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Your Market Mindset: How to Think about Volatility

It is likely that February 2018 will prove to be a month that stock investors remember for quite some time. The month started with the US stock indexes close to all-time highs. But even as President Trump was commenting favorably on the recent strength of the markets in his State of the Union address, trouble was brewing—with a surprising cause.

In a classic case of "good news equals bad news," a February 2 employment and wage report from the Department of Labor highlighted strong employment growth and, more significantly, a solid 2.9-percent increase in wages, one of the strongest gains since the Great Recession. This was widely interpreted as a sign that the economic recovery was finally starting to make itself felt in a meaningful way where the majority of Americans need it most: in their pay checks.

Most of us would regard these as good developments. However, to an overvalued stock market that many analysts believed was long overdue for a pullback, the growth in wages, coupled Like 0 Share Tweet Share this Page: with record-low unemployment, sounded like a recipe for higher inflation and possible monetary tightening by the Federal Reserve Board. Those fears sent sellers into high gear, driving stock prices down by around 10 percent before the end of the first full week of February—the market's worst weekly performance since 2016.

And then, starting about the middle of the month, the crazy swings in stock prices returned—but in the opposite direction. On Monday, February 12, the Dow climbed 410 points, and the S&P 500 gained 36, with other indexes performing similarly. As this is being written near the end of the month, we have seen several more days of high-percentage swings, both up and down, in the major market indexes, though markets have remained several percentage points below their 52-week highs.

In their dramatic drops and rises, the equity markets have been exhibiting high volatility, with breathtaking intraday swings in prices and huge volumes of shares traded. For many investors, it can all be rather unsettling, especially when the financial headlines are shouting superlatives —both positive and negative—and pundits are offering contradictory theories about what will happen next.

What should the long-term investor's attitude be during periods of volatility like the one we witnessed in February? Along with Christopher Hyzy, Chief Investment Officer at Bank of America Global Wealth and Investment Management—and many other experts—we believe it is important for investors to: 1) remain calm, 2) maintain a historical perspective, and 3) stay on track with the strategies they have put in place in order to reach their goals.

Remain Calm. First, it is important to recall that the price drops we saw in early February 2018 were likely induced by temporary, technical factors, not long-term shifts in the national or global economy. As a matter of fact, the economic fundamentals in both US and global markets remain very strong. Corporate profits are healthy, including 16-percent earnings growth in the US; global economies are also in favorable territory, with consumer spending and business investment expanding worldwide; and rising wages in the US and elsewhere likely portend more purchasing power for consumers and, thus, increased revenue for the businesses serving them. All of these are demonstrated reasons for remaining composed—while maintaining alertness, of course. Despite the recent market gyrations, the well-run, innovative companies whose stocks make up the major exchanges remain worthy of continued confidence. As part owners of those companies, stockholders may reasonably expect the value of their investments to satisfactorily perform over the long term. This, too, is a reason to remain calm and confident.

Maintain a Historical Perspective. Historically, market pullbacks are certainly not unusual. For example, over the past thirty years, the S&P 500 has averaged eight price retreats of 2 percent or more per year, three pullbacks of 5 percent or more annually, and at least one drop of 10 percent or more each year. It is easy to forget these facts during a long run-up like the one we saw from 2016 to February 2018. Such extended market expansions tend to lull investors into a false belief that the markets can't go down—but they always do, eventually! Tweet Share this Page: During periods of volatility, a historical perspective on market action can help to relieve the jitters that result from reading too many sensationalistic headlines.

Stick with Your Investment Strategies. Finally, we advise investors to stay the course. Any investment in the financial markets should be the result of a carefully considered plan that is designed with your unique goals, risk tolerance, and long-term objectives in mind. Such a plan will feature appropriate and broad-based diversification of holdings among various asset classes. It will take into account your investment life cycle and anticipated needs. It will afford opportunities that maximize value and minimize transaction costs and fees. And, finally, it will not be driven by emotional responses to short-term financial events. Indeed, those who take a long-term, patient view of the markets may reasonably expect to find attractively priced investments during periods of market downturns. Such "sale-priced" investments, when made as part of a cohesive, long-term strategy, can be expected to greatly enhance the profitability of a portfolio.

Forming and adhering to a well-conceived, long-term strategy is the principal service that a professional, accredited financial advisor can offer. Such an advisor can provide resources, products, and research that are based on empirical evidence, delivered in a way that places the client's best interests above any benefit to the advisor or any particular product or company. Over the long haul, evidence-based investing and the counsel of a qualified professional advisor can be the best antidotes to the type of emotionally driven investment behavior that almost inevitably proves harmful to an investor's desired outcomes.

So, when the markets are volatile, keep your cool, recall your history, and maintain your course. Also remember: sound advice is your best and most reliable resource.

Stay Diversified, Stay YOUR Course!

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