

7 Ways to Fight Fear With Facts

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You wouldn't be human if you didn't fear loss.

Nobel Prize-winning psychologist Daniel Kahneman demonstrated this with his loss-aversion theory, showing that people feel the pain of losing money more than they enjoy gains. As such, investors' natural instinct is to flee the market when it starts to plummet, just as greed prompts us to jump back in when stocks are skyrocketing. Both can have negative impacts.

But smart investing can overcome the power of emotion by focusing on relevant research, solid data and proven strategies. Here are seven principles that can help fight the urge to make emotional decisions in times of market turmoil.

1. Market declines are part of investing.

Stocks have risen steadily for nearly a decade. But history tells us that stock market declines are an inevitable part of investing. The good news is that corrections (defined as a 10% or more decline), bear markets (an extended 20% or more decline) and other challenging patches haven't lasted forever.

Market Downturns Happen Frequently and They Don't Last Forever

Dow Jones Industrial Average 1900-2017

	-5% or more	-10% or more	-15% or more	-20% or more
Average Frequency ¹	About 3 times a year	About once a year	About once every 2 years	About once every 3.75 years
Average Length ²	46 days	115 days	216 days	338 days

¹ Assumes 50% recovery of lost value

² Measures market high to market low

The Dow Jones Industrial Average is an unmanaged, price-weighted average of 30 actively traded industrial and service-oriented blue chip stocks.

The Dow Jones Industrial Average has typically dipped at least 10% about once a year, and 20% or more about every 3.75 years, according to data from 1900 to 2017. While past results are not predictive of future results, each downturn has been followed by a recovery and a new market high.

2. Time in the market matters, not market timing.

No one can accurately predict short-term market moves, and investors who sit on the sidelines risk losing out on periods of meaningful price appreciation that follow market downturns

Every Standard & Poor's 500 Index decline of 15% or more, from 1929 through 2017, has been followed by a recovery. The average return in the first year after each of these market declines was nearly 55%.

Even missing out on just a few trading days can take a toll. A hypothetical investment of \$10,000 in the S&P 500 made in 2002 – the start of the recovery following the bursting of the technology bubble – would have grown to more than \$18,000 by the end of 2012. But if an investor missed the 10 best trading days during that period, he or she would have ended up with just \$9,378 – less than the initial investment.

3. Emotional investing can be hazardous.

Daniel Kahneman won his Nobel Prize in 2002 for his work in behavioral economics, a field that investigates how individuals make financial decisions. A key finding of behavioral economists is that people often act irrationally when making such choices.

Emotional reactions to market events are perfectly normal. Investors should expect to feel nervous when markets decline. But it's the actions taken during such periods that can mean the difference between investment success and shortfall.

One way to encourage rational investment decision-making is to understand the fundamentals of behavioral economics. Understanding behaviors like anchoring, confirmation bias and availability bias may help investors identify potential mistakes before they make them.

4. Make a plan and stick to it.

Creating and adhering to a thoughtfully constructed investment plan is another way to avoid making short-sighted investment decisions — particularly when markets move lower. The plan should take into account a number of factors, including risk tolerance and short- and long-term goals.

One way to avoid futile attempts to time the market is with dollar cost averaging, where a fixed amount of money is invested at regular intervals, regardless of market ups and downs. This approach creates a strategy in which more shares are purchased at lower prices and fewer shares are purchased at higher prices. Over time investors pay less, on average, per share. Regular investing does not ensure a profit or protect against loss. Investors should consider their willingness to keep investing when share prices are declining.

Retirement plans, to which investors make automatic contributions with every paycheck are a prime example of dollar cost averaging.

5. Fixed income can help bring balance.

Stocks are important building blocks of a diversified portfolio, but bonds can provide an essential counterbalance. That’s because bonds typically have low correlation to the stock market, meaning that they have tended to zig when the stock market zags.

Cumulative Returns During Recent Market Corrections



Sources: Bloomberg Index Services Ltd., RIMES, Standard & Poor’s. Dates shown for market corrections are based on price declines of 10% or more (without dividends reinvested) in the unmanaged S&P 500 with 50% recovery between corrections.

What’s more, bonds with a low equity correlation can offer protection from losses even when the broader market is in turmoil. Funds providing this diversification can help create durable portfolios, and investors should seek bond funds with strong track records of positive returns through a variety of markets.

7. The market tends to reward long-term investors.

Is it reasonable to expect 30% returns every year? Of course not. And if stocks have moved lower in recent weeks, you shouldn't expect that to be the start of a long-term trend, either. Behavioral economics tells us recent events carry an outsized influence on our perceptions and decisions. When stocks are falling, it's important to maintain a long-term perspective. Although stocks rise and fall in the short term, they've tended to reward investors over longer periods of time. Even including downturns, the S&P 500's mean return over all 10-year periods from 1937 to 2014 was 10.43%.

It's natural for emotions to bubble up during periods of market volatility. Those investors who can tune out the news are better positioned to plot out a wise investment strategy. At Gleba & Associates, we pride ourselves on understanding your needs and tailoring an investment plan that best suits your goals. Give us a call at 248.879.4510 or email us at info@glebaandassociates.com