LORING WARD
A BETTER WEALTH EXPERIENCE

December 2015

PORTFOLIO PERSPECTIVES

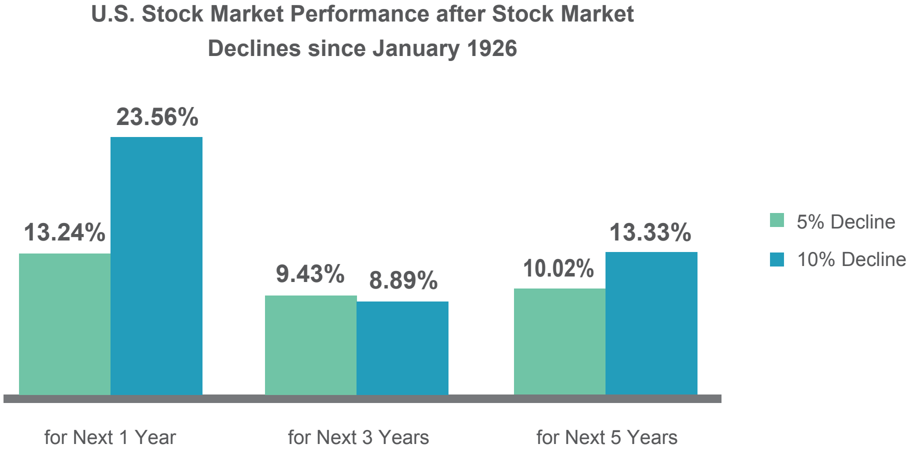
The Odds Favor the Optimist

By Sheldon McFarland
VP, Portfolio Strategy & Research
Loring Ward

When the stock market gets rocked it's easy to hit the proverbial panic button and sell. Many investors believe that to avoid large losses they need to sell once the stock market drops more than 5 or 10 percent. Panicking during bouts of volatility is one of the classic investor mistakes.

It would be great to be able to know exactly when the market will go up and down, but the truth is that no one can predict it consistently. Based on history, it may be best to do nothing during down markets.

The chart below shows the average U.S. stock market returns 1, 3 and 5 years after a 5% or 10% decline. On average, when the U.S. stock market declines 5%, the market return over the next 1, 3, and 5 years is 13.24%, 9.43%, and 10.02%. Not bad! (In fact, U.S. stock market returns following declines have been better than the long-run average annual return of 9.32% in both the 1-year and 5-year returns shown.[1])



Source: Wellington, Weston. 2015. "Should Investors Sell After a 'Correction'?" Down to the Wire, (September). Returns from January 1926 through June 2015. Declines are defined as periods with consecutive days of negative index returns with cumulative losses at or above the cutoff. Annualized compound returns are averages across all declines. US Stock Market performance is the S&P 500 Index, provided by Standard & Poor's Index Services Group. Past performance is not indicative of future results. Indexes are not available for direct investment and their performance does not reflect the expenses associated with the management of an actual investment.

Unfortunately, many investors never get the benefits of those returns because they panicked and sold during a down market and waited too long to get back in. Don't make that same mistake! Missing out on these opportunities will have a dramatic effect on your investment outcome. To put it simply, you'll have less money.

We see similar results in non-U.S. stock markets as well; on average they also experience positive returns 1, 3, and 5 years following 5% and 10% stock market corrections. These corrections last 4.8 days on average, similar to the length of U.S. stock market declines. And the opportunities were just as significant, with both developed and emerging international stock markets earning returns higher than their long-run averages in all three time periods following 5% and 10% declines.[2]

If history is your guide then there's no reason to panic during declines. Over the last 90 years the U.S. stock market declined more than 5% 262 times and the average length of that decline was 4.1 days. Over the same 90-year period the U.S. stock market declined more than 10% 28 times and the average length of that decline was 4.6 days. Declines have only been temporary and the market recovered after every one.

If history is your guide then there's no reason to panic during declines.

Trying to time the entry and exit points in anticipation of a market correction is almost impossible and certainly not sustainable over every correction. Being an optimist, sticking with your investment discipline and taking the good with the bad, I believe, is a better strategy.

---

[1] Wellington, Weston. 2015. "Should Investors Sell After a 'Correction'?" Down to the Wire, (September).

[2] Ibid