What do you do when the market drops 1,000 points?

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Market volatility is a part of investing, but there are ways to make sure you have some protection in a downturn.

After steadily—and quietly, for the most part—heading upwards during 2017, the stock market rudely got investor's attention in early February 2018. However, by the end of that week, the market recovered some ground to end down by slightly more than 5 percent.[1] March continued to be volatile, with the Dow having five major drops, the lowest being 742 points. Market analysts believed investors were spooked by the prospect of rising inflation.

How unusual is this most recent spurt of market volatility? Not very—market swings are common although each individual event may have a different cause. Fear of loss is a very common reaction, and that fear can manifest itself in a variety of ways. The worst reaction is panic-induced selling, while a more moderate reaction might involve seeking reassurance from a financial advisor.

For others, market volatility is a byproduct of investing and they don't make rash decisions because of their emotions. While there is no right reaction to a market drop, pausing to consider what reaction is most appropriate and in your best interest is better than panicking and selling. Discussing risk tolerance, diversification, asset allocation and strategies to produce guaranteed income during retirement with a financial advisor can help reassure investors that their portfolios are on the most appropriate path to meet its/their objective.

Reducing Risk

Risk tolerance involves assessing an investor's ability to handle loss in an investment portfolio. Think about it as the "sleep at night" factor—if investment loss has the potential to keep an individual up at night, it is probably too risky. Risk tolerance depends on many factors, including an individual's age, occupation, and portfolio balance.

An investor's perception of risk changes throughout their life. For those who are younger and still working, risk can mean opportunity. That's because they are actively contributing to their investments. A market downturn may represent an opportunity for this group because they can buy more securities at a lower price when the market is down. In fact, by regularly investing a fixed amount and buying more or less depending on market conditions, these individuals may be able to reduce the average price per share of their investments, giving them an opportunity to save more over time. This is known as dollar-cost averaging.[2] When investing for the long term, patience works because an investor has time to ride out the ups and downs of the market.

Near-retirees and retirees, however, generally perceive risk from a very different viewpoint. Retirees have a relatively shorter time horizon. They have more to lose if the market drops and less time to recover from it. Their risk tolerance also changes to become more risk adverse. They don't know how long they are going to live, and many fear running out of money.

One way to guarantee income for life is through an annuity. Annuities can help protect retirement savings from market uncertainty and provide ongoing income, relieving anxiety about the direction of the market and performance of investments.

Creating Diversification

One of the best ways to lessen market risk is to diversify. Diversification, which involves putting money into a variety of different investments, is an important component of risk reduction. Through diversification, invested funds may be placed into stocks, bonds, cash and other investments, such as annuities.

Many investors work with an experienced financial advisor to create a diversified portfolio that is in line with their goals and risk tolerance. Advisors use a specific asset allocation strategy to build a diversified investment portfolio.[3]

Protection During Downturns

For those who are nearing retirement or who are retired, market volatility and large market declines can lead to concern, if not actual worry. After all, you've been saving your entire career, and a down market could be devastating to your retirement investment portfolio.

Annuities help protect pre-retirees and retirees when the market falls, ensuring that they will have guaranteed monthly income to enjoy a secure retirement. There are many different types of annuities: Index Annuities, Variable Annuities, Fixed Annuities and more. Investors should consult with a financial advisor to determine the most appropriate type for their situation. For example, during the Great Recession, when the S&P 500 fell 38 percent in 2008,[4] an investor who solely invested in the market lost a great deal, whereas retirees with index annuities would have had less to worry about, since their principal and monthly income would not have declined due to market downturns;[5] instead, no interest would have been earned during this volatile time.

In contrast, the individual who was 100% invested in the market may have had to cut back on his or her lifestyle. The investor might have also jumped out of the market at just the wrong moment because of fear and missed out on the subsequent gains as the market rebounded. In fact, the S&P roared back with a 26.46 percent gain in 2009 and didn't have a down year until 2018.[6] Please note that past performance is not a guarantee of future results.

Building Long-term Retirement Security

Consulting with an experienced financial advisor can help avoid the pitfalls created by emotions. An advisor who has worked with clients through several bull and bear market cycles understands how to position portfolios for appropriate risk and return. With retirements lasting 30 or more years, mixing opportunities for growth with investments carrying guaranteed income can help ensure security into and through retirement.

Don't leave your retirement security to chance. Consider the steps you need to take to help create enough ongoing, secure income to enjoy your retirement, cover your expenses and ensure that you don't run out of money.

[1] "U.S. Stocks Rebound as Wild Week Ends," The Wall Street Journal, Feb. 9, 2018, https://www.wsj.com/articles/global-stock-slump-continues-1518138066

[2] Dollar cost averaging does not guarantee profits or prevent losses in a declining market. This strategy requires regular investment regardless of fluctuating prices. Potential investors should consider their financial ability to continue purchases through periods of low price levels.

[3] Diversification and asset allocation do not guarantee a profit, nor do they insure against market loss.

[4] S&P 500 Annual Total Return, YCharts.com, https://ycharts.com/indicators/sandp_500_total_return_annual

[5] Principal may decline due to withdrawals and/or fees associated with optional features.

[6] S&P 500 Annual Total Return, YCharts.com https://ycharts.com/indicators/sandp_500_total_return_annual

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