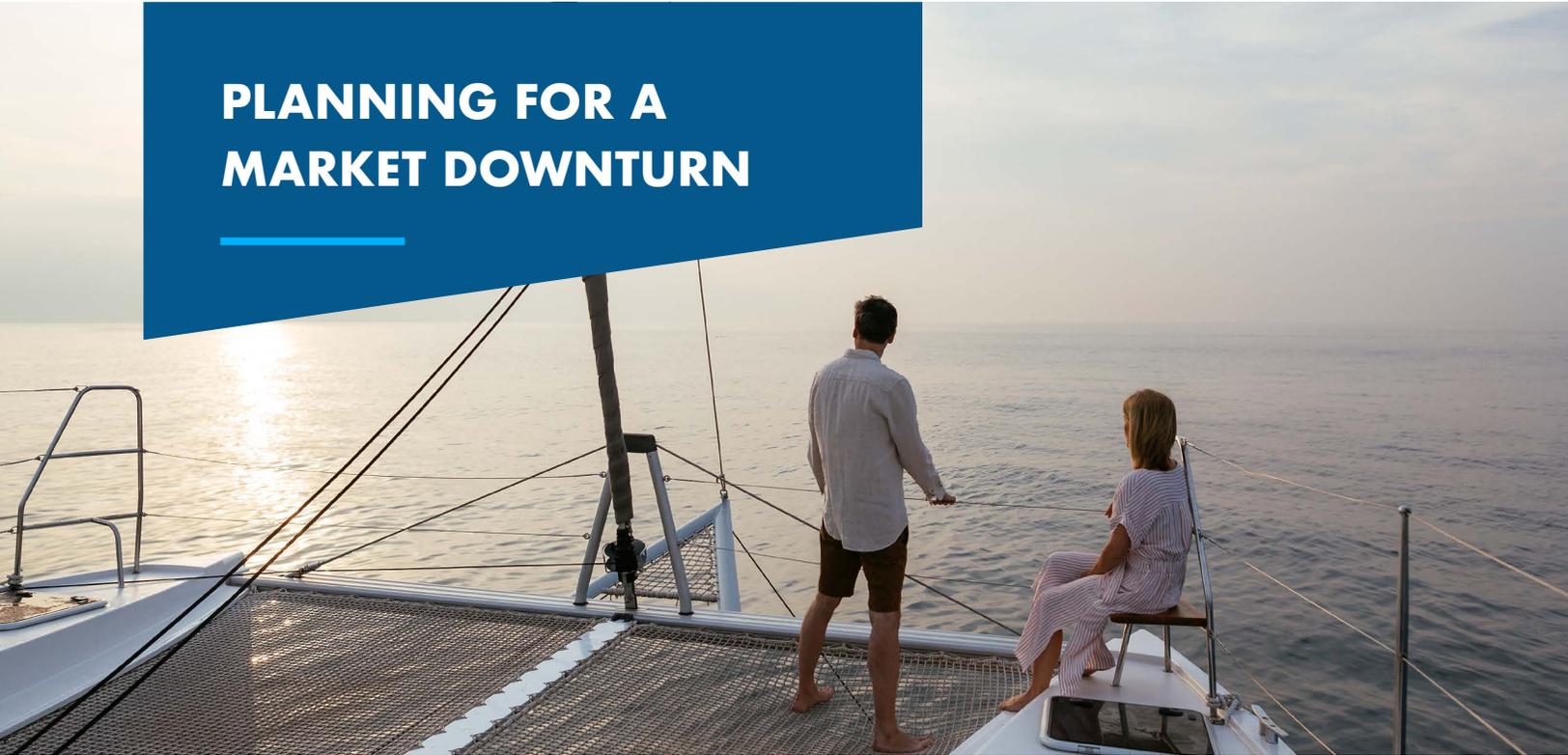


# PLANNING FOR A MARKET DOWNTURN



Recent market volatility reminds us of the ever-present risks inherent in stock investing. When bear markets occur, many investors instinctively seek shelter on the sidelines. But, as history demonstrates, leaving the market—even temporarily—can be costly over the long-term.

