CAPITAL GROUP® | AMERICAN FUNDS®

How to handle market declines

Smart investing can overcome the power of emotion by focusing on relevant research, solid data and proven strategies.

You wouldn't be human if you didn't fear loss.

Nobel Prize-winning psychologist Daniel Kahneman demonstrated this with his loss aversion theory, showing that people feel the pain of losing money more than they enjoy gains. The natural instinct is to flee the market when it starts to plummet, just as greed prompts people to jump back in when stocks are skyrocketing. Both can have negative impacts.

But smart investing can overcome the power of emotion by focusing on relevant research, solid data and proven strategies. Here are seven principles that can help fight the urge to make emotional decisions in times of market turmoil.

Market downturns happen frequently but don't last forever

Standard & Poor's 500 Composite Index (1952–2021)

Size of decline	-5% or more	-10% or more	-15% or more	-20% or more
Average frequency*	About three times per year	About once per year	About once every three years	About once every six years
Average length†	43 days	110 days	251 days	370 days
Last occurrence	October 2021	September 2020	March 2020	March 2020

* Assumes 50% recovery of lost value.
† Measures market high to market low.

Sources: Capital Group, RIMES, Standard & Poor's. As of 12/31/21.

Investments are not FDIC-insured, nor are they deposits of or guaranteed by a bank or any other entity, so they may lose value.

Every S&P 500 decline of 15% or more, from 1929 through 2020, has been followed by a recovery. The average return in the first year after each of these declines was 55%.

1. Market declines are part of investing

Over long periods of time, stocks have tended to move steadily higher, but history tells us that stock market declines are an inevitable part of investing. The good news is that corrections (defined as a 10% or more decline), bear markets (an extended 20% or more decline) and other challenging patches haven't lasted forever.

The Standard & Poor's 500 Composite Index has typically dipped at least 10% about once a year, and 20% or more about every six years, according to data from 1952 to 2021. While past results are not predictive of future results, each downturn has been followed by a recovery and, over time, a new market high.

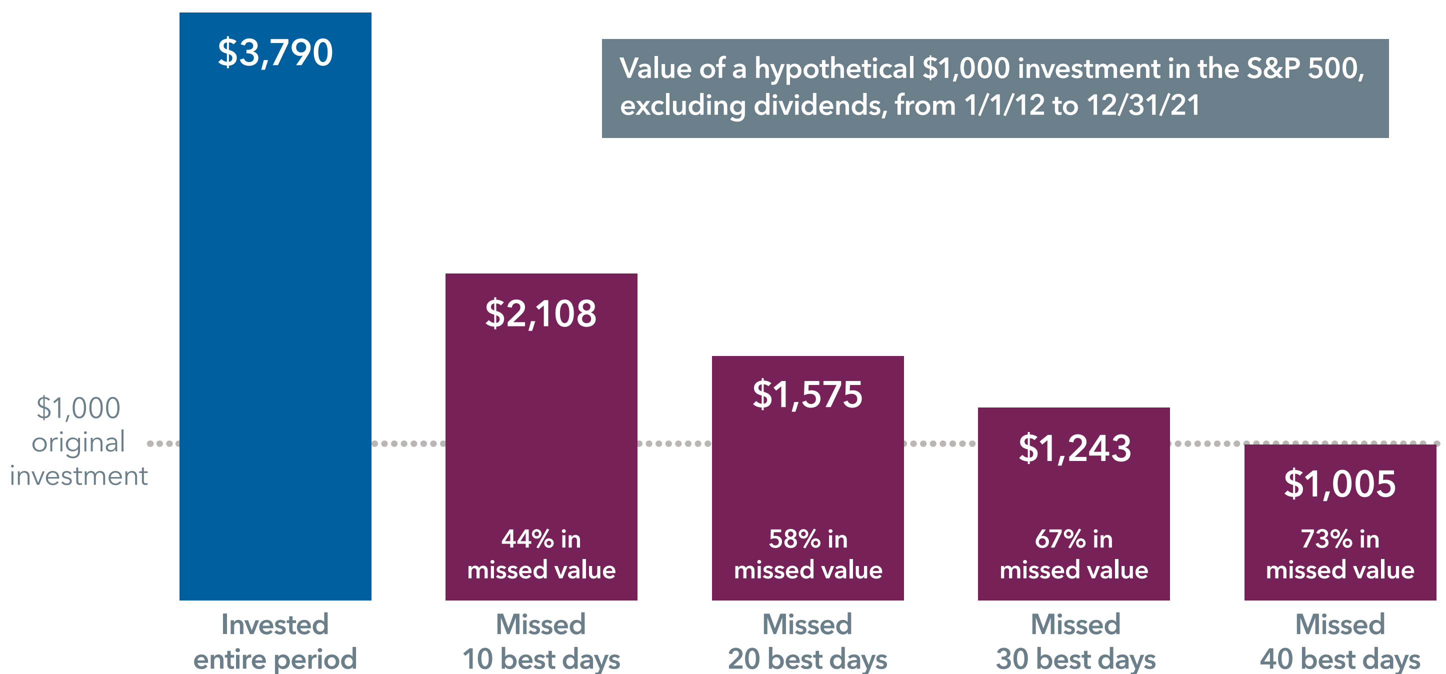
2. Time in the market matters, not market timing

