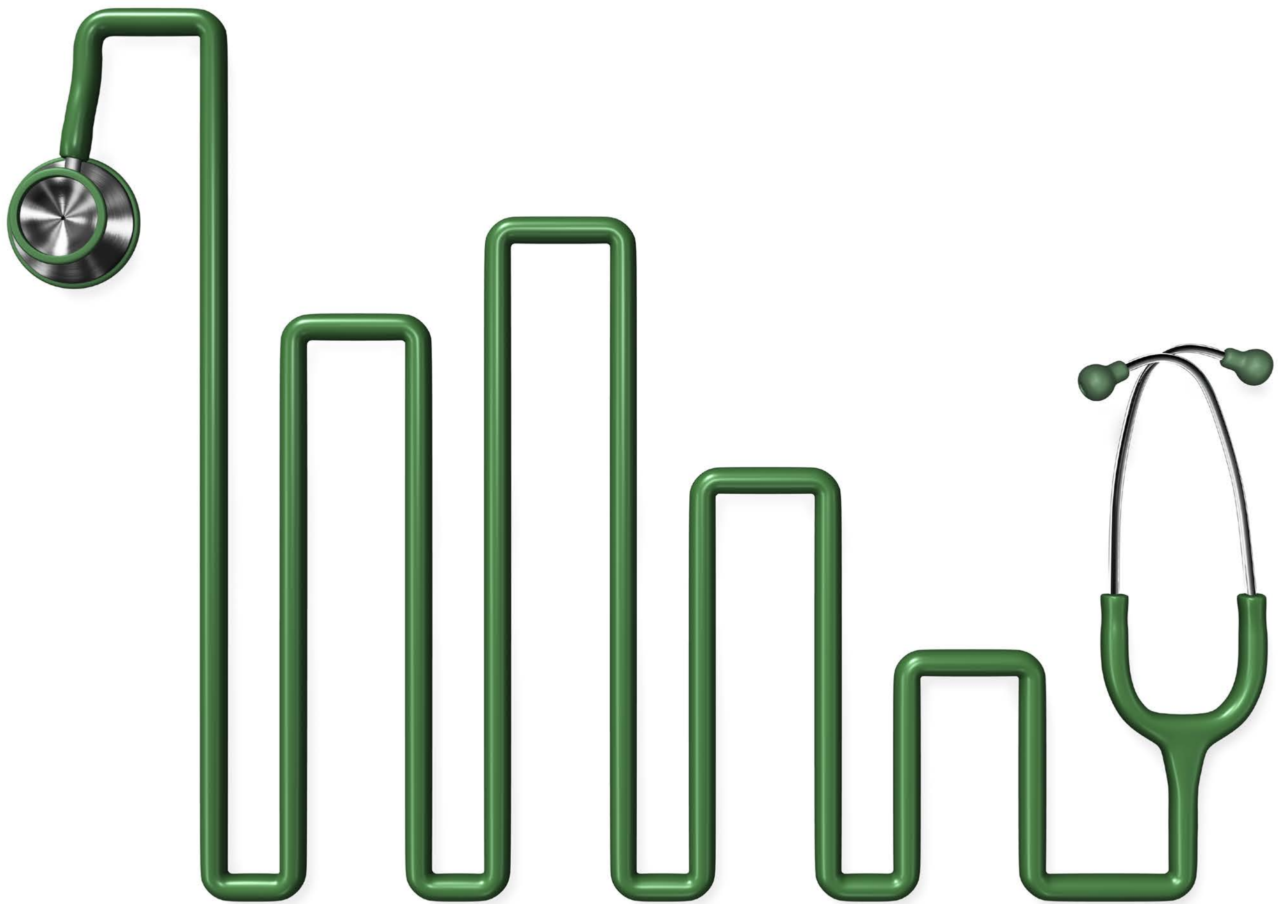
INVESTOR

Fight Fear With Facts

Helping you make informed investment decisions

Due to popular demand, this timely edition has been updated to help you steer the course through market volatility.



