Most investors today are survivors of the 2008 market crash. The emotional and financial toll of that market decline will influence investors for the rest of their lives. For younger investors, the impact may be less pronounced, but for all investors – with some accumulated wealth – it was a reminder of the potential damage of turbulent market declines.

At Summit Place, our client portfolios fared much better than the broad market. We achieved this protection through careful and individualized asset allocation, and an unwavering focus on our investment discipline. You, too, can stay on track to reach long-term goals by embracing a consistent investing strategy. Our four steps to thriving in turbulent times can help you stay disciplined and provide greater peace of mind when markets hit the next correction.

For most investors corrections can be uncomfortable, but history shows us that it’s not a good time to make changes to your portfolio and that doing nothing is often the best approach. As an investor with specific goals for your portfolio, you should not let market disruptions deter you from those commitments. For many people, though, doing nothing is nerve-wracking and unbearable. So here are four steps you can take to feel more comfortable in a turbulent market and build confidence in your portfolio: review your market history, focus on the fundamentals, take advantage of tax management opportunities, and if you can, sit back and do nothing.
The stock market often rewards those who can wait, by staying invested in your stocks and taking advantage of buying opportunities you might even prosper through a correction. So no matter what your impulses are telling you to do, try taking a deep breath and following our steps for added comfort.

1. **Review your market history**

“What goes up, must go down” and the equity markets are a perfect example. Stocks regularly move up or down 2-3%. We as investors don’t feel those movements very often. But, as we all know, not all downs are created equal. Since 1945, there have been 89 times that the S&P 500 has lost more than 5% of its value in a short amount of time. However, each time the market has fully recovered the loss. According to S&P Capital IQ, a 5-10% pullback, has recovered its value in about a month. Corrections, where the S&P 500 lost 10-20% of its value, have taken, on average, 5 months to recover. Most investors will experience a number of these in their investing lifetime and will reverse their losses fully by staying committed to their disciplined investment strategy. Even total meltdowns like 2008 - investors’ greatest fear - have retraced their full decline, on average, in a couple years. Total meltdowns don’t happen very often, but when they do, investors that don’t have a long time horizon can really have their life plans derailed. No matter how big the decline, it’s important to know the market’s volatile history when investing, so you can remain focused on your investment plan and the fundamentals when markets get turbulent.

2. **Focus on the fundamentals**

Do you know why you own the investments you do? Successful long-term investing includes knowing what facts about a company or fund make it attractive to you irrespective of price. Fundamentals include economic indicators that inform an overall view of our economy’s current strength and potential future growth.

Fundamentals also include all the facts about your investments. What industry is the company in? How is a company positioned competitively? What have been the most recent financial results and what are the projected financial results? What is happening at the company that makes the future look interesting to you? Fundamental analysis is essentially getting down to the basics and focusing on creating a picture of the investment to determine its value. Cash flow, asset returns, history of profit retention, future growth potential, new product cycles and capital management are all pieces of a company’s fundamentals.

When the stock market becomes volatile, it is best to go back and review the fundamentals for
each of your investments. Has anything actually changed besides the price of the investment? If a stock market correction eventually leads to an economic slowdown, then perhaps the fundamentals will change. Most often, however, a market correction is short-lived and when you review your investments you will renew your confidence in your past conclusions. It is the same attractive investment you chose in the past, and now it is available at a lower price.

Finally, reviewing fundamentals also does include looking at the history of your investment in the stock market as to its value. Since we know that markets regularly correct, it is useful to look at how the investment has been valued in the market over time. How low was the valuation in the 2008 market meltdown? How low did the valuation get in the past correction in the summer of 2011? What has been the recent valuation of the investment before the current market volatility? By reviewing all the fundamentals of your investments, you can gain confidence to stick to your long-term investment strategy regardless of the market’s short-term action. You may even find there is a buying opportunity.

3. Look at tax management opportunities

While stock market corrections are painful, for some investors they offer a valuable tax management opportunity. Since it has been almost four years since the last minor correction and many years since the start of this bull market, you may have accumulated a large sum of unrealized gains in your portfolio. Perhaps you have held onto investments that were not as attractive as they had been simply because you were trying to defer the capital gains tax.

