

# How to handle market declines

This article was originally published on June 29, 2016. It has been updated with 2017 figures and additional information.

## 7 ways to fight fear with facts

You wouldn't be human if you didn't fear loss.

Nobel Prize-winning psychologist Daniel Kahneman demonstrated this with his loss-aversion theory, showing that people feel the pain of losing money more than they enjoy gains. As such, investors' natural instinct is to flee the market [when it starts to plummet](#), just as greed prompts us to jump back in when stocks are skyrocketing. Both can have negative impacts.

But smart investing can overcome the power of emotion by focusing on relevant research, solid data and proven strategies. Here are seven principles that can help fight the urge to make emotional decisions in times of market turmoil.

### 1. Market declines are part of investing.

Stocks have risen steadily for nearly a decade. But history tells us that stock market declines are an inevitable part of investing. The good news is that corrections (defined as a 10% or more decline), bear markets (an extended 20% or more decline) and other challenging patches haven't lasted forever.

#### Market Downturns Happen Frequently and They Don't Last Forever

##### Dow Jones Industrial Average 1900-2017

	-5% or more	-10% or more	-15% or more	-20% or more
Average Frequency <sup>1</sup>	About 3 times a year	About once a year	About once every 2 years	About once every 3.75 years
Average Length <sup>2</sup>	46 days	115 days	216 days	338 days

<sup>1</sup> Assumes 50% recovery of lost value

<sup>2</sup> Measures market high to market low

The Dow Jones Industrial Average is an unmanaged, price-weighted average of 30 actively traded industrial and service-oriented blue

The Dow Jones Industrial Average has typically dipped at least 10% about once a year, and 20% or more about every 3.75 years, according to data from 1900 to 2017. While past results are not predictive of future results, each downturn has been followed by a recovery and a new market high.

## 2. Time in the market matters, not market timing.

No one can accurately predict short-term market moves, and investors who sit on the sidelines risk losing out on periods of meaningful price appreciation that follow market downturns.

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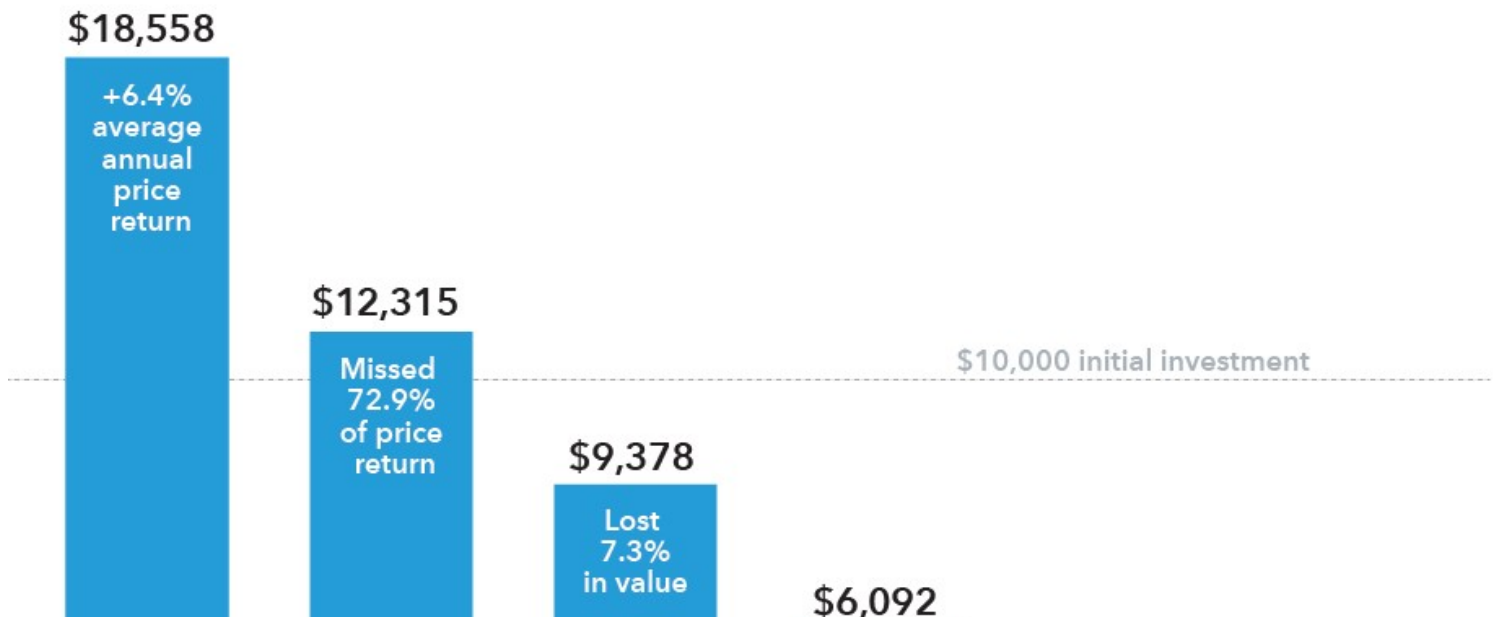
Every Standard & Poor's 500 Index decline of 15% or more, from 1929 through 2017, has been followed by a recovery. The average return in the first year after each of these market declines was nearly 55%.

