

# What to do when Investment Markets fall

When investment markets start bouncing around, and especially when they fall, investors can often have a sense of unease or even mild panic. When this happens it is important to maintain some discipline and ensure you stick to your investment plan.

No-one likes to see their investments lose value when the market has had a large and unexpected fall, but the falls (and the rises) are a normal part of investing. Often you'll hear these situations referred to as "Volatility" - which is just a general word to describe how much and how often the market can rise and fall, nothing else. Investment markets that trend up and down more consistently over the long-term very rarely attract attention.

It's a natural reaction to worry about your money whenever there's a large movement in the markets, especially when it's a larger than normal fall. That worry can make you react impulsively e.g. to want to sell down your shares; but that may not be the right thing to do in the long term.

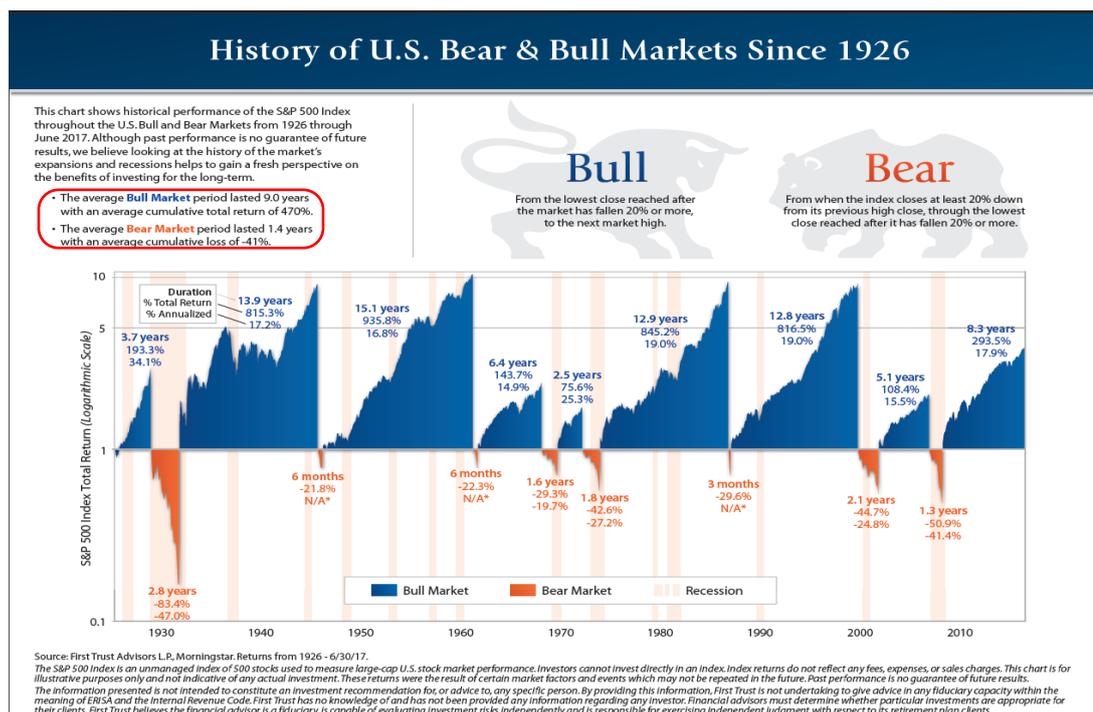
One thing you can do is to make sure you're well prepared with an investment strategy in place that is well structured to meet your goals and financial situation. Having a plan in place means that when the market does fall unexpectedly you are better equipped to cope with the normal ups and downs of the markets and feel less anxious as a result. This will also mean you're well placed to take advantage of opportunities as they arise, but more about that later.

So what can you do to make sure you're prepared? Here are some guidelines to help:

## 1. Downturns in the market are normal and usually only last a short time\*

There's no doubt at all market downturns can be upsetting, but history shows that markets have been able to recover from drops and return to providing positive long-term returns. The U.S. share market is a good example to look at in order to demonstrate this. Over the past 90 years the market has experienced a number of ups and downs, but what's most interesting is that the average "Bull Market" (i.e. a period of rising values) lasted 9 years with an average return for the full 9 year period of 470%, compared to the average "Bear Market" (i.e. a period of falling values), which lasted just 1.4 years with an average loss of -41% for the 1.4 year period.

\*Based on U.S. share market as it has the longest statistical history





### 3. The dangers of trying to time the market

When uneasy investors see markets drop often they try to prevent losing more money by selling down their investments as quickly as possible; but this impulsive reaction can in fact do more harm to your potential return.

The picture below shows how investors might react when a drop in the market occurs:



The *buyers* in this example generally tend to be investors who believe they are *on to a good thing*, often not realising that they're buying in at the top of the market when prices are high, and then *selling* when the market's at its lowest. The winners in these scenarios are the investors who take the opposite approach; i.e. they *sell* when they predict the market's getting overpriced and *buy* when the markets are cheap. The result being that they make a profit. This is what active fund managers aim to do for you when you invest in a managed fund.

