Stay invested in times of market uncertainty

Overview

- Facing unprecedented levels of panic and market volatility, some investors may react irrationally and may easily fall into the trap of “selling low and buying high”
- Timing the market may be easy in theory, but difficult in practice
- Under the current market environment, remain calm and stay invested may ride out volatility

In times of uncertainty, it is only natural to be concerned about making an investment, or even consider selling existing investments, when markets decline. However, many experts agree that investors will usually be better off resisting the temptation to make changes to their long-term plan in reaction to short-term market movements. This is because if you sell your shares as they fall in panic, you might miss the recovery and timing the market may not worth the risk. The keys here are:

Don’t bail out your long- term plan irrationally, stay calm and stay invested!

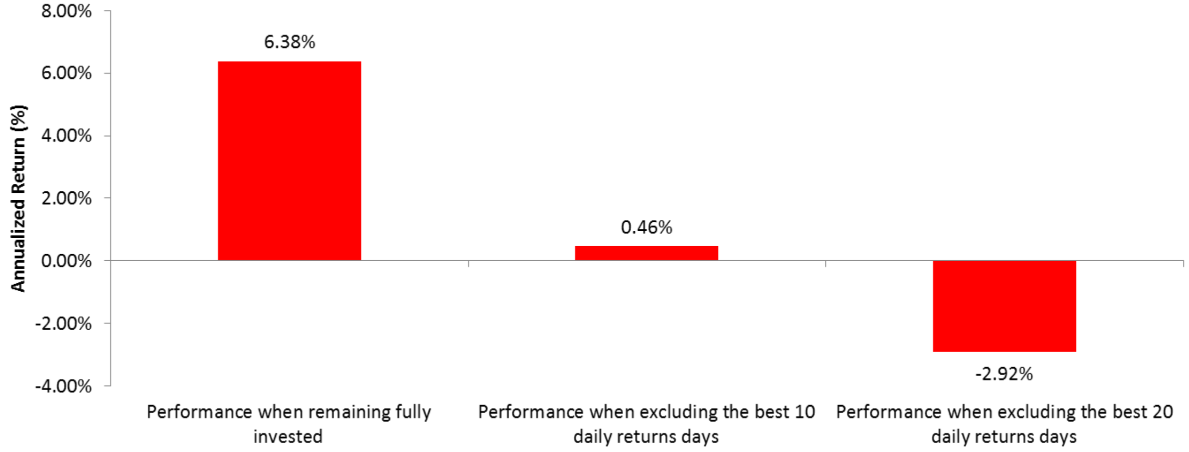
If history is anything to go by, one should realise that volatility is normal in stock markets and sometimes it can appear quite sharp. Empirically, financial panics do not last forever and historically stock markets have risen far more than they have fallen, and the long-term trend of the markets has been upward. Although the recent market correction looks severe, it might just become another short-term setback in the overall uptrend of the markets in the long run.

You might argue that cash is safe but it might not necessarily get you to your financial goals. However, despite their volatility, stocks could outperform cash over the long-term. Market data also suggests that the longer you stay invested, the smaller the chance you have of losing money in the stock markets.

Don’t time the market !

In times of market volatility, it may be tempting for investors to try timing the market to avoid losses and maximise gains. However, trying to buy before the market goes up and sell before it declines may be easy in theory, but difficult in practice. Especially, investors are easily affected by market noises and tend to act in herd mentality. Few investors can predict with any degree of accuracy when, and how much, the markets will rise and fall.

In reality, market data also indicates that trying to time the market can be a costly strategy. The chart below illustrates the impact on the performance of different stock markets by missing out the best 10 and 20 days in a period of nearly 10 years. The study reveals that the differences in annualised returns can be quite significant, and the impact can be even more dramatic for emerging markets or single countries. Simply speaking, it is just too easy to miss out the gains!



Source: Bloomberg, HSBC global Asset Management, 30 June 2005 to 30 June 2015.

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What should you do?

- Taking any radical actions at the first sight of higher volatility may prove to be irrational later on. Hence, you should take the chance to sit back and review personal investments in the context of your financial objectives and risk appetite, not short-term market performance. If personal circumstances and investment goals are unaltered, you should stay committed to the investment plan. For example, if you are putting money aside for 10, 20 years for your children's education or your retirement, then the stock market may well provide long-term capital growth potential. If you are saving for a short-term objective, tax payment for example, stock market risk should be avoided. Again, by remaining calm and staying invested, this may help to trim the short-term losses and sow the seeds for gains in the long term.
- On a contrary, if you are looking into investment opportunity in times of uncertainty, you may consider investing in tranches of small amount on a regular basis (e.g. monthly) or in phases to smooth out the effects of market ups and downs. Dollar-cost-averaging can reduce exposure to risks associated with making a single large purchase by spreading the investment over a number of periods. In addition, this can also spread the costs out over intervals, providing insulation against changes in asset prices.

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