More Risk does not mean more Return, just more Risk

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Higher risk means higher return, right? It's one of the most popular beliefs when it comes to financial markets. It's a truism repeated so often, it seems almost foolish to question it. And yet, this is precisely what I want to do in this paper.

Looking at stock returns over the past decade, it's easy to see why this belief is especially popular right now. Meme stocks, crypto and other speculative themes have been turning random people into millionaires over the course of an afternoon. The S&P 500 seems to be setting new all-time highs every other week, cheered on by relentless chants of "Buy the dip". In this environment, it's no wonder that investment decisions are increasingly driven by *FOMO*[1] rather than fundamental analysis. Since the beginning of 2020, the most predictive factors of return have been Realized Volatility, Momentum, and Growth, while fundamentally driven factors like Value, Quality, and Dividend Yield have lagged.[2] The result? In mid-2025, speculative trading volumes reached levels last seen during the 2020-2021 meme stock craze and, before that, just ahead of the dot-com crash.[3]

In such an environment it´s natural to think it's different this time – that fortune indeed favors the brave. Blackrock recently argued that *"Historical trends are being permanently broken in real time as mega forces, like the rise of artificial intelligence (AI), transform economies."* This is why *"comparing today´s index to that of the past is like comparing apples to oranges."* Despite all-time high valuations in US stocks, Blackrock advise staying *"pro-risk"*. After all, more risk should be rewarded with return. Consider this contrarian perspective from Eric G. Falkenstein:

"This idea (that more risk implies more return) has so many interested constituencies that it's as though a conspiracy were acting to keep everyone from noticing that the riskiest investments are not those with the highest expected returns but rather like lottery tickets catering to the deluded."[4]

Our core belief at Accumulus is that more risk does not mean more return, just more risk. We believe this to be a key ingredient to producing long-term absolute return. And with FOMO ruling valuations and risk appetite at seemingly record levels, now seems to be as good a time as any to lay out our reasoning. I will explain why we think that a conservative and risk-conscious approach to investing will lead to better long-term outcomes for most investors and why now more than ever a cautious approach might pay off.

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[1] "Fear of missing out."
[2] Morgan Stanley, Callodine Capital Research Team.
[3] Goldman Sachs Global Investment Research.
[4] Eric G. Falkenstein, *The Missing Risk Premium: Why Low Volatility Investing Works* (Eric Falkenstein, 2012).

More specifically this paper will:

- Examine why investors are drawn to high-risk strategies, and how psychology often overrides human risk aversion.
- Lay out the empirical case for low volatility investing and argue that its advantages persist even though markets currently favor highly volatile assets.
- Explore the psychological pitfalls that make high-risk approaches far more fragile than they appear and why even experienced investors struggle to navigate high volatility.

Because this white paper centers on risk, it is worth defining what I mean by it. In finance risk is often equated with volatility, and for most of this paper I will use that definition, though the conclusion will discuss some of the flaws and pitfalls of using such a simplified definition of risk.

The Temptation of the Risky Bet

The idea that more risk should give you more return is more than just popular belief. It is deeply embedded in financial theory.[5] The core assumption on which it is based is that humans are, by nature, risk averse. Consider a choice between the following two scenarios:

- Scenario A: Win $50 with certainty.
- Scenario B: Flip a coin – win $100 if heads, win nothing if tails.

Although the average payoff is the same, according to theory, most people prefer the sure $50 over the risky coin flip. This preference for certainty over risk, even when the expected return is equal, is what economists refer to as *risk aversion*.

It stands to reason that if investors want to avoid risk, they'll steer clear of riskier assets, all else equal. Reduced demand drives down the price of these assets until the expected return is high enough to make investors feel adequately compensated for taking on the additional risk.

