

## PLANNING ESSENTIALS

# Putting Market Volatility to Work for You



**During the 2008 financial crisis—from the market’s peak in October 2007 to its bottom in March 2009, the S&P 500® experienced more than a 50% drop in value.<sup>1</sup>**

Not surprisingly, a great many people panicked upon seeing their account balances (a lifetime’s worth of savings) decimated. Deciding to “cut their losses,” they sold their stocks and moved to the safety of low-yield investments such as Treasury bills and CDs. Over the following decade, however, the market proceeded to deliver a cumulative return that exceeded 400%!

Ultimately, many of those who had moved to the sidelines experienced all of the pain with little to none of the benefit. On the other hand, those investors who weathered the volatility and stuck with their long-term plan ended up duly rewarded for their patience.

### KEY TAKEAWAYS:

- 1. Volatility is a necessary component of a healthy stock market**, which although stressful to endure, is best addressed by remaining focused on your long-term plan.
- 2. More often than not, trying to time the market is a recipe for investment failure.** Instead, use it as an opportunity to acquire lower-cost shares by continuing regular contributions to your retirement and investment accounts (dollar-cost averaging).
- 3. Make sure to periodically rebalance your portfolios during times of high volatility**, as target allocations can drift causing you to take on too much or too little risk for your investment goals.

### A little volatility is a good thing

Rather than something to be feared, market corrections are normal and necessary to maintaining a healthy stock market. If you think of a rising stock market as a pressure cooker, corrections are the pressure release valve that periodically allows enough steam to escape to prevent everything from boiling over. It's only when corrections don't occur often enough that investors should be wary.

One of the biggest challenges, though, lies in our inherent behavioral biases. Even in the best of times, people tend to make financial decisions that are counter to their own best interests. Add the stress of volatile financial markets to the equation, and those negative behaviors become amplified:

- Because **loss aversion** makes the pain we associate with losses far more intense than the pleasure we associate with gains, we tend to err on the side of caution. It's why investors often sell their winners while holding on to their losers, and why so many flee to "safe" assets when volatility ramps up.
- Humans are social animals who tend to follow the herd—even when the herd is behaving in a way that isn't in our individual best interest. This **herding bias** helps explain our tendency to buy high and sell low, and our reluctance to stand alone and move counter to the herd.
- When we make decisions, we typically place greater emphasis and focus on the most recent information and news, rather than stepping back and looking at longer trends. This **recency bias** can lead us to overreact to short-term disruptions at a cost to our long-term interests.

To counteract these innate tendencies—especially during tumultuous times—requires a steady hand and a strong commitment to concentrate on your goals and your financial plan despite all the noise and distractions of the moment.

### Maintain your long-term focus

If there's one lesson the stock market has taught us repeatedly over the years, it's that the duration of your time **in** the market is a far better determinant of investment success than your timing **of** the market. Of course, it's never easy to adhere to your strategy while other investors scramble for the more tranquil waters of money market funds. And if you're dealing with a short investment window (e.g., retirement is on the near-term horizon), then locking in gains and exploring various asset protection strategies should be your top priorities.

But for those with at least a five-year investment time horizon, market volatility may provide a valuable opportunity to reduce the average share cost of your investments if you're employing a dollar-cost averaging strategy of periodic purchases—whether through regular contributions to your employer's retirement plan or monthly transfers of cash into a brokerage account.

### Make sure you rebalance

Over time, your portfolio allocations may significantly shift due to the more rapid growth of certain investments compared to others. After a prolonged bull market, what was originally a 60/40 stocks to bonds allocation may have gradually drifted to a 75/25 allocation as a result of the much faster growth of stocks. The problem, however, is that along with this allocation drift comes a great deal more investment risk than you

and your advisor either planned on or need. Conversely, after a major market correction, that original 60/40 portfolio could suddenly be at 45/55 (due to bonds outperforming stocks) and thus not taking on enough risk to achieve your long-term goals.

By periodically rebalancing your investment portfolio—buying and selling shares to bring it back in line with your target allocation—you're able to more effectively manage your risk. Since rebalancing involves making transactions, however, you and your advisor need to approach the process thoughtfully and strategically to help minimize costs and potential taxes resulting from long-term capital gains.

### **Stay the course**

Markets rise and markets fall, but on balance, the long-term trend is always higher. Although occasionally frightening and unnerving, periodic volatility is an unavoidable part of this cycle.

When you have a sound, well-constructed long-term portfolio, doing absolutely nothing can be the most impactful action you can take. When in doubt, turn to the sage advice of Warren Buffett: ***“If you aren't willing to own a stock for ten years, don't even think about owning it for ten minutes.”***

***Have specific questions concerning market volatility or want additional info? Talk to your Eagle Strategies Financial Advisor.***

<sup>1</sup>MSNBC Global Financial Data, March 2020.

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