No one can accurately predict short-term market moves, and investors who sit on the sidelines risk losing out on periods of meaningful price appreciation that follow downturns.

Every S&P 500 decline of 15% or more, from 1929 through 2020, has been followed by a recovery. The average return in the first year after each of these declines was 55%.

Even missing out on just a few trading days can take a toll. A hypothetical investment of $1,000 in the S&P 500 made in 2012 would have grown to more than $3,790 by the end of 2021. But if an investor missed just the 10 best trading days during that period, he or she would have ended up with 44% less.

Missing just a few of the market's best days can hurt investment returns



Sources: RIMES, Standard & Poor's. As of 12/31/21. Values in USD.

Creating and adhering to a thoughtfully constructed investment plan is another way to avoid making short-sighted investment decisions – particularly when markets move lower.

3. Emotional investing can be hazardous

Kahneman won his Nobel Prize in 2002 for his work in behavioral economics, a field that investigates how individuals make financial decisions. A key finding of behavioral economists is that people often act irrationally when making such choices.

Emotional reactions to market events are perfectly normal. Investors should expect to feel nervous when markets decline, but it's the actions taken during such periods that can mean the difference between investment success and shortfall.

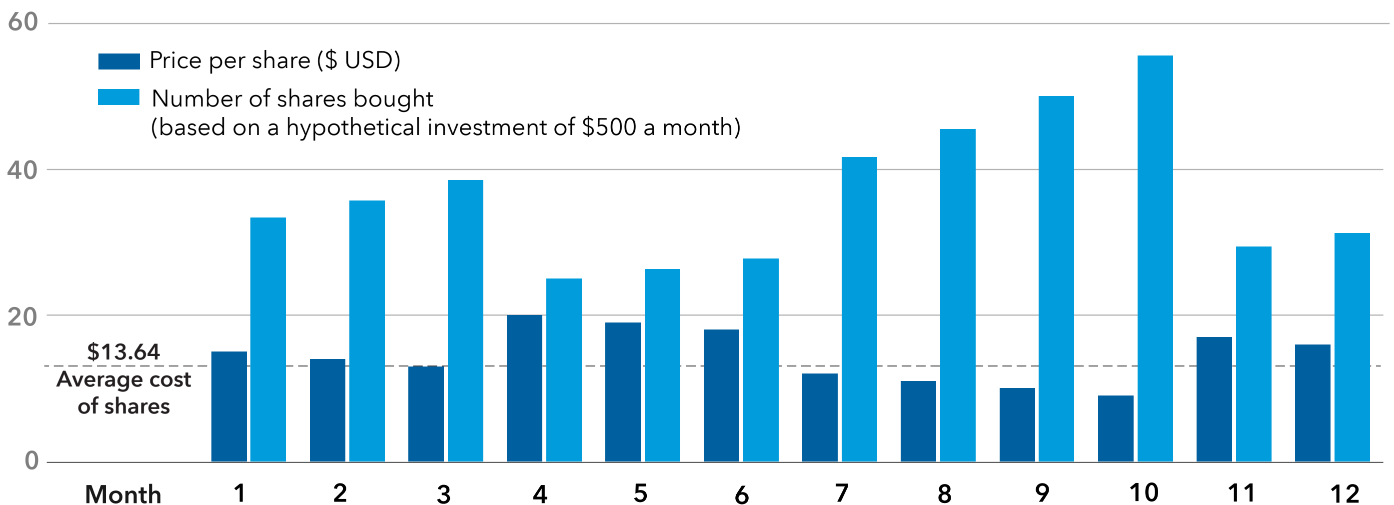
One way to encourage rational investment decision-making is to understand the fundamentals of behavioral economics. Recognizing behaviors like anchoring, confirmation bias and availability bias may help investors identify potential mistakes before they make them.

