Keeping calm and staying invested

Taking the fear out of FOMO ('fear of missing out')

KEY POINTS

- Investors who exit the market to avoid a fall may miss out on strong returns before and after market `peaks'
- The compounding effect means that relative losses are likely to be significant over the long term
- Volatility is often short-lived — it might be that staying invested helps lock in long-term gains

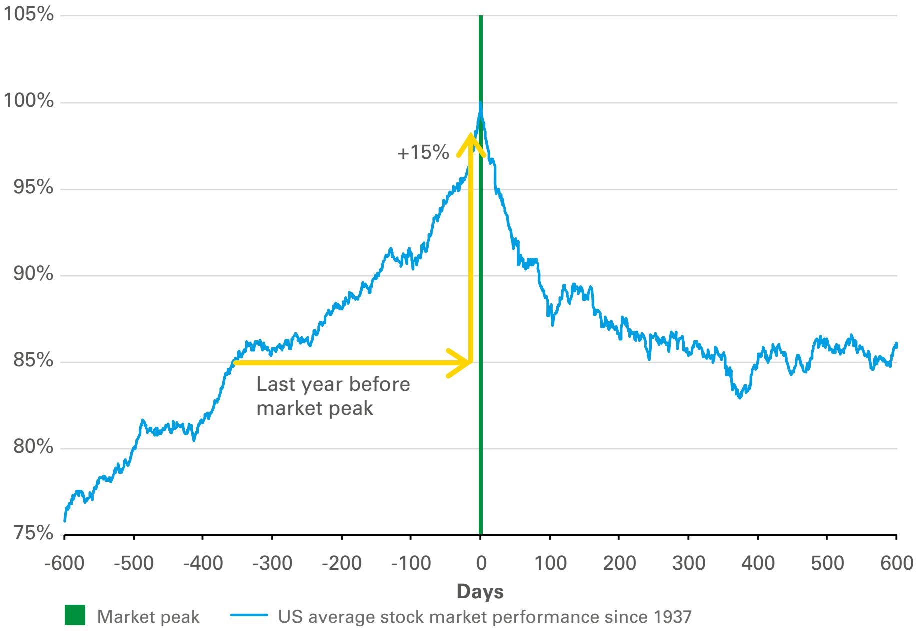
Recent years have been dominated by drastic political and economic headlines. With a number of risk events on the horizon, investors may be feeling nervous.

Markets often take their cue from elections, referenda, policy changes and economic guidance by governments. When these give cause for concern, markets experience periods of volatility. More than a decade after the global economic crisis of 2008, there are signs that we are once again entering the 'late' stage of the economic cycle. Many share prices are hovering at record heights, inflation is picking up, and markets may be extra-sensitive to any bad news. However, selling up could cost investors a lot more than just an average few days', or months' return.

TIMING THE MARKET OR TIME IN THE MARKET?

'Timing the market' seems like a deceptively easy investment strategy.

Figure 1: Average gains before and losses after the US stock market peak



Source: LGIM. The value of investments and any income from them may fall as well as rise, and investors may get back less than they invest. Past performance is not a guide to future performance.

Investors sell their portfolio, or simply stop adding to it, before a market downturn and then start buying again once prices have fallen.

Yet it is difficult to know when the market will 'turn'. As you can see from the chart above, the period leading up to a fall — known as 'late stage' — has often seen a period of accelerated returns. In trying to guess when the fall will happen, investors could be sacrificing a considerable amount of return by exiting the market too early.