So trying to "time" the market could mean that you miss out on growth in your investment when the market goes back up again.

### 4. Investing regularly

If you maintain a regular investment regime over a sustained period of time, short-term drops in the markets won't have as much impact on your overall investments. So instead of worrying about when to buy and/or sell based on market conditions, keeping to a regular savings/investment strategy will help to smooth the journey.

One technique that can be used to achieve this is known as **Dollar cost averaging**. This is a strategy where someone invests a fixed amount into an investment regularly (say fortnightly or monthly etc.) regardless of whether markets are moving up or down. So, for example, if you're buying shares when prices are rising then you will purchase fewer shares than if you were buying shares when the price is lower.

#### Let's look at an example of how that works

Let's assume an investor decides to purchase \$1,000 worth of XYZ Company Ltd shares at the same time every month for four months. In this example, we'll also assume that the shares first decline in value, but then rally strongly.

Date	Price/Share	Shares	Cost
Jan. 1st	\$20	50	\$1,000
Feb. 1st	\$15	66.66	\$1,000
Mar. 1st	\$10	100	\$1,000
Apr. 1st	\$18	55.55	\$1,000
	Total	272.22	\$4,000
	Avg. Price Per Share		\$14.69

Here's what we learn from this:

- Using a dollar cost averaging strategy the investor would have purchased 272.22 shares for a total of \$4,000;
- The average price per share for this period would have been just \$14.69 (calculated as follows:  $\$4000 / 272.22 = \$14.69$ );

- With the stock ending at \$18 at the end of this period, the investor's total position would now be worth \$4,900 (calculated as follows: 272.22 shares \* \$18 = \$4,900). As a result, the investor would actually have made a profit of \$900, despite the fact that the share price declined in value over the full four-month time period (dropping from \$20 to \$18).

By comparison, if the investor had decided to invest \$4,000 in shares of XYZ Company Ltd all at once at the beginning of this period, then they would have purchased 200 shares at a price of \$20 per share. With the share price finishing at \$18 at the end of the four months, the investor would have lost \$400 on the value of the shares purchased.

### So why does this matter?

Millions of investors around the world use *dollar cost averaging* because it offers the following benefits:

- It's an attractive option for investors who want to contribute to their investment portfolios on a regular basis;
- It eliminates the issue of market timing. An investor's returns will be determined more by the overall trend of the market as opposed to a specific entry (or exit) price.
- In addition, it can help to reduce the cost of buying investments that are declining in value.

So if you're looking to smooth out the ride, then investing regularly can help to make that happen.

## 5. Get expert advice

To help you manage your investment portfolio through challenging times, engaging the services of a *Financial Adviser* (if you haven't already) is well worth considering as they can assist you with:

- a) Evaluating your investment goals to ensure your investments are appropriate for your stage of life, aiming for a smoother journey and reducing any day to day concerns you have to keep you on track towards achieving your goals;
- b) Ensuring that you understand and are comfortable with the level of risk you are taking with your investments and that this level of risk appropriate to your circumstances;
- c) Undertaking regular reviews and making any necessary changes to ensure you remain on track to meet your goals.

## 6. The bottom line

Rather than worrying about what the markets are doing and whether you should be doing something now or what the market might do in the future, it makes more sense to work on developing a sound investment plan. A well-structured plan will help you ride out the ups and downs and help to keep you on track to achieve the financial goals you're after.

Here are two "stories", found on the Internet, that take a different approach to explaining investment markets that might help to keep you on track.

1. "When you are driving alone, and you see a speed trap – you slow down. However, after you've passed it, you continue to drive slowly because you think there is another one out there. Similarly, people panic when their portfolio goes down and they think it will continue to do so. They feel excited when their portfolio goes up and they think it will continue to go up. What they forget is that their goal is long term. Markets go up and down every day! The current performance of the market does not alter their goal to retire comfortably 20 years down the line."

*Courtesy of Don Connelly*

2. "Think of yourself standing on the corner of a high building in a hurricane with a bag of feathers. Throw the feathers in the air. You don't know much about those feathers. You don't know how high they will go. You don't know how far they will go. Above all, you don't know how long they will stay up...  
... Yet you know one thing with absolute certainty: eventually on some unknown flight path, at an unknown time, at an unknown location, the feathers will hit the ground, absolutely guaranteed. There are situations where you absolutely know the outcome of a long-term interval, though you absolutely cannot know the short-term time periods in between. That is almost perfectly analogous to the stock market."

*Courtesy of Jeremy Grantham*

*Your Adviser has a disclosure statement that is available on request and is free of charge. The information in this article is of a general nature only and is no substitute for personalised advice. To the extent that any of the above content constitutes financial advice, it is class advice only. If you would like advice that takes into account your particular financial situation or goals, please contact your Financial Adviser. The information has been published in good faith and has been obtained from sources believed to be reliable and accurate at the time of publication).*

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