Use this advice to weather the volatility storm

Mickey Kim
November 9, 2018

Extreme stock market volatility is the norm, not the exception. According to Crandall Pierce, since 1900, 5 percent corrections have occurred about three times a year and 10 percent corrections about once a year. You may not realize, but when you decided to invest in stocks, you also bought a ticket to ride an emotional roller coaster.

For the first time in history, the S&P 500 saw positive total returns for every month during 2017. Not only was the trend straight up in 2017, there were also no setbacks along the way. Stocks didn't suffer a 10 percent pullback and didn't experience a 5 percent or even a 3 percent pullback. In fact, the S&P 500 hadn't had a 3 percent pullback from a high in more than 409 calendar days going back to Nov. 4, 2016, the longest streak on record (going back to 1928).

This calm was shattered after the S&P 500 reached an all-time high on Jan. 26, 2018, when stocks declined 10 percent over the next 13 days. The plunge featured the headline-grabbing two steepest declines (in points) in the history of the Dow Jones Industrial Average (DJIA), 1,175.21 (4.6 percent) on Feb. 5 and 1,032.89 (4.1 percent) on Feb. 8.

Fast forward to Oct. 10, when the DJIA plunged 831.83 points (3.1 percent), the third steepest point decline in history. ***None of the 2018 declines ranked in the top 100, in percentage terms.***

I've written of the work of behavioral finance pioneer and Nobel-prize winning Richard Thaler of the University of Chicago. In classical economics, individuals are highly intelligent, perfectly rational and capable of unemotionally analyzing all relevant data. They possess tremendous self-control, enabling them to make optimal decisions, unburdened by biases or other "supposedly irrelevant factors," or SIFs. Picture Mr. Spock in "Star Trek."

In reality, these "Econs" are mythical characters existing only in theory. Not only are humans highly emotional and lacking in self-control, they are influenced by all sorts of biases and SIFs. They act on biases in irrational and predictable ways, often leading to poor decisions. In fact, we're more like Homer Simpson.

I recently attended a presentation by Jay Mooreland, founder of The Behavioral Finance Network, "Helping Clients Overcome Behavioral Biases to Improve Investment Choices." Mooreland believes using empathy and understanding is better than my way of spouting facts and figures and has given me permission to share his advice on helping investors deal with volatility.

"When volatility increases as it has recently, few investors are able to ignore it. Most investors get concerned and some become obsessed by it. Since we are emotional beings, such response is natural and expected. But that does not mean it is good for us; decision-making while emotional often leads to regret. **So, how do we live with the volatility of the market while remaining level-headed?**

"I only know of two antidotes to market volatility: ***stop looking*** and ***maintain the proper perspective.***

"We cannot control the volatility of the market, but we can control how much volatility we experience – it is a function of how often we look. The stock market, by nature, is volatile. **The more often we look, the more often we experience its volatility**.

"As of Oct 27th, the stock market is about flat for the year. If you had hibernated January 1st, you would have thought we didn't do anything. You missed the melt up in January, correction in February, concerns about a trade war this summer and the volatility in October.

"Not looking is not easy, that's why I call it a virtue. But it's a desirable trait. If you don't see the volatility, you don't feel it.

"Assuming we are unable or simply choose to look at the market's constant movements, we can lessen its effects on us by ***maintaining the proper perspective***.

"I am not immune to emotions or concerns about uncertainty. But I have learned, through experience that keeping the right perspective can have significant financial benefits. The following three perspectives help me:

1. ***The media's job is to get us to tune in, not to make good decisions***. Headlines and news stories are simply the means to the end.

2. ***Short term performance is not an indicator of the wisdom or success of a strategy,*** but simply the result of variability in asset prices.

3. ***Investors don't fall short of financial goals by following a disciplined investment strategy***, but by deviating from the strategy during difficult times."