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Steering the course through market volatility

It's scary when markets are volatile. Most of us invest to reach a specific goal—the ability to enjoy our retirement, to fund a child's education, buy a new home, or take a longed-for vacation. When markets go down and the value of our portfolio falls, we worry that we won't be able to meet our financial goals.

Some of us may be tempted to pull our money out of the market altogether, while others may sell with the aim of reinvesting when things calm down.

These emotional responses to volatile markets are natural, but they could be devastating to our long-term goals. Keeping our money in cash (such as a bank account) or a fixed income instrument such as a Certificate of Deposit (CD) will preserve our principal, but is unlikely to provide the long-term growth that most of us need our portfolios to provide. And investors who sell during market downturns not only lock in those losses, but also have to correctly guess the right moment to get back in.

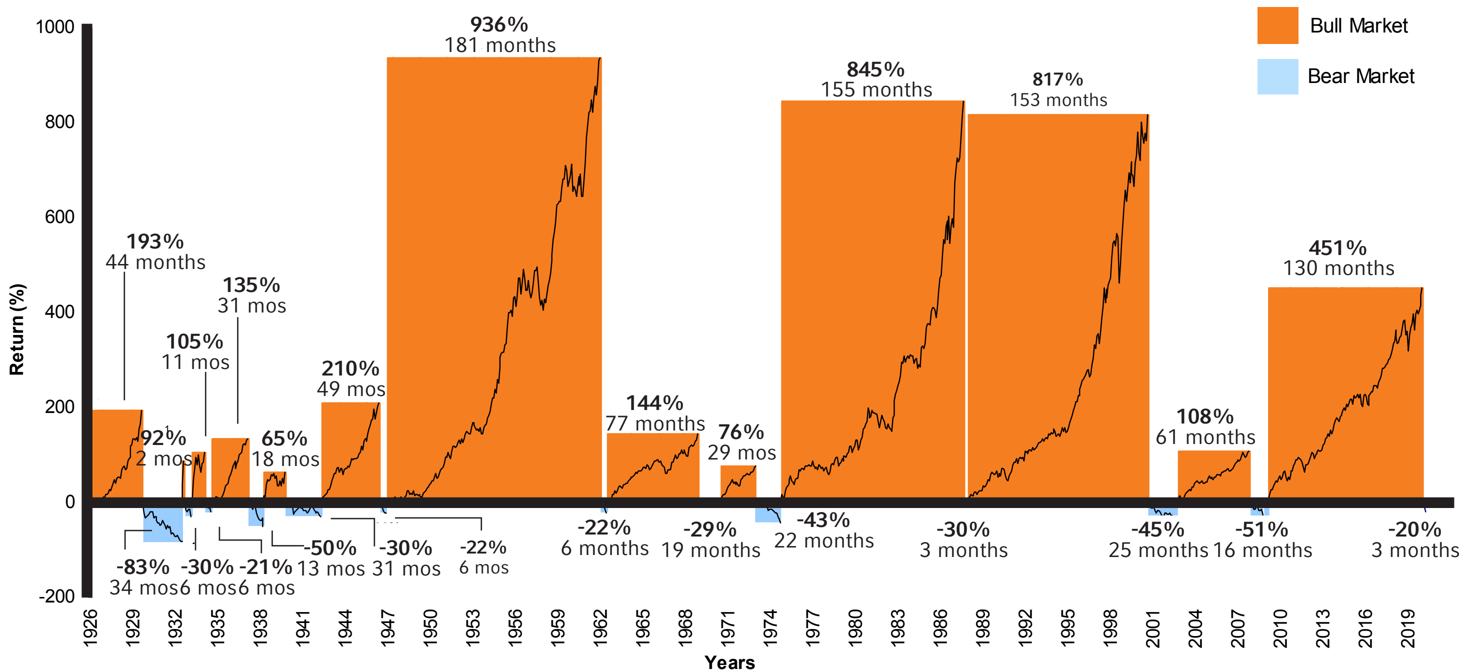
Rather than let our reaction to the market's movements lure us into making rash decisions, knowing the facts can help us deal with the emotions that erratic markets can cause.

