

On The Mark

March 20, 2020

Keeping Calm During Market Volatility

Key Takeaways

- The one certainty of investing is that your portfolio will experience volatility.
- Volatility can often lead to irrational decisions, such as exiting markets prematurely. Evidence shows that market timing is a poor investment strategy.
- For long-term equity investors, the most powerful factor is time. An investor's time horizon is directly correlated with the likelihood that his or her portfolio will experience a positive return.

The US stock markets entered bear market territory after coronavirus was declared a pandemic, ending the longest bull market in US history just days after its 11th anniversary. The bear market reflects a 20 percent drop from record highs. Looking forward, a sustained rally will likely require three key developments. First, evidence of a successful virus containment in developed markets. Second, clarity on the economic impact of the virus, and finally a concerted global policy response. Market volatility is likely to remain as progress towards these three developments continue, leaving investors wondering what to do in the meantime. In the middle of a bear market it's prudent that investors remain focused on the long term to avoid being derailed from their goals. Consider the following tips for some perspective.

Staying invested matters

Many investors are tempted to go to cash and wait for the coast to clear before getting back in. However, research shows that the results of doing so are less than optimal. The below chart illustrates the growth of \$10,000 in the S&P 500 for the period from January 1, 1994 through

December 31, 2019¹. It looks at the impact of the portfolio for investors who missed the 10, 20 and 30 best days of the market performance for that 26-year period. Simply missing the ten best days drops the overall return by 50%. The results only get worse as more good days are lost. One of the reasons is that *while many of the worst performing days occur during bear markets so do many of the best performing days*. Trying to time the market without missing the top ten days requires surgical precision, to say the least, suggesting that it just doesn't work consistently.



Source: Standard & Poor's and Lord Abbett.

What can investors do?

This is not to say that investors are to do nothing. The best advice for investors is still to focus on one's goals and rarely should short-term market fluctuations significantly derail the likelihood of success. Second, re-affirm your risk tolerance. Many investors overestimate their comfort level when it comes to market volatility, especially when markets have consistently risen over the past 10 years. Third, volatile markets can reveal whether a portfolio was

adequately diversified. Regardless of market conditions, diversification is key and one of the best ways your portfolio can cushion itself from market downturns. Finally, seek opportunities. Strategies such as tax-loss harvesting, and re-financing debt given low interest rates can be considered.

Remember the big picture

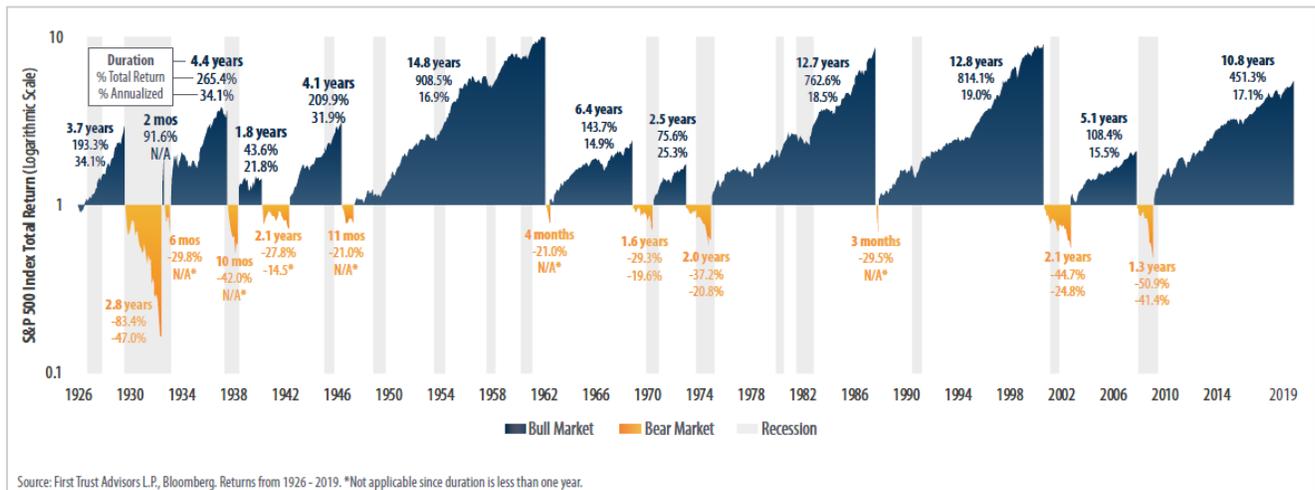
The increase in volatility has understandably renewed anxiety. For long-term investors, time is the greatest ally as historically bear markets do not last as long as bull markets. While past performance is no guarantee of future results, the below chart of the historical performance of the S&P 500 stock market index returns through bull and bear markets from 1926 through 2019 is a reminder to maintain perspective². The average bull market period lasted 6.6

years with an average cumulative total return of 339%, while the average bear market period lasted 1.3 years with an average cumulative loss of -38%.

Conclusion

The famous motivational slogan “Keep Calm and Carry On” was produced by the British Government in 1939 in preparation for World War II. It was intended to raise the morale of the public as citizens faced threats of mass air attacks. While we are not facing war, investing during periods of volatility can certainly cause us to lose our calm. When emotions and investing cross paths, it can lead to costly decisions in the long run. It’s critical that investors look beyond volatility, focus on their financial goals and time horizons, and, most importantly, identify their appropriate tolerance for risk to remain invested.

History of Bull and Bear Markets for S&P 500



¹ <https://www.lordabbett.com/en/perspectives/marketview/market-volatility-three-things-remember-scary-times.html>

² <https://www.ftportfolios.com/Common/Content/FileLoader.aspx?ContentGUID=4ecfa978-d0bb-4924-92c8-628ff9bfe12d>

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