



## Tips for Surviving a Market Decline

By Ryan Zacharczyk, CFP, CSA, CRPC

**M**arket corrections are an inevitable part of investing. Most investors will likely see 30 declines of 5% or more and three declines of 20% or more over a ten-year time period. Although it's the last thing you want to experience, it's your response to those unpredictable declines that will play a crucial role in the success of your long-term investment strategy.

Jonathan Pond, author of several books on personal financial planning, sums it up perfectly: "It's the investors who get frightened into making big changes in the way they invest who have ended up with mediocre investment results."

Market declines are so stressful on investors because of the inability to determine whether the decline is just a slight dip or a protracted bear market. History has shown that market declines vary greatly by intensity, length, and frequency. The study below shows how frequently declines in the Dow Jones Industrial Average have occurred since 1900. As you can see, they are a regular part of the investing landscape.

Charles Schwab put it simply: "The markets tend to fluctuate." It is a straightforward rule to remember when making your investment plan. When these inevitable declines occur, keep in mind these important tips:

**1** Don't try to predict when a market decline will happen. This is a fool's errand. Even the professionals have been remarkably unsuccessful at anticipating declines. It is easy to look back with the benefit of hindsight to determine that the market was overvalued at this stage or that, but much more difficult to accomplish this task looking forward. Most analysts firmly believed that the market was overvalued from 1994 until the inevitable bear market of 2000. But if they'd sold stocks and purchased bonds in 1994, they would have missed out on returns of over 350% to protect against a 40% pullback.

You will always hear the occasional story on CNBC about the hedge fund manager who sold at the top, but have you ever heard of a money manager that predicted the last four or five sell-offs? Of course not, because predicting a sell-off is like predicting the flip of a coin. Even with all the experience, education, and knowledge that most of the top money managers have, they are still unable to predict market downturns with any regularity.

**2** If you ignore rule number one, define exactly when to get back in. You must be right twice. Even if you are able to call the coin flip correctly, you have to make a second great call getting back into the market. Assuming that you have not given up on stocks completely and are just waiting for values to become more reasonable, at what point do you decide to take the leap back into stocks? Any time spent sitting out during a decline will save you money, but what if we experience a shallow decline when you expect a large one?

### A History of Declines (1900 – November 2007)

Type of decline	Average frequency	Average length	Last occurrence
Routine (-5% or more)	About 3 times a year	47 days	November 2007
Moderate (-10% or more)	About once a year	114 days	October 2002
Severe (-15% or more)	About once every 2 years	216 days	October 2002
Bear Market (-20% or more)	About once every 3 1/2 years	332 days	October 2002

Source: Capital Research and Management Company

\* As measured by the unmanaged Dow Jones Industrial AverageSM.

Assumes 50% recovery rate of lost value.

† Measures market high to market low. (Does not include recovery period of 50% increases.)

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I once had a client who told me to sell all his stocks and move to bonds in early 2006. He was afraid of the market and wanted some safety. This client was only 34 years old and I did my best to talk him out of this move, but he insisted. I moved the money, and he turned out to be absolutely right. About one month later the market began to decline. The Dow Jones declined from 11,700 to around 10,700, a decrease of around 9%. He was absolutely thrilled and not too happy with me for trying to talk him out of it. In fact, he didn't even give it a thought when I asked him when he wanted to put his money back into stocks. Shortly thereafter, the market rebounded. Stocks turned higher in the second half of 2006 and continued up through most of 2007. My client did get back into the market when the Dow Jones was at 12,200. He'd decided he'd had enough of the market moving higher without him.

Most of us can probably relate to such experiences. The market can be quite humbling and the less emotional involvement, the more successful an investor you will be.

