

How to react when markets drop

Introduction

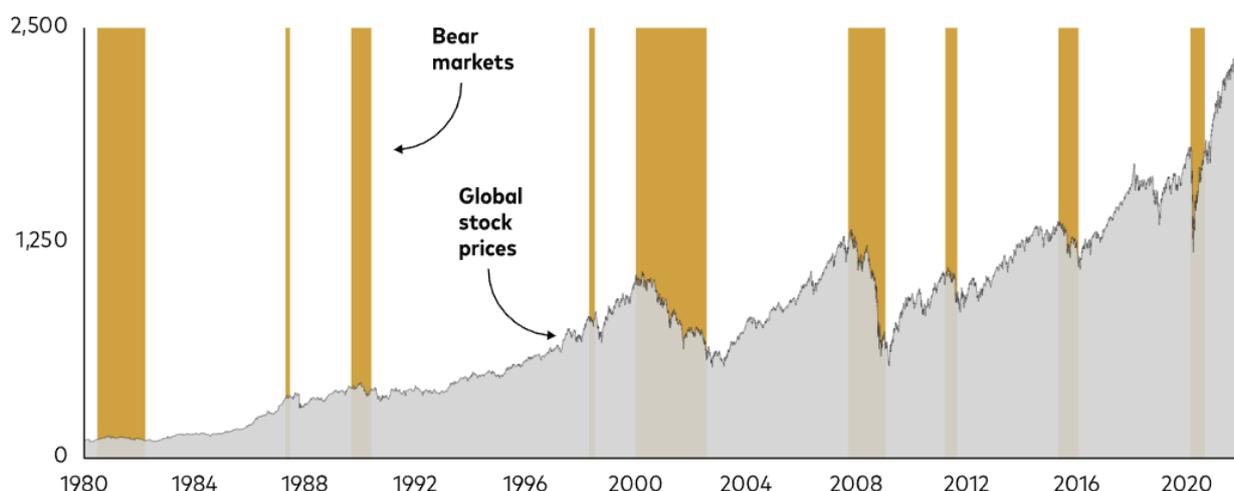
While investing in the stock market is typically a prudent choice for investors seeking long-term growth, sharp drops can still be hard to stomach. Below are some things to keep in mind if a market tumble makes you feel the need to "do something."

Some of the charts below use U.S. data, but we believe the broad findings we draw from them generally hold across the globe. That's because the United States is the largest and most mature financial market in the world and has robust data allowing us to perform rigorous research across numerous market cycles.

Downturns aren't rare events: Typical investors, in all markets, will endure many of them during their lifetime.

Since 1980 there have been:

9 bear markets  Declines of **20%** or more, lasting at least two months



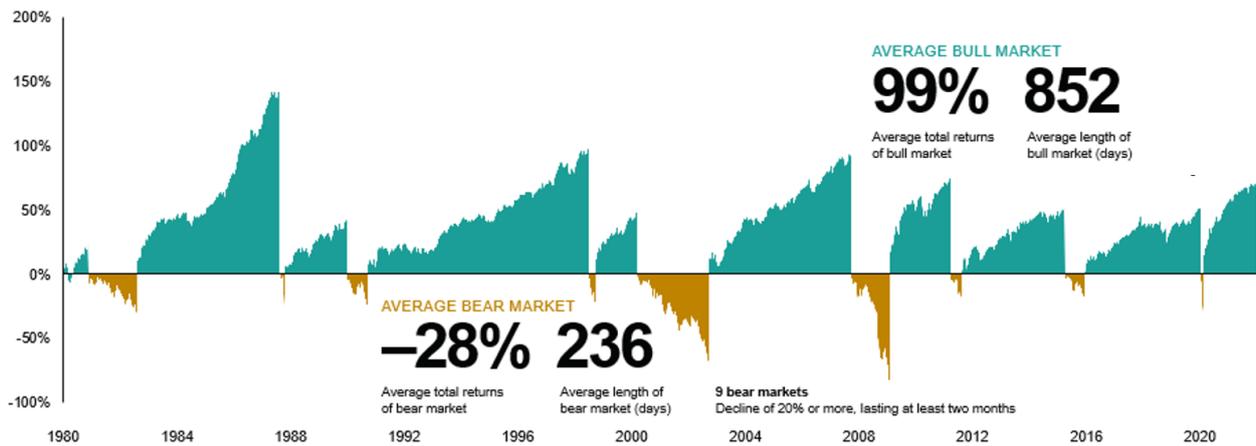
Note: Although the downturn that began in March 2020 doesn't meet our definition of a bear market because it lasted less than two months, we have included it in our analysis because of the magnitude of the decline.

