HANOVER ADVISORS

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How to Navigate Market Downturns

Fears about the spread of the coronavirus have roiled the markets in recent weeks. The S&P 500, after hitting a record high just weeks ago, has entered correction territory. A correction refers to a 10 percent decline in a security or index from its most recent peak. While the speed of the decline has left investors spooked, stock market corrections are not in and of themselves a reason to panic.

During market downturns, it is important to focus on the long term. Investors can make themselves crazy obsessing over where the market was yesterday and where it will be tomorrow. Instead, disciplined investors ignore the day-to-day swings in the market, knowing it is much more important to consider where the market will be 1, 5, or even 10 years down the road. The most important thing to remember is that market downturns are not rare events. The typical investor is going to experience several of them during their lifetime.

Since 1980 there have been

12

Corrections

Declines of 10% or more

8

Bear markets

Declines of 20% or more, at least two months long

5

Recessions

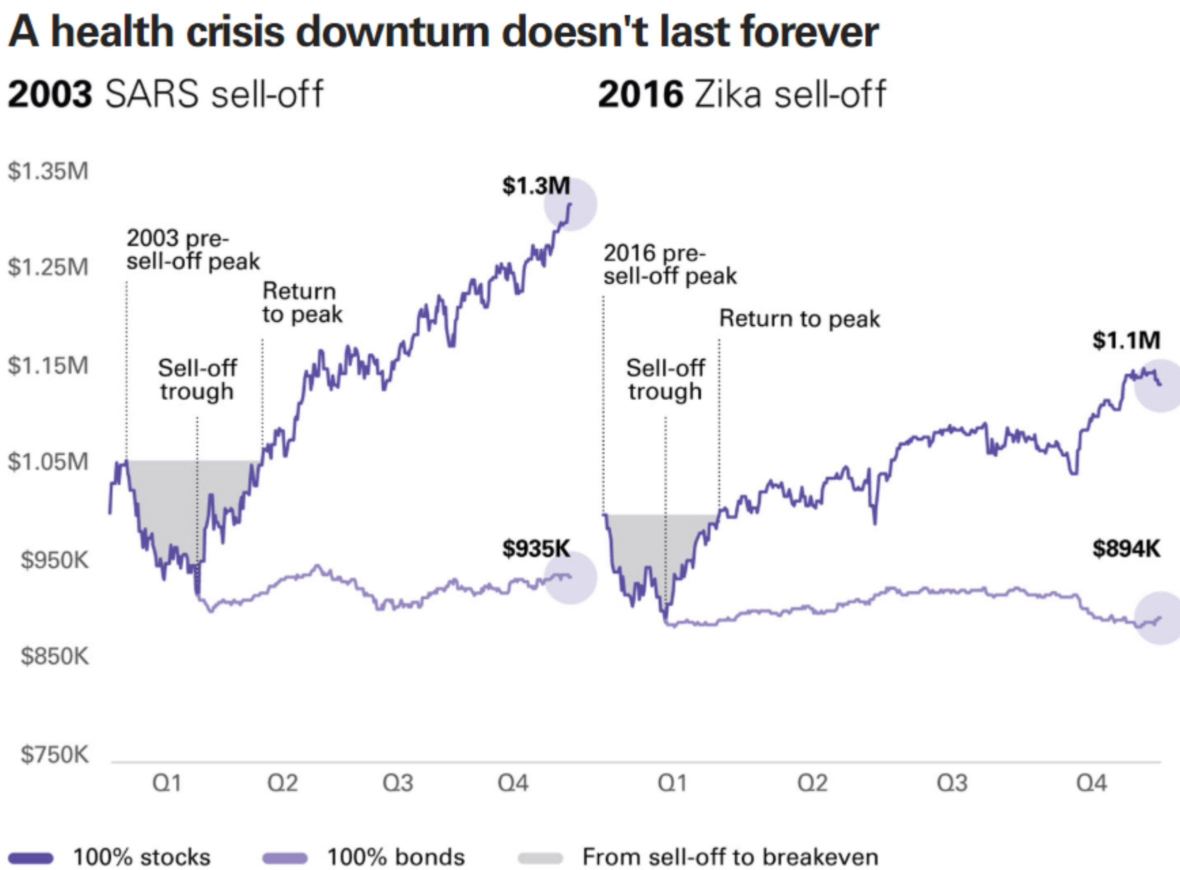
Declines in economic conditions for two or more successive quarters [1]

Source: Vanguard.

1 Refers to declines in the broad economy rather than the financial markets, though the two can be linked.

According to a CNBC report from 2018, the average correction for the S&P 500 lasted about four months and saw values fall about 13 percent before recovering.

The cause of the current downturn, a viral outbreak, may seem more alarming for some investors, but again, it is important to remember that we have been here before. Both the SARS outbreak of 2003 and the Zika virus outbreak of 2016 caused a downturn in the market and lead to periods of increased volatility.



Source: Vanguard calculations, based on data from FactSet.

As the above chart shows, the most recent downturns caused by health crises lasted just a few months. Furthermore, these charts illustrate the dangers of pulling out of the stock market during such times. While pivoting to out of stocks may seem more secure, such a move leaves you in a position to miss out on the inevitable rebound.

There remains the possibility that the current downturn extends beyond correction territory and we enter a bear market. It is even possible that the fallout of the coronavirus could disrupt the economy severely enough that the economy enters a recession. Such a scenario would mean that the losses may be more severe and the recovery would be slower, but it does not change the fact that a successful investor will navigate the downturn by remaining disciplined and focusing on long term goals.

Consider an example from recent history. The Great Recession was the most severe financial downturn since the Great Depression. However, as the chart below demonstrates, even such a profound downturn rewarded patience and discipline.

Value of $1,000 invested on October 9, 2007 (pre-crisis peak) through June 28, 2019

Sources: Vanguard calculations, using data from FactSet. All data as of June 28, 2019.

If an investor had $1,000 invested in a 60% stock/40% bond portfolio and simply left it alone during the upheaval, neither pulling money out nor adding even a single penny more, their money would have more than doubled over the next decade.

In periods of downturn in the markets, many investors just want to stop their immediate losses. While these investors may avoid losses, they also risk missing out on the rebound. Studies have shown that the market has spent more time rising than falling. Rather than predicting when the best time to move in or out of the market, investors should do their best to ignore every swing the market makes and focus instead on their long term investment goals.

This is not to say that there are not strategies that make navigating downturns easier. Risk assessment and asset allocation can mitigate losses and leave investors poised to take advantage of the inevitable rebound. If you have any concerns about how your portfolio is prepared for a downturn and how you can keep working toward your investment goals, even during a downturn, please contact us to speak to an advisor.