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Nothing to fear but fear itself

Investors who stay the course end up on top

It's not easy for investors to stay calm when they're bombarded by negative news reports.

Although it's a given that stock markets fluctuate, volatility still makes investors' hearts beat faster. It's understandable. If not placed into the context of either market history or investment horizon, a significant market drop can wreak havoc on a nervous system. Investors forget that when their portfolios are stocked with quality investments and they have the right mix and timeline, there is little to worry about. When the markets turn around, as they always do, good investments will rebound and continue to grow.

However it's not easy for investors to stay calm when they're constantly bombarded by increasingly negative media reports *that have more to do with the media than the markets.* When multitudes of media vie for eyes and ears with the same information, there is only one way for them to compete. Each must deliver it in an edgier manner than their competition.

The facts are the same but ever-keener reporting causes jitter. Investors may dismiss one report as rhetoric but the cumulative effect, *of all media putting an excitable edge on the same facts,* causes them to doubt the wisdom of their plans and become nervous. They forget that, with high quality businesses, *volatility does not mean risk*. However, portfolio risk *is* created when knee-jerk reaction replaces rational thought.

Nervous investors put their long-term portfolios at risk by making short-term decisions during market turbulence. They say "sell, sell, sell" when, in most cases, they are doing so at the worst possible time.

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Panic selling in the midst of the turmoil further exacerbates things by driving down share prices. Investors want to 'cut their losses' but only succeed in turning *paper losses into real losses* when good stocks return to their intrinsic values.

Manic-depressive behavior in the markets doesn't mean that well managed and solid companies are suddenly different. Consider Coca-Cola. Their stock is down about 15% from its 52 week high, yet it is a very 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."

Some investors ignore that advice, believing they can 'time the market', hoping to sell now and buy again when things are about to get better. Unless they've suddenly been blessed with psychic capabilities, it's not a wise course of action. 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.

The consequence of missed timing is missed profits. In any downturn in history, the investors who stayed the course came out on top once the dust settled. For example, in the 20 months from November 1980 to August 1982, the S&P 500 fell continuously until it had lost 27% of its value. A month later it was up 19%, in three months it had risen 36%, and after six months it was up 45%.

Just as nervousness causes investors to sell at the wrong time, it's nervousness that causes them to miss buying opportunities. After experiencing significant declines, they want certainty before they can feel confident. They want to 'know' that things have truly turned around and that it is safe to get back into the markets. However, by the time the investor has regained confidence, it's too late.

When markets start turning, they can be quick. They can also be bumpy on the way up, making it difficult to recognize that they're actually rising. Unfortunately, one third of bull market gains come in the early stages of recovery so that, instead of buying stocks on sale at the bottom of the market, market timers usually pay regular prices and experience only mediocre gains.

Markets will continue to have rough patches but investors should rest assured, they will recover. Since 1956 the S&P/TSX Composite has experienced 12 Bear and 11 Bull markets, defined as losing or gaining more than 15% and lasting at least three months. The average bear market lasted 9 months, losing 25%, whereas the average Bull lasted 47 months and gained 127%. (Source: Mackenzie Financial)

Market volatility is not the investor's worst enemy. Fear is. It takes discipline to remain calm in bear markets, but it's critical for investors who seek long-term success.

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