Why It's Important to Stay Invested, Even in Rocky Markets

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With inflation running hotter than it has in decades and stocks off to their worst start in any year since World War II, the market is about as volatile as it's been since the start of the Covid outbreak. Yet a bedrock principle of sound investing is never let fear dictate your long-term strategy.

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So, before acting on your emotions, investors should consider the following:

We've been here before. Remember the Covid bear?

For investors who may be losing conviction about staying the course, the market scare at the onset of the global pandemic in 2020 is a good lesson. When things looked even bleaker than they do today, it was important not to let fear and emotion rule your decision-making.

In March 2020, as cities throughout the country began shutting down offices, shops, and restaurants to enforce social distancing, stocks lost more than a third of their value in about a month. In the aftermath of the plunge, 42% of individual investors sold stocks, and 24% cashed out of equities entirely, according to a survey by the personal finance website MagnifyMoney. Yet investors who acted on their fears “to play it safe” turned their paper losses into actual losses by selling at the market lows. Worse still, they missed out on the 120% rebound in U.S. stocks from March 23, 2020, through the end of 2021, a rebound that few had predicted.

Of course, there are no assurances that a market recovery is just around the corner this time. Nevertheless, for long-term investors who have a multi-year time horizon ahead of them, the lesson of 2020 was that selling stocks to avoid short-term risks can be just as risky, if not more so, than staying the course and holding onto a well-diversified basket of stocks.

Downturns are normal, and you may not be down as much as you think.

While the S&P 500 is down around 14% from its January peak through the end of May, market downturns such as this are actually quite common. In fact, last year’s stunning surge in stock prices, when the S&P 500 returned more than 28% during a global pandemic, was the aberration, not this year’s market slide. Stock market declines of 10% or more (which are referred to as “corrections”) have historically taken place about once every two years.

Also, remember that you didn’t start investing on Jan. 1. Most of us have been in the market for years if not decades. So, how does the market look from a longer-term perspective?

- Over the past year through the end of May, the broad stock market is down less than 1% even after factoring in the recent sell-off.
- Over the past three years, the market is still up nearly 60%.
- And over the past decade, stocks have returned roughly 280% (which works out to an average of about 14% a year), nearly quadrupling investors’ money.

Market downturns don’t last forever.

Investors tend to assume that current market conditions will persist well into the future. In reality, stocks eventually recover from all corrections and “bear markets” (losses of more than 20%). And as 2020 demonstrated, some of those recoveries take far less time than you might assume.

For instance, in the 29 market corrections since 1946, it has only taken four months, on average, for the market to fully recoup its losses. In the 12 bear markets since World War II, it has taken an average of 24 months to recover. However, if you discount so-called mega bears such as the global financial panic, which are considered once-in-a-generation type events, it has only taken about 14 months on average for stocks to recover from a “normal” bear market in which stocks lose 20% to 40% of their value.

Trying to time the market is the reason many investors fall short.

As the Covid downturn showed, investors can rarely predict the precise time to exit stocks. Nor can they tell the best time to reenter the market when stocks are about to recover. Instead, investors tend to sell only after stocks have already plunged and buy back into the market only after equities have rebounded.

This is why stock fund investors have even had difficulty matching the market in passive S&P 500 index funds. For instance, in the 30 years ending Dec. 31, 2021, U.S. stocks have returned 10.7% annually. Yet during this same time, the average stock fund investor earned just 7.1% because they mistimed the market, according to the financial research firm Dalbar. While that may not sound like a huge difference, it adds up over time. A $10,000 investment made 30 years ago would have turned into $211,000 over the past 30 years, if it earned the market’s 10.7% annual gains. However, that same amount earning 7.1% annually became just $78,000 for the average equity fund investor.

Missing even a few good days can set you back in the long run.

You might wonder what’s the harm in missing out on a handful of good days in the stock market if heading for the sidelines buys you a little bit of peace of mind? Well, history says the cost of missing out on the market’s good days is far greater than you think. Consider that in the 15 years ending Dec. 31, 2021, a $10,000 investment in the stock market would have turned into more than $45,000 if you left it there the entire time. If you missed out on just the 10 best days during this 15-year stretch, that $10,000 investment would have turned into less than half as much: around $20,000.

There is no question it can be daunting to stay invested during periods of stress in the market. However, understanding your risk tolerance and having a long-term perspective can reap meaningful rewards.