What Does the Market Decline Mean for You?

Presented by David M. Weidmayer

Market drops are scary, especially when they come day after day. The decline on Monday, February 5, was particularly bad. In fact, it has been billed as the largest point drop ever for the Dow Jones Industrial Average. Looking at that, it's normal to think that the stock market is in a downward spiral. History shows, however, that this is often not the case. Although declines like we have seen in the past week are not fun, they generally are not reason to panic.

Putting the decline in context

Let's look at this more closely. February 5 was a bad day; the last time we had a day like that was in 2011, about seven years ago. This tells us two things about how we should react. First, this was an unusual event, so we should be paying attention. Before we get to the second, though, answer this: Do you remember when the market had that bad day in 2011? Has it affected your life since then? The answer for almost everyone is no, which tells us the second thing—that bad market days don't really matter over time. What matters is how markets perform over the long term. If you ignored that bad day, and forgot about it, you probably ended up doing quite well.

Here's something else to consider. This market drop has taken us back to the levels of late November 2017. So, the drop, in fact, doesn't look all that bad. We are still near all-time highs. And we are still above the long-term trend lines that support further market gains. In other words, from a market perspective, we are still in good shape.

This is possible because the economic fundamentals remain very strong. Consumer and business confidence are high, hiring and investment continue, and economic growth appears more likely to accelerate than to slow. Corporate earnings are growing rapidly, and expectations are getting better, not worse. The factors that have driven the market to all-time highs are still there, ready to support it despite the recent declines.

So, what is driving the market down? In short, a break in confidence. Perhaps investors started to worry when interest rates moved up at the end of January. Or maybe they are growing more concerned about the pending debt ceiling debate. Whatever the reason, they became less confident—and decided to sell. The question now is whether that loss of confidence will hold or not.

The strong economic fundamentals suggest that confidence will come back—and with it, so will stock valuations. We saw the same situation in early 2016, the last time the market declined significantly, when confidence faded and then returned—and with it, so did the stock market. We have seen this movie before, and it had a happy ending.

Keep your focus on the long term

Happy endings aside, we could certainly see a further decline from here. These confidence-led declines tend to be sharp, so more downward moves are possible and even likely. They also tend to be short, however, burning themselves out relatively quickly.

The biggest risk for most investors is panicking over short-term volatility. If you had sold on that bad day in 2011—the one you don't remember today—you would have missed out on years of gains. Short-term pain is, unfortunately, the price we pay for long-term gains.

None of which is to minimize how real that short-term pain is, of course. We all feel it. The right solution, though, is to understand where that pain comes from—and do our best to ignore it. That way, we can remain focused on maintaining a well-diversified portfolio aligned with our long-term financial goals.

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