Understanding market downturns

For prepared investors, market downturns can represent great opportunity

Nearly everywhere you turn, from friends and colleagues to cable news shows, you can find someone with a strong opinion about the financial markets. People will often use specific terms, such as *correction* or *bear market*, to render judgments about the direction of markets, especially when market performance is choppy or trending down.

Is it worth getting concerned when markets stop or even reverse their upward advance?

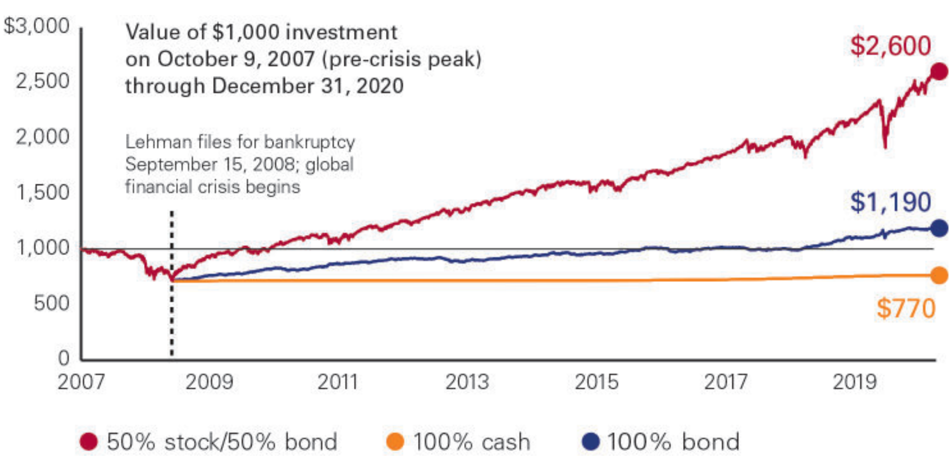
To answer that, it's important to realize that downturns are not rare events: Typical investors, in all markets, endure many of them during their lifetimes.

Even knowing this, it can be unsettling to witness the decline of your portfolio during one of these events. After all, that account balance is more than a number—it represents very important personal goals, such as the ability to retire comfortably or to provide a quality education for family members. When market conditions jeopardize those goals, you may feel compelled to do something, such as sell most of or all your investments. You may assume that converting to cash will give you a better long-term result than staying invested.

But such action would shut you out of the strong recoveries that have historically followed market downturns. The answer is to come up with a game plan before the next market pullback, so you're well-positioned to try to take advantage of the opportunities that follow. What's more, you'll probably know what to expect as markets cycle through their phases, so you can tune out messages that don't help your strategy.

It's worth noting that not all financial declines are the same in length or severity—for example, historically speaking, the global financial crisis of 2008–2009 was an extreme anomaly. As challenging as that event was, it was followed by the longest stock market recovery in U.S. history.[1]

Riding out a rough period



Sources: Vanguard calculations, using data from FactSet. All data as of December 31, 2020.

Notes: This is a hypothetical illustration. The balanced portfolio is represented by 50% S&P 500 Index and 50% Bloomberg Barclays U.S. Aggregate Bond Index; bonds are represented by Bloomberg Barclays U.S. Aggregate Bond Index; and cash is represented by 3-month Treasury bills. *Past performance is no guarantee of future results. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.*

1 Lu Wang, "The Bull Market Almost No One Saw Coming," Bloomberg Businessweek, December 15, 2019, https://www.bloomberg.com/news/articles/2019-12-15/the-bull-market-almost-no-one-saw-coming, accessed on December 19, 2019.

Since 1980, there have been:

19 Corrections
Declines of 10% or more

10 Bear markets
Declines of 20% or more, at least two months long

6 Recessions
Declines in economic conditions for two or more successive quarters (refers to declines in the broad economy rather than the financial markets, though the two can be linked)

Source: Vanguard.

Notes: Figures for corrections and bear markets based on MSCI World Index from January 1, 1980, through December 31, 1987, and the MSCI AC World Index (price return) from January 1, 1988, through December 31, 2020. Number of recessions based on S&P 500 Index (price return) from January 1, 1980, through December 31, 2020.

Best defense: Making a plan and sticking to it

We can develop a plan now that prepares you and your portfolio for financial system shocks, whenever they happen to occur. That means focusing on the factors of your investing strategy we can control (including things such as asset allocation and costs) and not worrying about those things out of our control, such as downturns in the markets and economy.

In the meantime, remember that bearish market conditions—while inevitable—don't last forever. As a savvy investor, you can ignore short-term pullbacks of the market (and any commentary that might cause you to veer off course) and remain committed to achieving your long-term vision.

Downturns come and go. The results of a well-designed and faithfully followed plan, on the other hand, can serve you the rest of your life.

In coming up with the best plan for you, it is helpful for you to think about the following:

- How do you feel about risk? Are you okay with a greater amount of up-and-down movement in your portfolio if it means potentially higher returns? Or, alternatively, would you rather have more stability in your portfolio even if it means forgoing higher returns?
- Where are you along your investing journey? Depending on how close you are to retirement or other financial goals, we can adjust your portfolio's risk profile to a level appropriate for your personal risk-comfort level and investing objectives.

Notes: All investing is subject to risk, including the possible loss of the money you invest.

Mid- and small-capitalization stocks historically have been more volatile than large-cap stocks.

Investments in bonds are subject to credit, interest rate, and inflation risk. High-yield bonds present higher credit risk than other types of bonds.

Be aware that fluctuations in the financial markets and other factors may cause declines in the value of your account. There is no guarantee that any particular asset allocation or mix of funds will meet your investment objectives or provide you with a given level of income.