Good Panic, Bad Panic

A sharp fall in price can be an opportunity - or evidence that the system carrying risk is itself under strain. The distinction matters more than the word 'panic' suggests.

ONE FRAMEWORK. THREE DISTINCT QUESTIONS.

Investors often describe every abrupt market decline with the same vocabulary: fear, stress, capitulation, panic. Yet two episodes can look similar on a price chart while presenting very different investment problems.

PRICE IS ONLY ONE PART OF THE DIAGNOSIS

In an ordinary repricing, expected returns change while the market's essential machinery continues to work. Funding is available, spreads remain tradable and investors can transact without the act of trading becoming the dominant source of risk. Lower prices may then improve the prospective reward for accepting risk.

A disorderly liquidity event is different. The same decline can be accompanied by impaired funding, thin dealer capacity, forced selling and unstable price discovery. What looks inexpensive may simply be an asset whose clearing mechanism is under pressure. The relevant question is no longer only whether price has fallen far enough. It is whether the system can carry additional risk safely.

> *A good panic reprices risk inside a functioning system. A bad panic puts the functioning of that system in doubt.*

TWO QUESTIONS, NOT ONE STRONGER SIGNAL

This distinction argues for separating risk appetite from market integrity. They often deteriorate together, which is economically intuitive, but they do different jobs in a portfolio process. Measures of risk appetite ask how much risk markets are rewarding. Measures of liquidity ask whether that apparent opportunity is structurally sound.

Combining them is not about producing a louder forecast. It is about refusing to let one observation answer two questions. A deep sell-off can justify a larger risk budget only if the conditions required to own that risk remain sufficiently intact.

WHY THIS MATTERS FOR PORTFOLIO CONSTRUCTION

Static portfolios make the same broad allocation available through every kind of decline. A more deliberate process can preserve optionality when market plumbing is impaired and recognise that cash has value beyond its short-term yield: it creates the capacity to act when conditions improve.

The implication is not that every episode can be identified perfectly. Liquidity indicators are noisy, crises are rare and the next failure may not resemble the last one. The discipline lies in defining separate questions, applying them consistently and keeping the portfolio robust when either answer is wrong.

RESTRAINT IS PART OF THE FRAMEWORK

A useful model should know what it does not know. The evidence for severe system stress is necessarily limited because such episodes are infrequent. That makes boundaries, liquid implementation and governance part of the investment design - not additions made after the model is built.

'Good Panic, Bad Panic' is therefore less a prediction than a decision structure. First ask what price is saying about risk. Then ask whether the market can support the action that answer implies. Only then decide how much capital to commit.

IMPORTANT INFORMATION

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