UNDERSTANDING
MARKET
CORRECTIONS

LIKE THE WEATHER, THE STOCK MARKET EXPERIENCES HIGHS AND LOWS –

While some days in the market are sunny, others may be gloomy – and the forecast can change at any time. But even when storms seem to be unrelenting, we can usually count on brighter days ahead. That's why it's important to keep market corrections in perspective.

WHAT IS A MARKET CORRECTION?

A market correction is a decline of at least 10 percent of a stock, bond, commodity or market index from its highest recent point. Market corrections are generally temporary and typically end when the price of a stock or bond "bottoms out" and investors start buying again.

Investors sometimes confuse corrections with bear markets, which occur with drops of 20 percent or more. Although a market correction can be a precursor to a bear market or recession, that's not always the case. For example, a market correction has occurred 22 times since 1974, and only four of those corrections – in 1980, 1987, 2000 and 2007 – led to a bear market.[1]

Despite a general perception that market corrections are bad, in reality, they can be healthy for the stock market.[2] Corrections provide opportunities for the market to digest recent gains and for investors to develop a better understanding of how comfortable they are with market risk and/or potentially add stocks to their portfolios at discounted prices.

It is important to note that the stock market, while fairly volatile on a short-term basis, has a strong track record of long-term success. Since 1980, market corrections have averaged about 14.6 percent.[3] However, looking at the overall picture each year, the positive years outweigh the negative years, with negative returns occurring approximately one out of every four years.[4] As history has shown, those who choose to stay the course are rewarded for their patience more often than not.

[1] Sue Chang. MarketWatch. Oct. 28, 2018. "Here's a reminder that stock-market corrections don't always become bear markets." https://www.marketwatch.com/story/heres-a-reminder-that-stock-market-corrections-dont-always-become-bear-markets-2018-10-25. Accessed Feb. 11, 2019.
[2] Coryanne Hicks. U.S. News & World Report. Feb. 5, 2018. "What Is a Stock Market Correction?" https://money.usnews.com/investing/investing-101/articles/2018-02-05/what-is-a-stock-market-correction. Accessed Jan. 16, 2019.
[3] Howard Gold. MarketWatch. Oct. 17, 2018. "Opinion: If U.S. stocks suffer another correction, start worrying." https://www.marketwatch.com/story/if-us-stocks-suffer-another-correction-start-worrying-2018-10-16. Accessed Jan. 16, 2019.
[4] Dana Anspach. The Balance. Dec. 8, 2018. "20 Years of Stock Market Returns, by Calendar Year." https://www.thebalance.com/stock-market-returns-by-year-2388543. Accessed Jan. 16, 2019.

WHAT TRIGGERS A MARKET CORRECTION?

Several factors may play into a market correction, including:

PROFIT SELLING

Investors may choose to sell their stocks to realize their profits after a sustained rise in the stock market. Collectively, if the volume of stocks traded is high enough, it could trigger a correction.

TECHNICAL ANALYSIS

Stock market analysts aim to predict future price movements based on past stock trading patterns. When analyses indicate that a group of stocks or the market as a whole is in a pattern similar to a pattern that has prompted a correction in the past, investors may choose to sell their stocks. If enough investors do so, a market correction can occur.

CORPORATE EARNINGS

As a whole, the stock market follows corporate earnings. When a corporation's earnings are projected to rise, its stock price typically increases as well. On the other hand, a drop in earnings prompts stock prices to drop. Although an individual corporation's performance does not typically have a wide-reaching impact on the market, a downturn in the global economic outlook may negatively affect many companies' earnings – and, in turn, their stock prices – prompting a market correction due to sell-offs of groups of stocks.

FEAR

A broad sense of fear based on a negative event in the news or perception about the economy can trigger a sell-off and, in turn, a market correction.[5]

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[5] Zacks Investment Research. "Why the Stock Market Makes Corrections."https://finance.zacks.com/stock-market-corrections-5979.html. Accessed Jan. 16, 2019.