Volatility is normal

Let's face it—financial markets are cyclical. Volatility is an inherent part of their nature. Different asset classes go into and out of favor. Geopolitics, major news from a key company, unexpected earnings results, changes in public policy, technical factors and any number of events can spark volatility.

But if you look at how financial markets have behaved over the last century (see Exhibit 1), it's pretty clear that any downturns are relatively short-lived and invariably followed by a significant rally that has more than made up for any previous losses. While past performance doesn't predict future gains, it does help to have some historical context.

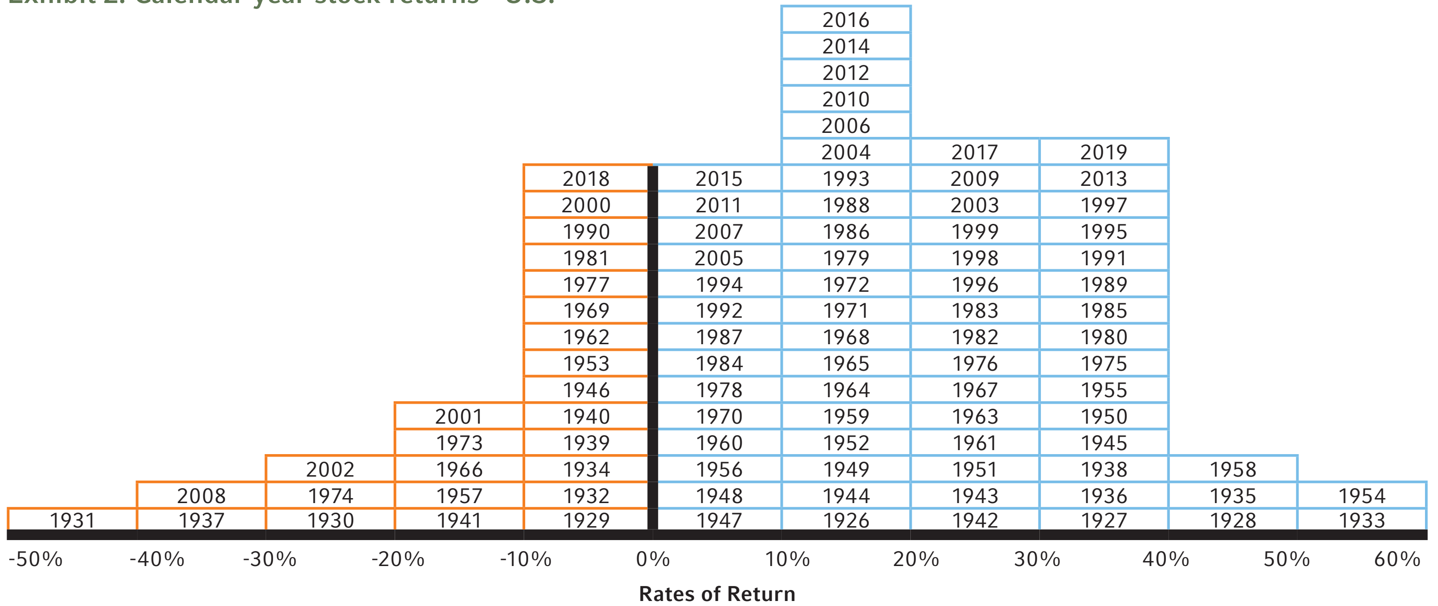
Exhibit 1: Bull & Bear Markets / January 1926 - March 2020



Sources: U.S. Equity — BNY Mellon, Thompson Reuters DataSteam, Russell Investments, returns based on S&P 500® Index. Indexes and/or benchmarks are unmanaged and cannot be invested in directly. Returns represent past performance, and are not a guarantee, and are not indicative or any special investment. As of March 31, 2020.

