5 timeless tips to manage market ups and downs

Market volatility is unnerving, for even the savviest of investors. In this article we provide you with some tips on how to manage—and potentially benefit from—market volatility.

The notion of investing in the stock market without volatility is as illusory as a car without an engine. Like it or not, the two concepts invariably go hand-in-hand. But does that mean you should avoid volatility—and investing—altogether? Market uncertainty can naturally cause panic and lead to poor investment decisions yet by recognizing short-term market uncertainty for what it is, you can help ensure that it doesn't derail your long-term goals. Here are five tried and tested principles that can help you gain needed perspective.

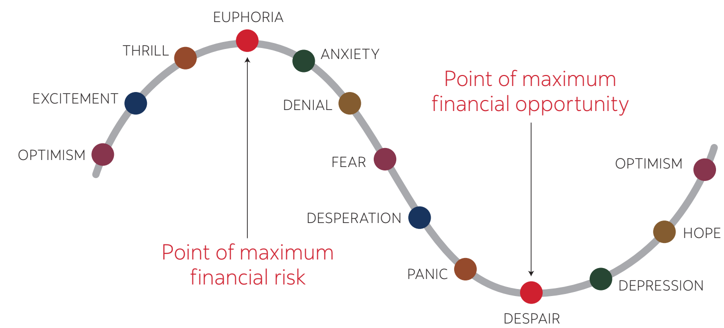
> “
> Investing is most intelligent when it is most businesslike.
>
> BENJAMIN GRAHAM

1 Keep calm and carry on

Investors generally feel a financial loss about two and a half times more than a gain of the same magnitude*. Understandably, many of us experience a roller coaster of emotions when investing (as the diagram below illustrates), which can translate into poor buy and sell decisions. Being aware of these emotions during periods of increased volatility can help you stay focused on reaching your long term goals.

Cycle of market emotions

*Daniel Kahneman and Amos Tversky, “Prospect Theory: An Analysis of Decisions Under Risk”, Econometrica, 47,2, pp. 263–91



2 It's time, not timing

Why shouldn't you automatically sell your investments when market uncertainty sets in? Because trying to time the ups and downs of the market is a bit like rolling the dice.

As the illustration below shows, sitting on the sidelines can cost you. Over a 10-year period if you're out of the market for even a small number of days when the market is outperforming, you can substantially reduce your return potential. Staying invested—while not always easy—can potentially translate into a better outcome.

Sitting on the sidelines can cost you

The impact of missing the best performing days from November 2008 to 2018 on a $10,000 investment

Bloomberg. S&P/TSX Composite Total Return Index, November 30, 2008 to November 30, 2018. It is not possible to invest directly in an index. Assumes reinvestment of all income and no transaction costs or taxes. Value of investment calculated using compounded daily returns. Missing 10, 20 and 30 best days, excludes the top respective return days.

3 Manage risk, don't avoid it

Risk can be a loaded term when it comes to investing—and is often misunderstood. Often seen as synonymous with risk, volatility simply measures how much the return of an investment or the broader market fluctuates—up and down. While some may fixate on these fluctuations, the permanent loss of capital should be of greater concern. Reducing exposure to securities that are perceived as 'risky' will certainly lower market risk, but by doing so, long-term investors can be unduly exposed to inflation and longevity risk (the risk that you'll outlive your savings).

Whether we like it or not, investing in the stock market and risk are a package deal. The key to long-term success is to manage your exposure to risk by using time and diversification to your advantage.

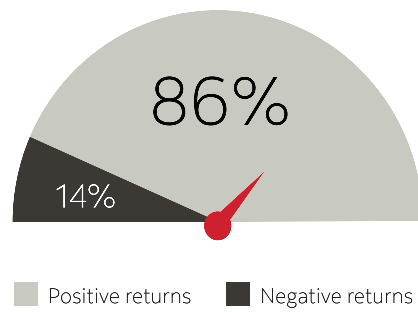
Diversification's impact on three-year returns

While the performance of any portfolio can swing significantly each year, a balanced portfolio has historically resulted in fewer negative returns when compared to an all stock portfolio over the long term.

Equity Portfolio[1]

8 occurrences

Worst Year:
2002
-6.3%



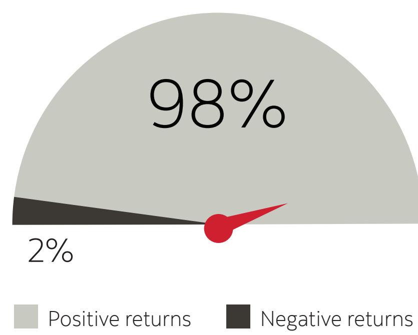
49 occurrences

Best Year:
1980
34.7%

Balanced Portfolio[2]

1 occurrence

Worst Year:
1975
-0.4%



56 occurrences

Best Year:
1980
18.5%

[1] Based on 3-year annualized returns ending December 31 of the S&P/TSX Composite Total Return Index from 1960 to 2018. [2] Based on 3-year annualized returns ending December 31 of a portfolio of 50% the S&P/TSX Composite Total Return Index and 50% Canadian Fixed Income Composite from 1960 to 2018. Canadian fixed income composite consists of 80% FTSE Canada LT Bond & 20% TMX Canada Residential Mortgage Index from 1960 to 1980; 100% FTSE Canada Universe Bond Index from 1981 to 2018. Source: Morningstar. Returns are calculated in Canadian currency. Assumes reinvestment of all income and no transaction costs or taxes. The portfolios are hypothetical and for illustrative purposes only. It is not possible to invest directly in an index.

