How To Handle Market Volatility

If you're relatively new to the investing world, you may have *heard* of market volatility, but you may not have experienced it firsthand. After all, the markets have been incredibly calm — and incredibly good (2022 notwithstanding) — for many years.

Take the Standard & Poors 500, for example. The S&P 500 (also just called “the S&P”) is an index that tracks the top 500 publicly traded companies in the U.S. It rose steadily from 1983 to early 2000, climbing from 162 to over 1,500. Then, when the 2008 Great Recession hit, it spiked down to 770, but climbed back to over 4,766 by December of 2021 — even with a brief pandemic-induced drop that we saw in 2020 and a big down year in 2022. Today it stands at 4,300.

Bottom line: While the markets have had their fair share of volatility and downturns, the S&P 500 is nearly 27 times higher today than it was just 40 years ago. What’s the takeaway here for new investors? We shouldn’t lose sleep over market swings. While past performance is never a 100% guarantee of future performance, historically we’ve seen that a stock market rebound is always coming. This means that when we see dips and valleys — when we experience volatility — the best course of action is to hold on tight and wait it out.

But of course we know that’s much easier said than done — it’s never fun to see losses, even if they are just “on paper.” Here’s a look at what smart investors should do if the markets tumble.

Remember You’re Playing The Long Game

“It’s not about *timing* the market, it’s about time *in* the market,” explains financial expert Jean Chatzky, founder and co-host of the InvestingFixx investing club for women.

In other words, investing is a marathon, not a sprint. Over time, market growth has prevailed. Investors who chose to sell their stocks during the Great Recession in 2008 locked in market losses of nearly $80,000 compared to those who chose to ride out the storm and leave their accounts unchanged, according to a study from Fidelity Investments.

“Market volatility will never go away,” says Tyler E. Smith, certified financial planner and founder at BBK Wealth. “It's very important for investors to stay objective in the face of volatility to avoid making the biggest mistakes — selling low and buying high.” Yes,

there will always be another unexpected financial crisis or natural disaster on the way that may be a pothole in your road to building wealth, but you'll reach the finish line in much better shape when you stay invested.

"Markets fall sharply, but can also rebound quickly," says Greg McBride, CFA, chief financial analyst at Bankrate.com. "No one knows when that comes, and you don't want to be sitting on the sidelines when that happens."

Reflect On Your Risk Tolerance And Time Horizon

During times of market volatility, Jason Preti, Certified Financial Planner at Unleashed Financial LLC, says that both your risk tolerance and time horizon can serve as a helpful guide for any market moves you may want to make. What are they, precisely?

Your risk tolerance is the measure of how comfortable you are with the idea of losing money if the markets take a dip. No one wants to be kept awake at night with worry over investment losses, but we also want to make sure we're taking enough risk so that our portfolio sees the growth we need for retirement. Put some thought into your risk tolerance when times are good (*before* the markets take a dip) by asking yourself how you would a) feel and b) cope if the markets turned down. If you couldn't handle it, the time to adjust your investment mix is now. (More on that in a sec.) Then if the market stumbles, remind yourself that you always knew there would be a downturn coming — being prepared makes all the difference!

Meanwhile, "time horizon" refers to the number of years away from retirement you are. For example, if you're 40 years old and plan to retire at age 70, your time horizon is 30 years. If the market takes a turn for the worse, but you still have a decade or more left until you hit retirement, you can rest easy knowing that you have time to make up any losses.

One thing not to do? Try to predict those ups and downs. It simply doesn't work. "Stay invested based on your timeline and risk tolerance, and ignore any thought of timing the market ups and downs," Preti says.

Rebalance Your Portfolio

Following a downturn, the markets can take years to rebound. So, if you find you're losing sleep over the idea of future losses, then it may be time to consider rebalancing

your portfolio. Rebalancing simply means shifting the holdings in your portfolio to invest in (or sell) different asset classes, like stocks and bonds.

For example, if your portfolio is invested with the conventionally recommended split of 60% stocks, 40% bonds, then a market shake-up — when the markets move either up or down — can be a good time to rebalance. Why? Stocks and bonds usually (but not always) move in opposite directions, which means it's possible for your portfolio to become too heavily weighted in either stocks or bonds to match your time horizon and risk tolerance. You may want to tweak some of your investments to make sure your holdings are still matched up with your time horizon and risk tolerance.

There is one caveat here, however: If you're invested in a "target-date" fund — a fund that automatically adjusts your portfolio's holdings the closer you get to retirement — then you don't have to worry about rebalancing. When it comes to 401(k) participants, 59% are in a target date fund. If you're one of them, you can sit back, relax, and let your fund do the rebalancing for you.

As you get closer to retirement, you should look to not only have a mix of stocks and bonds, but also a cash reserve, Smith says. "If markets are volatile and your investments are down, you can rely on this cash reserve as opposed to the consideration of liquidating your portfolio."