4. Make a plan and stick to it

Creating and adhering to a thoughtfully constructed investment plan is another way to avoid making short-sighted investment decisions – particularly when markets move lower. The plan should take into account a number of factors, including risk tolerance and short- and long-term goals.

One way to avoid futile attempts to time the market is with dollar cost averaging, where a fixed amount of money is invested at regular intervals, regardless of market ups and downs. This approach creates a strategy in which more shares are purchased at lower prices and fewer shares are purchased at higher prices.

When stock prices fall, you can get more shares for the same amount of money and lower your average cost per share



Source: Capital Group. Over the 12-month period, the total amount invested was $6,000, and the total number of shares purchased was 439.94. The average price at which the shares traded was $15, and the average cost of the shares was $13.64 ($6,000/439.94). Hypothetical results are for illustrative purposes only and in no way represent the actual results of a specific investment.

Over time investors pay less, on average, per share. Regular investing does not ensure a profit or protect against loss. Investors should consider their willingness to keep investing when share prices are declining.

Retirement plans, to which investors make automatic contributions with every paycheck, are a prime example of dollar cost averaging.

5. Diversification matters

A diversified portfolio doesn't guarantee profits or provide assurances that investments won't decrease in value, but it does help lower risk. By spreading investments across a variety of asset classes, investors can buffer the effects of volatility on their portfolios. Overall returns won't reach the highest highs of any single investment – but they won't hit the lowest lows either.

For investors who want to avoid some of the stress of downturns, diversification can help lower volatility.

6. Fixed income can help bring balance

Stocks are important building blocks of a diversified portfolio, but bonds can provide an essential counterbalance. That's because bonds typically have low correlation to the stock market, meaning that they have tended to zig when the stock market zagged.

Asset classes go in and out of favor

Calendar-year total returns of select asset classes (%)

