Putting Stock Market Volatility in Perspective

As of this writing, in late 2018, the U.S. stock market has been extremely volatile. By the time you read this article, in February 2019, stocks may have stabilized, may have risen, or may have dropped dramatically. The last stunning market retreat, which made tumultuous news in late 2008, reached its bottom in February 2009.

Future stock prices are unknown. That said, a knowledge of history may help you invest prudently. Over time, staying the course has largely paid off for patient investors.

Looking Back

Perhaps the most traumatic day for stocks in the last half-century was October 19, 1987. In a single day, the benchmark S&P 500 Index fell by more than 20%. An investor who went to sleep on Sunday night with $100,000 in stocks and stock funds may well have seen that balance drop below $80,000 by Monday afternoon.

Moreover, Black Monday was hardly a one-day pullback. In August 1987, the S&P had peaked at 337 index points. After Black Monday, that index was down to 225, a drop of more than 33%. Even after Black Monday, however, the S&P regained its peak value by 1989.

Similar events have occurred in this century. After a long bull market fueled largely by tech stocks, the S&P peaked at 1,527 in 2000. That bubble burst, and a long decline lasted until 2002, when the S&P bottomed at 777. The stock market recovered, but the following financial crisis took the S&P from a peak of 1,565 in 2007 to a trough of 677 in 2009, which was also followed by a lengthy rebound. After flirting with 3,000 in September 2018, the index was over 2,700 two months later.

Successful Strategies

One key takeaway from this history lesson is that the broad U.S. stock market, measured by the S&P, has gone from 337, shortly before the 1987 meltdown, to a value that's more than 8 times as great in about 3 decades. Every market stumble, correction, or crash in this time period has proven to be a buying opportunity for investors who buy and hold stocks.

Such returns in the future aren't guaranteed, but this prior experience is encouraging. Two proven investment methods are suggested.

For one, periodic investing has paid off. If you participate in a retirement plan such as a 401(k) and you direct some of your contributions into the stock market, money is coming out of each paycheck into equities. You're buying during market lows as well as during highs, which may lower your cost per share and raise your return from long-term gains.

The second tactic involves what to buy, rather than when to invest. Despite the long-standing strength of equity markets, many investors have lost money in stocks. Often, the reason is buying the wrong stocks and suffering from problems or unrealized expectations at the chosen companies.

You can reduce company-specific risk and increase your chances of participating in any broad market gains by buying multiple stocks with various attributes. Many investment advisers recommend some form of diversification within the equities markets: foreign as well as domestic companies, small firms as well as large ones, a mix of industry sectors in your portfolio. Blending stocks with other holdings, such as bonds, can dampen overall volatility and provide valuable comfort when equities plunge.

A Matter of Time

The preceding statistics paint a rosy picture, but there is a major caveat. Markets always have rebounded to the benefit of those buying when stocks go "on sale." That's not the case, however, if you are not able to keep investing regularly. Once you stop working and the paychecks stop, you might be taking dollars out of your portfolio, rather than investing at possible bargain prices.

Therefore, as you approach retirement, a steep decline in the value of your holdings can imperil your future lifestyle. Regardless of whether stocks are soaring or sinking, shifting assets to less volatile investment categories might be considered.