Even missing out on just a few trading days can take a toll. A hypothetical investment of \$10,000 in the S&P 500 made in 2002 - the start of the recovery following the bursting of the technology bubble - would have grown to more than \$18,000 by the end of 2012. But if an investor missed the 10 best trading days during that period, he or she would have ended up with just \$9,378 - less than the initial investment.

#### The Dangers of Market Timing

Missing just a few best days in the market can hurt your investment returns

Value of a hypothetical \$10,000 initial investment in the S&P 500, excluding dividends, from 10/9/02 to 10/9/12, the 10-year period following the 3/24/00-10/9/02 market decline of 49.1%





Results exclude dividends. The market index is unmanaged and, therefore, has no expenses. Investors cannot invest directly in an index.

### 3. Emotional investing can be hazardous.

Daniel Kahneman won his Nobel Prize in 2002 for his work in behavioral economics, a field that investigates how individuals make financial decisions. A key finding of behavioral economists is that people often act irrationally when making such choices.

Emotional reactions to market events are perfectly normal. Investors should expect to feel nervous when markets decline. But it's the actions taken during such periods that can mean the difference between investment success and shortfall.



One way to encourage rational investment decision-making is to understand the fundamentals of [behavioral economics](#). Understanding behaviors like anchoring, confirmation bias and availability bias may help investors identify potential mistakes before they make them.

## 4. Make a plan and stick to it.

Creating and adhering to a thoughtfully constructed investment plan is another way to avoid making short-sighted investment decisions – particularly when markets move lower. The plan should take into account a number of factors, including risk tolerance and short- and long-term goals.

One way to avoid futile attempts to time the market is with dollar cost averaging, where a fixed amount of money is invested at regular intervals, regardless of market ups and downs. This approach creates a strategy in which more shares are purchased at lower prices and fewer shares are purchased at higher prices. Over time investors pay less, on average, per share. Regular investing does not ensure a profit or protect against loss. Investors should consider their willingness to keep investing when share prices are declining.

### When Stock Prices Fall, You Can Get More Shares for the Same Amount of Money and Lower Your Average Cost Per Share



Over the 12-month period, the total amount invested was \$6,000, and the total number of shares purchased was 439.94. The average price at which the shares traded was \$15, and the average cost of the shares was \$13.64 ( $\$6,000/439.94$ ). The figures shown are for illustrative purposes only and in no way represent the actual results of a specific investment.

[Retirement plans](#), to which investors make automatic contributions with every paycheck are a prime example of dollar cost averaging.

## 5. Diversification matters.

A diversified portfolio doesn't guarantee profits or provide assurances that investments won't decline in value, but it does lower risk. By spreading investments across a variety of asset classes, investors lower the probability of volatility in their portfolios. Overall returns won't reach the highest highs of any single investment - but they won't hit the

lowest lows either.