WHAT DOES A MARKET CORRECTION MEAN FOR MY INVESTMENTS

Don't panic! In the event of a stock market correction, the best thing you can do is stay calm. Remember the adage "buy low, sell high"? Don't let your emotions take over and convince you to do the opposite. Selling good-performing, long-term investments may be the worst thing you can do when the market experiences short-term bumps.

Remember, "long term" means years of being invested in the stock market – not weeks or months. Even if the market continues on a bumpy streak, generally the only circumstance under which you should consider changing your current portfolio or investment strategy is if your financial goals have changed and/or you have an immediate need for the money. Don't let temporary market conditions derail your long-term investment plan.

HOW LONG WILL THE MARKET TAKE TO RECOVER?

While the length of time it takes to recoup losses depends on several factors, since WWII the average U.S. stock market correction has lasted about four months.[6] When looking at the big picture of a long-term investment plan, this is a relatively short window. Therefore, it's important to sit tight and hold steady with your investments.

Historical data from the S&P 500, which represents 500 of the largest U.S. companies, paints a nice picture of the long-term performance of the U.S. market and its ability to rebound. From 1928 through 2018, the S&P 500 has experienced 25 bear markets while also producing an average annualized return of about 10 percent, outperforming lower-risk assets such as bonds and cash.[7,8] So, while short-term market corrections are relatively common, it's important to remember that if you are not invested when rebounds begin, you may not recoup all possible gains.

WHAT DOES ALL OF THIS MEAN FOR MY LONG-TERM PLAN?

The bottom line is that it's normal for the stock market to go up and down, and it's important to keep a long-term outlook focused on years of performance, not weeks or months. Remember: If you're in the stock market, you'll likely see your investments go up and down many times throughout your life. Don't let a few weeks of stormy weather cast a dark cloud over your long-term investment plans!

Our team keeps a daily tab on the market and will update you with any information you need to know in times of extreme market volatility. Call our office anytime with questions about market performance and how it might affect your financial picture.

WHAT'S THE DIFFERENCE?

Type of market downturn	Percentage decline from recent market high
Pullback	**5% – 9%**
Correction	**10% – 19%**
Bear Market	**20% or more**

[6] Thomas Franck and Kate Rooney. CNBC. Oct. 26, 2018. "The stock market loses 13% in a correction on average, if it doesn't turn into a bear market." https://www.cnbc.com/2018/10/26/the-stock-market-loses-13percent-in-a-correction-on-average.html. Accessed Jan. 16, 2019.
[7] Jade Scipioni. Fox Business. Dec. 26, 2018. "History of bear markets since 1929." https://www.foxbusiness.com/markets/history-of-bear-markets-since-1929. Accessed Jan. 21, 2019.
[8] J.B. Maverick. Investopedia. "What is the average annual return for the S&P 500?" https://www.investopedia.com/ask/answers/042415/what-average-annual-return-sp-500.asp. Accessed Feb. 11, 2019.

5 THINGS TO DO DURING A MARKET CORRECTION

BE PATIENT

It's natural to be concerned about how a market decline might affect your current investments, but now is not the time to make any spur-of-the-moment moves. Stay the course and stay in the market, keeping in mind that corrections are temporary and often lead to higher gains once they are over.

DON'T OVERTHINK

Stock market corrections occur regularly as part of a normal market cycle. Turn off the TV, step away from the computer and be careful not to overanalyze what is actually a sign of a healthy market.

FIGHT YOUR INSTINCTS

The "rules" of investing can seem counterintuitive. While your instincts might tell you it's better to invest in a rising market than a falling one, the markets have consistently shown that the opposite is true.

STAY DIVERSIFIED

Despite a significant decline in the value of your stock holdings during a market correction, bonds should maintain their value, so it's important to have a healthy mix in your investment portfolio. The conventional practice is an allocation of 60 percent stocks and 40 percent bonds, but consult with your financial advisor regarding your individual situation.

WORK WITH YOUR FINANCIAL ADVISOR TO REASSESS YOUR SITUATION

Although moving your investments may not be advisable during a market correction, it can be a good time to review your financial plan and assess whether the amount of risk you have is appropriate for your situation. Having a well-constructed investment strategy can give you confidence for the future when the going gets tough.

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