Explanations on terminology used: Bull, Bear and Neutral markets: Bull markets are markets where the cumulative returns exceeded 20%; Bear markets are determined to be markets where cumulative returns were lower than -20%; Neutral markets are defined as those where there was no clear directional trend and returns were cumulatively in the range of +5% to -19%.

Exhibit 2: Calendar year stock returns - U.S.



Source: eVestment Alliance, LLC. Returns based on S&P 500 Index from 1926-2019. For illustrative purposes only. Index returns represent past performance, are not a guarantee of future performance, and are not indicative of any specific investment. Indexes are unmanaged and cannot be invested in directly.

The trend is your friend

Sure, there have been bad years—most notably 1931, which led to the Great Depression, and 2008, when a credit crisis sparked a worldwide recession—but as Exhibit 2 shows, markets generally have more positive than negative years.

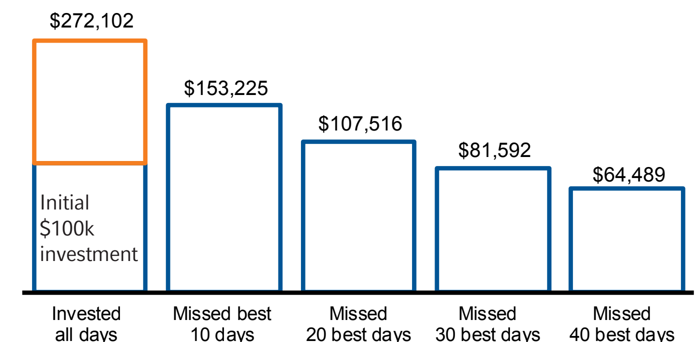
Indeed, while negative years are painful, the general tendency of financial markets is to move higher, as economies expand due to technological changes, increased trade, and improved productivity.

Things can change quickly

It is almost impossible for anyone to accurately predict the market's short-term moves. While there are signals that traditionally have pointed to a downturn—a flattening of the yield curve[1] has generally preceded a recession, for example—but the exact moment when the market begins its decline is extremely hard to pinpoint.

And market triggers can be unexpected, especially in the geopolitical arena. You may not realize the market is retreating until it has already declined significantly, and also may not realize the market is in an upward trend until after you have missed the opportunity for gains. Trying to "time" the market is virtually impossible and getting it wrong could cost you. (See Exhibit 3.)

Exhibit 3: Why is market timing difficult / 10 years ending March 31, 2020



Source: Russell Investments, Confluence. In USD. Returns based on S&P 500 Index, for 10-year period ending March 31, 2020. For illustrative purposes only.

Index returns represent past performance, are not a guarantee of future performance, and are not indicative of any specific investment. Indexes are unmanaged and cannot be invested in directly.

Rather than reacting to volatility and trying to time short-term market gyrations, we believe you should base your investment strategy on your personal long-term goals, time horizon, financial circumstances and risk tolerance, not on what markets are doing at a given moment. Staying invested over the long-term has generally been a better option.

And there is another way to view a volatile market—as an opportunity. Indeed, volatility can give you the chance to buy low and sell high. Strategies such as dollar-cost averaging[2], rebalancing and dynamic multi-asset investing can help you navigate volatile markets. This can make more sense than waiting for signs of a market turnaround and potentially missing significant market advances.

[1] When interest rates on short-term and long-term bonds become very similar and is generally seen as an indication the market is concerned about the economic outlook.

[2] Dollar Cost Averaging does not assure a profit or prevent a loss in declining markets, and you should consider your ability to continue investing during low price levels. Diversification and strategic asset allocation do not assure profit or protect against loss in declining markets.

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