

How to Handle Volatility

Market volatility can increase or decrease depending on where we are in the business cycle. Here's why this shouldn't worry long-term investors.

It's been nearly 12 years since the stock market bottomed at the end of the financial crisis. Investors who had grown accustomed to steady growth in their portfolio since then got a rude reminder early last year that markets are not always so well behaved.

Since then, despite an ongoing global pandemic, the S&P 500 retrenched and reached new highs only six months after bottoming in early March of last year. The rapidity of the market's recovery in the face of extraordinary stimulus from fiscal and monetary authorities has many investors wondering if a hangover is in store, and if the next downturn will be a harbinger of a more prolonged bear market.

Does this troubling possibility mean you should exit the stock market? In short, no.

Volatility fluctuates based on where we are in the business cycle and due to external events that heighten risk and threaten growth. It is a normal feature of markets that investors should expect.

Right now, we are at the start of a new business cycle following the COVID-19 recession. This time around will no doubt differ from the prior business cycle, which began in the wake of the financial crisis of 2008, and continued uninterrupted for a record length of time.

One thing we can say about this new expansion with near certainty is that, whether it is tomorrow or in ten years, at some point the market will begin discounting a new recession in business activity, and returns will head lower in ways that leave investors with material losses, as they did very briefly last year.

Common Investing Mistakes

Does that mean you should sell now or at some point in the near future? Not necessarily. It's extremely difficult to predict the timing of a bear market with the accuracy needed to profit from such a prediction.

More to the point, it is easy to get such a prediction wrong, which can be costly. While we do tilt our portfolios more aggressively or more conservatively based on our market outlook, the data shows that individual investors who radically reposition out of stocks in an attempt to catch the tip of a market top reliably miss out on gains more than they prevent losses, and generate excessive transactions and tax costs along the way.

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While “buy low, sell high” may sound like time-honored advice, the challenge of getting it right means it rarely is a good way to make decisions in practice. Indeed, individual investors who stay in cash waiting for a bear market to come and go, often lose patience as stocks continue to go up. This results in their missing out on gains rather than preventing losses. That costly mistake is the reciprocal of another, wherein panicking investors sell during a major market selloff, and remain on the sidelines too long as stocks rebound. The market action last year was a profound illustration of just how damaging this particular behavior can be, as investors who sold near the bottom in March will have effectively locked in significant losses if they had waited on the sideline even for a few weeks as markets roared back. The prevalence of these value destroying behaviors helps to explain why individual investors as a group tend to dramatically underperform market benchmarks.

There is a caveat to the generally superior buy-and-hold approach, which is that seeing a paper loss in your portfolio doesn't feel good. Some investors would rather take less risk, which may mean giving up some long-term returns, in order to reduce the period of time they may need to wait out losses, making for smoother sailing.

Consider Your Goals

Another factor to consider is how you're doing relative to your financial goals. That's where a Financial Advisor can help by talking through goals and priorities and reassessing your portfolio based on where you stand. For instance, if you are saving toward a goal and have made good progress, it may make sense to take on less risk, regardless of the market outlook. This is for two reasons. First, it intuitively makes sense to take less risk when you have more to lose than to gain. Second, for additional peace of mind that your progress won't be jeopardized, you may desire the lesser uncertainty that can come from a more conservative blend of stocks, bonds and cash.

If, like many of us, you have more progress to make and more road to travel towards achieving your goals, riding out the market's jitters can be the best advice. Our research shows that markets are most predictable when you have a seven- to 10-year time horizon (due to how well current yields and valuations predict returns over those horizons). Our forecasts continue to suggest that stocks will outperform bonds and cash over that time horizon.

Bottom line: Working with your Financial Advisor can help you avoid short-term thinking and remember that investing is a long-term proposition. Keeping your eye on the horizon is your best strategy as an investor.

Contact the advisors with the Okby Group at Morgan Stanley to schedule a review of your own financial goals:

- [Click here to book time with Stephen Aguglia, Financial Advisor](#)
- [Click here to book time with Zach Zaloga, Financial Advisor](#)

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