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10 principles of successful investing in volatile markets

Stock market volatility is a normal part of investing. But what you do – and don't do – during times of higher volatility can make the difference between success and failure as an investor. The following 10 principles can help you manage volatility and achieve your long-term investment goals.

1. Stay calm and invest on

When the markets are particularly volatile, there's a natural tendency for investors to move into safer investments, hoping to avoid further losses, and wait until the markets recover. But unfortunately it's nearly impossible to predict when the markets will recover. As a result, investors may miss out on the eventual recovery, which can negatively affect their long-term investment goals. As the chart (below) shows, the investor who stays invested tends to do better than the investor who bails out and misses even some of the recovery.

2. Avoid market timing

On a related note, some investors try to improve their returns by attempting to "time" the market – selling right before the markets go down, then buying right before they go up again. In theory, this sounds great. But in practice, it rarely works, simply because it's so difficult to predict when the markets will go up or down. Unfortunately, that doesn't stop investors from trying, which is why the "average investor" tends to underperform virtually every asset class.

Why it's best to stay invested

Based on the annualized returns of the S&P/TSX Composite Index for 10 years, ending December 31, 2018.
Source: Bloomberg, RBC Global Asset Management.

Market recoveries following major downturns (S&P/TSX)

Year (event)	Return	Return in the following year	Average return over next 5 years
1974 (oil embargo)	-25.0%	+18.5%	+22.3%
1981 (double-digit inflation)	-10.2%	+5.5%	+13.7%
1990 (Gulf war)	-14.8%	+12.9%	+10.8%
2002 ("Tech Wreck")	-12.4%	+26.7%	+18.3%
2008 ("Subprime crisis")	-35.03%	+30.7%	+8.7%

Source: Based on the returns of the S&P/TSX Composite Total Return Index.

3. Maintain your sense of perspective

Unquestionably, stock market downturns can be painful, especially when you're in the middle of one. It's not always easy, but it's important to remember that downturns have happened before – and will happen again – and that historically, as the table above shows, the markets have always recovered and reached new highs.

4. Reassess your comfort level with risk

It's one thing to say you are comfortable with a higher level of risk when the markets are only going up, and another thing when the markets are volatile. If you are finding it difficult to sleep at night because of market volatility, then it might be time to consider how much risk you are truly comfortable taking with your investments.

5. Stay diversified

Diversifying your investments is a proven way to reduce market volatility. It involves including a certain mix of stocks, bonds and cash in your investment portfolio, as well as investments representing different industry sectors or geographic areas. At any given time, one type of investment may do better than another. So by diversifying between them, you can offset weaker performers with stronger performers, reducing volatility. What's more, as the table (next page) shows, it can be difficult to determine exactly when one type of investment will do better than another, which is why it makes sense to stay diversified.

6. Look for opportunities

"Summer sale! Prices slashed!" When it's a retail store saying those words, it's usually a good thing. Yet when it's the stock markets, people often have the opposite reaction. When prices drop, they sell instead of buy. But when the stock markets go down, it can be fairly indiscriminate: both good and bad stocks can be caught up in the sell-off. What that means is, during a market downturn, there can be some high-quality stocks, likely to be among the first to bounce back, available at temporarily reduced prices.

A strong case for diversifying your investment portfolio

2014	2015	2016	2017	2018
US Equities 24.4%	US Equities 20.8%	CDN Equities 21.1%	EM Equities 28.3%	US Equities 3.8%
Balanced 11.4%	INTL Equities 19.0%	US HY Bonds 14.3%	INTL Equities 16.8%	Global Bonds 1.9%
CDN Equities 10.6%	Balanced 6.5%	US Equities 8.6%	US Equities 14.1%	CDN Bonds 1.4%
Global Bonds 9.4%	CDN Bonds 3.5%	EM Equities 7.3%	CDN Equities 9.1%	Cash 1.3%
CDN Bonds 8.8%	EM Equities 2.0%	Balanced 6.5%	Balanced 8.8%	Balanced -1.3%
EM Equities 6.6%	Global Bonds 1.9%	Global Bonds 3.5%	US HY Bonds 6.4%	US HY Bonds -2.9%
US HY Bonds 4.3%	Cash 0.6%	CDN Bonds 1.7%	CDN Bonds 2.5%	INTL Equities -6.0%
INTL Equities 3.7%	US HY Bonds -2.7%	Cash 0.5%	Global Bonds 1.8%	EM Equities -6.9%
Cash 0.9%	CDN Equities -8.3%	INTL Equities -2.5%	Cash 0.6%	CDN Equities -8.9%

CDN Equities (Canadian Equities)	S&P/TSX Composite Total Return Index
US Equities	S&P 500 Total Return Index
INTL Equities (International Equities)	MSCI EAFE Total Return Index
EM Equities (Emerging Market Equities)	MSCI Emerging Markets Total Return Index
CDN Bonds (Canadian Bonds)	FTSE TMX Canada Universe Bond Index
US HY BONDS (U.S. High-Yield Bonds)	ICE Bank of America Merrill Lynch US High-Yield BB-B TR Index
Global Bonds	Citigroup World Global Bond TR Index
Balanced (Balanced Portfolio)	55% Equity / 45% Fixed Income
Cash	FTSE TMX Canada 30 Day T-Bill Index

All performance is in C$.
Source: RBC Global Asset Management Inc. as of December 31, 2018.