So, what can investors do now to manage current market volatility?

## STAY INVESTED

First, it's important to acknowledge that basic human instincts are at odds with what it takes to invest successfully over the long term. After all, what did our ancestors do when faced with danger? It was either fight or flight. "Do nothing" probably wouldn't have been a good strategy, but it's exactly what most investors should do when a sharp downturn occurs.

## BE PATIENT

Patience is key. As Oracle of Omaha Warren Buffett says, "The stock market is a device for transferring money from the impatient to the patient." When markets

are volatile, either up or down, it's easy for investors to let emotions like euphoria or fear get the better of them, causing them to make impulsive investment decisions. Being aware of how emotions can impact decision-making is a great first step to avoiding making regrettable investment choices during a market downturn.

## RESIST THE URGE TO SELL AT THE WRONG TIME

A well-known cognitive bias humans have is loss aversion. Put simply, people have a stronger negative reaction to losing money than they do a positive reaction to gaining the same amount. How does loss aversion play out for investors? It can cause investors to sell at their most panicked, when stock prices have already considerably declined.

When panic sets in and investors are tempted to sell, stop and ask:

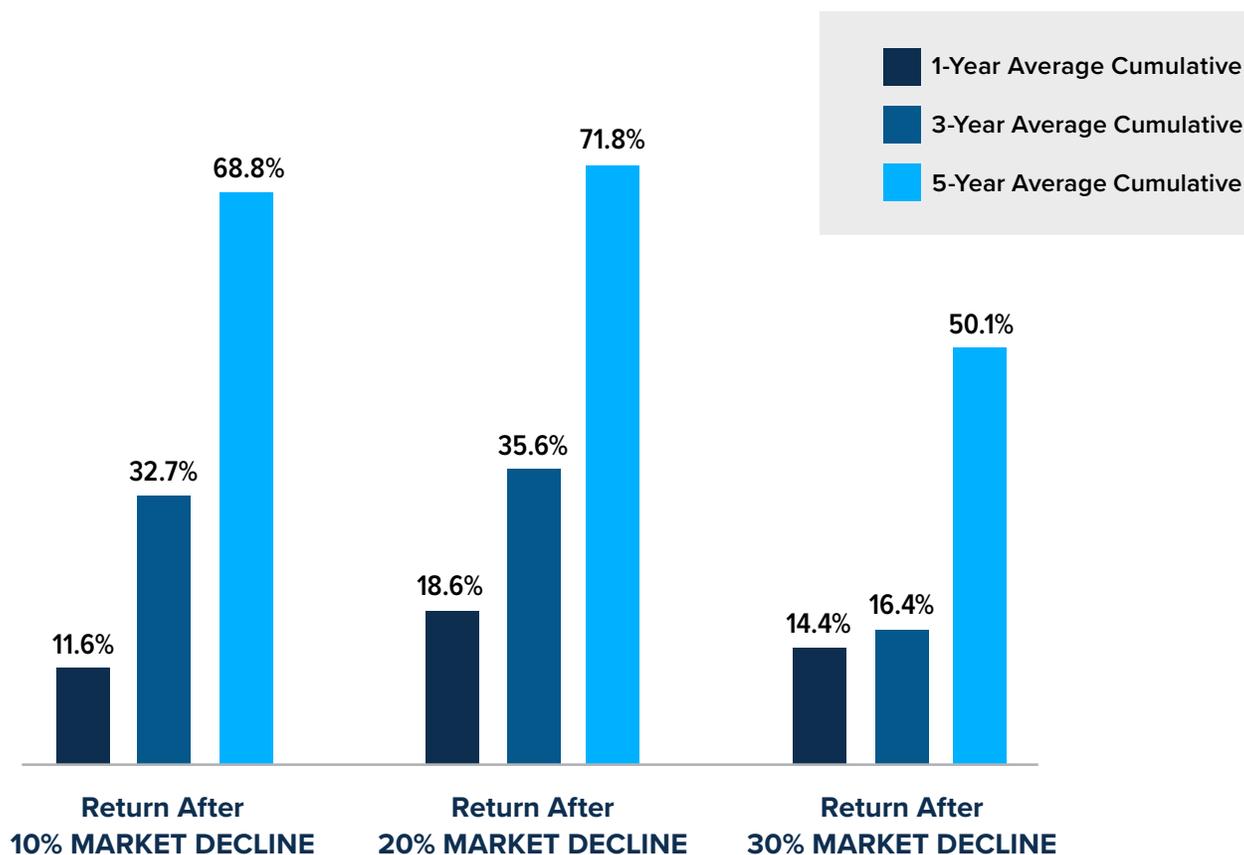
- Who is buying my shares?
- Why would they buy my shares?
- Could it actually be a good time to buy?