On the one hand, this assumption is intuitively reasonable – I know I would opt for the $50 over the uncertain $100. On the other hand, humans also love gambling. The casino industry presents a strong case against risk aversion. At the gambling table, not only are people not risk-averse, but they are willing to pay for risk. Casino games with the highest volatility are also the ones with the lowest expected winnings.[6] In horse betting, the horses with the worst odds of winning also have the lowest expected payout. Similarly, lotteries with the largest Jackpots on offer are usually the ones with the worst expected return.[7]

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[5] https://doi.org/10.1016/j.jfineco.2013.10.005.
[6] https://link.springer.com/article/10.1007/s10899-011-9238-0#Tab2.
[7] Eric G Falkenstein, *The Missing Risk Premium: Why Low Volatility Investing Works* (Eric Falkenstein, 2012).

So why are risky investment approaches so popular? Why does our predilection for gambling overwhelm our fear of losses? Here are three psychological arguments that I believe to be particularly convincing:

Optimism and Overconfidence

"To win the lottery, you have to buy a ticket, but buying a ticket will not make you rich on average." [8]

As humans, we are inherently optimistic. Not only do we overestimate our luck, but we also overestimate ourselves against others. It's the paradox of the American dream. Most won't go from rags to riches, but the hope that it's possible, makes the story so powerful. We love hearing about the few who make it and tend to forget the many who don't.

Similarly, when we look back at the track record of stocks, we tend to remember only the big winners. We point to stocks like Amazon or Apple and convince ourselves that anyone paying attention should have known they were destined to rise. That's hindsight bias at work. We forget the dozens, even hundreds, of other stocks that looked just as promising at the time but quietly faded away.

Fueled by success stories we imagine being able to foresee which stocks will do well and which stocks don't, even though empirical evidence suggests that, on average, investors (and especially retail investors) are not able to outperform the market.

Recency Bias

This effect is sometimes magnified because humans tend to extrapolate the more recent past. This trait helps us identify changes in patterns quickly and adapt to them. In financial markets, however, patterns can sometimes unfold over years or even decades. In that case, focusing only on the recent past can be misleading.

You can see how this would affect investors' perception of the current market and especially risk. As Howard Marks has recently argued:

"The last sustained market correction ended in early 2009, meaning it's been over 16 years since risk bearing was seriously punished and "buying the dips" wasn't rewarded. That means no one under 35 or so – professional and amateur investors alike – has ever experienced a prolonged bear market. Older investors have experienced one or more, but, with the passage of such a long time, some may have been lulled into a false sense of security."[9]

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[8] Eric G Falkenstein, *The Missing Risk Premium: Why Low Volatility Investing Works* (Eric Falkenstein, 2012).
[9] https://www.oaktreecapital.com/insights/memo/the-calculus-of-value.

FOMO

"There is nothing so disturbing to one's well-being and judgment as to see a friend get rich."[10]

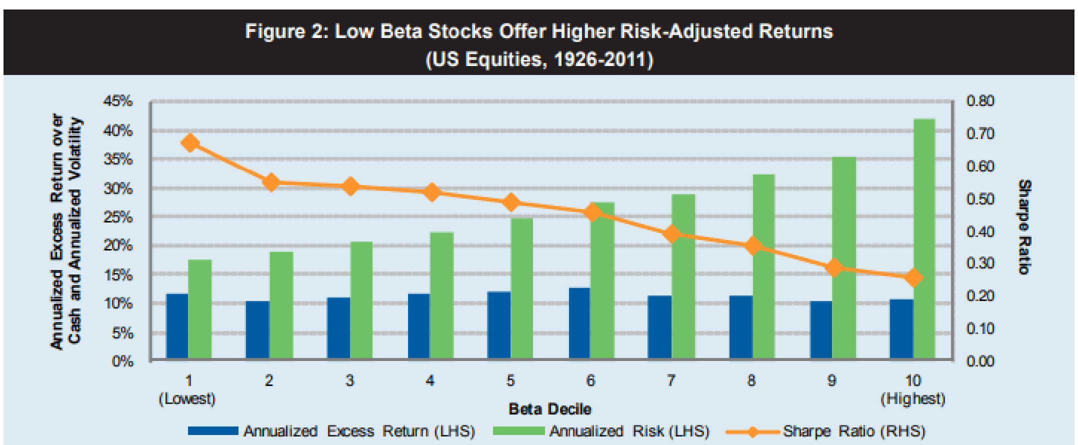
Investors love benchmarks; performance only matters relative to others. If the market rises 10% and my investments rise only 5%, I'll be frustrated. On the other hand, if the market loses 5% and I lose only 4%, I might even be happy. Because what matters most is keeping up with everyone else. When markets soar, I don't want to be left behind watching others get rich. Also, when markets crash, losing money isn't quite as painful if everyone else is losing it too. Misery, after all, loves company.