For investors who want to avoid some of the stress of down markets, diversification can help lower volatility.

## No Asset Class Has Consistently Offered the Best Returns Year In and Year Out

### Calendar-year total returns of select asset classes (%)

#### Best performing assets

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
U.S. bonds	5.24	78.51	26.28	7.84	18.22	32.39	13.69	1.38	11.96	37.28
Emerging markets stocks										
Global small-company stocks										
U.S. large-company stocks										
Int'l bonds	4.79	50.67	18.88	5.64	18.05	28.66	5.97	0.55	11.59	27.19
Global small-company stocks										
U.S. bonds										
Int'l stocks										
Cash	1.60	41.45	15.06	2.11	16.83	15.29	1.78	0.02	11.19	23.81
Int'l stocks										
U.S. large-company stocks										
U.S. large-company stocks	-37.00	26.46	11.15	0.04	16.00	0.02	0.59	-1.04	4.50	21.83
Global small-company stocks										
Int'l bonds										
U.S. large-company stocks										
Global small-company stocks	-43.68	6.93	6.54	-11.30	4.32	-2.02	0.02	-3.15	2.65	7.39
Int'l bonds										
U.S. bonds										
Int'l stocks										
U.S. large-company stocks										
Int'l stocks	-45.53	5.93	5.54	-13.71	4.21	-2.60	-2.19	-5.66	2.09	3.54
Emerging markets stocks										
U.S. bonds										
Emerging markets stocks	-53.33	0.10	0.12	-18.42	0.06	-2.60	-3.87	-14.92	0.20	0.80
Cash										
Emerging markets stocks										
Cash										
Emerging markets stocks										
Cash										

#### Worst performing assets

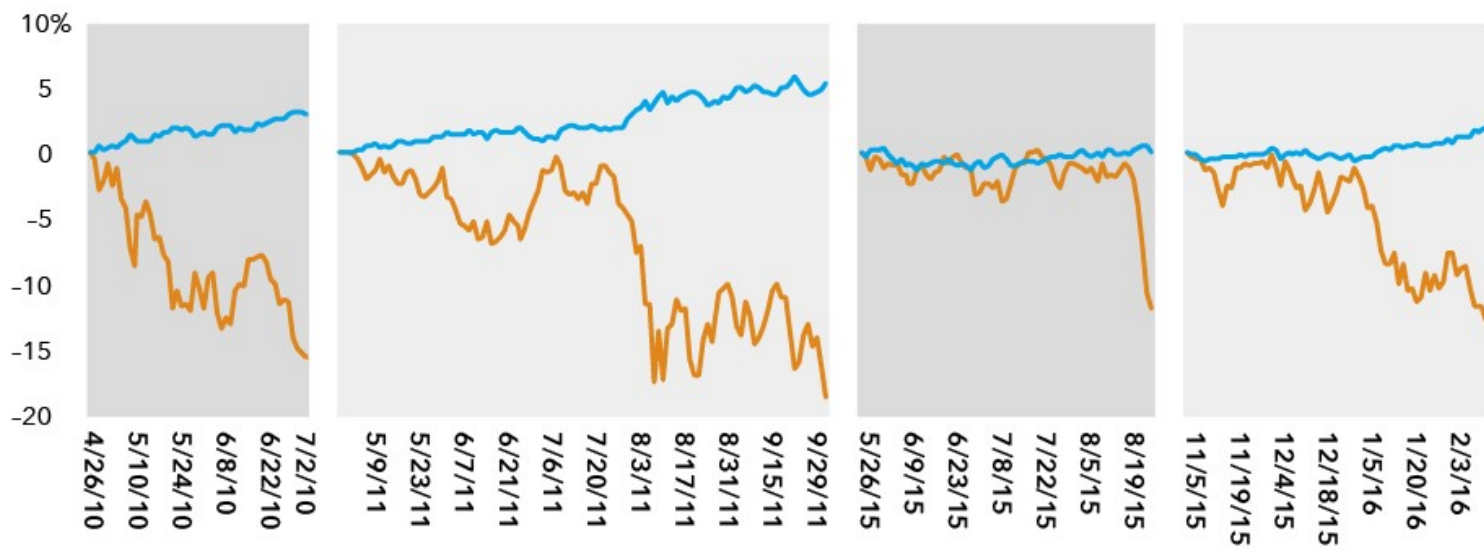
Sources: U.S. large-company stocks – Standard & Poor’s 500 Composite Index; Global small-company stocks – MSCI All Country World Small Cap Index (net dividends); International stocks – MSCI All Country World ex USA Index (net dividends); Emerging market stocks – MSCI Emerging Markets Index (net dividends); U.S. bonds – Bloomberg Barclays U.S. Aggregate Index; International bonds – Bloomberg Barclays Global Aggregate Index; Cash – 30-day U.S. Treasury bills, as calculated by Ibbotson Associates. Unlike fund shares, U.S. Treasury bills are guaranteed. Indexes are unmanaged and, therefore, have no expenses. Investors cannot invest directly in an index.

