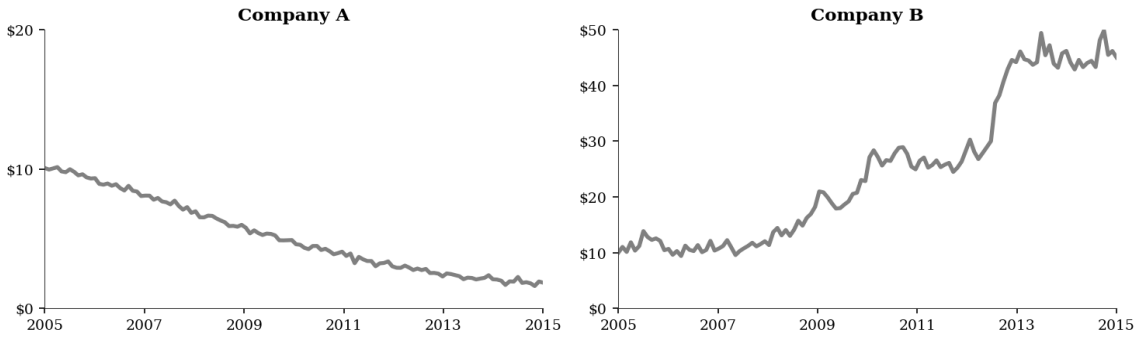
Would you rather have a bumpy but safe path, or a smooth path with a hidden cliff? Standard deviation can't tell the difference. Figure 2 makes this concrete: Stock A has *lower* volatility (σ = 7.7%) but contains a single catastrophic month that devastates cumulative returns. Stock B has *higher* volatility (σ = 10.7%) but delivered far better outcomes.

Figure 2: Low Volatility Can Hide Catastrophic Risk



Over longer horizons, the picture is the same. Company A drifted steadily downward: lower volatility, but permanent loss of capital. Company B was a roller coaster, but a patient holder multiplied their wealth. Yet volatility metrics would label Company A as "lower risk." Volatility metrics judge the ride, not the destination, labeling wealth-creating Company B as "riskier" than wealth-destroying Company A.

Figure 3: Long-Term Price Performance



The Value Investor Paradox

Here's where it gets absurd.

Say you understand a business deeply. You know its intrinsic value is $100 per share. The stock drops to $60 during a market panic. You buy. Six months later, it recovers to $95. You sell.

What just happened? You bought a dollar for sixty cents and captured the reversion. You had a margin of safety. You took *less* risk than someone buying at fair value, because you had room to be wrong.

But what does the volatility framework say? It says you're a risky investor. Your portfolio held a "high volatility" stock. Your returns were lumpy. Your standard deviation was elevated. The safest behavior, buying below intrinsic value with a margin of safety, gets labeled as reckless. The framework has it exactly backwards.

So What Is Risk?

If volatility isn't risk, what's the right metric?

There may not be a clean one. Risk is the probability of permanent loss of capital: buying the wrong business, paying too much, being forced to sell at the wrong time, or watching a competitive advantage erode while you hold. These things are hard to quantify. They require judgment, not formulas.

And that's okay.

As Mark Twain said: "It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so."

A pilot with no altimeter flies carefully. A pilot with a broken altimeter flies into a mountain. Using volatility as a proxy for risk isn't just incomplete; it's confidently wrong. That's worse than nothing.

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