

How to Learn to Worry Less and Love a Market Correction

IN THE AFTERMATH OF THE FINANCIAL CRISIS, EQUITIES HAVE BEEN THE GO-TO INVESTMENT OPTION FOR MORE THAN A DECADE NOW.

We've been riding a high for so long, it can be easy to forget that market corrections are a natural part of investing.

When the next market correction takes place, don't be alarmed. It could actually be good news for long-term investors—if everyone stays calm and has a plan.

A correction isn't a crash

A market correction is just what the name implies—a 10% drop in stock prices that occurs when a market rally has gotten a little ahead of itself. The drop may seem a bit frightening at first. With 2008 still fresh in investors' minds even after years of recovery, it's understandable why most of us would feel a tinge of apprehension. But don't panic.

A correction doesn't necessarily indicate that the market will nosedive into global financial crisis territory of 50% market losses. If losses begin to creep above 20%, we're no longer in a correction—we're entering a bear market.

Develop and stick to a sensible plan

Timing the market is extremely difficult; some would even say it's impossible. But that doesn't stop many investors from shifting their investments into cash in an effort to avoid market downturns. Consequently, they may miss out on some of the market's biggest gains while they sit on the sidelines.

Rather than trying to time the market, investors should focus on time in the market, allowing their investment returns to compound year after year. Don't sell just because others are selling. If you sell your stocks after they drop in value, you may end up in worse shape than if you stayed invested.

When you look at quarterly returns for the stock market, it appears to be quite volatile. But viewed over a longer time period, the market appears relatively tranquil—an insight that may be forgotten amid short-term market swings. Buying and holding stocks for the long term may not be exciting, but it has historically been an effective strategy.

Be greedy when others are fearful

"The more [the market] goes down, the more I like to buy," investor Warren Buffett said as he bought stocks during a sell-off in 2014.¹ Likewise, you can take advantage of volatility by buying quality stocks at a discount if this strategy makes sense based on your investment time horizon and risk profile. Buying stocks when they're attractively priced could help enhance the long-term growth potential of your portfolio.



Key Points

- A market correction is just what the name implies—a 10% drop in stock prices that occurs when a market rally has gotten a little ahead of itself.
- Buying and holding stocks for the long term may not be exciting, but it has historically been an effective strategy.
- A diversified portfolio consisting of a broad assortment of investments can be a wise strategy to help weather market corrections.

¹ "Warren Buffett: I Bought Stocks in Wednesday's Big Selloff," CNBC, 10/14

Client Conversations

FIGURE 1 shows the effects of three different historical approaches to volatility. Each assumes \$10,000 invested on 12/31/77 into the S&P 500 Index² and no taxes or transaction costs. The opportunistic investor added \$2,000 in stocks each time the market dropped 8% or more in a month, the buy-and-hold investor made no portfolio changes, and the apprehensive investor shifted assets into cash in the face of volatility. Ultimately, the opportunistic investor had a return that was significantly higher at the end of 2018.

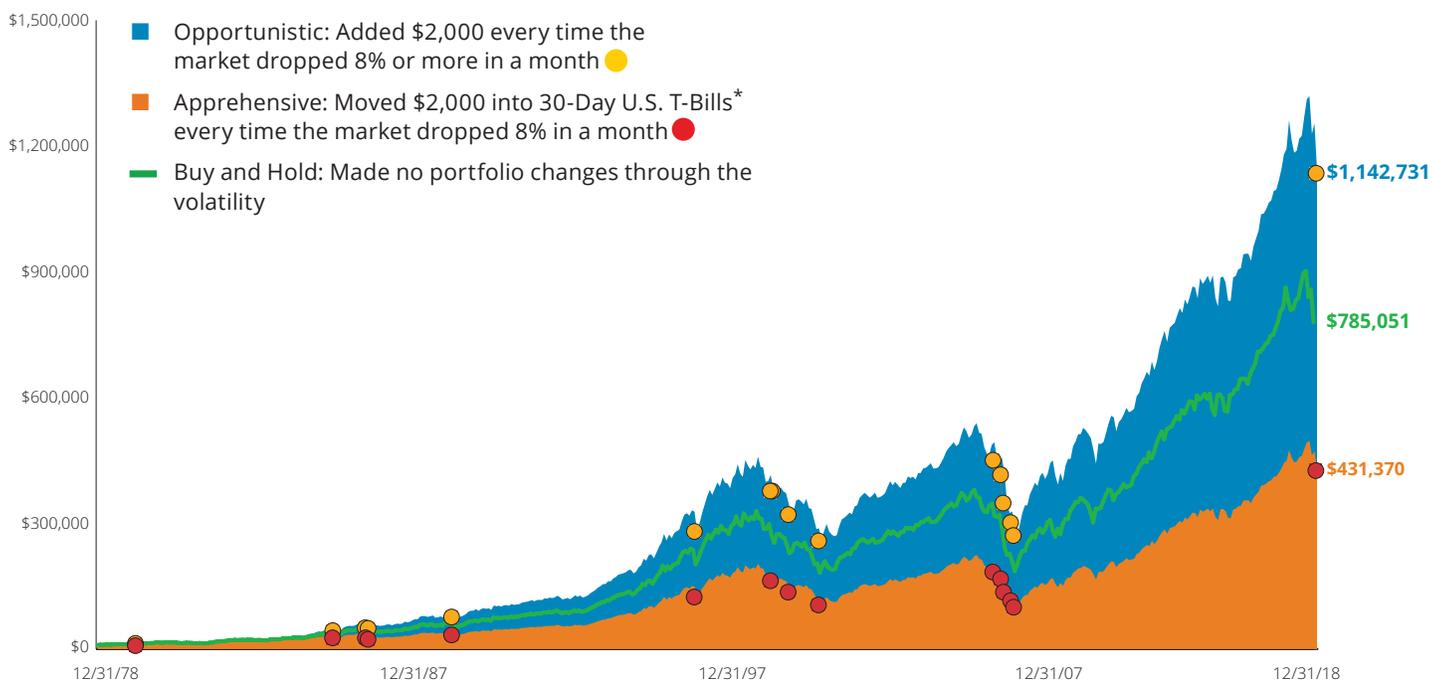
Failing to plan is planning to fail

The market's cyclical nature is a fundamental truth investors should keep in mind, and a diversified portfolio consisting of a broad assortment of investments can help lessen the impact of market corrections.

FIGURE 1

An Opportunistic Investment Approach Has Historically Been Profitable

Hypothetical Growth of \$10,000 Invested in S&P 500 Index (12/31/77-12/31/18)



Data Source: Thomson Reuters, 1/19; index past performance is not a guarantee of future results. Assumes reinvestment of capital gains and dividends and no taxes.

*T-Bills are guaranteed as to the timely payment of principal and interest by the US government and generally have lower risk-and-return than bonds and equity. Equity investments are subject to market volatility and have greater risk than T-Bills and other cash investments

²S&P 500 Index is a market capitalization-weighted price index composed of 500 widely held common stocks. The S&P 500 Index is unmanaged and unavailable for direct investment

Talk to your financial advisor today about how you can potentially make volatility work in your favor

Important Risks: Investing involves risk, including the possible loss of principal. Diversification does not ensure a profit or protect against a loss in a declining market.

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All information and representations herein are as of 12/18, unless otherwise noted.

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