

# Fasten Your Seat Belts

Volatility is back. In late January and early February, the S&P 500 fell over 10%, then bounced back some, only to tumble again at month end. But in stock investing, volatility is the rule, not the exception, and long-term investors would do well to put the recent correction in perspective.

The abrupt stock market correction in early February saw the Dow Jones Industrial Average drop over 1,000 points - twice - in a week's time.

Hiccup, convulsion, correction - call it what you will. But the dramatic swings in stock prices in late January and February marked an abrupt end of an unusually steady trajectory in stocks. Markets had been uncharacteristically calm since late 2016. In all of 2017, the S&P 500 experienced only eight days where the index moved more than 1%. And the CBOE VIX, a widely used measure of stock market volatility (alias, the "fear gauge"), recorded an historically low average of only 11 in 2017, before spiking to levels rarely seen since the financial crisis of 2008. What's more, nearly 500 trading days had passed since the market's last correction (a decrease of 10% or more from the previous high).

The immediate catalyst for the correction was widely attributed to a U.S. Labor Department report showing a jump in average hourly earnings, stoking fears of inflation. Other fears -- of rising interest rates, historically high stock market valuations and an overheating economy -- added to the angst.

Regardless of the cause, the whole jolt is a reminder that stocks tend to be volatile investments. Up years typically contain many downward stumbles, and down years often feature many surges. For long-term investors, coping with volatility can be key to pursuing long-term objectives.

## Four tips to living with volatility

**Diversify.** When you diversify across a range of investments, you may reduce risk by creating the potential for better performers to compensate for poor performers. But effective diversification involves more than simply owning a jumble of different investments. It means first allocating your portfolio among different asset classes, such as stocks, bonds, and cash. It also involves selecting a mix of investments that may not react the same to a given set of conditions -- investments that carry a low correlation to one another.

**Keep a long-term perspective.** The only certainty about the stock market is this: It will always experience ups and downs. That's why it's important to keep emotions in check and stay focused on your financial goals. A buy-and-hold strategy -- making an investment and then holding on to it despite short-term market moves -- can help. Trying to time the market, as most investment professionals will tell you, is risky. If

your predictions are wrong, you could invest when the market is on its way down or sell when it's on its way up. In other words, you risk locking in a loss or missing the market's best days.

**Consider dividend-paying Stocks** Equity investors looking to limit volatility may want to consider dividend-paying stocks. Although a company can potentially eliminate or reduce dividends at any time, a dividend may provide something in the way of a return even when stock prices are volatile. When evaluating dividend-paying stocks, it may be worthwhile to review how long a company has paid a dividend and whether the dividend has increased over time. According to a 2016 study by S&P Dow Jones Indices, firms that had increased their dividends for the past 25 years outperformed the broader market and also were less volatile.<sup>1</sup> However, past performance does not guarantee future results.

**Talk with a professional.** A financial professional may help you separate emotionally driven decisions from those based on your goals, time horizon, and risk tolerance. Researchers in the field of behavioral finance have found that emotions often lead investors to read too much into recent events even though those events may not reflect long-term realities. With the aid of a financial professional, you can sort through these distinctions, and you'll likely find that if your investment strategy made sense before the crisis, it will still make sense afterward.

Whether the recent correction is an isolated blip or a sign of things to come is anyone's guess. Economic fundamentals remain strong, but the current bull market, now approaching its nine-year anniversary, is getting long-in-the tooth. What's important to remember that periods of volatility are a natural part of investing in stocks. Having a well-thought-out investment plan and then sticking with it may be the best way to weather them.

<sup>1</sup>Source: S&P Dow Jones Indices. Returns are based on the S&P 500 Dividend Aristocrats. Volatility is measured by a statistic known as standard deviation. Past performance does not guarantee future results.

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