The Market Is Crazy

On August 24, 2015, the stock market went crazy. Sure, the market is crazy enough on most days, but on this particular day it went particularly crazy.

The stock of Johnson & Johnson, a nearly $300 billion healthcare company you are probably familiar with, dropped more than 14% at one point that morning. *Fourteen percent!* That completely, though only temporarily, wiped out all the gains JNJ experienced over the prior two and a half years.

The stock of Home Depot, a nearly $200 billion home improvement retailer, also fell precipitously shortly after the market opened for business at 9:30am. By 10:30am, HD stock was back up again, 25% higher than it had been less than an hour earlier.

For the stocks of such large, stalwart companies to swing around so much in such a short amount of time is nothing short of insane.

To Black Friday And Back, All in One Morning

And it wasn't just J&J and Home Depot. Pepsi dropped more than 20%, Bank of America fell 10%, General Electric was down 22%, and on and on. *General Electric down 22% in one day?!* That's how far the Dow Jones Industrial Average fell on Black Friday in October 1987!

All of this news would be crazy enough if the stocks had stayed down at those levels for a while. But the truly crazy part is that most of them recovered nearly all of their losses before most traders had taken their mid-morning coffee break:

source: Google Finance

What is an investor to do amid such craziness? How should you respond? We have three thoughts to share.

Thought #1: Crazy Is Normal

The first thought is that the market is always crazy. Always has been, always will be. Of course, sometimes days like August 24 come along, making us think that it's crazier than it's ever been. But most of that perception is due to the fact that the market has seemed so *un-crazy* for the past few years.

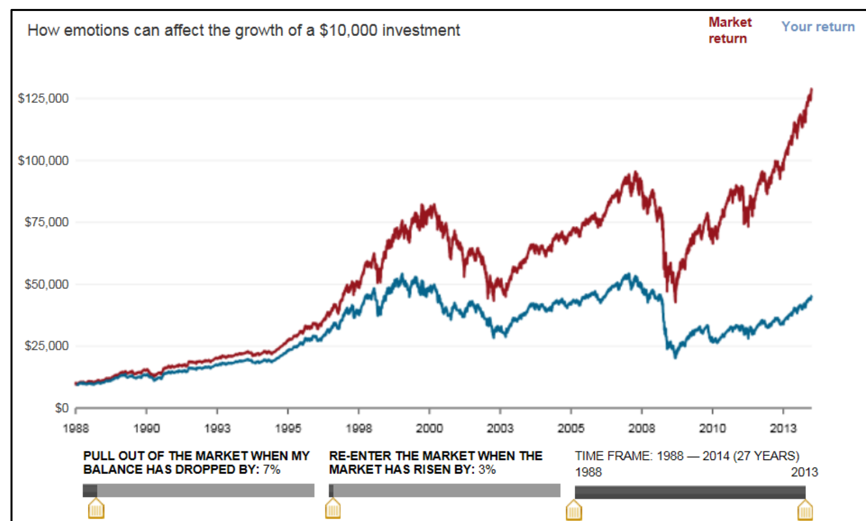
Since touching bottom in March 2009, it's been a relatively smooth ride up for the overall stock market from then until now. There has been precious little volatility over the prior six and a half years, which is rare. So when a violently volatile day like August 24 comes along after such a long stretch of tranquility, it seems even worse than it actually is.

Thought #2: Stay the Course

Our second thought is that investors should stay calm and stick to the plan in the midst of great upheaval. It can be incredibly tempting to try to get out of the market before a big drop, then get back in before it recovers again. Though many have tried to succeed at that task over the years, none have come up with a foolproof system for doing so. Emotions always get the better of such "market timers," but even with a mathematical system in place to over-ride such emotions, investors who stay invested throughout the volatility still do better than market timers.

Vanguard has a cool tool that demonstrates this fact on their website. You can set the numerical parameters for timing the market, but for practically every time frame and every possible set of parameters, portfolios that stay invested throughout the volatility perform better than market-timing portfolios. Go ahead and check it out for yourself: it's fun to play around with.

Below is one example chart from that site. The red line shows the value of a portfolio that stayed invested throughout the ups and downs of the market, while the blue line shows the value of a portfolio that tried to time its entry and exit points according to a mathematical formula.



source: Vanguard

And while the market can experience some days where prices drop precipitously, it's important to remember that it can also experience days where prices rise dramatically. If you are attempting to time the market and you miss out on a few of those days, the results can be devastating.

Consider the period 1990 through 2014. There was a long bull market that culminated in the Internet bubble in 2000, followed by a three-year bear market, then another bull market that ended with the Great Financial Crisis of 2008, followed by another bear then another recovery.

For an investor who bought in 1990 and held on throughout the vicissitudes to the end of 2014, she would have earned an annualized return of +9.6%. Not bad. An initial $100,000 investment would have been worth $994,000 at the end, just shy of an even million dollars.

But if she had happened to miss out on the 35 best days of that 6,300-day period (in other words, just 0.6% of all trading days), her return would have been just +0.2% per year. In this case, $100,000 would have grown to just $106,000, and that doesn't even take into account the capital gains taxes that would have been paid along the way.

In other words, during this 25-year stretch, virtually all of the market gains were achieved on just 35 days. You really can't afford to be out of the market on days like those, and the only way to ensure that you're in the market on those important days is simply to always be in the market.

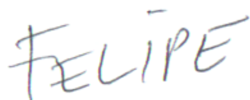
Thought #3: Only Two Prices Matter

Finally, keep in mind that any fluctuations in the price quotes you see on your computer screen or your monthly statement are just that: fluctuations. Until you actually sell a stock you own, your gain or loss on that stock will always be unrealized. After you buy a stock, the only number you—or the IRS—will care about is your sale price. Any price quotes that come between your purchase and your sale fade away into irrelevant oblivion, so it's important not to allow your emotions to be swayed by them.

The market will undoubtedly continue to behave in crazy ways in the future. When it happens, keep your even keel. Do not allow the market's craziness to affect your investment plan. The businesses you own will continue to expand and grow, and the market will eventually come to its senses again, allowing your portfolio to grow along with them.

Conclusion: Don't Be Like the Market

Yes, the stock market is crazy. But don't you be crazy, too. Just do your best to ignore the day-to-day price fluctuations, and stick to the course. The only two prices that matter are your cost of a certain stock and your eventual sale price. Anything that happens in between is just noise.



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