Profit From Volatility

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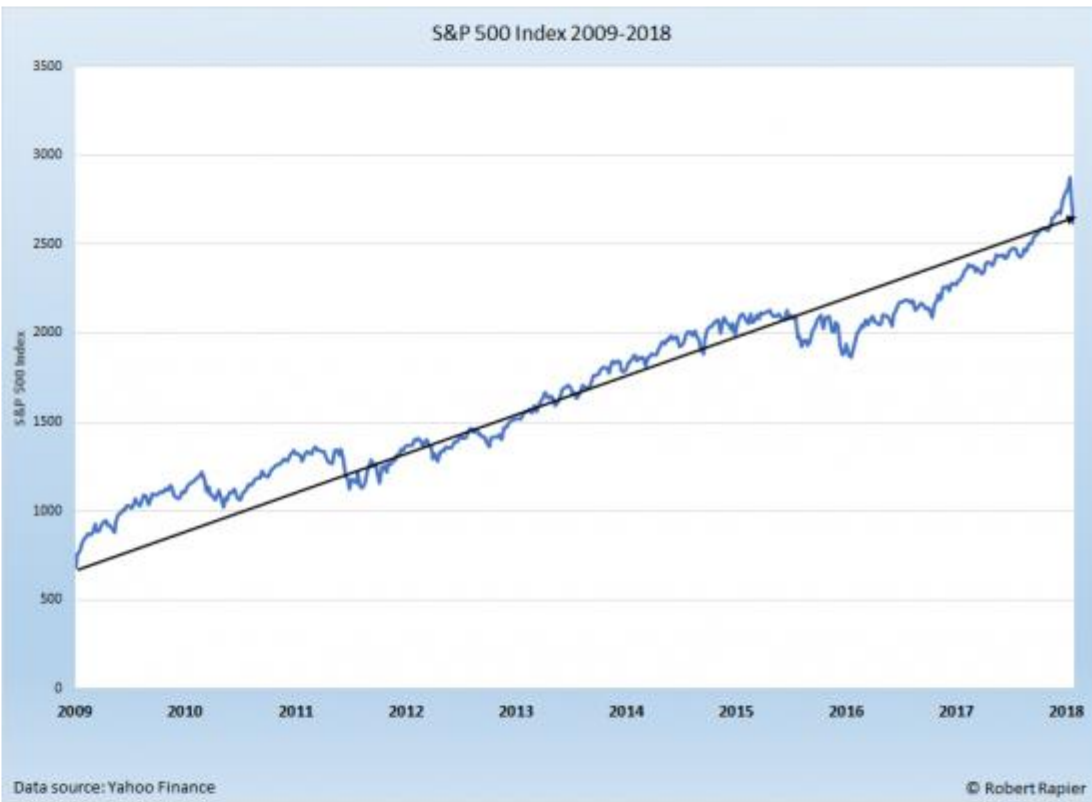
Profit From Volatility

By Robert Rapier
April 10, 2018

After a relatively smooth upward climb over the past nine years, volatility has come roaring back to the markets. I commented to a friend recently that the first quarter was brutal, and he said: "Oh, and how much were the indices down in the quarter?" He has a point, which I will get to below, but my point was about volatility.

A Smooth Ride

I posted the following graphic in the recent article Nine Years Of Bull to put the recent market swings into perspective:

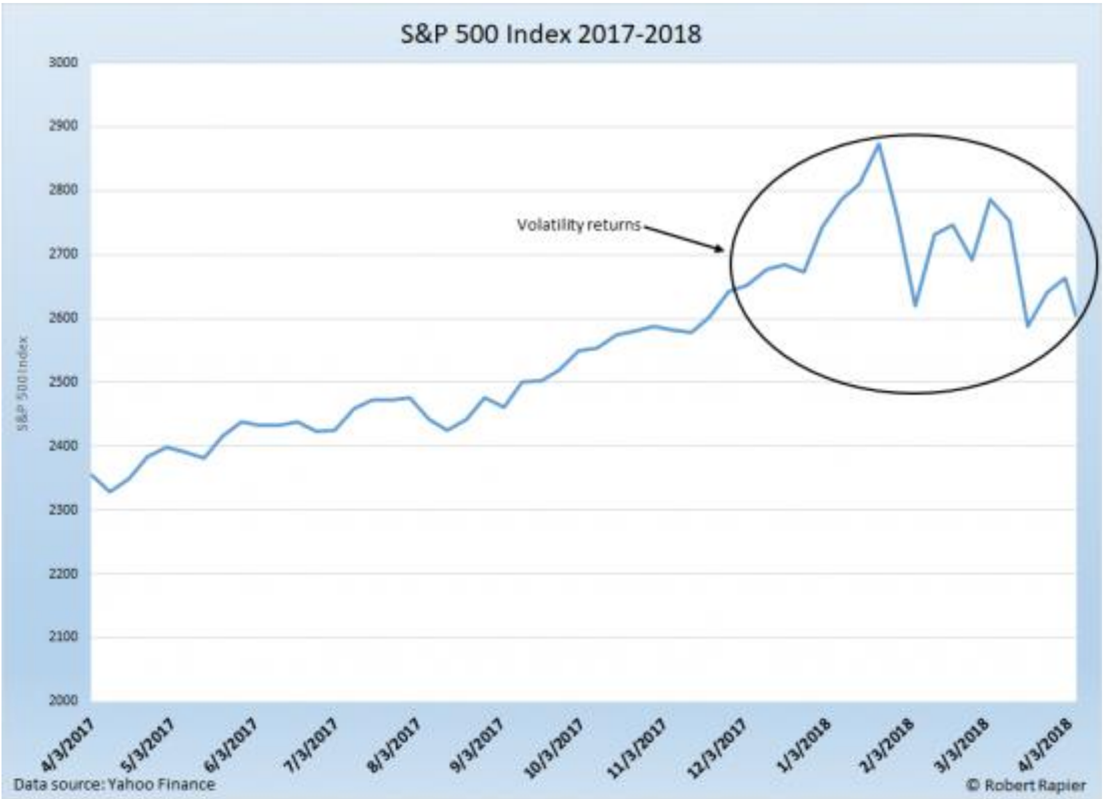


Overall, there have been some corrections during the past nine years, but it has been a relatively smooth period.

Volatility Returns

But the market became more volatile in the first quarter.

Let us look at that graphic for the past year to highlight how wildly things began to swing in Q1:



But my friend's point was, despite all of that volatility, that the S&P 500 was only down 2% in the first quarter. Of course, that is not much consolation for investors who sold in a panic as the S&P 500 lost more than 10% in early February.

I count myself among those concerned about the spike in volatility. For me, it signals that the chance of more 10% or more flash crashes in the near term is growing.

Use Volatility To Your Advantage

But the positive side of that volatility is that it allows investors to buy quality companies that have become overvalued. I cannot tell you how often I have looked at an **Apple Inc.** (NASDAQ: AAPL) or an **Intel Corporation** (NASDAQ: INTC) or a **Pfizer Inc.** (NYSE: PFE) and thought **--** I would love to pick that up at a 10% discount.

Opportunities like that on quality companies often present themselves only during these violent market swings. Sure, I could have bought Apple in January for $175 a share. But I wanted it for $160 a share.

Guess what? I got it for that. Then I sold it a month later at $175 a share. I did not get the lows on that cycle (who would have believed I could have got it for $155 a share?) or the highs (~$180 a share), but I did manage to turn a profit in a whipsaw market.

Keep Some Powder Dry

I always keep some cash in reserve for that rare opportunity to pick up quality companies at dream prices. At any one time, I have some dozen limit orders out for great companies at deep discounts to their current values.

Most of the time the orders don't trigger. It may be asking a bit much to pick up **Applied Materials** (NASDAQ: AMAT), which is currently trading at $52, for $40. But if the market plummets, I have a limit order at that price waiting to execute.

There is one risk in this approach, and that is if there is a huge one-day drop in the market. If you have too many of these "dream price" limit orders open, a steep stock market drop like the 22.6% drop of Black Monday in 1987 could see them all execute at the same time. So, be sure you have enough cash in reserve to cover such a rare event.

Shorting With Options

Of course, this strategy works both ways. I explained in Safely Betting Against Tesla that I also like to short companies that I believe to be overvalued, but I like to catch them spiking upward on volatility.

Going short, however, can be quite risky. So as I explained in that article, I utilize a modified strategy with options that protects me against unlimited losses should the stock price soar.

Editor's Note: Options can also be used to safely generate steady income during periods of market volatility as explained HERE

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About the Author

It’s hard to imagine anyone better suited to covering the energy-investment waterfront than Robert Rapier. Robert is no armchair analyst—he has two decades of in-the-trenches experience in a wide range of fossil fuel and biofuel technologies, including refining, natural gas production, gas-to-liquids, ethanol production and butanol production. During a six-year stretch at ConocoPhillips, Robert ran a team of engineers in Scotland working on oil and gas projects in the North Sea.

For two years, Robert was an efficiency expert in a Texas petrochemical plant. The process changes he implemented saved the facility $9 million a year. He later worked as the Engineering Director for a Dutch environmental-technology company and provided engineering support for a Chinese facility the company was constructing.

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Robert was also a butanol engineer in Germany for the Celanese Corporation, where he designed a novel butanol unit that cut production costs by $5 million per year.

In all, Robert has spent more than a dozen years working on liquid fuels technologies. Along the way he's picked up five patents, including one for a breakthrough way to convert ethane into ethylene (U.S. Patent 7,074,977).

Now, in addition to guiding readers to timely energy plays in his twice-monthly *Energy Strategist*, Robert travels the world evaluating startup energy companies for deep-pocketed investors. After grilling management and assessing the technology on-site, he makes a go/no-go investment decision. His wealthy private investors and hedge fund backers trust him to make the right choice for the same reason we do: his vast real-world experience in just about every facet of the energy industry. If Robert votes thumbs-up, millions of dollars flow into these cutting-edge outfits.

Robert earned his master of science in chemical engineering and a bachelor of science in chemistry and mathematics (double major) at Texas A&M University. He tells us he was "this close" to finishing his Ph.D. before he decided he was having a lot more fun making money in energy stocks.

A prolific writer, Robert's articles have appeared in *Forbes, The Wall Street Journal*, *The Washington Post* and the *Christian Science Monitor* — and he has been a featured expert on *60 Minutes* and *The History Channel*. His new book, *Power Plays: Energy Options in the Age of Peak Oil* (Apress, 2012), helps investors sort through doom and gloom, hype and misinformation to understand the true costs, benefits and trade-offs for each of our major energy options.

In what little spare time he has left, Robert consults for a number of energy projects, including biodiesel, ethanol, butanol and biomass gasification facilities.