Capital gains on investments are taxed as ordinary income if the investment is held less than 12 months. If the investment has been held longer than 12 months, the rate varies depending on your income and has a top rate of 20% plus a Medicare surcharge of 3.8%. Selling investments that are at a loss reduces these taxes.

Corrections offer some investors the opportunity to book losses in investments that can be used to offset current and future investment gains. Even if you have concluded that you want to own the investment, you can sell it today if it has a loss and re-purchase it in 31 days. The repurchase price becomes your new cost basis, and the loss that was realized can be used against any gains this year and even used to offset gains into the future. During those 31 days, you can buy any different investment that might have similar characteristics so you don’t miss a market rebound. For example, if you have a loss in a recent purchase of Pfizer (PFE), you might sell the stock for the loss and buy Merck (MRK) to own for at least 31 days. In this way, you maintain your exposure to pharmaceutical stocks.

“Corrections offer some investors the opportunity to book losses in investments that can be used to offset current and future investment gains.”
This is also a very effective strategy for investors that have been holding large positions in very low basis stock for years. During the short-term market decline, losses across a portfolio can be harvested. Those losses then can be used at any appropriate time in the future to help reduce the over-exposure in the low-basis stock.

Selling stocks in a correction is usually not a wise investment strategy. However, some investors have specific tax situations in which a short-term sale can bring valuable tax benefits. Before pursuing a tax-sale strategy, check in with your investment advisor and accountant to be sure the benefits make this the right strategy for you.

4. Do nothing

The S&P 500 has had one-day declines of 3 percent or more nearly 100 times since 1950 and has had two dozen days where it fell by 5 percent or more in a single day. It used to be more common to see slow-motion crashes, where big declines were spread out over several trading days rather than these one-day crashes. However with high frequency traders, we may see more and more of these large one day swings in the market. Keep in mind that these swings are unpredictable and they have all been followed at some point by a meaningful rebound. That means that if you take your money out of the market during declines, unless you get back in at just the right time, you’ll miss the benefit of the market recovery.

Over the long term, equity market returns have essentially been positive. Therefore, investors who are out of the market for any period of time can expect to lose money relative to a long-term investment strategy. Research has shown that over 20 years (ending 2013) investing in the market consistently led to an annual return of over 9%. Missing just the 5 best days in the market reduced that annual return to 7%. If you sold every time the stock market declined 5 percent and bought back each time it gained a percentage after it bottomed out, your holdings would still be much less than if you had left it untouched and invested all that time. Investing in the stock market takes a long-term commitment and by selling in a down market, you lose money every time you wait for a rebound. As long as you have no immediate need for the money, the best thing to do is to ignore the day-to-day ups and downs entirely and leave your investments set for your goals, such as retirement and college tuition.

Prospering in uncertain times is possible.

Many investors report that they worry about the downside losses in their portfolio more than the upside gains. These fears often come bursting out during market corrections even as they know that investing in the stock market requires a long-term commitment. These investors often feel they have to do something when markets are gyrating. If you are such an investor, try following these four steps to help you make the commitment you need to grow your savings and fund long term goals. There is risk in any market investment, and you can always lose money. However, market volatility alone is not usually the reason investors lose money in the long-term; it is by buying and selling in fear rather than confidence. By sticking to your thoughtful disciplined investment strategy throughout turbulent times, your investments can still reach all your goals with a long enough time horizon.
After more than 20 years’ experience on Wall Street, Liz Miller founded Summit Place Financial Advisors to offer personalized asset management and financial consulting and coordination to elite families and individuals.

Liz started her career as a mergers & acquisition analyst and proprietary trading analyst for The First Boston Corporation. She went on to become a mutual fund portfolio manager for Oppenheimer Funds and spent 15 years managing portfolios for institutions and individuals with Trevor Stewart Burton & Jacobsen Inc. in New York.

Liz received a B.S in economics from The Wharton School at the University of Pennsylvania and an M.A. from Columbia University. She holds the Chartered Financial Analyst designation from the CFA Institute, the Chartered Investment Counselor designation from the Investment Advisor Association and the Certified Financial Planner™ designation.

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