## 6. Fixed income can help bring balance.

Stocks are important building blocks of a diversified portfolio, but bonds can provide an essential counterbalance.

That's because bonds typically have low correlation to the stock market, meaning that they have tended to zig when the stock market zags.

### Cumulative Returns During Recent Market Corrections



	Cumulative Total Return			
	Correction 4/23/10-7/2/10	Correction 4/29/11-10/3/11	Correction 5/21/15-8/25/15	Correction 11/3/15-2/11/16
<b>S&amp;P 500 Composite Index</b>	-15.63%	-18.64%	-11.89%	-12.71%
<b>Bloomberg Barclays U.S. Aggregate Index</b>	3.00%	5.35%	0.04%	1.92%

Sources: Bloomberg Index Services Ltd., RIMES, Standard & Poor's. Dates shown for market corrections are based on price declines of 10% or more (without dividends reinvested) in the unmanaged S&P 500 with 50% recovery between corrections.

What's more, bonds with a low equity correlation can offer protection from losses even when the broader market is in turmoil. Funds providing this diversification can help create durable portfolios, and investors should seek bond funds with strong track records of positive returns through a variety of markets.

Though bonds may not be able to match stocks' growth potential, they have often shown resilience in past equity market declines. For example, in four recent equity market corrections, U.S. core bonds were flat or notched gains as the S&P 500 declined.