Legal & General
INVESTMENT MANAGEMENT

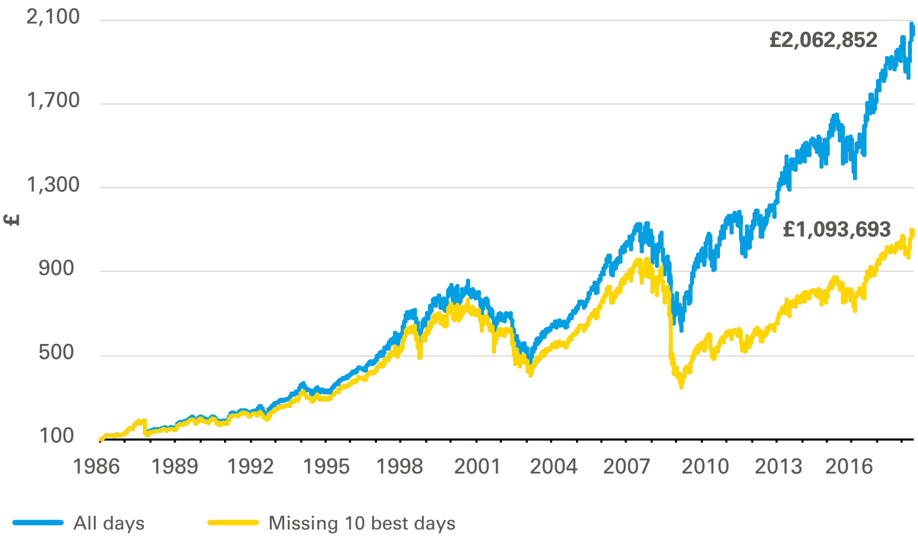
Often after a sharp fall, historically, there has been a period of rapid correction, where markets retrace their losses and actually move higher. In some cases, this has happened over a single day, and these have made up some of the best performing days over a long time (as in the chart opposite). These 'best days' have often happened shortly after the markets have sustained a shock – even in the first few weeks.

Being out of the market means investors may miss out on some strong returns, as well as repurchasing their holdings at a higher price than they sold them for.

Over the long term, the effect of missing out on the ten best performing days makes a pronounced difference to a portfolio's performance, owing to compounding (the cumulative effect over time of investing returns back into the market). As figures two and three demonstrate, this is true of share and bond indices.

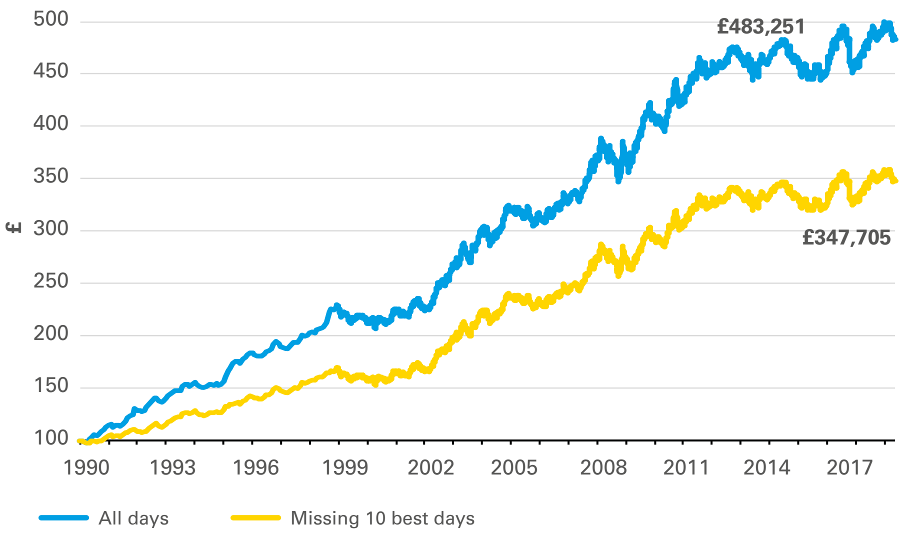
Volatility often comes in short bursts, which is why we believe staying invested and riding through the storm might just be the path to stronger long-term performance. Sometimes, a little 'fear of missing out' is no bad thing.

Figure 2: Effect of missing the 10 best days of the FTSE All Share TR Index 1986 - 2018



Source: LGIM, Bloomberg

Figure 3: Effect of missing the 10 best days of the Barclays Global Aggregate Index 1990 - 2018



Source: LGIM, Bloomberg. The value of investments and any income from them may fall as well as rise, and investors may get back less than they invest. Past performance is not a guide to future performance.