5 Ways to Keep Calm During Turbulent Markets

FACTS AND FIGURES TO HELP WEATHER THE STORM.

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Key Takeaways

- **Market declines are a part of investing** — history tells us that stock market declines are an inevitable part of investing.
- **Market/Economic Shock** — Shock events such as the coronavirus outbreak and related stock market volatility can cause investors and 401(k) plan participants to act on their emotions.
- **Emotional Investing can be Hazardous** — A key finding of behavioral economists is that people often act irrationally when making investment choices.
- **Keep Investors Informed** —The current market volatility gives investors, advisors and plan sponsors a golden opportunity to talk about what to do, or not do if there is a sustained downturn.
- **The Market Tends to Reward Long-Term Investors** — It's always important to maintain a long-term perspective, but especially when markets are declining.

During turbulent markets it is important to remain focused on your long-term plan and look at the market swings from a historical perspective. Market downturns are inevitable, but markets have bounced back from crises in the past.

You would not be human if you didn't fear loss. Nobel Prize-winning psychologist Daniel Kahneman demonstrated this with his loss aversion theory, showing that people feel the pain of losing money more than they enjoy gains. The natural instinct is to flee the market when it starts to plummet, just as greed prompts people to jump back in when stocks are skyrocketing. Both can have negative impacts.

But smart investing can overcome the power of emotion by focusing on relevant research, solid data and proven strategies. Here are 5 principles that can help fight the urge to make emotional decisions in times of market turmoil.

1. Market Declines are Part of Investing

Stocks have risen steadily for most of the last decade, but history tells us that stock market declines are an inevitable part of investing. The good news is that corrections (defined as a 10% or more decline), bear markets (an extended 20% or more decline) and other challenging patches haven't lasted forever.

Market downturns happen frequently but don't last forever
Standard & Poor's 500 Composite Index (1950-2019)

Size of decline	-5% or more	-10% or more	-15% or more	-20% or more
Average frequency*	About three times per year	About once per year	About once every four years	About once every six years
Average length†	43 days	112 days	262 days	401 days
Last occurrence	August 2019	December 2018	December 2018	December 2018

* Assumes 50% recovery of lost value.
† Measures market high to market low.

Sources: Capital Group, Standard & Poor's.

The Standard & Poor's 500 Composite Index has typically dipped at least 10% about once a year, and 20% or more about every six years, according to data from 1950 to 2019. While past results are not predictive of future results, each downturn has been followed by a recovery and a new market high.

2. Emotional Investing can be Hazardous

Kahneman won his Nobel Prize in 2002 for his work in behavioral economics, a field that investigates how individuals make financial decisions. A key finding of behavioral economists is that people often act irrationally when making such choices.

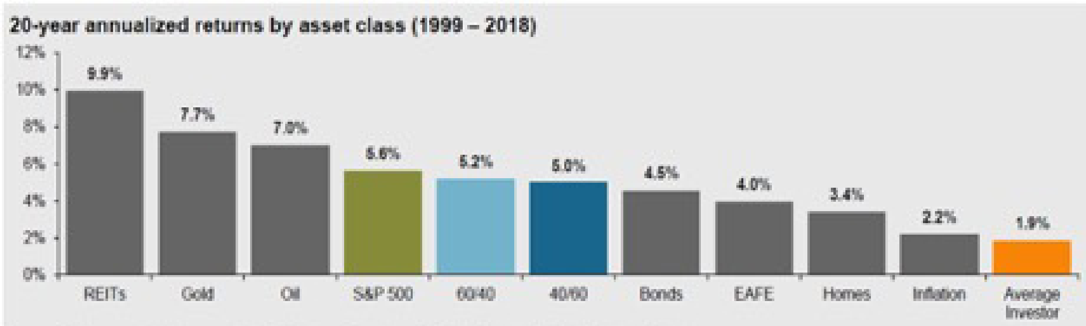
Emotional reactions to market events are perfectly normal. Investors should expect to feel nervous when markets decline, but it's the actions taken during such periods that can mean the difference between investment success and shortfall.

3. Acknowledge the power of emotions

At the end of the day, we are all emotional beings. A key finding of behavioral economists is that people often act irrationally when making investment choices. The key is to put current activity into the context of the bigger picture and to acknowledge that biases can affect investor thinking. These factors may lead investors to believe that markets are doing worse or better than impartial analysis would reveal:

- **Confirmation bias:** Giving more weight to trends you already believe in
- **Availability bias:** Giving more weight to recent events
- **Framing effect:** Letting the presentation of information affect your interpretation of it

It is important to remember that there are always going to be things we don't know, things we can't predict. The JP Morgan chart (on the next page) illustrates how the average investors makes emotional investing decisions over a 20-year rolling average.



Source: J.P. Morgan Asset Management; (Top) Barclays, Bloomberg, FactSet, Standard & Poor's; (Bottom) Dalbar Inc.
Indices used are as follows: REITS: NAREIT Equity REIT Index, EAFE: MSCI EAFE, Oil: WTI Index, Bonds: Bloomberg Barclays U.S. Aggregate Index, Homes: median sale price of existing single-family homes, Gold: USD/troy oz., Inflation: CPI. 60/40: A balanced portfolio with 60% invested in S&P 500 Index and 40% invested in high-quality U.S. fixed income, represented by the Bloomberg Barclays U.S. Aggregate Index. The portfolio is rebalanced annually. Average asset allocation investor return is based on an analysis by Dalbar Inc., which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. Returns are annualized (and total return where applicable) and represent the 20-year period ending 12/31/18 to match Dalbar's most recent analysis.
Guide to the Markets – U.S. Data are as of December 31, 2019.

J.P.Morgan
Asset Management

4. Make a plan, stick to it and Diversify

Creating and adhering to a thoughtfully constructed, diverse investment plan is another way to avoid making short-sighted investment decisions — particularly when markets move lower. The plan should consider several factors, including risk tolerance and short- and long-term goals.

A diversified portfolio doesn't guarantee profits or provide assurances that investments won't decrease in value, but it does help lower risk. By spreading investments across a variety of asset classes, investors can buffer the effects of volatility on their portfolios. Overall returns won't reach the highest highs of any single investment — but they won't hit the lowest lows either.

For investors who want to avoid some of the stress of downturns, diversification may help lower volatility.

5. The Market Tends to Reward Long-Term Investors

Is it reasonable to expect 30% returns every year? Of course not. If stocks have moved lower in recent weeks, you shouldn't expect that to be the start of a long-term trend, either. Behavioral economics tells us recent events carry an outsized influence on our perceptions and decisions.

It's always important to maintain a long-term perspective, but especially when markets are declining. Although stocks rise and fall in the short term, they've tended to reward investors over longer periods of time. Even including downturns, the S&P 500's average annual return over all 10-year periods from 1937 to 2021 was 10.57%.

S&P 500 rolling 10-year average annual total returns

Sources: Capital Group, Morningstar, Standard & Poor's. As of 12/31/19. Returns are in USD and are calculated on a monthly basis.

It's natural for emotions to bubble up during periods of volatility. Those investors who can tune out the news and focus on their long-term goals are better positioned to plot out a wise investment strategy.

SOURCES

"How to Handle Market Declines." Capital Group, https://www.capitalgroup.com/advisor/insights/articles/handle-market-declines.html

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The Russell 1000 is a subset of the Russell 3000 Index. It represents the top companies by market capitalization. The Russell 1000 measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.

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