## 7. The market tends to reward long-term investors.

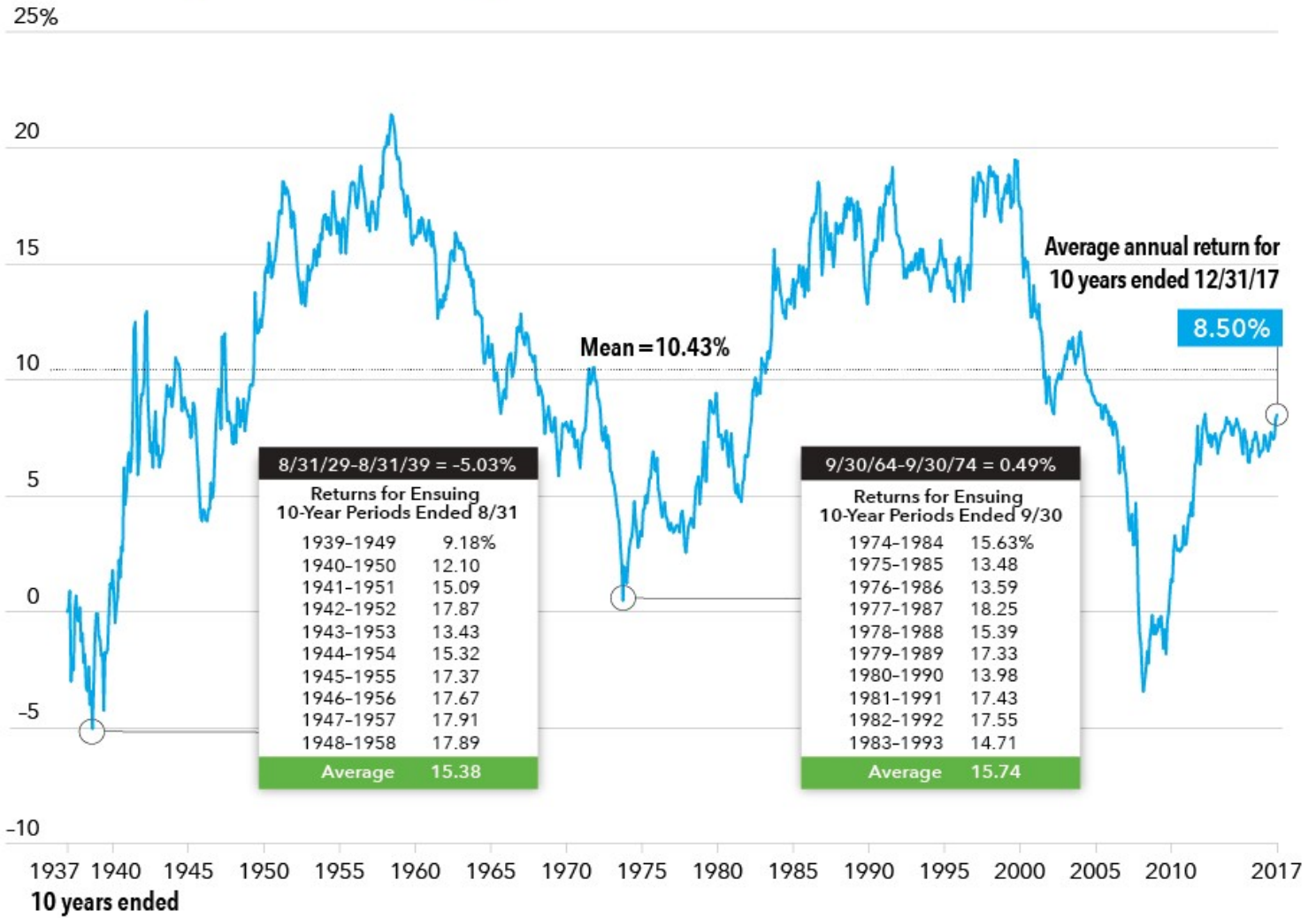
Is it reasonable to expect 30% returns every year? Of course not. And if stocks have moved lower in recent weeks, you shouldn't expect that to be the start of a long-term trend, either. Behavioral economics tells us recent events carry an outsized influence on our perceptions and decisions.

When stocks are falling, it's important to maintain a long-term perspective. Although stocks rise and fall in the short term, they've tended to reward investors over longer periods of time. Even including downturns, the S&P 500's mean return over all 10-year periods from 1937 to 2014 was 10.43%.

### S&P 500 Rolling 10-Year Average Annual Total Returns

Year-to-Year Return to Year Average Annual Total Returns

December 31, 1937 - December 31, 2017



Source: Capital Group

Results are calculated on a monthly basis. The index is unmanaged and, therefore, has no expenses. Investors cannot invest directly in an index. Past results are not predictive of results in future periods. The Standard & Poor's 500 Composite Index is a market capitalization-weighted index based on the results of 500 widely held common stocks. The S&P 500 Composite Index ("Index") is a product of S&P Dow Jones Indices LLC and/or its affiliates and has been licensed for use by Capital Group. Copyright © 2018 S&P Dow Jones Indices LLC, a division of S&P Global, and/or its affiliates. All rights reserved. Redistribution or reproduction in whole or in part are prohibited without written permission of S&P Dow Jones Indices LLC.

It's natural for emotions to bubble up during periods of market volatility. Those investors who can tune out the news are better positioned to plot out a wise investment strategy.

Past results are not predictive of results in future periods.

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