GLOBAL & LOCAL

THE INVESTMENT EXPERTS

Why Is It Best To Do Nothing?

In times of extreme market volatility caused by blinded investment sentiment, where global indexes tumbled for the majority of 2022, with the Nasdaq 100 falling 32.94%, the S&P 500 dropping 20.19%, the Dax slipping 15.13%, the FTSE 100 falling marginally by 3.09%, the Shanghai Composite going down by 15.63%, and the JSE Large Cap modestly falling 7.21%, year-to-date respectively.

This plunge in global markets put to the test our investment styles, strategies, philosophies, and patience. Whether you are an arbitrageur, a speculator, a hedger, a fundamentalist, or a technicalist, investment sentiment somewhat shapes and frames our emotional and cognitive financial behaviour in face of market turmoil.

In these present market uncertainties, what is the best course of action to take? Is it best to do nothing, or is it best to take abrupt corrective measures to ride with the sentiment? Or alternatively, you could consult with your financial advisor about withdrawing all of your investments to cushion your hard-earned financial resources.

Whether you agree or disagree with me, no one wants to look at a portfolio that is rapidly and significantly losing value on a daily basis. This, on its own, causes unprecedented panic, leading to drastic decisions that might make a short-term difference or result in catastrophic outcomes. But, in such market doldrums, the key question to ask yourself is, “What should I do?”

The simple answer to the above-posed question is not to panic. When markets are in a state of panic, harsh investor-wide impulsive decisions such as fire sales across markets occur, resulting in a massive drop in value. This is why it is essential beforehand to fully understand your risk tolerance, investment objectives, investment horizon, and how price volatility will affect your investment in the short and medium terms.

The sacred ability to understand your risk tolerance in advance helps you make investment choices that are suitable for you and thus prevents you from having investment panic attacks during market downturns. Furthermore, diversifying your portfolio among several asset classes with low correlations can alleviate risks during market crashes, thereby maintaining much-needed portfolio buoyancy.

A long-term investment horizon is also recommended because your investment will benefit from the magic of compounding. However, this long-term investment horizon is heavily influenced by one’s liquidity needs; if one’s liquidity needs are significant, having a long-term goal may become meaningless. Moreover, long-term investors recognise that markets experience contractions and expansions and that every contraction is followed by an expansion, as was the case in March 2020 when Covid-19 induced significant losses when the S&P 500 lost 34% of its value, the MSCI World Index was down 23.6% and the JSE All Share Index losing 22.8% in the same period. However, the end-of-year global market performance of 2020 revealed a different story, with a strong rebound following historic lows, highlighting the importance of maintaining a long-term perspective. The S&P 500 finished 16.26% higher in 2020, while the MSCI World Index increased by 14.45% and the JSE All Share increased by 8.76%.

In hindsight, if one took the drastic emotional measure of panic selling, the likelihood of missing out on the upswing was evidently high. On the contrary, long-term investors who remained anchored in their investment approaches experienced a “sweet” recovery and fared well in the preceding years.

To revert back to the topic question, “Why is it best to do nothing?” The answer lies in one’s ability to avoid the panic button, which leads to locking in losses by selling at lows during a sharp market correction, as is the case in 2022. In such cases, developing a bear market strategy to protect your portfolio is highly recommended. To do so, you must first understand your risk tolerance, investment objectives, and liquidity needs, and put in place strategies to hedge and diversify your portfolio. Ultimately, you must have a long-term investment horizon. Please keep in mind that this strategy is not exhaustive and is dependent on individualistic needs.

Additionally, when markets bottom out, it presents a better buying opportunity because most asset prices are relatively low, despite a slew of negative headlines. Buying cheap, as is well known, has an amplifying effect on performance when the market is on the rise. What is critical, however, is the timing. Most seasoned investors will tell you that time in the market, not market timing, is the key to successful investing because missing the market's best days (which are practically impossible to predict) has a significant negative impact on portfolio performance.

Knowing what to do when stock prices fall is critical because a market crash can be both emotionally and financially devastating, particularly for inexperienced investors. When the stock market is falling, panic selling can harm your portfolio rather than help it. There are numerous reasons why investors should avoid selling during a bear market and instead stay invested for the long term. This is why understanding your risk tolerance, time horizon, and how the market operates during downturns is critical, thus somewhat answering the question:" Why it is best to do nothing".

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