Keeping Emotions at Bay During Virus Volatility

Fear, uncertainty, volatility, panic—these emotions are nothing new to the world of investing. In fact, they seem to reappear on a fairly consistent basis. The outbreak of Covid-19 has brought them back with a vengeance, but wise investors know how to stay the course, keep their emotions in check, and take advantage of new opportunities.

Crises Are an Expected Part of the Economy

Throughout stock market history, market bubbles and crashes have been regular occurrences, either leading or lagging other events. Since 1957, there have been 12 bear markets. Every single time, markets eventually recovered, usually in less than 24 months.

The key to managing these types of crises isn't to avoid them (that's not possible), but instead to manage them correctly. Although the financial crisis of 2008 was difficult for a year and a half, it was followed by more than a decade of phenomenal stock market gains. The same can happen again. But you have to know how to make it through the bottom in order to capitalize on the upswing.

Lessons from Behavioral Finance

Behavioral finance has revealed that the human tendency in these types of situations is to panic and sell. Oftentimes when people do this, they sell at a bottom, which of course is the exact opposite of what they should do.

Selling in a panic is a type of fleeing, which results from the fight-or-flight response. This is an animal instinct, evolved over millions of years, that exists in humans and other animals. It creates one of two responses in the face of a perceived threat: either fight it or run away.

The wise investor will do neither. He'll control his emotions, focus on the long term, and look for buying opportunities. In essence, the key to successfully navigating stock market panics is to do the opposite of what the ill-informed masses will do.

Learning to Navigate the Storm

In the midst of a stock market crash (and that's exactly what the coronavirus pandemic has caused), it's important to take a step back and look at history.

The stock market slump that preceded the Great Depression lasted less than three years (October 1929 until July 1932). One of the best buying opportunities in American stock market history came during one of the greatest economic calamities. The economic crisis would not last, with World War II on the horizon, and the country pulling out of its doldrums.

Pandemics themselves don't last, either. Polio, Zika, Ebola, the Spanish flu, the Black Death of Europe—all of these were eventually conquered, and usually quite quickly.

Already a study has predicted there may be a resurgence of coronavirus later in 2020 (Covid-19 itself is a sister strain of the SARS virus of 2003). If so, there may be more market volatility later in the year.

But this outbreak will eventually run its course. Scientists and politicians will find ways to control and cure the virus. During the process to eradicate it, your goal is to make prudent investment decisions while others panic and sell at the wrong time.

Reevaluate Your Financial Plan

Take a second look at your financial plan or Investment Policy Statement. Examine your time horizon, life goals, and risk tolerance. Try to stick to these original objectives if you can. Although some of your circumstances may have changed, your mission throughout this crisis is to maintain your investments or possibly add to them.

If your circumstances have changed and you need to make adjustments to your financial picture, remember that the epidemic will eventually end and the markets will recover. Take a long-term view when making financial decisions.

If you do find yourself in need of short-term cash needs in the near feature, consider taking out a home equity line of credit. Interest rates are at all-time lows and are expected to remain there for some time.

Stocks Have Outperformed Other Asset Classes Over the Long Term

Historically, stocks have produced higher returns than other investments over the long term. Although bonds have so far outperformed stocks in the first part of 2020, this is a short-term trend that will be erased by the inevitable upswing of the stock market.

Because of the inherent volatility of the equity market, one of the key strategies is to stay the course and let bull markets outweigh bear markets. This type of long-term, buy-and-hold investing has the ability to overcome short-term drawdowns. The long-term tendency of the U.S. stock market has always been up—and it still is.

Although the coronavirus outbreak has caused a bear market, that doesn't mean there will be no bull markets in the future. April 2020 has already demonstrated the market's ability to bounce back from significant downturns.

Dollar-Cost Averaging

Because of the expected U-shaped economic and market recoveries, one possible investment approach to adopt could be dollar-cost averaging. With this investment philosophy, you periodically invest a fixed-dollar amount.

If you know how much you plan to invest this year, you could divide that amount by five and make five investments over the next five months. For example, if you plan to contribute $10,000 to a retirement account this year, you could make five $2,000 contributions.

Although many companies will suffer earnings and revenue decreases due to the coronavirus outbreak, the market has priced these expected declines in already. Thus, there are good buying opportunities out there.

Surviving the Storm

The volatility we have seen so far in 2020 probably isn't over just yet. The re-opening of the American economy will occur in phases, and there probably won't be a flawless rollout. The stock market will react with more ups and downs.

During this process, you may want to seek out the assistance of a competent financial advisor to help you navigate through the storm. With professional assistance, you'll have the guidance you need to come out the other side intact.

For more information on how to manage your investments with a sound psychological framework during the coronavirus epidemic, see the following resources:

https://www.investopedia.com/articles/basics/10/how-to-avoid-emotional-investing.asp

https://www.marketwatch.com/story/what-john-bogle-might-say-about-the-coronavirus-and-your-investments-2020-03-19

https://www.finra.org/investors/insights/market-volatility-check-emotions-door https://www.raymondjames.com/commentary-and-insights/markets-investing/2020/03/26/the-psychology-of-investors