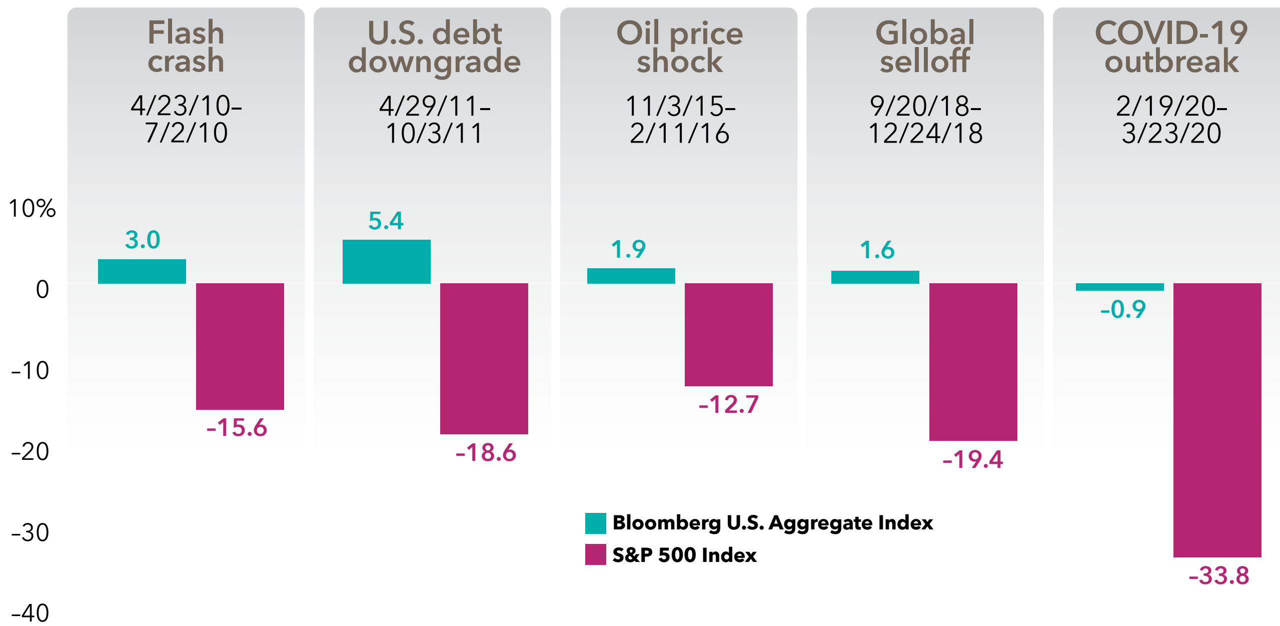
Best-performing assets

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Emerging markets stocks 18.22	U.S. large-cap stocks 32.39	U.S. large-cap stocks 13.69	U.S. large-cap stocks 1.38	U.S. large-cap stocks 11.96	Emerging markets stocks 37.28	Cash 1.82	U.S. large-cap stocks 31.49	U.S. large-cap stocks 18.40	U.S. large-cap stocks 28.71
Global small-cap stocks 18.06	Global small-cap stocks 28.66	U.S. bonds 5.97	U.S. bonds 0.55	Global small-cap stocks 11.59	International stocks 27.19	U.S. bonds 0.01	Global small-cap stocks 24.65	Emerging markets stocks 18.31	Global small-cap stocks 16.09
International stocks 16.83	International stocks 15.29	Global small-cap stocks 1.78	Cash 0.03	Emerging markets stocks 11.19	Global small-cap stocks 23.81	International bonds -1.20	International stocks 21.51	Global small-cap stocks 16.33	International stocks 7.82
U.S. large-cap stocks 16.00	Cash 0.05	International bonds 0.59	Global small-cap stocks -1.04	International stocks 4.50	U.S. large-cap stocks 21.83	U.S. large-cap stocks -4.38	Emerging markets stocks 18.42	International stocks 10.65	Cash 0.04
International bonds 4.32	U.S. bonds -2.02	Cash 0.02	International bonds -3.15	U.S. bonds 2.65	International bonds 7.39	International stocks -14.20	U.S. bonds 8.72	International bonds 9.20	U.S. bonds -1.54
U.S. bonds 4.21	International bonds -2.60	Emerging markets stocks -2.19	International stocks -5.66	International bonds 2.09	U.S. bonds 3.54	Global small-cap stocks -14.39	International bonds 6.84	U.S. bonds 7.51	Emerging markets stocks -2.54
Cash 0.08	Emerging markets stocks -2.60	International stocks -3.87	Emerging markets stocks -14.92	Cash 0.26	Cash 0.82	Emerging markets stocks -14.57	Cash 2.21	Cash 0.54	International bonds -4.71