This explains some of the ridiculous valuations of certain meme stocks or cryptocurrencies. You're not really paying for the assets' sensible, risk-adjusted return. You're paying because your neighbor or your friend bought it, and you don't want to be the one stuck at your nine-to-five while he drives off in a Ferrari. It's envy insurance, plain and simple.

The Case for a Low-Risk Approach

If everyone else is chasing risks how about opting for a low-risk strategy instead?

Consider the following graph from AQR:

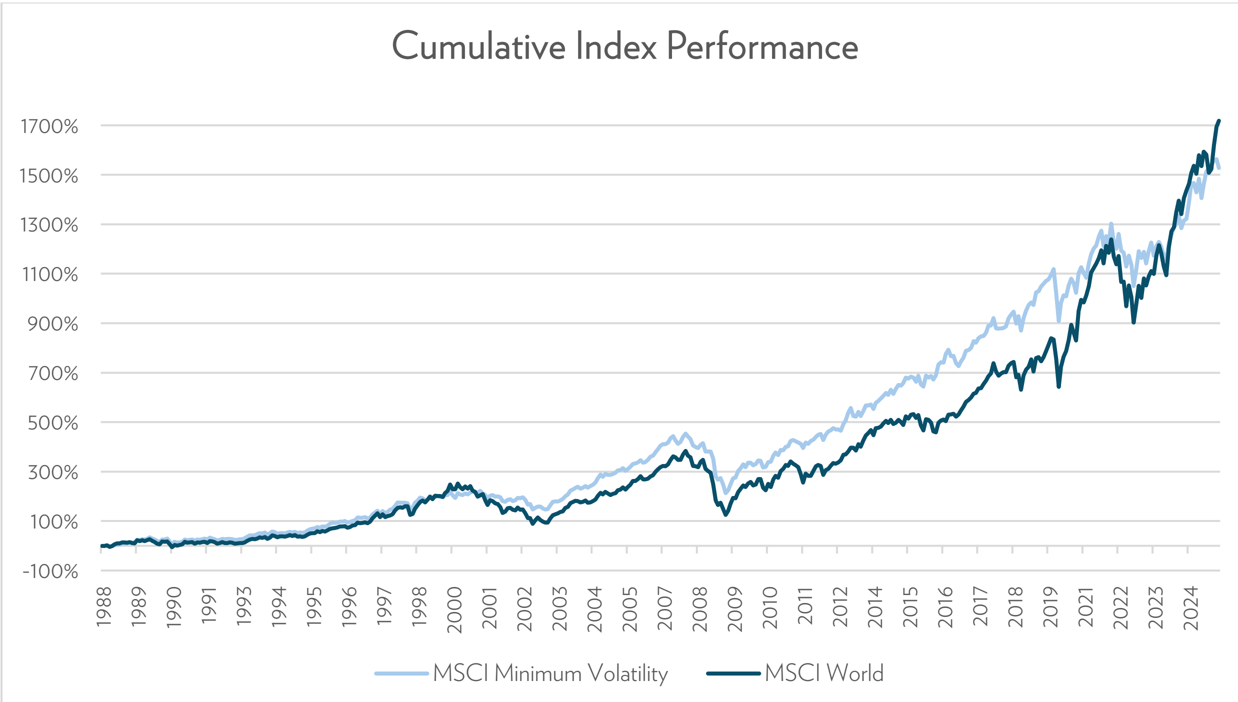


Source: https://www.aqr.com/-/media/AQR/Documents/Insights/White-Papers/Understanding-Defensive-Equity.pdf

