Don't Fear the (Market) Reaper

Many of us invest in stocks for their ability to grow our wealth. So when volatility rears its ugly head, our instinct is to take our money out of the market to safeguard it. However, history shows that rather than giving in to fear, staying invested and buying stocks during volatile times can be beneficial in the long run.

That analysis comes from examining the Cboe VIX,[1] an index that measures volatility. It's often referred to as the "fear index" because it gauges the market's expectation of 30-day volatility. On average, the VIX measures around 20. But market events can quickly jolt it higher.

For example, during the last week of February 2020, stocks had their worst week of returns since the Financial Crisis in 2008 due to fears about the Coronavirus outbreak. This sent the VIX level up over 40 for the first time since 2015.

Seasons Don't Fear the Reaper…

Volatility is, by definition, a rapid and unpredictable change. It's not an enjoyable experience. But there's something to be said about staying the course despite the discomfort.

And if we step back and examine seven of the previous VIX spikes above 40 that indicated extremely high fear levels, there's a trend. Within three years of volatility-induced declines, the market not only recovered its losses, but also produced additional positive returns in each case. Five years out, those gains remained positive, too.

A takeaway, then, is that while volatility is difficult to endure, it can present opportunities for long-term investors. When the broad sentiment is fear and others are selling, it may be time to be contrarian: consider it an opportunity to not only stay invested, but to buy while prices are depressed.

Key Points

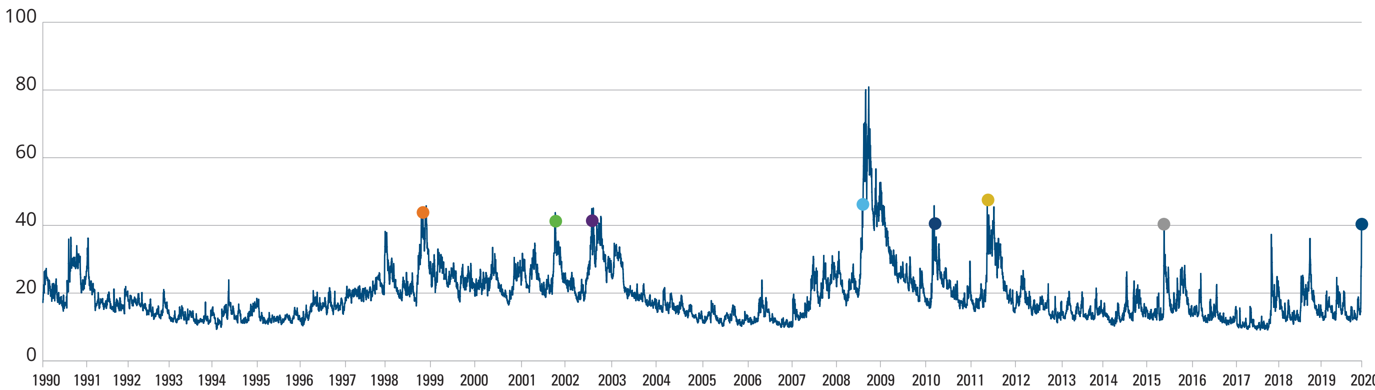
- When volatility and fear strike the stock market, our instinct is to remove our investments from danger.
- However, while prices are depressed because fear is high, staying invested and even buying additional stocks can lead to long-term gains.
- It can be difficult to weather market swings, but the opportunities for long-term investors are worth considering.

[1] "VIX," commonly referred to as the "Fear Index," is the ticker symbol for the Chicago Board Options Exchange (Cboe) Volatility Index and measures the market's expectation of 30-day volatility. VIX levels below 20 reflect complacency, while levels of 40 or higher reflect extremely high levels of volatility.

Buying Stocks When Fear Runs High Has Historically Led to Long-Term Gains

Chicago Board Options Exchange (Cboe) Volatility Index

VIX[1] levels of 40 or higher indicate extremely high levels of fear



S&P 500 Index Returns When VIX >40 Since 1990

Date	1 Year	3 Year	5 Year	S&P 500 Percentage Daily Loss*	Event
8/31/1998	39.82	7.14	2.48	-6.80%	Russia's economic crisis
9/17/2001	-14.64	4.55	6.76	-4.92%	Trading resumes for the first time following the September 11 terrorist attacks
7/22/2002	22.73	16.64	15.43	-3.29%	Accounting scandals highlighted by bankruptcies at Enron and WorldCom
9/29/2008	-1.54	3.90	11.32	-8.81%	US House of Representatives rejects a proposed $700 billion bank bailout plan
5/7/2010	23.05	15.98	15.88	-1.53%	"Flash Crash" causes stocks to decline rapidly with no apparent reason. Dow Jones Industrial Average[2] falls 999 points intraday before recovering.
8/8/2011	28.09	22.59	16.76	-6.66%	European debt crisis and S&P downgrades US government debt from AAA to AA+ for the first time in history
8/24/2015	17.48	20.16	?	-3.94%	China currency devaluation sparks selloff
2/28/2020	?	?	?	-0.81%	Coronavirus outbreak induces fear-based selling

Assumes reinvestment of capital gains and dividends and no taxes. Past performance does not guarantee future results. Indices are unmanaged and not available for direct investment.
* This column shows the S&P 500 Index's one-day loss on the date shown in column 1.
Data Sources: Hartford Funds, Morningstar, and Factset, 2/20

…Nor do the Wind, the Sun, or the Rain…

Another advantage to resisting fear is that it's impossible to tell when the market will resume its upward course after a bout of volatility. So remaining invested during a market dip means participating in the recovery as soon as it happens, rather than waiting until things seem to be back on track and missing the beginning of the turnaround.

In a stark example of that advantage, take the financial crisis, arguably the most challenging market environment in our collective memory. As the chart and table show, volatility picked up significantly in September 2008. This was followed by a record amount of outflows.

However, Fidelity Investments compared the returns of retirement accounts for those who stayed invested versus those who sold all their stocks in 2008.[3] In the 10 years following the financial crisis, those who stayed invested saw their retirement account balances increase by 240%.

[2] Dow Jones Industrial Average is an unmanaged, price-weighted index of 30 of the largest, most widely held stocks traded on the NYSE.
[3] "Lessons Learned 10 Years After the Global Financial Crisis Serve as Power Reminders for Investors," Fidelity Investments, 10/26/2017

But investors who moved into cash missed out on the market's recovery. Even if they did buy stocks again eventually, after the worst was over, that delay dampened their return potential. Ten years on, investors who sold when the market declined only saw a 157% increase from their pre-crisis account balances.

In short, although difficult, staying the course for the long term meant a better return than giving in to fear.

…We Can Be Like They Are

Now, we realize it's easy to say volatility and market dips work themselves out in time, but we realize it's much harder to experience in reality. It can be incredibly difficult to watch a hard-earned portfolio lose value, no matter how much of a buying opportunity it presents. And in today's world of instant gratification, it can be difficult to keep in mind you're more likely to recoup those losses over time, not immediately.

That's why it's critical to be proactive by working with a financial advisor to put a solid, long-term financial plan in place. By doing so, you can build a portfolio that's allocated according to your personal risk tolerances, which can help you stay confident no matter the market's movements. And when you're confident, you can be the contrarian who sees the opportunity in fear.

A financial advisor can help you create a plan so you can be confident during periods of volatility.

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