4 Put diversification to work

Often equated to not putting all your eggs in one basket, diversification is a tried and tested technique that mixes different types of investments in a portfolio to lower risk.

By including investments that are less correlated to one another—or react differently to economic and market events—gains in some can help offset losses in others. As the chart below illustrates, a diversified portfolio of different asset classes provides the opportunity to participate in potential gains of each year's top winner while aiming to lessen the negative impact of those at the bottom.

Calendar year returns (in Canadian dollars)

%	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
	75.1%	38.5%	9.7%	16.0%	48.1%	23.9%	21.6%	35.4%	28.7%	7.7%
	52.0%	20.2%	8.3%	15.3%	41.3%	14.4%	19.5%	21.1%	17.4%	4.2%
	35.1%	17.6%	4.6%	13.8%	31.6%	11.2% Balanced Portfolio	16.2%	17.1%	13.8%	1.4%
	15.9% Balanced Portfolio	13.0%	0.4% Balanced Portfolio	13.4%	13.3% Balanced Portfolio	10.6%	14.6%	8.2% Balanced Portfolio	9.1%	-2.0% Balanced Portfolio
	12.5%	10.1% Balanced Portfolio	-1.8%	7.9% Balanced Portfolio	13.0%	9.7%	4.4% Balanced Portfolio	8.1%	8.2% Balanced Portfolio	-3.0%
	8.0%	9.1%	-8.7%	7.2%	7.8%	8.8%	3.5%	7.7%	7.1%	-5.6%
	7.4%	6.7%	-9.6%	3.6%	4.3%	7.0%	2.4%	1.7%	6.4%	-6.5%
	5.4%	2.6%	-14.2%	2.5%	3.9%	4.1%	-8.3%	-1.5%	2.5%	-8.9%
	-9.2%	0.0%	-16.2%	2.0%	-1.2%	-0.1%	-13.8%	-2.0%	0.3%	-18.2%

ASSET CLASS	INDEX
Canadian Small Cap	BMO Small Cap Index
U.S. Equities	S&P 500 Index
Canadian Equities	S&P/TSX Composite Total Return Index
Canadian Bonds	FTSE Canada Universe Bond Index
International Equities	MSCI EAFE Index
Emerging Markets	MSCI Emerging Markets Free Index
U.S. Small Cap	Russell 2000 Index
Global Bonds	Barclays Global Aggregate Bond Index
Balanced Portfolio	40% FTSE Canada Universe Bond Index, 30% S&P/TSX Composite Total Return Index, 30% MSCI World Index

Source: Morningstar. Priced in Canadian currency, as at December 31, 2018. Assumes reinvestment of all income and no transaction costs or taxes. Annual returns compounded monthly.

The asset classes are represented by their indicated indices and the balanced portfolio is hypothetical in nature. This information is for illustrative purposes only. It is not possible to invest directly in an index.

5 Take advantage of dollar cost averaging

Dollar-cost averaging is an investment method used to help reduce the risk of timing a lump-sum investment. By investing a fixed dollar amount on a regular basis, the "dollar-cost averaging" process helps control the effect of market volatility by smoothing out the average cost per unit of mutual funds purchased. Over time, and in certain market conditions, it could result in a lower average cost and a higher return. The accompanying chart simulates a dollar cost averaging strategy with a lump sum purchase from September of 2007 to September of 2009, a period punctuated by extreme market volatility and a significant correction.

While it's important to note that dollar-cost averaging doesn't always produce a better result than a lump sum purchase, it's the systematic approach that makes investing easy and takes the guesswork out of deciding when to invest.

Staying the course in times of turmoil

Source: Dynamic Funds and Morningstar Direct

Hypothetical investment in S&P/TSX Composite TR. Dollar-cost averaging assumptions: Contributions of $400 at the of each month, starting from Sep 1, 2007 to Sep 1, 2009. 25 Contributions totaling $10,000.

The value of advice

Short-term market ups and downs can cause even the most experienced of investors to lose sight of the big picture. An advisor can help you develop a financial plan, recommend suitable investment and navigate rough waters. In fact, research on the value of advice has shown that investors find they have better savings and investment habits and almost four times the wealth of those who don't have an advisor.

With the help of your advisor, understanding your initial reactions to market ups and downs can help you make better investment choices and view your portfolio more objectively.

WEALTH ACCUMULATION

Investors who work with an advisor accumulate

3.9x

the financial assets than those who don't have an advisor.[2]

CONFIDENCE

3 of 5 investors who have a financial plan feel more confident that they're prepared to deal with unexpected financial changes.[4]

VALUE

96%

Investors say the financial advice they receive from their advisor is valuable.[3]

[1] IFIC Investor Survey (2019) | [2] The Gamma Factor and the Value of Financial Advice, CIRANO (2016) | [3] Consumer Voice Survey, Advocis & FAAC (2015) | [4] The Value of Financial Planning (Comprehensive Financial Plan), FPSC (2012)

Staying invested during market ups and downs is simple—but not always easy.

Contact your Scotia Wealth Management relationship manager today to develop a plan that makes sense for you.