What to Do in a Market Downturn

It's no surprise that stock prices experience short-term declines in response to factors like an overheated market, geopolitical issues, deteriorating economic conditions or even a global pandemic. If stock prices always climbed in a straight line without the occasional dip, every investor would be incredibly wealthy.

However, markets do decline – sometimes dramatically. In the past couple of decades alone, we witnessed a major market crash in 2000 (technology "bubble"), 2008-09 (financial crisis) and 2020 (COVID-19). What such crashes have in common is that markets rebounded over time. It might take a while or be relatively quick, but markets overall tend to follow an upward long-term trend.

Knowing how markets have responded historically to sharp declines, it makes sense to stay invested through short-term challenges, doesn't it? Yes, but that type of investment discipline in the face of extreme market volatility is easier said than done.

Investing can be highly emotional because it involves our hard-earned money and may have a profound impact on our future if we don't invest successfully. Consider three common emotional responses that investors would be wise to avoid as they work toward their long-term financial goals.

Benefits of mutual funds

1. **Herding.** It takes courage to stand out from the crowd and take a different stance. That's why people tend to invest the same way others do – it provides a sense of safety and comfort. For example, many investors wait until they see proof that a certain stock is popular and its price has been firmly rising. They also like to hear glowing media reports about a "hot stock" before taking the plunge. Unfortunately, by this time the stock is likely overvalued and potentially poised to decline. Investing wisdom says to "buy low and sell high," but people who blindly follow the herd are often doing the opposite.
2. **Anchoring.** This type of behaviour occurs when an investor makes decisions based solely on reasoning that no longer applies. For instance, let's say you notice that a stock you own has been trading in a certain price range. As the stock price approaches the top of its typical range, you might sell before the "inevitable" decline begins – even if the company announces positive news and its outlook has improved dramatically. By anchoring in flimsy or outdated logic, you may miss a good investment opportunity.
3. **Loss aversion.** People generally feel more pain when they lose than happiness when they win. Maybe it's because of people's innate fear of being wrong or their feelings toward money. Whatever the reason, we try to avoid situations where we're likely to lose or make a mistake, and that includes investing. Therefore, when the price of a stock we own declines sharply for valid reasons, emotions prevail and we might be reluctant to sell, since it's only a "paper loss" until we actually sell it. The result is we may continue holding a bad investment and lose more money.

Stay invested for the long term

There are other emotionally triggered investor biases, but you get the point. The trick is to put emotions aside and stick with the long-term investment plan that you and your advisor have created. By staying the course during market downturns, you may avoid taking unnecessary losses and will have an opportunity to participate in any market rebound.

It may also be appropriate to start a pre-authorized contribution plan (PAC). By automatically investing a set amount of money on a regular basis in a given stock or fund, you will invest with discipline and can take advantage of market downturns by purchasing more shares/units when their price is lower (this strategy is called "dollar-cost averaging"). PACs may be a viable way to strip emotions out of investing so you can benefit from positive long-term market trends.

A knowledgeable and trusted advisor can help you navigate challenging markets and invest rationally. Contact us today.