What to Do While the Market Tanks

The Motley Fool

By John Rosevear

Why do market corrections upset us so much? We all know—at some level—that the market is bound to hit bumps on its march upward, and some of those bumps will be big ones. But even so, those selloffs tend to be white-knuckle heartburn-inducing rides. I think there are two big reasons why that's the case.

Corrections tend to be fast and big. The market might spend a year going up 20% only to give up three quarters of that gain in a few trading days. The downward spikes happen so quickly that it's hard to avoid the fear that they'll keep going all the way to the bottom, even if we "know" that that's incredibly unlikely.

We hate losses more than we like gains. This principle, which the pros call "loss aversion," is a cornerstone of behavioral finance and was demonstrated by Nobel laureate Daniel Kahneman and Amos Tversky in a famous (among finance geeks, anyway) 1979 paper. Research has shown that losses may have as much as *twice* the psychological power of equivalent gains—in other words, the upset we'd get after losing half our portfolio is twice as big as the joy we'd get if our portfolio doubled. I don't quite understand how they measure it, but that sounds about right to me.

Put these two together, and what you get is this: When the market goes down hard, investors panic and sell, hoping to avoid further losses. Even if you know better, it's still tempting to sell—I've done it, many pros have done it, and if you've been investing for any length of time, you've probably felt the urge to sell on dips like last week's—even if you haven't actually sold.

Of course, selling on market dips is usually a bad idea, even if it is human nature. Not only do you lock in a loss, but you also pass up good *buying* opportunities. I probably have a dozen books on my shelves that quote Warren Buffett's famous dictum: "Be fearful when others are greedy, and be greedy only when others are fearful."

One reason Buffett's a multibillionaire while most of us aren't is that he has been able to hold on to his hat, swallow his emotions, and approach market dips rationally. He's one of many savvy value investors who buy up those good stocks that we've rushed to sell—and then make a bundle during the recoveries that follow.

How might we join them?

Grab an umbrella

It's best to think of a correction as a passing storm. You don't abandon your beach holiday and go home when a thunderstorm hits, do you?

Continued on back

Here are some things to keep in mind when squalls hit the market.

Don't panic. The market has *always* recovered. Odds are high that it'll recover this time, too. Remember that your investment horizon is years away, and corrections are often over and gone in a few weeks—and remember that you're wired to panic when you see losses, even "paper" losses. *Unless your reason for owning a stock has fundamentally changed*, there's no good reason to sell—even if the dip drags on for several months.

Remember that corrections often bounce. Sometimes, recoveries happen more quickly than the correction did—and even during the correction, prices will bounce up and down. Selling might increase your distress when you see prices recover a few days or weeks later. Some folks sold **Apple Computer** (Nasdaq: AAPL) at $135 last Wednesday—it closed near $144 just *two days later*. Oops.

Look for buying opportunities. It goes against our natures to plow *more* money into the market when things are looking bad, but... well, see that Warren Buffett quote above. For a buyer, a correction means that stocks are on a storewide sale. So take a look at your favorite stocks and see whether you can grab some bargains. Sure, they might go lower—but even if you don't get the lowest price, you can still set yourself up for good long-term gains.

If all else fails, just go to the beach. Or the lake, or the mountains, or the ice cream shop, or the library, or wherever you go when you're taking some time for yourself. Seriously: If you're fully invested in good stocks, there's really no need to do anything. Turn off your computer, skip your nightly date with CNBC, and use the business section of the Sunday paper to line the bird cage this week. If you built your portfolio using sound investment principles, those principles are *still* sound, even if Mr. Market is having a tough month. Have the confidence to walk away from it, and let Mr. Market work out his indigestion on his own.

Want more great advice on improving your personal finances? Check out the Fool's Green Light newsletter service. Each month's issue offers excellent tips that together can save you hundreds of dollars—guaranteed. Get full access free for 30 days—there's no obligation to buy.

Fool contributor John Rosevear invites you to send him your comments, questions, and ideas. He owns shares of Apple. The Motley Fool has a disclosure policy.