Why Market Corrections Can Be A Good Thing

Our investment clients know that we have been saying for at least 18 months that we are due for a market correction, and it appears that we currently have it happening.

A market correction is not necessarily a bad thing!

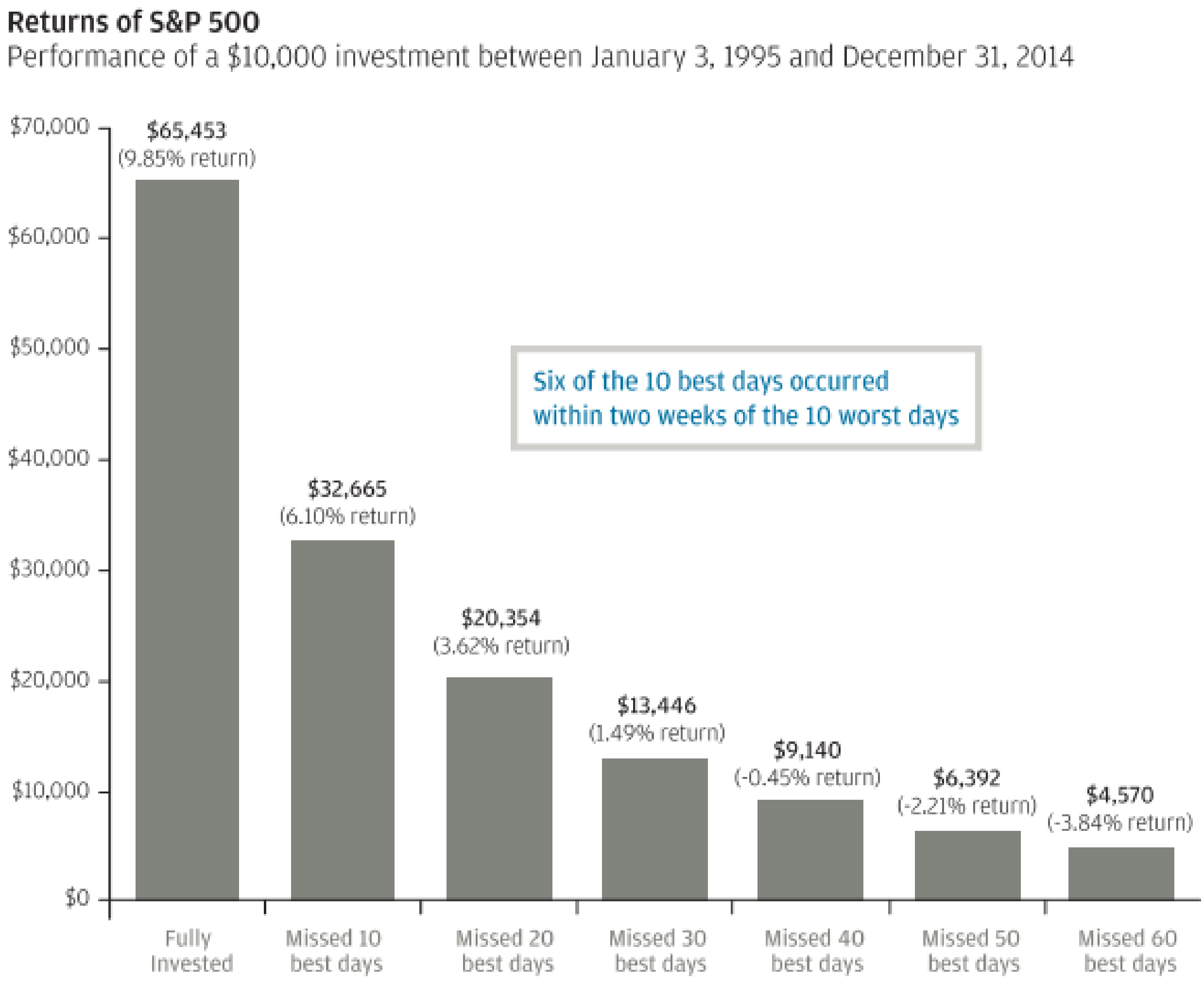
Market corrections happen OFTEN. It is in the nature of share markets (and property markets) to peak and trough.

Market corrections RARELY LAST LONG. The average share market correction in the last 70 years (from 1945) has averaged 87.8 trading days (source: USA Today 24/8/15). That is just over 17 weeks as an average correction.

Market corrections are NOT PREDICTABLE. They are inevitable, but no matter how clever we think we are, no-one can accurately predict when they will arrive. And once they arrive, no-one knows when the magic upswing will happen until it has taken place! In an upswing, if you miss the first 3 days of the upswing, you have missed the best value of the upswing.

Take advice on whether to HOLD YOUR POSITION. Over the medium to long term, people who keep calm and hold their position make considerably more money than people who come in and out of the market.

The chart below comes from J P Morgan Asset Management and appears in their 2014 guide to retirement. The chart shows that not remaining invested can be really detrimental. The first bar shows the return if a client was invested in the S&P 500 every day for 20 years.



Source: *Guide to Retirement 2015 Edition - J.P. Morgan Asset Management*

Using this strategy gives the investor an average annual return (in US dollars) of 9.2% per annum. If the same investor missed the 10 best days in the market over that 20 year period (which is 0.13% of the time that the money was invested), the annual return over 20 years drops to 5.49% per annum over 20 years.

Frequently, the best days in the market are the initial upswings after a market correction. And as you can see, missing the best 60 days in 20 years (or 0.8% of the time that the money was invested) reduces your return to 4.3% per annum.

The other reason that market corrections are good is because they BRING OPPORTUNITIES. They offer a value point to buy new investments.

They also cause investors to STOP AND THINK about what they are doing. In a rising tide, all boats float. If the markets are storming along, even mediocre investments can look good, and taking more risk seems to be an easy choice to make. But in the words of Warren Buffett “only when the tide goes out do you discover who has been swimming naked”. Not all investments are created equal, and what appeared to be a “safe” strategy or a “safe investment” is not always as it seemed when the tide was coming in.

Janet Natta **is a financial adviser and director of Smart Money Advice, offering investment portfolio construction and management services to clients throughout NZ, as well as comprehensive financial planning advice to assist clients to build and protect wealth to achieve their dreams.**