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How To Prepare For A Market Correction

Anna-Louise Jackson, Benjamin Curry
Contributor, Editor
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After more than a decade of robust stock market gains, it's worth reminding yourself that market corrections are an inevitable part of investing. Stock market corrections tend to take people by surprise, but the truth is that they happen fairly regularly.

While that may sound intimidating, here's the good news: Market corrections can be a great opportunity for investors to buy stocks "on sale." Broad stock market declines tend to reduce the price of your favorite investments for a limited time—until indexes return to fresh highs.

the short term, here are five steps you can take to prepare your portfolio for the dip.

1. Put Market Corrections in Context

History suggests that the stock market is more likely to end the day higher than lower. Since 2010, for example, the S&P 500 has posted gains of about 55% of trading days. Still, an especially bad day or a prolonged period of declines can cause more than a little investor anxiety.

It doesn't help that many market watchers are always keen to predict a correction. For example, 2021 has been rife with calls for a market correction—with probable causes ranging from sluggish economic growth to higher inflation to the risk the federal government will default on its debut. Thus far? No correction.

While market corrections are common, they're not nearly as common as predictions of market corrections. Since 1928, a correction of at least 10% has happened in the S&P 500 about once every 19 months. Of the 27 corrections since World War II, the index has experienced an average decline of 13.7%.

Below is a list of the peaks and troughs (the lowest point) of the six corrections in the S&P 500 since the end of the Great Recession in 2009. This includes the Covid-19 crack-up in February and March 2020, which would be more accurately described as a market crash, given the 33.9% peak-to-trough decline in the S&P 500.

Peak	Trough	Decline	Days Peak to Trough
April 23, 2010	July 2, 2010	-16%	70 days
April 29, 2011	Oct. 3, 2011	-19.40%	157 days
Nov. 3, 2015	Feb. 11, 2016	-13.30%	100 days
Jan. 26, 2018	Feb. 8, 2018	-10%	13 days
Sept. 20, 2018	Dec. 24, 2018	-19.80%	95 days

Feb. 19, 2020	March 23, 2020	-34%	33 days

Look at the number of days it took the stock market to move from its peak to trough. The longest recent correction, in mid-2011, lasted 157 days before the S&P 500 started climbing again. This highlights the simple truth that investing is a long game, and you should be holding onto the assets in your portfolio for periods measured in years, not days.

"Just remember this one, simple piece of advice: 'When in doubt, wait it out,'" says Randy Frederick, managing director of trading and derivatives with Schwab Center for Financial Research.

If you're convinced a sell-off is coming, rather than a bout of shorter-term volatility, and you still want to adjust your portfolio, consider making the following changes.

2. Sell Profitable Investments

If you believe stock prices are headed lower, you may want to sell some of your investments that are trading near their highs.

"Lock in some profits," advises Craig James Ferrantino, a certified financial planner (CFP) and founder of Craig James Financial. "Selling some portion of investments that have done well, while preserving the principal amount you invested in the first place, is one way to prepare for a correction."

Alternatively, you may want to establish a selling strategy that dictates when you sell stocks and removes any emotion from the decision, Ferrantino says. For example, you may decide to sell some portion of your holding after a stock's price has fallen a certain threshold (say, 10%) from its record high, he adds.

This type of strategy is a good way to manage anxiety about a selloff, particularly for investors who "can tolerate a loss, but not much more downside," he notes.

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3. Focus on Asset Allocation

Diversification is a smart investing strategy because it can help to balance out your risks in the market. Generally speaking, that means having a healthy mix of different types of investments in your portfolio, including stocks, bonds, commodities and cash.

"As the market gets volatile, the old tried-and-true single most important thing you can do has always been, and always will be, diversification," says Frederick. "Make sure you're invested in some other asset classes that don't all move together," Frederick advises. Bond funds or commodity-focused exchange-traded funds (ETFs) are examples of an easy way to diversify your portfolio beyond stocks.

You can also mix things up within your stock holdings. In the equity portion of your portfolio, make sure that you're not overly invested in one particular market sector, Frederick notes. For example, some investors may find that they are too heavily exposed to the tech sector, particularly because these stocks have led the market in gains for many years, he adds.

based on their profits and expenses; growth are those targeting rapid growth by running up large corporate tabs that can make them more vulnerable during economic downtimes.