Asking these questions reminds one that there are two sides to every trade. And the person on the other side may be just as knowledgeable, or more so, on current and future economic conditions. Thinking about the answers to these questions can temper the urge to sell. Bear markets don't pose the same "danger" that saber-toothed tigers did to our ancestors. Pausing and thinking critically can help overcome the fight or flight instinct.

## USE HISTORY AS YOUR GUIDE

Knowledge of how markets have behaved in the past can be a highly effective tool for calming investor emotions or overcoming cognitive bias. What many investors don't realize is just how quickly markets tend to bounce back after hitting bottom. In Figure 1, an analysis of bounce-backs since 1926 shows that markets tend to rebound swiftly and strongly.

Figure 1: Markets Can Bounce Back Swiftly and Strongly



FAMA/FRENCH TOTAL US MARKET RESEARCH INDEX 1926—present: Fama/French Total US Market Research Factor and One-Month U.S. Treasury Bills. Source: Ken French website. Investing risks include loss of principal and fluctuating value. There is no guarantee an investment strategy will be successful. Past performance is no guarantee of future results. Short-term performance results should be considered in connection with longer-term performance results. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio.

Market declines or downturns are defined as periods in which the cumulative return from a peak is -10%, -20%, -30%, or lower. Returns are calculated for the 1-, 3-, and 5-year look-ahead periods beginning the day after the respective downturn thresholds of -10%, -20%, or -30% are exceeded. The bar chart shows the average returns for the 1-, 3-, and 5-year periods following the 10%, 20%, and 30% thresholds. For the 10% threshold, there are 28 observations for 1-year look-ahead, 27 observations for 3-year look-ahead, and 27 observations for 5-year look-ahead. For the 20% threshold, there are 14 observations for 1-year look-ahead, 13 observations for 3-year look-ahead, and 13 observations for 5-year look-ahead. For the 30% threshold, there are 6 observations for the 1-, 3-, and 5-year look-ahead periods. Peak is a new all-time high prior to a downturn. Data provided by Fama/French.

Selling during times of fear can cause investors to miss out on the sizable recoveries that have historically followed downturns. Those who choose to stay invested tend to achieve higher returns over the long-term

than those who cash out altogether or who exit the market near its lowest point, only to reinvest a year later (Figure 2).

