5 Investing Mistakes to Avoid during a Downturn

Prepared by: Affin Hwang Asset Management

A market downturn can be scary. The past month has seen one of the most volatile swings in stock market history that can unnerve even the steeliest investor. But many forget that we've been through this before.

Whether it's selective memory or a case of financial amnesia, many investors might give in to their worst instincts that often leads to poor investment decisions. Here are 5 common investing mistakes to avoid that could set you back even further in a downturn.

1 Panic Sell

It can be painful to see a sea of red in your portfolio. But giving in to fear and panic selling would only crystallise your losses and making them permanent. Instead, take a long-term view of your portfolio by realising that markets move in cycles and that downturns are temporary.

History shows that each bull cycle tends to end higher than the previous top. For example during the 2008-GFC, global markets plummeted as the subprime meltdown spread carnage around risk assets. However, markets found its bottom in March 2009 and eventually recovered to former levels and beyond that.

More recently in March 2020, stock markets cratered as the COVID pandemic shuttered the global economy with the MSCI World Index plunging by 34% in a span of 6 weeks. However, the recovery was equally swift with benchmark gauges retracing back their losses in April and notching new highs since then.

Investors who cashed out entirely from the market has no chance of recouping back their losses or riding the eventual recovery.

2 Trying to Time the Market

Another common mistake is that investors may attempt to time the bottom by selling entirely and then piling back in when markets start to rebound. Unfortunately, investors even professional ones rarely get both the timing right and end up in a far worse position than they were before.

Instead, practice dollar-cost averaging by continuously investing in fixed sums through regular intervals. This helps lower the purchase price of your investments over time by taking advantage of market dips as well as reducing the risk of bad timing or investing according to one's emotions.

3 Inflation Hedge

Investors are advised to rebalance their asset allocation (% equities, % fixed income) at least biannually to correct portfolio drifts back to its target allocation. However, a major market movement such as a downturn could also throw it off balance.

In a downturn, the % equity portfolio of the portfolio would tend to fall much more than the target allocation as global stocks are sold down. Jittery investors may neglect to rebalance it back and increase their exposure in equities because they are worried of the volatility occurring now in markets. After all, it sounds counterintuitive to invest when market conditions are shaky.

However, it's important to do so in order to stay on track towards achieving your long-term goals. Rebalancing is also important to ensure that you are taking the desired level of risk that you have set out in your investment plan. Taking too little risk especially for young investors who have a long time-horizon to recover from market dips may not be making full optimal use of their financial resources and capital.

4 Cutting your Winners and Hanging on to Your Losers

An important investment maxim is to 'ride your winners and cut your losers' from your portfolio. It sounds logical, but during a downturn investors tend to do the opposite as they attempt to stem losses. Thus, they lock-in gains from their winners in order to compensate for losses in other areas of the portfolio.

But this only digs a deeper hole for the investor who could be worse-off in the future by hanging on to the portfolio's losers. Instead, establish clear parameters for corrective action where needed in your investment plan to avoid mistakes like these.

Be clear about the particular asset class' fundamentals and be rational in your decision. Sitting down with an investment professional can help you in this step to glean a better perspective of your portfolio to preserve capital and spread risks.

5 Monitoring and Doing too Much

In a downturn, investors are often plugged-in to news alerts and social media to keep up-to-date with markets. This could prompt investors to buy, sell and sometimes even take advice from unscrupulous 'financial gurus' with a hidden agenda.

But looking at your portfolio 24/7 and tinkering with it too much does not usually end well for the investor. Financial anxieties kick-in and you start to lose sight of your goals including why you've decided to invest in the first place. Learn to tune out the noise and take every sensational headline with a pinch of salt. Media outlets rely on eyeballs for advertising revenues and clickbait articles are their go-to tactic.

Instead, stick to your investment plan through regular contributions and practice diversification. Ensure that your portfolio is geared towards its stated purpose with an asset allocation that matches your risk-tolerance.

Keeping Perspective

The first rule in any market downturn is to stay calm. We may not always be in control of any given situation, but we can control how we respond to it. This is especially true for investing where succeeding has little to do with how much you know, but rather how you behave. Thankfully, it mostly involves inaction, staying the course and lots of patience.

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