If you're looking for one piece of evidence to convince yourself that low-risk investing pays off, this is it. Higher Beta stocks offer the same return on average at a higher risk. If you only invested in the lowest beta stocks, you would have maximized your Sharpe ratio and achieved comparable returns as with higher risk stocks.

[10] Charles Kindleberger.

Just to prove this is more than a theoretical exercise, you can buy an index fund following the MSCI Minimum Volatility Index. Over the past 30 years, this simple approach has given you better risk-adjusted returns than the regular MSCI World.[11]

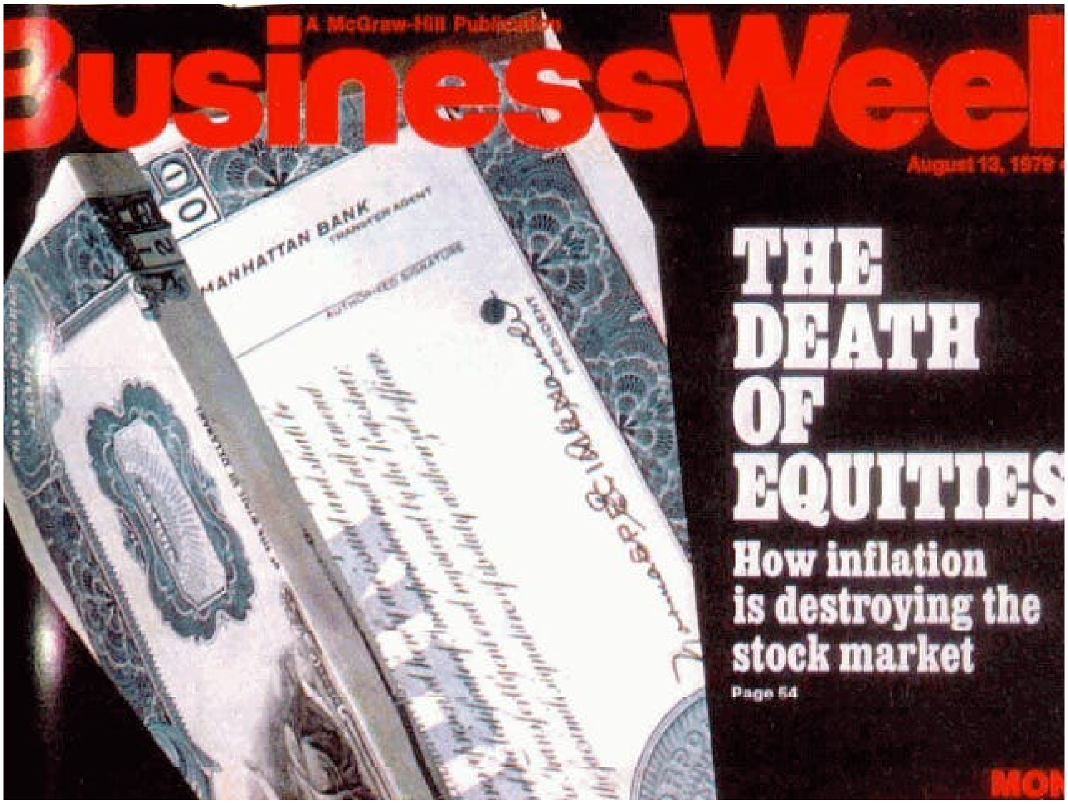


Source: Bloomberg

Looking at the chart above, you can see that for the first time in a long while, the regular MSCI World is outpacing the MSCI Minimum Volatility Index. That's exactly what makes the current market so challenging for investors. There are two ways to read this. On the one hand, you can argue that the recent past is more important than what happened more than 10 years ago. It has been quite a while since low volatility investing has really paid off. If things were to return to "normal", shouldn't they have done so by now?

