Financial Alternatives Inc
integrated wealth management

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Stock Market Corrections

"Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves."
- Peter Lynch

Why does this happen? The simple answer is fear. It is usually fear and anticipation of corrections which cause investors to sell stock investments. The problem with corrections is that they are difficult to predict, and it's impossible to know quite how long they will last. Stock markets are just as likely to rise after investors sell stock as they are to fall. Because of this, investors can lose out on longer term profits by trying to avoid short-term corrections. Here are 10 tips to help you avoid making this mistake:

1. Understand stock market history and expect corrections.

Based on research from Capital Research and Management Company corrections occur more frequently than you may realize. For the period 1900 – 2010, 5% corrections occurred three times per year on average, 10% corrections occurred once per year on average, and 20% corrections occurred once every 3.5 years on average. Smart, experienced investors expect corrections and know ahead of time how they will react when they occur.

2. Understand what you own when you own a highly diversified portfolio of stocks.

When you own a highly diversified portfolio of stocks you have ownership in hundreds or even thousands of businesses, and you will share in the profits of these companies as long as you own them. Their market valuations will fluctuate widely at times in the short term, but as a group, the odds are excellent that their earnings will increase and eventually so will their underlying stock values. With our stock markets, nobody can make you sell these businesses against your will. It's important to remember that during market corrections you still own the same number of shares in your stock investments, and you would have the opportunity to buy additional shares at reduced prices.

3. Understand your real time horizon.

If you are 60 years old and married to somebody 60 years old, you have a joint life expectancy of roughly 30 years. Even though you may be approaching retirement or already retired, you have a very long time horizon and will likely need your assets to grow to keep pace with inflation over the coming decades. Stocks typically have a better chance of keeping pace with inflation than bonds over the long term.

4. Be sure you have ample emergency funds.

If you have sufficient money in an emergency fund and high quality fixed income bond investments, you do not need to be concerned with short-term stock market corrections because you may not need to sell your stock investments for a very long time – possibly many years.

5. Design a portfolio you can live with.

Make sure you have enough balance in your portfolio - including conservative investments. This way you will be less concerned when the growth oriented stock portions of your portfolio fluctuate.

6. Decide never to sell stock investments out of fear.

If you feel fearful about your stock investments, most likely everybody else does too - and generally this is the worst time to sell. Make a pledge never to sell a diversified stock portfolio in times of heightened fear during a market correction. If possible, make a pledge to do the opposite and add to the stock portion of your portfolio during such times.

7. Decide to be disciplined in your rebalancing.

Have the courage to rebalance your portfolio despite the prevailing attitudes of the day. This is very similar to item 6 above. During a market correction, rebalancing will lead to buying stock investments that have declined in price.

8. Pay attention to your withdrawal rate as a percentage of your portfolio on an annual

basis.

If you have a $1 million portfolio and are withdrawing $50,000 a year, your withdrawal rate is 5%. If your portfolio value drops by 20% to $800,000, your $50,000 withdrawal rate suddenly becomes 6.25% - and you may need to reduce your spending depending on your circumstances. For a newly retired 65 year-old, most studies show that a 4% withdrawal rate is relatively safe. Always know what your withdrawal rate is and work hard to keep your spending under control.

9. Pay attention to and calculate your savings rate as a percentage of your income on an annual basis.

If you are in the accumulation phase of your life, track your savings rate and be sure your savings rate is increasing or at least not dropping each year. In the accumulation phase of life you should be hoping for stock market corrections so you can buy shares at cheaper prices that you can hold for the rest of your life.

10. Disengage from the day to day financial news.

Watching the daily business news is almost always counterproductive to successful, rational investing. Try to limit your consumption of such programs.

Remember, stock market corrections are a normal and natural part of market behavior. They are never fun - but not really that big a deal if you understand stock market history, maintain the proper perspective and pay attention to the ten points above.

Quarterly Market Review Newsletter

Each quarter we send our clients two newsletters, this one and a second one focused more on the performance of various asset classes and stock markets around the world. For more detailed investment performance information, don't miss our second quarter 2015 Quarterly Market Review newsletter.

New Employee—Thao Truong

In an effort to continue providing excellent service to our clients, we have hired a new associate. We are pleased to welcome Thao Truong to Financial Alternatives as a Portfolio Administrator. In this role, she will work directly with you and other clients to maintain your accounts with various custodians such as Fidelity, Schwab, and Equity Institutional. She will also provide operational and investment support including quarterly investment reporting and trade order execution.

Thao is a graduate of the University of New Hampshire where she completed a bachelor's degree in Finance. She is originally from Vietnam and has made the US her home since 2006. She speaks three languages: English, Vietnamese, and French. See Thao's picture and bio on our website for more information about her.

Thao came highly recommended by a well-respected wealth management firm based in San Francisco - where she worked for almost 3 years. She has significant experience handling account service issues, portfolio accounting, and trading and we look forward to you meeting her.

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