Worst-performing assets

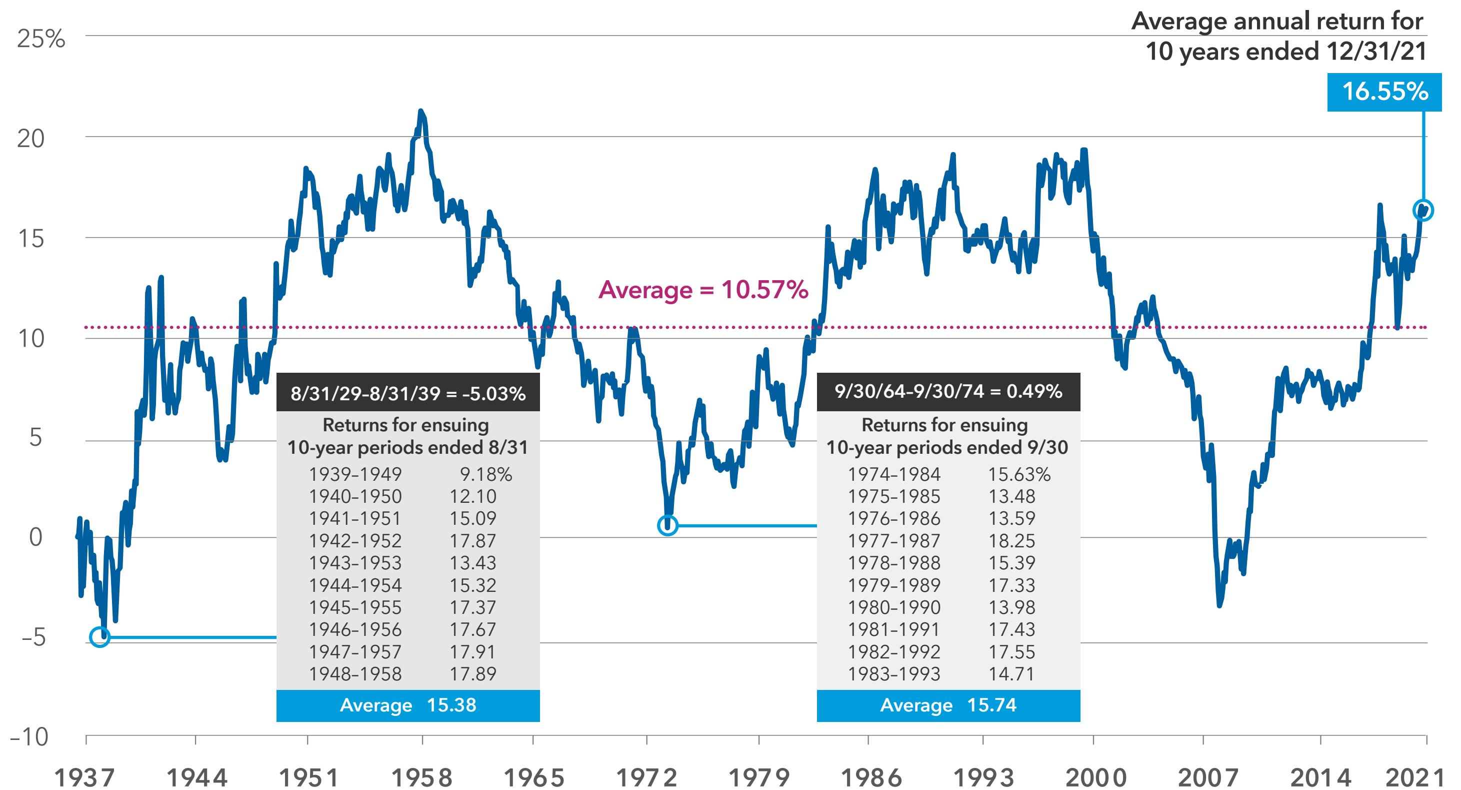
Sources: Refinitiv Datastream, RIMES. U.S. large-cap stocks – Standard & Poor's 500 Composite Index; Global small-cap stocks – MSCI All Country World Small Cap Index; International stocks – MSCI All Country World ex USA Index; Emerging markets stocks – MSCI Emerging Markets Index; U.S. bonds – Bloomberg U.S. Aggregate Index; International bonds – Bloomberg Global Aggregate Index; Cash – Bloomberg U.S. Treasury Bills Index: 1–3 Months.

High-quality bonds have shown resilience when stock markets are unsettled



Sources: Capital Group, Morningstar. Dates shown are based on price declines of 12% or more (without dividends reinvested) in the unmanaged S&P 500 with at least 50% recovery persisting for more than one business day between declines. The returns are based on total returns in USD. As of 6/30/21.

