Coping With Market Volatility

During periods of economic uncertainty, financial markets are often characterized by wide swings in market value. Such “market volatility,” with prices sharply rising and falling, is a reflection of changeable investor sentiment as well as more substantive economic or political events. Even during more stable times, financial markets will fluctuate, although price movements tend to be more moderate. By their very nature, financial markets rise and fall constantly, with an ever-present potential for gain or loss.

So, how does an individual cope with constant market volatility?

Avoid an Emotional Response

When markets fall sharply, some investors will panic, sell all or part of their holdings, and shift assets into what are seen as “safer” investments. Such emotion-based selling after a market decline simply turns paper losses into real ones and limits any possible gains should the markets recover. Some individuals will respond emotionally and buy when the markets are “hot” and values are rising. The end result is often an investor who buys high, sells low, and then wonders, “What happened?”

“Timing” the Market

Some investors attempt to “time” the markets, buying when the market is low and then selling when the market is high. The problem is that it’s never clear just when the market has reached a trough or a peak. In the classic Wall Street phrase, “No one rings a bell.” Market timing is a concept that, in theory at least, seems logical. In practice, however, no one has yet devised a system for consistently and accurately identifying market tops and bottoms.

Diversify Your Portfolio - Asset Allocation

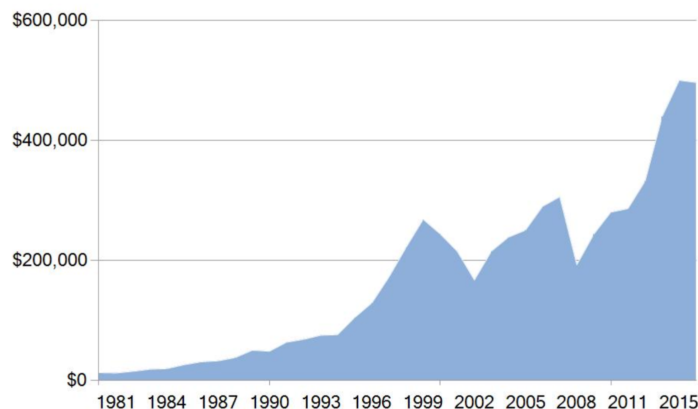
Asset allocation is an investment strategy that seeks to reduce investment risk by spreading an investor’s portfolio over a number of different asset types. This approach takes advantage of the tendency of different asset types to move in different cycles, and thus smooth out the ups and downs of the entire portfolio. Stocks, bonds, and cash (or cash equivalents) are the investments normally used. Tangible assets, such as real estate or gold, may also be included.

Coping With Market Volatility

The asset allocation process normally begins with an analysis of the historical levels of risk and return for each asset type being considered.[1] These historical values are then used as a guide to structuring a portfolio that matches the investor's individual goals and overall risk tolerance level.

Regularly Review Your Investment Strategy

An investor's portfolio allocation should reflect factors such as the investment goal, timeframe, need for liquidity, risk tolerance, and income tax bracket. As time passes, and as market and economic conditions change, it is likely that an investor's goals, and the optimal portfolio mix to reach those goals, will also change. Adjusting the asset allocation, known as "rebalancing," is a regular part of good investment management, in both up and down markets.



Take a Long-Term View

Historically, the long-term trend in equity markets has been upward, although there have been periods when the markets declined. To illustrate the point, the graph below charts the annual return from a $10,000 investment in the S&P500® Index for the period January 1, 1980, through December 31, 2015.[2]

---

[1] Historical data, while useful as a general guide, cannot be considered an accurate indicator of future results. There is no guarantee that past performance is a predictor of future investment performance.

[2] The chart is for illustrative purposes only and does not represent the actual performance of any investment. It is not possible to directly invest in an index. Past performance is no guarantee of future results. Source: Calculated by Advisys, Inc. using data provided by Morningstar, Inc. © 2015 Morningstar, Inc. All rights reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers, (2) may not be copied or distributed, and (3) is not warranted to be accurate, complete, or timely.

Coping With Market Volatility

An investor can more easily ride out periodic economic storms by clearly understanding his or her long-term investment goals and rebalancing the portfolio accordingly. Additionally, a portion of the portfolio can be placed in safer, more liquid assets, which can then be used to meet immediate cash needs. The balance of the portfolio remains invested for the long term.

Automatic Investing

Rather than making a single, lump-sum investment, some investors feel more comfortable investing an equal dollar amount at regular intervals. Also known as "dollar cost averaging," this strategy does not guarantee a profit, nor does it protect against losses in a declining market. It does have the advantage of buying more shares when the price is low and fewer shares when the price is higher.

Seek Professional Guidance

In both bull and bear markets, the guidance of trained financial professionals is strongly advised.