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Handling Market Volatility

Conventional wisdom says that what goes up, must come down. But even if you view market volatility as a normal occurrence, it can be tough to handle when it's your money at stake.

Though there's no foolproof way to handle the ups and downs of the stock market, the following common sense tips can help.

Don't put your eggs all in one basket

Diversifying your investment portfolio is one of the key ways you can handle market volatility. Because asset classes often perform differently under different market conditions, spreading your assets across a variety of different investments such as stocks, bonds, and cash alternatives (e.g., money market funds and other short-term instruments), has the potential to help manage your overall risk. Ideally, a decline in one type of asset will be balanced out by a gain in another, though diversification can't guarantee a profit or eliminate the possibility of market loss.

One way to diversify your portfolio is through asset allocation. Asset allocation involves identifying the asset classes that are appropriate for you and allocating a certain percentage of your investment dollars to each class (e.g., 70 percent to stocks, 20 percent to bonds, 10 percent to cash alternatives). A worksheet or an interactive tool can suggest a model or sample allocation based on your investment objectives, risk tolerance level, and investment time horizon, but your strategy should be tailored to your unique circumstances.

Focus on the forest, not on the trees

As the markets go up and down, it's easy to become too focused on day-to-day returns. Instead, keep your eyes on your long-term investing goals and your overall portfolio. Although only you can decide how much investment risk you can handle, if you still have years to invest, don't overestimate the effect of short-term price fluctuations on your portfolio.

Look before you leap

When the market goes down and investment losses pile up, you may be tempted to pull out of the stock market altogether and look for less volatile investments. The small returns that typically accompany low-risk investments may seem downright attractive when more risky investments are posting negative returns.

But before you leap into a different investment strategy, make sure you're doing it for the right reasons. How you choose to invest your money should be consistent with your goals and time horizon.

For instance, putting a larger percentage of your investment dollars into vehicles that offer safety of principal and liquidity (the opportunity to easily access your funds) may be the right strategy for you if your investment goals are short-term or if a long-term goal such as retirement has now become an immediate goal. But if you still have years to invest, keep in mind that although past performance is no guarantee of future results, stocks have

historically outperformed stable value investments over time. If you move most or all of your investment dollars into conservative investments, you've not only locked in any losses you might have, but you've also sacrificed the potential for higher returns.

Look for the silver lining

A down market, like every cloud, has a silver lining. The silver lining of a down market is the opportunity you have to buy shares of stock at lower prices.

One of the ways you can do this is by using dollar cost averaging. With dollar cost averaging, you don't try to "time the market" by buying shares at the moment when the price is lowest. In fact, you don't worry about price at all. Instead, you invest the same amount of money at regular intervals over time. When the price is higher, your investment dollars buy fewer shares of stock, but when the price is lower, the same dollar amount will buy you more shares. Although dollar cost averaging can't guarantee you a profit or protect against a loss, over time a regular fixed dollar investment may result in an average price per share that's lower than the average market price, assuming you invest through all types of markets. A workplace savings plan, such as a 401(k) plan in which the same amount is deducted from each paycheck and invested through the plan, is one of the most well-known examples of dollar cost averaging in action. Please remember that since dollar cost averaging involves continuous investment in securities regardless of fluctuating price levels of such securities, you should consider your financial ability to make ongoing purchases.

Don't count your chickens before they hatch

As the market recovers from a down cycle, elation quickly sets in. If the upswing lasts long enough, it's easy to believe that investing in the stock market is a sure thing. But, of course, it never is. As many investors have learned the hard way, becoming overly optimistic about investing during the good times can be as detrimental as worrying too much during the bad times. The right approach during all kinds of markets is to be realistic. Have a plan, stick with it, and strike a comfortable balance between risk and return.

Don't stick your head in the sand

While focusing too much on short-term gains or losses is unwise, so is ignoring your investments. You should check up on your portfolio at least once a year, more frequently if the market is particularly volatile or when there have been significant changes in your life. You may need to rebalance your portfolio to bring it back in line with your investment goals and risk tolerance, or redesign it so that it better suits your current needs. Don't hesitate to get expert help if you need it when deciding which investment options are right for you.

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