ALASKA HIGHWAY NEWS

Brad Brain: Read this the next time your investments are down 25%

Apr 26, 2021 12:02 PM By: Brad Brain / Smart Money

Brad Brain: "There is a reason that people hate uncertainty. Making good decisions in uncertain times can be tremendously challenging, and there is a tendency for people to have irrationally extreme reactions to uncertainty." | Getty Images

Let's talk about making good decisions in times of uncertainty.

Now that a year has passed since the big stock market volatility of 2020, that misery is beginning to fade from people's memories. People are beginning to forget the confusion and agony that came from the perception that their nest egg had apparently evaporated by maybe 30% or more in a matter of weeks, and the fundamental uncertainty about how the future would unfold in a pandemic.

There is a reason that people hate uncertainty. Making good decisions in uncertain times can be tremendously challenging, and there is a tendency for people to have irrationally extreme reactions to uncertainty.

In times of uncertainty some people will be dreadfully pessimistic and expect the absolute worst outcome as being inevitable. Others will be ridiculously overconfident and expect high risk strategies to have assured outcomes. Neither state is conducive to good decision making.

When I start working with a new client, inevitably I will tell them, "I can't say when the next bear market will happen. We won't know in advance what will trigger it. I can't tell you how much things will drop, or how long they will stay down. But I can definitely tell you that, sooner or later, we will see another bear market." Its not a question of "if" we will see a bear market, its "when."

So if you find it hard to make financial decisions in times of uncertainty, clip this column out and stick it on your fridge, along with a sticky note that says: "Read this the next time my investments are down 25%!"

There are some things that you can control, and some things that you can't. Focus on what you can control. Why are you investing? Is it for retirement, your kid's education, some bucket list item? Stay focused on those goals. Do you own high quality investments that are temporarily out of favour? Has anything changed about what you are trying to achieve? Will a knee-jerk, emotional reaction to market volatility help you reach your goals?

Consider dollar-cost averaging if you aren't doing it already. Purchasing investments at regular intervals can reduce the average price that you pay for your investments, which can turn price volatility to your advantage. It doesn't matter if investments go on sale in May or June or July, if you are buying in May and June and July.

Have a diversified portfolio, with lots of eggs in lots of baskets. Proper diversification will mean you can take a hit in one area, but have things spread out enough that you aren't going to capsize.

Embrace a long-term perspective. Sometimes the right thing to do in response to a temporary event is to do nothing at all.

Look at your investments opportunistically. If you are buying baseball cleats, or a house, or new underwear, do you want to pay a high price or a low price? Obviously, you want to pay a low price. Guess what? When you buy investments it's the same thing. Bear markets mean you can buy the same investments at lower prices.

You can't control when the next bear market will happen, but you can control what you do about it when it does. Focus on what you can control.

Better yet, with some of this you don't need to wait until the next bear market. Implement these ideas now and reap the rewards when opportunity comes knocking.

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