Discipline may be the best defence in market downturns

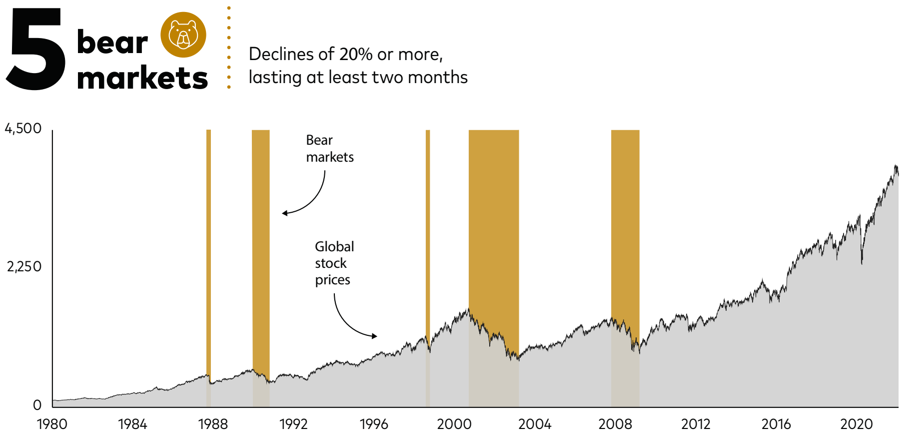
While investing in the stock market is typically a sensible choice for investors seeking long-term growth, sharp drops can still be hard to stomach. Below are some things to keep in mind if a market tumble makes you feel the need to "do something."

Downturns aren't rare events

Typical investors, in all markets, will endure many bear markets during their lifetime. A bear market refers to market declines of 20% or more lasting at least two months.

Source: Vanguard analysis as at 31 December 2021, based on the MSCI World Index from 1 January 1980 until 31 December 1987, and the MSCI AC World Index thereafter. Notes: Both indices are denominated in GBP.

Since 1980 there have been:



Timing the market is futile

Trying to time the market runs the risk of missing the best-performing days. The best and worst trading days often happen close together and occur irrespective of the overall market performance for the year.

Source: Vanguard calculations, based on data from Refinitiv using the FTSE All Share Index. Data between 1 January 1985 and 19 January 2022. All returns denominated in GBP.

Performance among asset classes can vary

Broad diversification keeps you from having too much exposure to the worst-performing areas of the market in the event of a downturn.

Key bond and share index returns (%), ranked by performance

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
17.4	28.3	19.6	8.8	35.4	21.1	0.8	26.5	16.5	28.1
15.5	24.0	18.8	5.5	34.1	17.2	0.5	22.3	13.0	20.0
12.7	21.0	14.6	5.4	29.6	16.9	0.1	21.3	12.8	18.3
12.3	20.8	12.5	4.0	25.5	13.8	-0.4	19.2	11.9	17.6
12.0	13.6	11.3	1.4	25.4	13.1	-2.2	15.9	11.3	4.0
11.2	1.6	7.9	1.0	21.2	11.3	-3.4	14.0	9.1	2.5
10.7	0.6	7.87	0.7	16.8	4.9	-7.6	11.0	8.9	1.0
5.9	0.0	2.8	0.5	12.3	2.5	-8.0	7.2	7.8	-1.5
2.9	-4.2	1.2	-1.1	10.7	2.0	-9.1	6.5	5.0	-3.3
0.6	-5.3	-1.4	-10.3	3.7	1.9	-9.5	6.3	-9.8	-5.3

