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WEALTH MANAGEMENT FOR A FLOURISHING RETIREMENT

Market Volatility – Five Things to Know

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Okay, let's all take a deep breath.

It's been a rough fourth quarter for the markets. It seems like week after week, the major indexes – like the Dow and S&P 500 – get hammered by volatility. These days, just about every news website you can find is packed with breathless headlines about plummeting stocks, photos of nervous-looking traders, and editorials about a possible bear market in 2019.

Frankly, it's true. One major index is brushing up against a bear already, and it's possible volatility will continue for the foreseeable future. But does that mean we should panic?

Nope.

Okay, take another deep breath. Market volatility is unpleasant, and my team and I certainly take it seriously. But panic? Never. Let's break this down objectively by discussing:

Five Things to Know about Market Volatility

1. The definition of a bear market.

A bear market is defined as a 20%-or-greater decline from a recent peak. As of this writing, the Nasdaq, an index largely comprised of technology stocks, is flirting with bear market territory.[1] The other two main indexes, the Dow and the S&P, are still some distance away.

Instead, the Dow and the S&P are hovering around what's known as a **market correction,** which is a 10%-or-greater drop from a recent peak. Whether that correction will eventually turn into a bear is impossible to say, but regardless, here's what investors need to remember:

2. Corrections – and even bear markets – are a *normal part of investing.*

On average, a market correction occurs about every 1-2 years. In fact, both the Dow and the S&P 500 endured brief corrections earlier this year before soaring to new heights.

Bear markets are less common, but far from rare. Between 1900 and 2015, the markets encountered 32 bears – roughly one every 3.5 years.[2]

Pleasant? No. Normal? Absolutely.

In a sense, a market correction is like the common cold. Annoying – but you tend to get one every year, and it hardly stops you from living your life. A bear market is more like influenza. It makes the average investor feel miserable, and you certainly should treat it seriously. But for most people, it's nothing to panic about. You get some rest, follow your doctor's orders, and wait to get better.

Right now, the markets have a cold. Do colds sometimes turn into the flu? Sure, and it's possible the current correction will develop into a bear. *But it's not unusual and it's nothing to freak out about.*

3. Panic only makes things worse.

Imagine you got sick and then didn't get better as quickly as you wanted. Would you start panicking? No. You would probably go see a doctor, but you wouldn't resort to extreme measures like using leeches or asking for an operation.

Unfortunately, investors aren't always so rational. The fact is, many investors *do* panic during corrections and bear markets, especially if they last for a long time. They sell all their investments without forethought, or move everything over into bonds, or any of a hundred other things. It's reckless – and recklessness has destroyed more wealth than any bear market.

History shows that it takes around four months for the markets to recover from a correction, and twenty-two months from a bear.[3] Some are shorter, some are longer, but regardless of the duration, *our own emotions are the bigger problem.*

When we get sick, we understand that it might take a while before we feel entirely normal. It's a healthy acceptance of reality – and it's a key part of getting better.

As investors, we need to bring the same acceptance to the markets.

4. The best way to combat panic is to increase our own knowledge.

When you're sick, you go to the doctor and ask questions. Or you research your symptoms online, hoping to find answers there. Maybe you fire up an old episode of *The Magic School Bus.* Either way, you seek to understand exactly what's going on in your body – and what your body's doing to fight the infection. And if you've ever known anyone with a chronic illness, you've probably heard them say that simply *understanding what was going on* made them feel much, much better.

Let's do that right now by looking at what's causing this current market malaise. In this case, there are four main factors:

Interest rates. The Federal Reserve raised the country's key interest rate on Wednesday, December 19.[4] This was expected. Part of the Fed's mandate is to raise interest rates when the economy is strong – as it currently is – because a strong economy mixed with *low* rates often leads to inflation. However, the markets don't always appreciate higher interest rates, because it makes borrowing more expensive. This, in turn, reduces spending and can slow economic growth. Which leads me to the next factor.

The economy may be slowing down anyway. Make no mistake, the economy is currently strong – but there are signs that it might be weakening a little. Corporate earnings are slowing, many corporations are deeply in debt, oil prices have fallen dramatically, and the housing market is coughing, too. Some analysts even believe the U.S. is due for a recession in 2020 or 2021. This has many calling for the Fed to cut back on raising interest rates, and the Fed itself predicted it would only do it twice in 2019.[4]

Another possible reason for a slowing economy is the third factor, which is:

The trade war. Trade tensions with China continue, and while new tariffs are on hold for now, there's no immediate end in sight.

It's not hard to understand why the markets worry about this so much. Tariffs – essentially a tax on imported goods and services – often hurt businesses. That's because higher tariffs often lead to higher prices, which in turn lead to higher expenses. For example, if companies must pay more for the raw materials they need, that can significantly eat into their own profits. This, in turn, can lead to shipping delays, supply chain problems, higher prices for consumers, a resulting loss of business, you name it. All *these* issues, of course, are then reflected in the stock prices of the various companies affected.

Investor psychology. We already talked about the dangers of panicking. With *any* market correction, fear is *always* a factor. In this case, pundits have been proclaiming for *months* that the bull market may be ending, and that a bear isn't so far away. This often becomes a self-fulfilling prophecy, because bear-phobic investors will soon see bear tracks everywhere they look. This fear leads to panic, panic leads to sell-offs, and sell-offs lead to corrections.

So, what can we do with this information? We can use it to understand there are *reasons* for the current market volatility, just as there are *reasons we get sick.* Neither, however, spells certain disaster or the end of the world.

5. Accepting market volatility as normal doesn't mean we don't have a plan for dealing with it.

The final thing you should know about bear markets is also the most important.

My team and I believe strongly in the use of **technical analysis.** That means we decide when to buy and when to sell based on *supply and demand,* not storylines in the media or emotion. We have long been prepared to "go on defense" when necessary, and we understand that *protecting* your money is just as important as growing it.

Using technical analysis, we look at market trends. Is the market trending up or down? What about different *sectors* of the market? What about your individual investments? As you know, we have rules in place *specific to you* that determine at what point in a trend we decide to buy, and at what point we decide to sell. For example, if an investment trends down below a certain price, we follow the rules and sell. Period. If an investment trends *up* above a certain price, we buy. This allows us to make investment decisions based on what makes sense for *you* rather than just following the herd. And the best part about this kind of approach? It works whether we're in a bull market or a bear! Other investment philosophies, like buy-and-hold, can't say the same.

It's cold-and-flu season here in the United States…and apparently in the markets as well. But it's also the holiday season! That's why you should focus on *living* and let us do the worrying. We'll continue to monitor the markets and the economy. We'll continue researching your investments to make sure they continue to make long-term sense for your goals.

We'll continue focusing on keeping your finances healthy.

As always, contact me if you have questions or concerns. My team stands ready, my door is open, and so is my inbox! In the meantime, best wishes for a Happy New Year!

-Steve Robbins, CFP®

Sources

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