ETF insight

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Dealing with market volatility

Short-term decisions can be detrimental to long-term performance

Although it's understood that stock markets fluctuate, volatility still makes investors uneasy. Unfortunately, nervousness about market turbulence can cause them to make short-term decisions with detrimental impacts on long-term portfolio performance. Investors hastily sell but are usually doing so at the worst possible time.

Such panic selling in the midst of market turmoil exacerbates matters by driving share prices down. Investors want to 'cut their losses' but only succeed in turning paper losses into real ones when good stocks return to their intrinsic values.

However, there is little to worry about when portfolios are composed of quality investments with the right mix and timeline. As volatility subsides and markets rebound, good investments bounce back and continue their growth. The effect of market volatility on share prices doesn't mean that well-managed and solid companies are suddenly different.

Wal-Mart or Procter & Gamble are good examples. Both stocks are down double digits on a year-to-date basis but each is a solid company with a great revenue base, a well-diversified range of products and significant potential. One of their largest holders, Warren Buffett, has always advised, "…identify good businesses, attempt to buy them at good prices, and hold them for the long term."

Instead some investors prefer to try timing the market, but that is a futile activity. William Sharpe, the noted professor of finance and winner of the Nobel Prize in Economics proved statistically that a timer has to be right 74% of the time to benefit from market timing.

Ultimately, missed timing means missed profits. Fidelity Investments found that when individual investors attempt to buy low and sell high they tend to do the opposite. A dollar invested in the Canadian stock market January 1, 1975 would be worth $58.66 today, an annualized return of 10.7%, despite many dips. Missing the 10 best months over that forty-year period drops the return to 5.4% and missing the 60 best months drops it to -1.2%.

Volatility should be embraced. Healthy corrections are necessary for the markets to move forward and, when they occur, investors need to be ready with a strategy. For those who have been invested over the recent market rise, volatility provides some options. They can take profits and re-balance portfolios; add to existing good quality positions on the dips; or do both.

For investors sitting on the sidelines waiting to rebuild portfolios, opportunities will be equally plentiful as quality companies trade at discounted prices. These investors should consider incorporating defensiveness by buying some dividend-paying stocks. Sustaining regular

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dividends and having them grow are also reliable indicators of a company's quality.

Fear is the investor's worst enemy. It takes discipline to remain calm in turbulent markets, but it's critical for investors who seek long-term success.

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