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Soaring risk aversion

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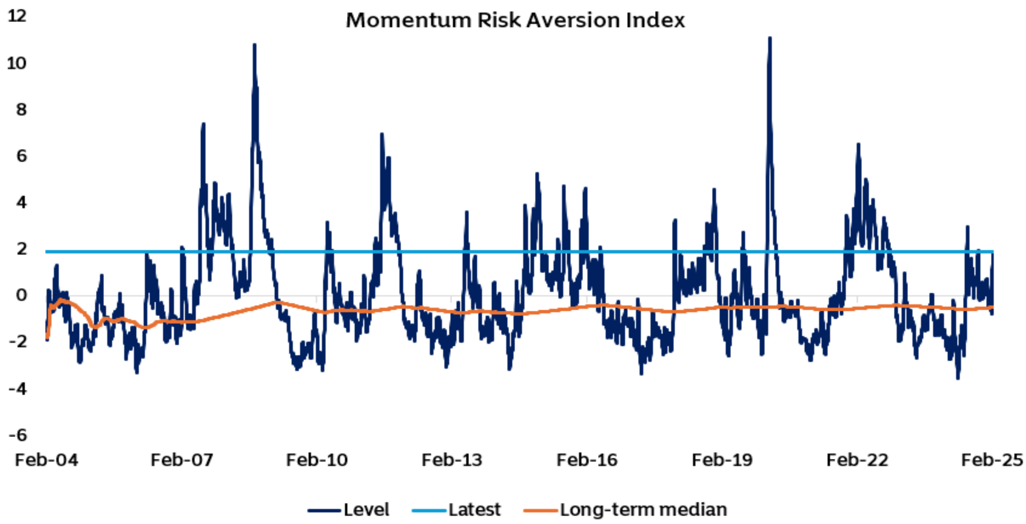
Chart of the Week



Source: Bloomberg Finance L.P., Momentum Global Investment Management, as at 7 March 2025.

What does the chart show?

This chart shows the Momentum Global Investment Management Risk Aversion Index over the past twenty-one years. The Index combines several different measures, such as global credit spreads, and forex and equity implied volatility to gauge what the current level of risk aversion is in markets. Risk aversion can be used as a measure of how tolerant investors are to taking on risk, given current and expected economic and financial conditions. Historically, peaks in risk aversion have taken place during periods of market stress, like during the global financial crisis in 2008, the European crisis in 2011 and the Covid pandemic in 2020, and very often were followed by rallies in risk assets as risk appetite returned in investors' behaviours. Today, whilst economic conditions are not bad, there is plenty of uncertainty around the path of inflation and interest rates, alongside significant geopolitical tensions. Risk aversion is well above long-term median, in the highest quintile of occurrences

Why is this important?

Risk appetite affects all asset classes differently and understanding how assets react to different types of risk is an important skill for any investor to have, and clearly not all periods of market stress are built the same. Typically, the most volatile assets are the most sensitive to changing risk appetite levels, with excess returns during periods of economic stability and security being countered by excess losses when conditions change for the worse. Very often, peaks in risk aversion coincide with bottoms for risk assets and are very often a contrarian signal, useful for investors to gauge when opportunities are opening or when perhaps riskier assets are oversold. And with a good understanding of how risk affects different securities, an investor can build a portfolio of assets with a diverse range of responses to changing economic conditions. With diversification comes protection and outperformance during periods of uncertainty and volatility.

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Important notes