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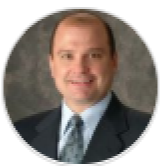
The Market Volatility Tipping Point, When Volatility Becomes Your Issue Too



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Many economists and market analysts have predicted that we will continue to see heightened market volatility for the near future. As a financial advisor, I'm asked about volatility often. People first want to know how they should react. I tell them that these periods of volatility underscore why you need to have a financial plan set well before a market decline. You want to be selective in your reactions, and having a well-thought plan in place helps you maintain an even-keeled approach. This response usually draws the follow-up question, "Does this market volatility even impact me?"

I think this is a frequent question because most people don't completely understand what market volatility is, let alone its level of impact. Stock market volatility is wide swings in stock prices often brought about by external market events such as the Chinese government's recent devaluation of its currency or the Greek government nearly defaulting on its debt. Events like these scare investors, who then act emotionally, which can negatively impact their portfolio.

Volatility itself, the up and down movement of the markets, will not have a direct impact on the typical investor who has a long-term goal such as retirement. However, volatility becomes your issue the closer you are to retirement today. This is the market volatility tipping point.

Traders work on the floor of the New York Stock Exchange (NYSE) in New York, U.S., on Thursday, Sept. 17, 2015. Federal Reserve officials left interest rates unchanged, opting to delay an increase amid stubbornly low inflation, an uncertain outlook...

Volatility & Retirement

If you are an investor with stock market exposure through your 401(k) plan or other defined contribution plan, your account value will be affected by stock market volatility. With a long-term perspective, you can look beyond the short-term market movement. However, if you are planning to withdraw retirement funds now or in the near future, you will be more impacted, and that is why proper planning is imperative.

Long before your estimated retirement date, it is important that you develop an asset allocation that can help withstand the inevitable stock market declines and accounts for your time horizon, which is the amount of time until you will start to need to withdraw your money. Asset allocation won't guarantee a gain and it will not ensure against a loss, but it may help reduce volatility in your portfolio.

Keep Calm & Carry On

A proper asset allocation will help you deal with the emotions that surface when you see your account value decline. Managing emotions is one of the most important skills an individual investor needs to master. During the severe stock market declines of 2008, I saw how people wanted to sell when things felt badly. For those who did sell during the decline, the challenge was trusting when to get back in the market and not missing the sharp reversal that started in March of 2009. If those who sold when things felt badly continued to think the economic recovery wasn't real and that stocks were a bad investment, they may have missed out on one of the biggest stock market rallies in history. As Warren Buffett says, "it's harder to be right twice."

Keeping calm and looking beyond the daily headlines can be a smart strategy.