On the other hand, 15 years isn't all that long. We've certainly had periods before when common opinion hailed the end of conventional investing principles and embraced higher volatility in the pursuit of higher returns. And we've seen the opposite, too: stretches of deep pessimism where investors considered abandoning equities altogether. That's hard to imagine today, but see below:

[11] https://www.msci.com/documents/10199/255599/msci-world-minimum-volatility-index.pdf.



In hindsight, that headline should have screamed "buy."

The mood couldn't be more different today. The consensus seems to be a mix of "AI will change the world as we know it" and "Buy the dip" nested against a backdrop of intense FOMO. 60% of gains in the S&P 500 this year come from four 'AI stocks'.[12] The S&P 500 Momentum Index, which is comprised of the 100 most momentum-driven stocks within the S&P 500, is up more than 20% vs the S&P 500's mere 10%. Buying the dip has worked time and time again.

As always, there are many who insist today that "this time is different," that the current optimism is justified. And maybe they're right. But if they're not, a year from now we might look back and wonder how we missed the warning signs.

The Psychological Trap of High-Risk Investing

The case against high-risk investment strategies goes beyond theoretical and empirical arguments. Practical implementation is equally challenging. It's worth listening to Andew Redleaf's investment principle: *"Avoid strategies that might overwhelm your abilities – or sensibilities."*[13]

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[12] https://www.morningstar.com/news/marketwatch/20250814149/the-entire-stock-market-is-being-carried-by-these-four-ai-stocks.

[13] Andrew J. Redleaf, The Whitebox Investment Principles.

Investors who ignore this advice often fall victim to their own psychology. A striking example is Cathie Wood's ARK Innovation ETF (ARKK). Since its launch, the fund has delivered an average annual return of roughly 9.7%. Yet the average investor in ARKK has lost about 17% per year.[14] This is because investors bought the fund after it had soared and optimism was at its peak. Then after the fund eventually fell they caved in to pessimism and sold. Unfortunately, this phenomenon is more than an isolated case.

An annual study by Morningstar has shown time and time again that funds with higher volatility tend to outperform their own investors. Latest figures show that on average an investor underperforms the funds he invests in by 1.2% per year.[15] In other words, investors tend to buy after strong performance and sell after weak performance, locking in losses and missing rebounds. Even though the investment might look promising on paper, investors can't tolerate or don't understand the risks they sign up for. Perhaps unsurprisingly the effect is magnified the more an investor trades but notably underperformance is also worse the higher the volatility of the underlying fund. The higher the volatility the higher the temptation to act and those actions are often driven by emotions rather than rationality.

Still, you might think you're smarter than the average investor. It sounds simple enough to stay calm, ignore your impulses, and do what the retail community loves to preach: "Buy the dip and HODL."[16] Don't be too sure of yourself though. Even George Soros – hardly a novice – saw his portfolio derailed during the 2008 crisis, not by the wrong thesis but purely by the volatility it had to endure on the way to the thesis playing out.

> *"[…] even I was taken by surprise by the extent of the uncertainty in 2008. It cost me dearly. I got the general direction of the markets right, but I did not allow for the volatility. As a consequence, I took on positions that were too big to withstand the swings caused by volatility, and several times I was forced to reduce my positions at the wrong time in order to limit my risk."*[17]

At Accumulus we don't presume to be immune to these pitfalls either. Quite the opposite. We neither can nor want to take part in the roller coaster ride associated with high volatility investments. That's why we've made the conscious decision that trying to time the market simply isn't worth it (for us at least).

