Managing Market Volatility – Principles of Investing Success

What Next?

The past months have tested the strength and resolve of individuals, businesses, and governments around the world. Investors, particularly retirement plan investors, have watched with a sense of disbelief and anxiety as steep market declines take their toll on portfolio values. The Dow Jones Industrial Average reached a high of 29,551 on February 12, 2020, and the S&P 500 reached a high of 3,386 on February 19, 2020. A little more than a month later, both had fallen by over 30%. The volatility in all the major indexes has been extreme, with drops of over 1,000 or 2,000 points in the Dow occurring on several separate days in late February and March.

It comes as no surprise that the financial markets, which thrive on certainty and stability, have not reacted well to all the turmoil and uncertainty associated with the sudden arrival on these shores of the COVID-19 virus, its rapid spread, and its adverse economic impact.

How to Handle the Volatility

Many people are apprehensive about the future. They are worried about their jobs and concerned that market declines are wiping out their retirement savings. The extreme volatility in the stock market is understandably unnerving for many.

It is impossible to predict with certainty how much more securities may fall or when the volatility will decrease. However, we can learn from the past. The financial crisis of 2009 and past downturns and recessions provide a learning opportunity for retirement plan investors on how to respond to the current volatility in the stock markets. Here are some lessons we have learned from past financial crises, lessons you should consider.

Your Losses Are Only Paper Losses

While it is unsettling to watch the value of your retirement plan portfolio fall, you need to remind yourself that this decline is only a loss on paper. It does not become real until you decide to sell or redeem those fund shares. Financial professionals typically don't recommend that you sell into a loss.

Focus on the Long Term

During times like these, it is important to focus on why you are investing. Your retirement plan savings are meant to help provide you with greater financial security once you retire. The record shows that investors who have stayed calm and remained invested during volatile periods have done better than investors who became frightened and jumped in and out of the market. They missed those periods when the market started to recover and enjoyed multiple up days. See the chart for what can happen when you miss the stock market's best performing months.

Missing Top-Performing Months in the Stock Market

	Annualized Index Return	Potential Value of $1,000
Period Jan. 1990-Dec. 2019		
Staying Invested	9.96%	$17,260
Missing Top 12 Months	6.15%	$5,992
Period Jan. 2000-Dec. 2019		
Staying Invested	6.06%	$3,244
Missing Top 12 Months	0.88%	$1,192
Period Jan. 2010-Dec. 2019		
Staying Invested	13.56%	$3,567
Missing Top 12 Months	4.47%	$1,549

This table summarizes the potential effects of missing top-performing months of the stock market, assuming investment performance mirrored the performance of the S&P 500.

Source: DST Retirement Solutions, LLC, an SS&C company. Stocks are represented by the S&P 500, an unmanaged index that is generally considered representative of the U.S. stock market. It is not possible to invest directly in an index. Past performance is not a guarantee of future results.

It's true that stocks are generally riskier and more volatile than either bonds or cash investments. This higher level of risk is the price investors pay for potentially superior returns. Stocks have outperformed other investments and the inflation rate over the long term. There is, of course, no guarantee that historical trends will continue into the future.

Markets Do Recover

Not counting the current decline, there have been 10 bear markets since 1950, defined as a decline of 20% or more from the market's previous high (as measured by the performance of the S&P 500). Yet, the stock market has always climbed back. The reality is that stocks climbed an average of 10.26% per year from 1926 through 2019 -- through the Great Depression, World War II and multiple armed conflicts, including those in Korea, Vietnam, Afghanistan, and Iraq, as well as many economic and political shocks.

Diversification[1] Matters

While there is no guarantee, investing in a combination of funds holding different types of investments -- stocks, bonds, and cash -- is a time-tested strategy for managing risk and may even help improve returns over the long term. Diversification works like this: When one asset class -- stocks, for example -- loses value, another asset class, such as bonds or cash, may deliver positive returns that can help offset those losses.

In addition, you can achieve an additional level of diversification by investing in subgroups within asset classes. Stocks, for example, have a variety of different categories, such as domestic, international, large capitalization, medium capitalization, and small capitalization. There are stock funds that invest in specific sectors of the economy. However, diversification does not ensure a profit or protect against losses in a declining market.

Buy on Sale -- with Dollar-Cost Averaging[2]

When you have money taken out of your paycheck to go into your retirement plan account and be invested on a regular basis, you are doing what is called "dollar-cost averaging." With dollar-cost averaging, you invest a fixed amount of money on a regular schedule in shares of stock or a fund.

When share prices fall, the fixed amount you invest buys more shares. Basically, you are taking advantage of a "sale" on fund shares when you continue adding money to your retirement account on a regular schedule during times when prices are lower. The bottom line: Downturns give you an opportunity to buy investments on sale.

Stick With It

If at all possible, keep saving and investing. All else being equal, the more you can save, the better your chances are of reaching your retirement goal.

[1] Diversification does not ensure a profit or protect against loss in a declining market.

[2] Dollar-cost averaging involves regular, periodic investments in securities regardless of price levels. You should consider your financial ability to continue purchasing shares through periods of high and low prices. This plan does not assure a profit and does not protect against loss in any markets.