

The Good Side of Bad Markets

After the recent downturn in the U.S. and global stock markets, you can be pardoned if you wished that the markets were a bit tamer. Wouldn't it be nice to get, say, a steady 4% return every year rather than all these ups and downs?

Be careful what you wish for. There are at least three reasons why you should hope the markets continue scaring investors half out of their wits.

1) The very fact that stock downturns scare people is one reason why stocks deliver a higher return than bonds. Economists call it the "risk premium," which can be roughly translated as: people are not willing to pay as much for an investment that will periodically frighten them to death as they would pay for an investment that delivers a less exciting investment ride. Over their history, stocks have been a fairly consistent bargain relative to less volatile alternatives, which is another way of saying that they've delivered higher long-term returns than bonds and cash.

2) If you're accumulating for retirement by putting money in the market every month or quarter, every downturn means that you can buy shares at a bargain price while many other investors are selling out at or near the bottom. Over time, as the market recovers, this can give a little extra kick to your overall return.

3) Market downturns give an advantage to those who are willing to practice disciplined rebalancing among different asset classes. Basically, that means that when stocks go down, any new cash goes disproportionately into stocks to bring them back up to their former share of the overall portfolio. This, too, allows you to buy extra shares when the prices are low, and can also boost long-term returns.

There's no question, the downward plunge on the stock market roller coaster is scary. It's hard to maintain your discipline when the voice in the back of your brain is telling you to bail out on the bouncy trip before somebody gets hurt.

But unless this is the first time in history that the market goes down and stays down forever, we will ultimately look back on the decline and see a buying opportunity, rather than a great time to sell and jump to the sidelines. The patient, disciplined, long-term investor should see market volatility as one of your best friends and allies in your journey toward retirement prosperity.

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