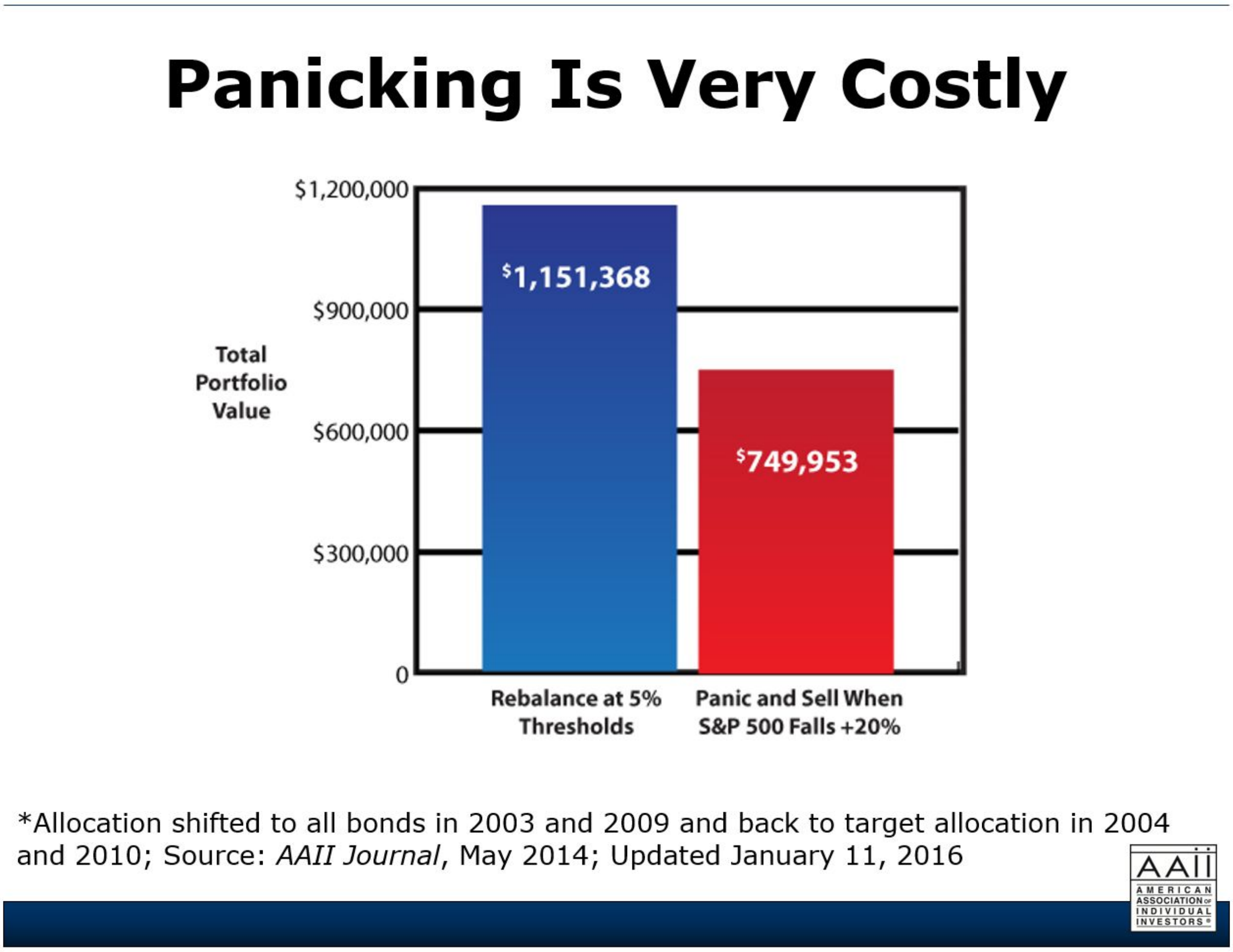
A Few Observations on Today’s Market Decline



The stock market has gotten off to a bad start this year, and to say Mr. Market is in a rotten mood today may be an understatement. Uncertainty about the Chinese economy and falling oil prices are to blame.

For all the growth China has experienced, its economy and its stock market is still relatively new. It should be no surprise that the country is experiencing growing pains, nor should it be a surprise to see Chinese investors exhibit the same type of behavioral errors seen by investors in more developed markets. More importantly, China might be a big trading partner, but it’s still a different country and a different economy than the U.S.

Oil has fallen more than most analysts expected. The big slump is projected to lead to declining earnings for the S&P 500 for the second consecutive quarter (triggering what is known as an earnings recession). Exclude energy, add in the propensity for companies to top expectations and it’s possible that fourth-quarter earnings may actually show growth.

The far bigger observation is that a year ago, no one (or at least the overwhelming majority of market pundits) was forecasting either $30 per barrel oil or a slumping Chinese stock market combined with a weaker-than-expected Chinese economy. If you didn't forecast these in advance, what gives you confidence that you (or anyone else) will be able to predict when the stock market will end its current slump?

I realize that on a day like today, the temptation to sell or at least reduce your exposure to stocks can be strong. I would suggest you resist this urge. What matters is not what your account balance is today, but what it will be 10, 15, or 20 years from now. Even if you are retired, you may well need your portfolio to last for many years.

Furthermore, panicking is very costly. An investor who pulled out of stocks at the end of 2002 and 2008 and stayed out of the markets for just one year would have forfeited more than $400,000 in lost wealth. (You can see the data behind the calculations here.)

If you are nervous, turn off the market news and don't look at your portfolio until next month. It will give your nerves time to cool down, leading to a potentially a more rational decision when you do revisit your portfolio. Reading AAII's Lifetime Investing Strategy may also help.