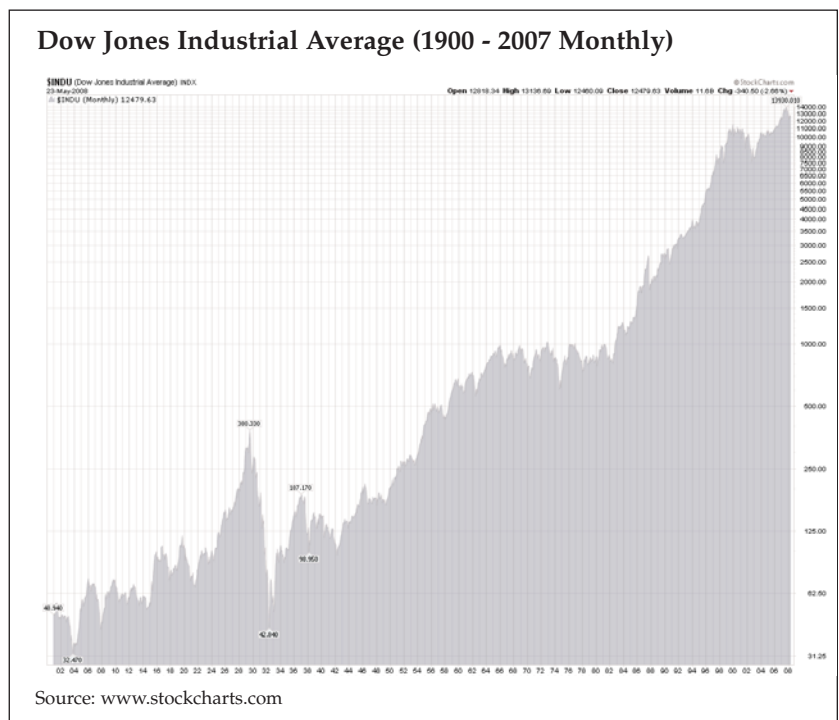
**3** Re-evaluate your risk tolerance and how much time you have until you need the money. Now would be a good time to think back on why you went into stocks in the first place. If you have 25 years left until you need your stock market money, the only question you need to ask is whether the market will be higher 25 years from now. I almost never recommend investing in stocks unless you have at least a three- to five-year time horizon. If you need the money sooner than that, your investment may have been faulty to begin with. Does that mean you should sell in a down market? Only you can decide. If you cannot tolerate any more losses, now may be a good time to sell and move on.

**4** Maintain a diversified investment portfolio. Every investor in almost every case should be diversified. Diversification means owning different asset classes, stocks, bonds, cash, real estate, and commodities. It is also advisable to diversify your stock and bond portfolio overseas to minimize the impact that a U.S. recession might have

on your portfolio. Mutual funds and exchange-traded funds (ETFs) are the best vehicles to create a mix of these assets that you feel is most appropriate. When a market sell-off comes, some assets will do poorly and some will do well. You will probably be down overall, but certainly not as much as the market.

**5** Continue to invest regularly. One of the most important things to remember during a down market is not to cut back on your 401k and IRA contributions. Dollar cost average into the market regularly. The graph below is the Dow Jones since 1900. Take a look at all the peaks and valleys. Pick any 30-year period and imagine you invested only when the market was high and going higher, not when it was down. How do you think you would have performed? You would have significantly reduced your rate of return and the dollars in your pocket. It is crucial as a long-term investor to use these down markets to buy more shares, not less. This is when your money is made.

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**6** Consider the taxman. If you are planning on selling stocks in anticipation of further declines, consider the tax consequences if you are in a taxable account. In most cases you will be hit with 15% federal tax and then, probably, some state tax. In New Jersey, the tax is roughly 7%. If you have gains you are looking to protect, you will be giving 22% to the government and that's a lot to make up.

**7** Talk with your financial professional. Some people, annoyed that their financial professionals were unable to "call" this market downturn, may start to disregard their advisor's advice. But just the opposite should occur during down markets. A good financial advisor can provide you with the reassurance and confidence to follow through with your plan. If things have changed during the downturn in the markets, sit down with your advisor and readdress your goals, risk tolerances, circumstances, and any other changes that may have occurred. Market declines are a good time to reevaluate your strategy even though there may be no need to make any moves.

Market declines are a common occurrence in investing. They are not unique to stocks. Bonds, real estate, gold, even fine art have ups and downs. It is important to accept some fluctuation if we are to move forward with our investment objectives. If you have lots of time left until you need your money, make a game of it. Recondition yourself to love market declines and put more money into the markets during one. I have always said that the best thing for my investment portfolio would be to see a severe recession or even depression while I'm young. Talk about buying shares cheap!

If you don't have much time left until you will need your money, make sure you have plenty of bonds, cash and alternative investments to help you ride out market declines. Follow these tips and I am confident that you too will survive any market decline ... and perhaps even thrive.

*Ryan Zacharczyk is President of Zynergy Financial Planning, LLC, a financial planning firm specializing in working with mature adults 50 years old and above. Zynergy provides comprehensive financial planning services for individuals 50 and older, helping them achieve their objectives in estate planning, investment management, tax minimization, and insurance planning.*