Top-performing asset class

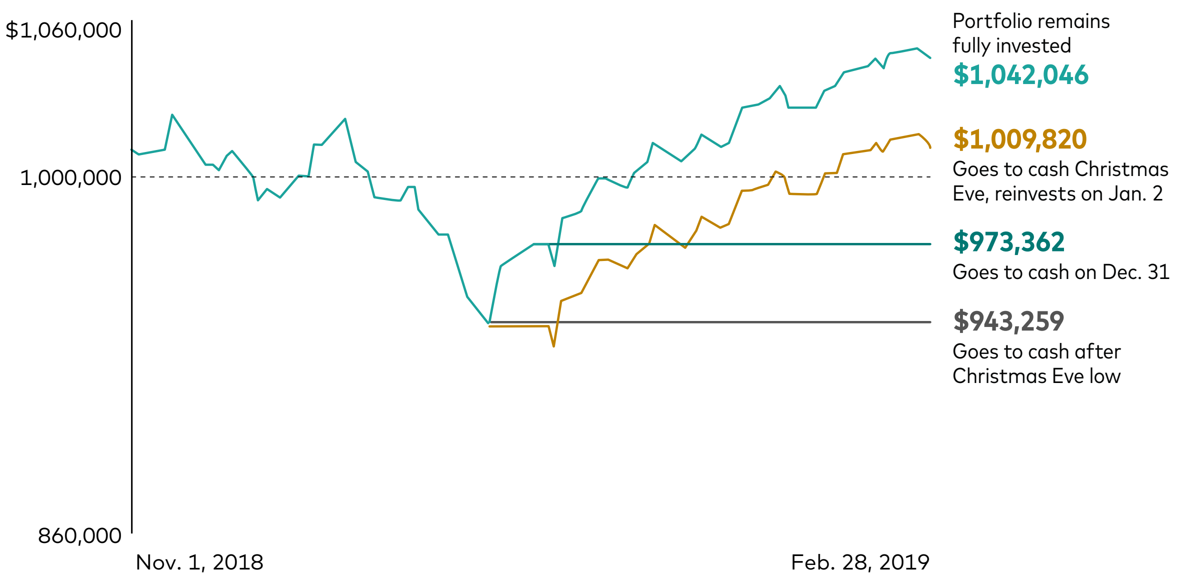
Bottom-performing asset class

- Global shares
- North American shares
- Emerging market shares
- UK shares
- UK government bonds
- UK index-linked gilts
- Developed Asia shares
- European shares
- UK investment grade corporate bonds
- Hedged global bonds

Source: Vanguard calculations as at 31 December 2021, using data from Barclays Capital and Thompson Reuters Datastream and FactSet. Global shares represented by the FTSE All World Index, North American shares by the FTSE World North America Index, emerging market shares by the FTSE All-World Emerging Index, developed Asia shares by the FTSE All World Developed Asia Pacific Index, European shares by the FTSE All World Europe ex-UK Index, UK shares by the FTSE All Share Index, UK government bonds by the Bloomberg Sterling Gilt Index, UK index-linked gilts by the Bloomberg UK Govt Inflation-Linked UK Index, UK investment grade corporate bonds by the Bloomberg Sterling Aggregate Non-Gilts – Corporate Index, hedged global bonds as Bloomberg Global Aggregate Index (hedged in GBP). Performance shown is cumulative and denominated in GBP. It includes the reinvestment of all dividends and any capital gains distributions.

Staying the course pays off

The chart below uses US data, but the broad findings we draw from it generally holds across markets – that riding out the rough periods can pay off. The time period shown is for illustrative purposes.



Source: Vanguard calculations, using data from FactSet. Data between 1 November 2018 and 28 February 2019.

Notes: This chart shows the performance of a hypothetical example 60% stock/40% bond portfolio, including US stocks, global ex-US stocks, US bonds and global ex-US bonds, during and after a sharp market downturn. US stocks represented by the CRSP US Total Market Index. US bonds represented by the Bloomberg U.S. Aggregate Float Adjusted Index. Global stocks represented by the FTSE Global All Cap ex US Index. Global bonds represented by the Bloomberg Global Aggregate ex-USD Float-Adjusted RIC Capped Index.

What you can do when volatility hits:

Tune out the market noise. There's an old adage about never checking your account when stocks are falling. It's smart advice. As the graphics above show, making a hasty decision usually results in a mistake.

Revisit your asset allocation. If market corrections are making you lose sleep, it may be time to reevaluate your risk tolerance.

Control what you can. Costs erode your returns. This is particularly painful when stock markets are correcting. Keep costs low to keep more of your returns.

Set realistic expectations. Vanguard anticipates higher market risks and lower returns over the near term and next 10 years than we did a year ago.

Stay diversified. A great way to insulate your portfolio is to be invested across a wide range of shares bonds and international markets as part of an asset allocation plan that makes sense for your risk tolerance and goals. Bonds can act as a ballast during downturns. International exposure can give you access to markets that may generate positive performance when others are falling.

Following these simple steps can help you avoid overreacting to short-term downturns and position you for long-term success.

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