S&P 500 rolling 10-year average annual total returns



8/31/29-8/31/39 = -5.03%	
Returns for ensuing 10-year periods ended 8/31	
1939-1949	9.18%
1940-1950	12.10
1941-1951	15.09
1942-1952	17.87
1943-1953	13.43
1944-1954	15.32
1945-1955	17.37
1946-1956	17.67
1947-1957	17.91
1948-1958	17.89
Average	15.38

9/30/64-9/30/74 = 0.49%	
Returns for ensuing 10-year periods ended 9/30	
1974-1984	15.63%
1975-1985	13.48
1976-1986	13.59
1977-1987	18.25
1978-1988	15.39
1979-1989	17.33
1980-1990	13.98
1981-1991	17.43
1982-1992	17.55
1983-1993	14.71
Average	15.74

Sources: Capital Group, Morningstar, RIMES, Standard & Poor's. As of 12/31/21.

Those investors who can tune out the news and focus on their long-term goals are better positioned to plot out a wise investment strategy.

What's more, bonds with a low equity correlation can potentially help soften the impact of stock market losses on your overall portfolio. Funds providing this diversification can help create durable portfolios, and investors should seek bond funds with strong track records of positive returns through a variety of markets.

Though bonds may not be able to match the growth potential of stocks, they have often shown resilience in past equity declines. For example, U.S. core bonds were flat or positive in four of the last five corrections of 12% or more.

7. The market tends to reward long-term investors

Is it reasonable to expect 30% returns every year? Of course not. And if stocks have moved lower in recent weeks, you shouldn't expect that to be the start of a long-term trend, either. Behavioral economics tells us recent events carry an outsized influence on our perceptions and decisions.

It's always important to maintain a long-term perspective, but especially when markets are declining. Although stocks rise and fall in the short term, they've tended to reward investors over longer periods of time. Even including downturns, the S&P 500's average annual return over all 10-year periods from 1937 to 2021 was 10.57%.

It's natural for emotions to bubble up during periods of volatility. Those investors who can tune out the news and focus on their long-term goals are better positioned to plot out a wise investment strategy. ■

Investors should carefully consider investment objectives, risks, charges and expenses. This and other important information is contained in the fund prospectuses and summary prospectuses, which can be obtained from a financial professional and should be read carefully before investing.

The market indexes are unmanaged and, therefore, have no expenses. Investors cannot invest directly in an index.

Standard & Poor's 500 Composite Index is a market capitalization-weighted index based on the results of approximately 500 widely held common stocks. The S&P 500 Composite Index ("Index") is a product of S&P Dow Jones Indices LLC and/or its affiliates and has been licensed for use by Capital Group. Copyright © 2022 S&P Dow Jones Indices LLC, a division of S&P Global, and/or its affiliates. All rights reserved. Redistribution or reproduction in whole or in part are prohibited without written permission of S&P Dow Jones Indices LLC.

MSCI All Country World Small Cap Index is designed to measure equity market results of smaller capitalization companies in both developed and emerging markets. MSCI All Country World ex USA Index is designed to measure equity market results in the global developed and emerging markets, excluding the United States. MSCI Emerging Markets Index is designed to measure equity market results in the global emerging markets. MSCI does not approve, review or produce reports published on this site, makes no express or implied warranties or representations and is not liable whatsoever for any data represented. You may not redistribute MSCI data or use it as a basis for other indices or investment products.

Bloomberg U.S. Aggregate Index represents the U.S. investment-grade fixed-rate bond market. Bloomberg® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). Bloomberg or Bloomberg's licensors own all proprietary rights in the Bloomberg Indices. Neither Bloomberg nor Bloomberg's licensors approves or endorses this material, or guarantees the accuracy or completeness of any information herein, or makes any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, neither shall have any liability or responsibility for injury or damages arising in connection therewith.

©2022 Morningstar, Inc. All rights reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.

Statements attributed to an individual represent the opinions of that individual as of the date published and do not necessarily reflect the opinions of Capital Group or its affiliates. This information is intended to highlight issues and should not be considered advice, an endorsement or a recommendation.

This content, developed by Capital Group, home of American Funds, should not be used as a primary basis for investment decisions and is not intended to serve as impartial investment or fiduciary advice.

All Capital Group trademarks mentioned are owned by The Capital Group Companies, Inc., an affiliated company or fund. All other company and product names mentioned are the property of their respective companies.

American Funds Distributors, Inc., member FINRA.

Lit. No. MFGEBR-126-0222P Printed in USA CGD/TM/10623-S87954 © 2022 Capital Group. All rights reserved.