Stock Market Corrections & Your Investment Strategy

If you're worried about the stock market's recent swings, consider taking a deep breath. Remember what we can learn from history, assess your long-term plans and implement some grounded, common-sense steps

Begin with basics What we know from history	Page 1
Create your plan and get help if you need it Start (or continue) dollar-cost averaging Start or build emergency savings	Page 2
Plan for the Long Term Asset allocation & diversification Stay calm & invest only in what you understand The bottom line	Page 3

Begin with the basics

Stocks, real estate, bonds or other investments have specific sectors or regions that can be impacted at any time. When there's an overall drop in prices across an index of 10% or more, experts consider it a **market correction.**

Many types of perceived risks can cause investors to sell. Political risks, widespread pandemic fears, business risks and other factors can cause investor panic. In our recent history, anything from a change in the presidency to a potential threat of a virus can be blamed for market upheaval. Whether rational or irrational, it can drive down the prices of stocks.

What we know from history

Market corrections are normal. If you consider the long-term upward trend of the stock market versus other investments, you'll see that within a few years of a severe market correction, most investments recover.

No one knows exactly how long it will take. Even the best analysts, who try to predict the peak or the bottom of the market, never know whether their predictions were correct until time passes. Some market corrections are more significant than others, but the important concept to remember is that **financial markets go through cycles.**

That being said, what if you didn't plan ahead for a market crash or get your finances completely in order? What can you do?

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Create (or stick with) your plan and get help if you need it

Prepare for the days when the market is down. While it's great to pat yourself on the back for your decision-making on a good stock market day, you should also expect that no matter how good your choices are, you'll still have days that are frustrating.

You've probably heard the old investing mantra, "buy low" and "sell high," but many people don't have the stomach for waiting it out. Investor behavior and emotional reaction are often to blame for irrational decisions. Too many investors sell at market lows when they feel they have to "get out" before the market goes any lower. Later, when there's an upward trend, most investors tend to "get in" close to the top of the market cycle. This phenomenon can lead to lower-than-average returns over time.

If you get stressed or uneasy and need someone to talk you out of possibly making poor choices, or simply want to get an expert opinion, consider working with an investment advisor.

Start (or continue) dollar-cost averaging

Dollar-cost averaging is consistently contributing to your investments regardless of market prices. This means that you buy when prices are low and high, rather than trying to buy on "the right day."

The good news is that when the market drops due to a correction, prices to buy are lower. If you have the funds available, it's an opportunity to buy great companies when they cost less. Be brave and start (or continue) investing with every paycheck.

An example of dollar-cost averaging is consistently contributing to a 401(k) or other retirement plan, meaning that you'll buy when share prices are low, and as the market recovers, you'll purchase shares at a higher price. Over time, the share price will average out.

And remember, if you receive an employer match to a retirement plan, it is "free" money that provides an instant return for the dollars you invest. **If your employer provides a matching contribution, take advantage of this benefit by contributing at least the minimum amount to receive the match.**

Start or build emergency savings

Having cash available if you need it will give you some peace of mind.

If your household suffers a loss in income, if you get a large medical bill or you want to take advantage of the discounted prices on stocks, you'll have savings to do it. Just make sure you always keep enough cash to cover expenses for 3 to 9 months, or keep building the account until you do.

Plan for the long term

If you did some planning prior to starting your investing journey, you'll remember that any money invested in the stock market should be long-term dollars that you don't need to spend this year, next year, or even five years from now. If market ups-and-downs make you nervous, remember that you won't be using this money for a long time.

If you do need to use some of your investment money, consider the timeframe for when you will use it. Money needed within one to five years should not be invested in the stock market. It should be in a safe, liquid account that can be accessed without penalty.

An example of this is emergency savings: be sure to have enough to cover living expenses of three months or more, and never invest emergency savings in anything other than a cash or cash equivalent account. If you need to use some of your emergency savings, you want to know that the full amount is readily available.

Asset allocation and diversification

Having the right mix of investments for you means having a balance of some level of risk-taking in an effort to gain a higher return and beat inflation. However, you should carefully consider the timeframe until you plan to use the money.

As you think about your comfort level with risk, along with your time horizon for the investments, you can complete an asset allocation questionnaire to come up with a balance of investment types and percentages in each investment category like stocks, bonds, and cash. By having a mix of investments, you balance out some risk by being diversified or avoiding having "all of your eggs in one basket."

Most experts recommend no more than 10-15% maximum in any one investment, to reduce your exposure to risk. This includes company stock, which many employees tend to hold, especially if it has performed well.

Stay calm & invest only in what you understand

Just as it can be scary to look at your account statements when the market is dropping, it can also be easy to get caught up feeling like you're missing out on the next hot investment if the stock market is recovering. If you're the type of person who doesn't want to miss out, try to exercise some caution.

Avoid investing based on hype over a new tech start-up or emerging industry.

If you decide it is time to invest, do your research. If you don't understand it, you may be taking risk without knowing it.

Consider working with an investment advisor if you are not confident in your ability to research investments and to understand all of the possible risks.

The bottom line

The next time you see headlines about a stock market correction, keep in mind that it's temporary and just a part of the market cycle. By taking steps to create a plan and prepare to patiently wait out a downturn, you can stick to your long-term plan.

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