We prefer to aim for steady returns regardless of market movements. That's also why we generally prefer bonds over stocks. Bonds have hard catalysts like contractual cashflows and a maturity date when a fixed principal is due. Their prices are usually characterized by convergence and not a random walk, as is often the case with stock prices. We still invest in equity strategies, but when we do, we do it with

[14] https://www.barrons.com/articles/ark-invest-stock-etf-cathie-wood-1047157e
[15] https://www.morningstar.com/financial-advisors/volatility-bedevils-fund-investors
[16] "Hold on for dear life."
[17] https://www.opensocietyfoundations.org/uploads/2b96bb8c-e2e1-4d88-9eea-badf16d0a2b8/george-soros-financial-markets-transcript.pdf

caution, limited beta exposure and driven by a belief (or hope) that over the long term the market is in fact, as Benjamin Graham suggests, a *"weighing machine"*[18].

Conclusion

Despite how it might appear, I am not trying to suggest that you shouldn't take risks. If you could get outperformance without taking on risk, government bonds would be a tough sell.

> *"You shouldn't expect to make money without bearing risk, but you shouldn't expect to make money just for taking risk. You have to sacrifice certainty, (...)."*[19]

The problem is rather that many investors fail to recognize the complexity of taking risk. Risk is often perceived as linear, and leverage is cited as a tool to scale your risk/return profile to the desired level. This simplification fails to capture the complexities associated with taking risk. As Eric Falkenstein explains:

> *"People take risks by not merely turning dials everyone understands to a higher set point but rather by doing things that generate above-average returns because of perceived systematic errors made by the masses."*[20]

If the masses are optimistic, maybe a pinch of pessimism doesn't hurt; if the masses only focus on what markets have been doing over the past 15 years, maybe it's wise to consider the past 50 years; if the masses are fueled by FOMO driving up the prices of growth stocks and crypto, maybe it's better to keep your distance. You get the picture.

Admittedly, when it comes to simplifying the idea of risk, I am not entirely guilt-free myself. As noted in the introduction, I have defined risk as volatility throughout this paper. That's common in finance and for good reason: volatility is easy to measure, easy to interpret, and straightforward to use in quantitative analysis. But while it's a useful proxy, it doesn't tell the whole story. Take the ARKK fund example from the previous chapter. If you define risk purely as volatility, you might assume the price swings in ARKK are merely a feature of getting exposure to the 'innovation economy', not a bug. Lumpy returns may even add to the allure – after all, something must explain the continued popularity of a fund that had destroyed the most wealth of any fund in history at one point. [21] The point is, the real risk is not necessarily the volatility, which investors may ignore or even embrace (see our section on FOMO, recency bias, and overconfidence above). The real risk is investor underperformance in more volatile assets. As our founder puts it: *"Volatility is certain. Whether you get the return is not."*

However, even if you are really convinced by the idea of low-risk investing, the current market environment is challenging. While for decades low-risk stocks outperformed their riskier counterparts,

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[18] Benjamin Graham, The Intelligent Investor (New York: Harper & Row, 1973), 524.
[19] https://www.oaktreecapital.com/insights/memo/the-indispensability-of-risk.
[20] Eric G Falkenstein, *The Missing Risk Premium: Why Low Volatility Investing Works* (Eric Falkenstein, 2012).
[21] https://www.morningstar.com/funds/15-funds-that-have-destroyed-most-wealth-over-past-decade.

for nearly 10 years now this trend seems to have reversed. It's understandable to question whether the low-risk approach is still as powerful as it used to be or if maybe instead AI, momentum, and growth factors have overpowered the old market structure.

But to close with one more quote from Howard Marks: "*You can't do the same things others do and expect to outperform*."[22] The boldest move might just be staying disciplined when everyone else isn't.

[22] https://www.oaktreecapital.com/docs/default-source/memos/2006-09-07-dare-to-be-great.pdf.