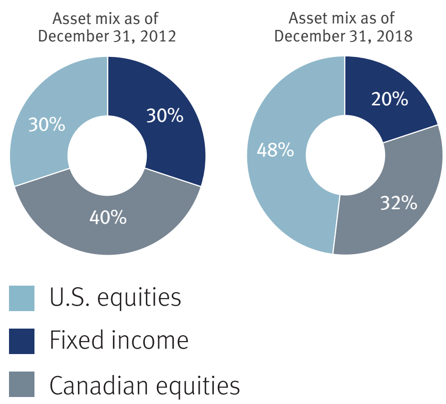
7. Regularly rebalance

How you diversify your portfolio between different investments plays an important role in how much volatility you can expect. In general, if you include more stocks in your portfolio, you will experience greater volatility, but also greater long-term growth potential. Conversely, if you include more bonds, you will experience lower volatility, but also lower growth potential. Everyone has an ideal balance, based on factors such as:

- How long you have to invest
- How much growth you need
- How much risk you are willing to take

But over time, market fluctuations can cause the balance to shift in your portfolio, as one asset class outperforms another and eventually represents a greater percentage of your portfolio than you had originally intended. As a result, it makes sense to regularly rebalance your portfolio, to get back to your ideal balance.

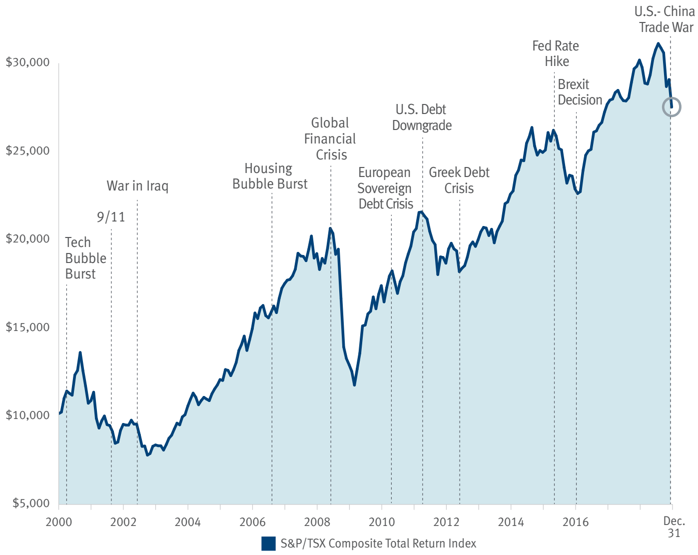
The impact of portfolio drift



Source: RBC Global Asset Management. Canadian equities – S&P/TSX Composite Total Return Index. Fixed income – FTSE TMX Canada Universe Bond Total Return Index. U.S. equities – S&P 500 Total Return Index.

Staying invested over time has its rewards

The growth of $10,000 from January 2000 to December 2018



The growth of $10,000 since January 2000. An investment cannot be made directly in an index. Graph does not reflect transaction costs, investment management fees or taxes. If such costs and fees were reflected, returns would be lower. Past performance is not a guarantee of future results. Performance data as of December 31, 2018.

Source: RBC Global Asset Management Inc.

8. Stay focused on the long term

Markets may go down in the short term, often in response to a global economic crisis, but over the longer term they tend to go up.

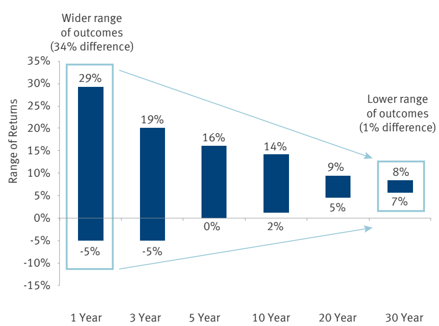
9. Put time on your side

In the short term, volatility can seem like the "Salt & Pepper" ride at your local amusement park. But over time, volatility smooths out. And the longer you have to invest, the more it tends to smooth out.

10. Review your portfolio

Have questions about your investments? Should you make any changes given the recent market volatility? We would be happy to help you review your investments to ensure your portfolio is right for you.

The volatility of a diversified portfolio decreases over time



Rolling 1-, 3-, 5-, 10-, 20- and 30-year average annual returns from January 1988 to December 2018.

Diversified Portfolio represented by 2% Cash, 43% Fixed Income, 19% Canadian Equities, 20% U.S. Equities and 16% International Equities. Cash represented by FTSE TMX Canada 30 DAY T-Bill Total Return Index; Fixed Income represented by FTSE TMX Canada Universe Bond Total Return Index; Canadian Equities represented by S&P/TSX Composite Total Return Index; U.S. Equities represented by S&P 500 Total Return Index; International Equities represented by MSCI EAFE Net of Taxes Total Return Index.

Source: Bloomberg, RBC Global Asset Management.