“Take some risk off the table by moving to a value play,” says Ferrantino. Value stocks generally pay dividends whereas many growth stocks do not, which means you will continue to earn money even if a stock’s price falls and therefore can help investors to “weather some storms” in the market.

4. Make Smart Trading Decisions

If you’re making changes to your portfolio in anticipation of a possible market correction, that inherently means you’ll be buying and selling assets. Especially when the stock market gets volatile, small trading decisions can actually make a big difference.

“One thing I think is really important is to always place limit orders and not market orders,” Frederick advises. With a limit order, you specify the price you want to buy or sell at, and the trade is only executed at that price or better.

Meanwhile, opting for a market order means your trade is at the whim of the market. You could be in for a big surprise, especially if you place an order at night and it’s executed the next trading day, Frederick adds.

In addition, now that trading commissions at most online brokers are free (or very cheap), you can trade in smaller increments, including fractional shares, and buy or sell a stock as its price moves higher or lower.

“There’s no cost of scaling in and scaling out, and I advocate it more than ever before,” Frederick says. “That can reduce your risk substantially because you’re not taking the full position initially.”

Preparing for a potential market correction may also be a good opportunity to change up how you invest. If you’re heavily invested in individual stocks, you may opt for ETFs instead when broadening the diversification within your portfolio. Doing so will also reduce your investment risks, Frederick notes. “It’s virtually impossible for an index to go to zero; that doesn’t happen very often, as we know,” he says.

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5. Remember Your Investing Goals

Even if you're a buy-and-hold investor, you'll eventually want to sell some of your investments. "You're investing to make money, not to hold things for the rest of your life," Ferrantino says. "People are never sad about taking profits."

While market corrections tend to be pretty short-lived—since World War II, the S&P 500 has taken four months, on average, to regain its losses—they can rattle some investors. By selling some stocks in advance, you can "dial down the risk" in your portfolio and you will have an opportunity to reinvest that money at lower stock prices if a correction does indeed materialize, Ferrantino says.

By having a plan in place before a selloff occurs, you can make a clear-headed decision when the market gets volatile. That way you won't be tempted to sell shares at the worst possible price, Frederick notes.

Finally, while a market selloff could catch you by surprise, that doesn't mean you have to scramble to react. Even bear markets—defined as a decline of at least 20% from a recent high—are relatively short-lived when compared with bull markets and have clocked in at an average length of about 10 months.

That's why even in those cases, "you can sit back and do nothing," Frederick says. Remember: Historically, the overall U.S. stock market has always recovered from its short- and longer-term market dips.

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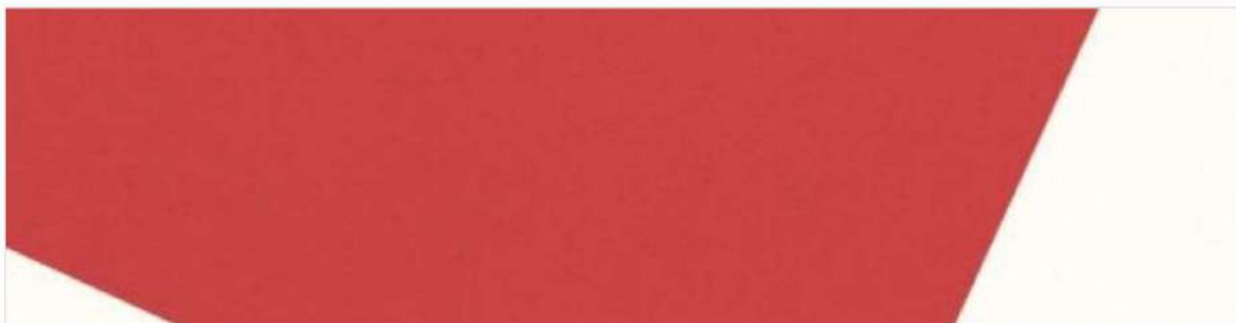

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Anna-Louise

Anna-Louise Jackson

Contributor

Benjamin Curry

Editor

business and finance journalism experience, Ben has covered breaking market news, written on equity markets for Investopedia, and edited personal finance content for Bankrate and LendingTree.

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