Emotional investing

When something is threatening us, experience tells us to get away as quickly as possible. That's a prudent reaction when dealing with bears, avalanches and hurricanes, but it's not so helpful when it comes to investing.

Markets bounce back

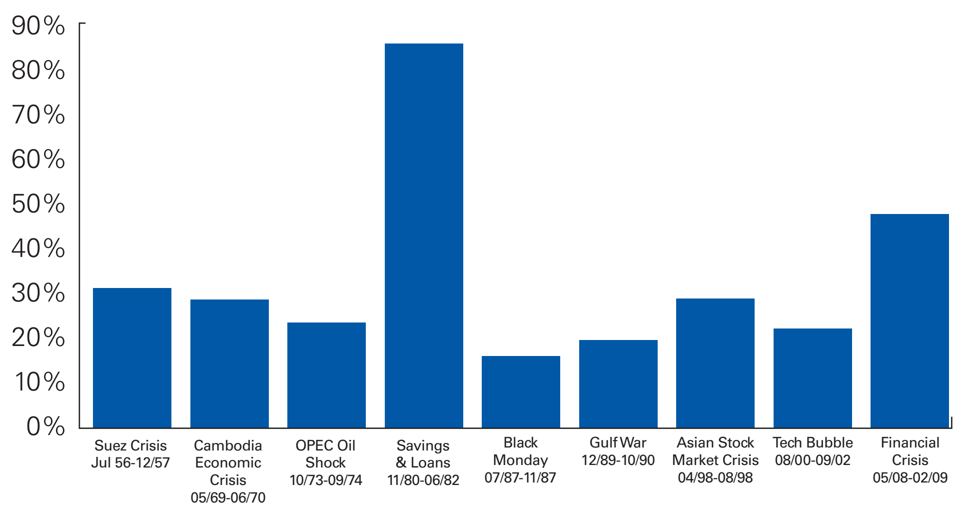
When markets drop, our first instinct may be to sell immediately. But that's often the worst thing to do.

In fact, by the time we're feeling that urge to sell, it's probably already too late to limit the damage. And the period right after a market drop is often the most profitable. This is when portfolio managers typically buy more of the stocks they believe in, because those stocks are now bargains.

And when the market recovers, it's often in vigorous fashion, as the chart below shows.

A year after a crisis, markets have been back up an average of 33%

S&P/TSX Composite Index total return 12 months after markets hit bottom



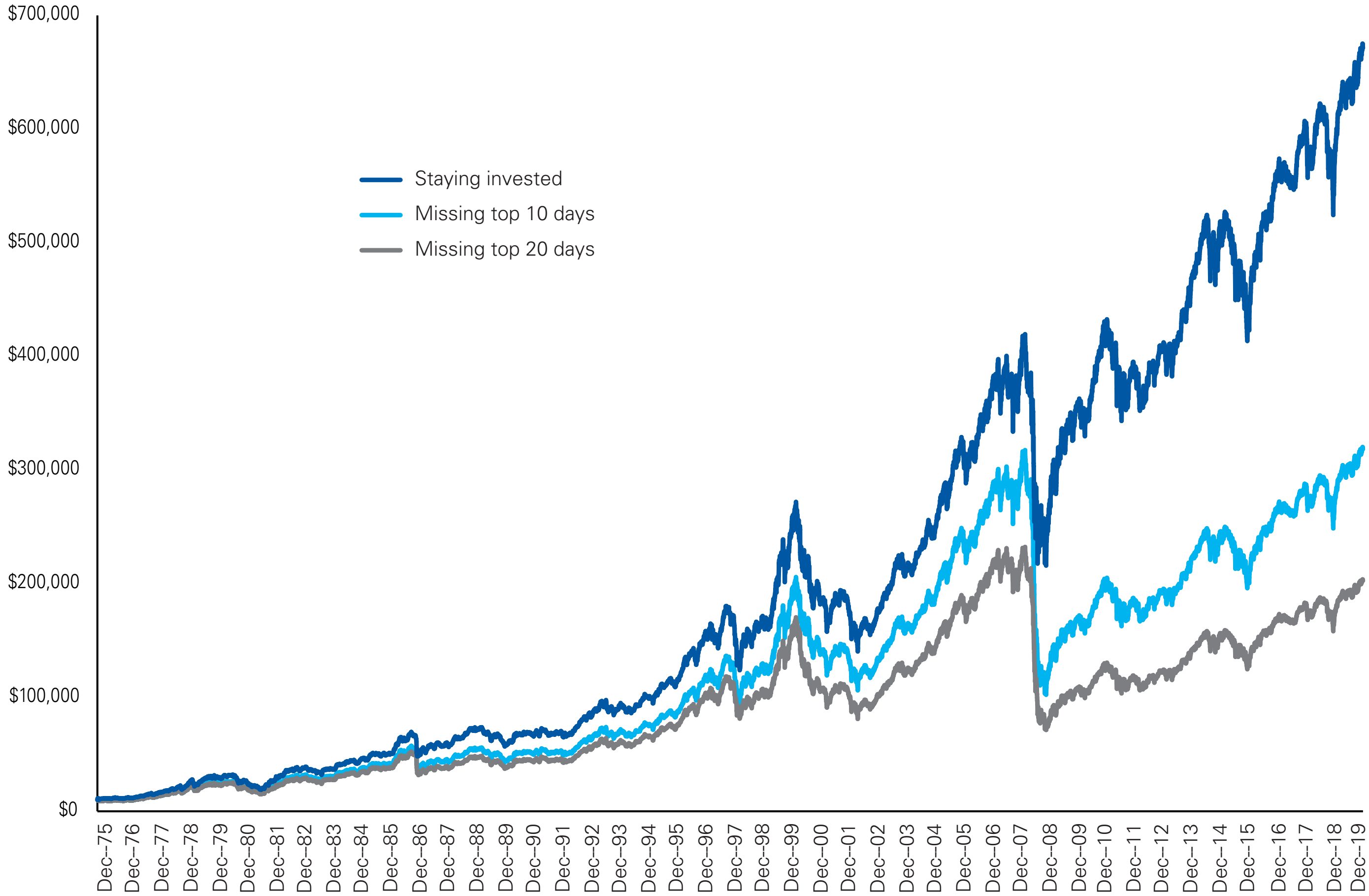
Source: Bloomberg, as at December 31, 2019.

By selling when your investments are dropping, you're locking in a loss and missing the possible run up to pre-decline or higher prices.

Selling in and out of the market based on fears and optimism will likely mean you'll be sitting on the sidelines on some of the best days. The chart below illustrates the potential effect.

Cost of missing the best 10 days on the Toronto Stock Market

S&P/TSX Composite Index CAD – growth of $10,000



Source: Bloomberg, as at December 31, 2019. This chart is a hypothetical illustration and should not be relied upon for any other purpose.

A better strategy may be to stay invested and focus on the long term, rather than react to the ups and downs of the market. This is where having a financial advisor can be helpful.

Speak with your advisor about how your investment portfolio fits with your risk tolerance, how it would likely be affected by a major market correction, and if there are protections built in.

(19-2140) 01/20-131313-04