Sources: MSCI World Index from January 1, 1980, through December 31, 1987, and the MSCI AC World Index thereafter.

Dramatic market losses can sting, but it's important to keep a long-term perspective and stay invested in order to participate in the recoveries that typically follow.

Some bear markets since 1980 have been sharp, but many bull market surges have been even more dramatic, and often longer, leaving stock investors well compensated over the long term for the risk they took on.

Global stock prices (January 1, 1980, through December 31, 2021)



Note: Although the downturn that began in March 2020 doesn't meet our definition of a bear market because it lasted less than two months, we have included it in our analysis because of the magnitude of the decline.

Sources: Vanguard calculations, using the MSCI World Index from January 1, 1980, through December 31, 1987, and the MSCI AC World Index thereafter. Indexed to 100 as of December 31, 1979.

Timing the market is futile: The best and worst trading days often happen close together and occur irrespective of the overall market performance for the year.



Sources: Vanguard calculations, based on data from Refinitiv using the Standard & Poor's 500 Price Index.

As the random pattern of returns below highlights, predicting which segments of the markets will do well is also a tough order.

Broad diversification keeps you from having too much exposure to the worst-performing areas of the market in the event of a downturn.

Returns ranked from highest to lowest

Annual returns

2021 (fourth quarter)
monthly returns

Equities

2014	2015	2016	2017	2018	2019	2020	2021	October	November	December
13.7%	1.4%	21.3%	37.3%	-4.4%	31.5%	19.8%	28.6%	7.0%	-0.7%	5.1%
5.0%	-3.0%	12.0%	24.2%	-11.0%	25.5%	18.2%	14.8%	4.3%	-3.7%	4.5%
-2.2%	-4.4%	11.2%	21.8%	-14.1%	22.5%	15.4%	11.8%	2.6%	-4.2%	2.2%
-4.3%	-14.9%	2.8%	14.7%	-14.6%	18.4%	10.2%	0.1%	1.1%	-4.9%	1.7%

■ Large-Cap Equity ■ Small-Cap Equity ■ Dev ex-U.S. Equity ■ Emerging Markets Equity

Fixed income

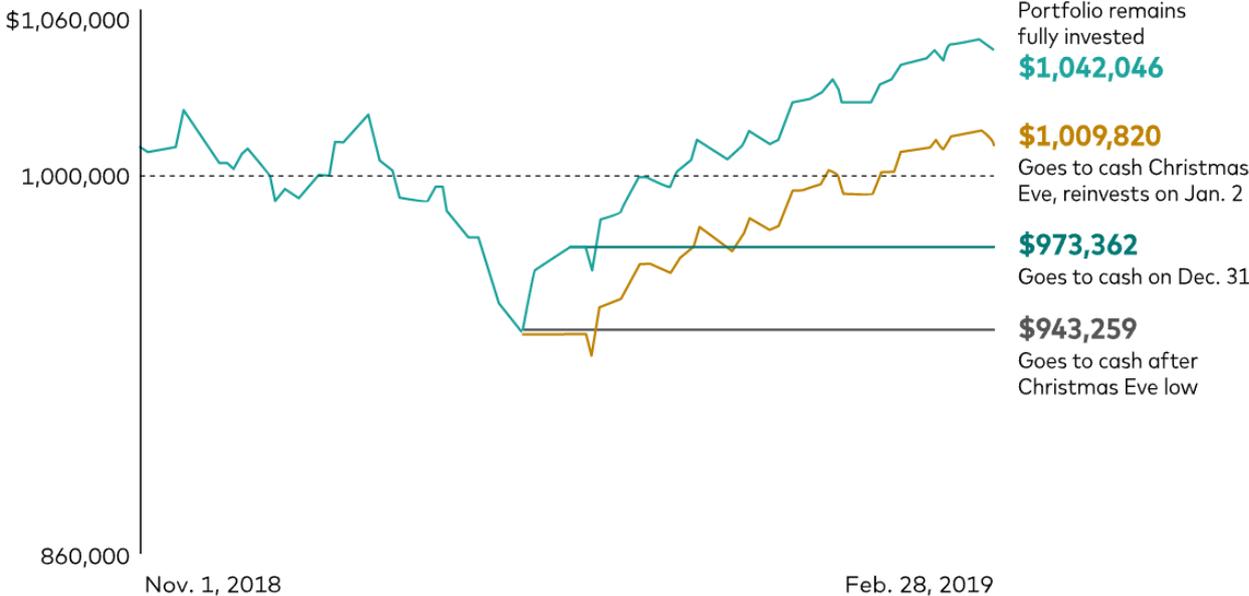
2014	2015	2016	2017	2018	2019	2020	2021	October	November	December
15.2%	0.6%	17.1%	10.5%	0.01%	21.9%	7.7%	32.4%	6.1%	1.2%	5.0%
6.0%	-0.8%	4.1%	10.4%	-2.1%	14.3%	7.0%	1.0%	-0.6%	0.3%	1.9%
2.5%	-4.5%	2.7%	7.5%	-2.2%	8.7%	4.8%	-1.6%	-0.5%	0.3%	-0.3%
-3.1%	-6.0%	1.5%	3.5%	-5.6%	5.1%	-18.9%	-2.1%	0.0%	-2.0%	-0.7%