**Figure 2: The Importance of Staying Invested**

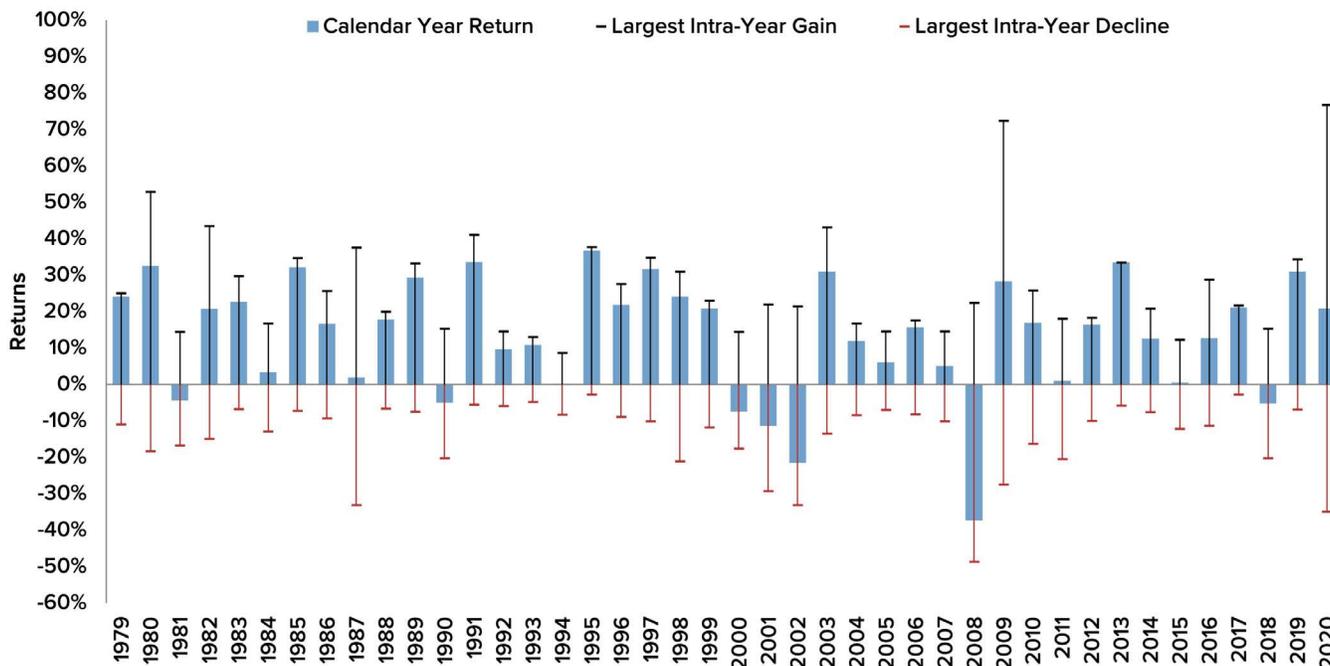


The image illustrates the value of a \$100 investment in the stock market during the period 2006-2020. Data sources: Strategic Capital Investment Advisors. The market is represented by the Russell 3000 Index. Cash is represented by the 30-day U.S. Treasury bill. An investment cannot be made directly in an index. The data assumes reinvestment of income and does not account for taxes or transaction costs. This is for illustrative purposes only and not indicative of any investment. This information has been taken from sources, which we believe to be reliable, but there is no guarantee as to its accuracy. For index definitions please visit <http://mfinwealth.com/index>

Short-term volatility can be the wind that whips up investors' emotions, but as Figure 3 shows, market highs and lows throughout the year are nearly always muted by the time the year ends. In other words, investors may

want to resist the urge to sell (or buy) when emotions are running high. Instead, consider staying invested and focused on your long-term plan.

**Figure 3: Short-term Fluctuations Rarely Result in Annual Changes**



Data source: Dimensional Fund Advisors. In U.S. dollars. Data is calculated off rounded daily returns. U.S. market is the Russell 3000 Index. Largest Intra Year Gain refers to the largest market increase from trough to peak during the year. Largest Intra-Year Decline refers to the largest market decrease from peak to trough during the year. Past performance is not a guarantee of future results. An investment cannot be made directly in an index. This information has been taken from sources, which we believe to be reliable, but there is no guarantee as to its accuracy. For index definitions please visit <https://mfinwealth.com/index>

### FEEL BETTER PREPARED

Navigating a market downturn is no different than navigating any other challenging event.

Understanding how emotions can impact decision-making and knowing how markets have behaved during previous downturns and afterwards may help

investors feel better prepared during periods of market unrest. It is important to remember that investment risk and return are highly correlated. Investors who can tolerate volatility and stay invested will likely receive enhanced returns over time.

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