■ U.S. Fixed Income ■ Global ex-U.S. Fixed Income ■ High Yield ■ Real Estate

Sources: Vanguard and FactSet, as of December 31, 2021.

Note: Sub-asset classes include large-cap equity as measured by the S&P 500 Index, small-cap equity as measured by the Russell 2000 Index, developed ex-U.S. equity as measured by the FTSE Developed ex-North America Index, emerging markets equity as measured by the FTSE Emerging Markets Index, U.S. fixed income as measured by the Bloomberg U.S. Aggregate Bond Index, global ex-U.S. fixed income as measured by the Bloomberg Global Aggregate ex-U.S. Bond Index, high yield fixed income as measured by the Bloomberg Global High Yield Bond Index, and real estate as measured by the FTSE EPRA/NAREIT Developed REIT Index.

Riding out the rough periods can pay off. That includes rebalancing into asset classes even when they are declining instead of pulling out of the market.



Notes: This chart shows the performance of a hypothetical example 60% stock/40% bond portfolio during and after a sharp market downturn. U.S. stocks represented by the CRSP US Total Market Index. U.S. bonds represented by the Bloomberg U.S. Aggregate Float Adjusted Index. Global stocks represented by the FTSE Global All Cap ex US Index. Global bonds represented by the Bloomberg Global Aggregate ex-USD Float-Adjusted RIC Capped Index.
Sources: Vanguard calculations, using data from FactSet, as of February 28, 2019.

What you can do when volatility hits:



Tune out the noise

There's an old adage that you should never check your account when stocks are tanking. It's smart advice. As the graphics above show, making a hasty decision usually results in a mistake.



Revisit your asset allocation

If market corrections are making you lose sleep, it may be time to reevaluate your risk tolerance.



Control what you can: Costs

Expenses erode your returns. This is particularly painful when stock markets are correcting.



Set realistic expectations

It's important to remember that Vanguard anticipates higher risks and lower returns over the near and medium term.



Stay diversified

A great way to insulate your portfolio is to have exposures to stocks, bonds, and international markets in an asset allocation plan that makes sense for your risk tolerance and goals. Bonds can act as a ballast during downturns. International exposure can give you access to markets that may generate positive performance when others are falling.

Note:

All investing is subject to risk, including possible loss of principal. Be aware that fluctuations in the financial markets and other factors may cause declines in the value of your account. Diversification does not ensure a profit or protect against a loss. Bond funds are subject to the risk that an issuer will fail to make payments on time, and that bond prices will decline because of rising interest rates or negative perceptions of an issuer's ability to make payments. Investments in stocks or bonds issued by non-U.S. companies are subject to risks including country/regional risk and currency risk.

Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

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