5 Tips to Handle (persistent) Market Volatility

Investments, annuity and insurance products

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In today's digitally connected world, short-term market volatility can be more prevalent thanks to the immense amount of information at one's fingertips. When dramatic sell-offs happen, it can be upsetting especially in the face of sensational headlines and negative media coverage, often challenging investors' commitments to their long-term investment plans.

Now that we are arguably in the later stage of the business cycle, further periods of volatility may lie ahead. While there is no fool-proof method to navigate market ups and downs, the following tips can help.

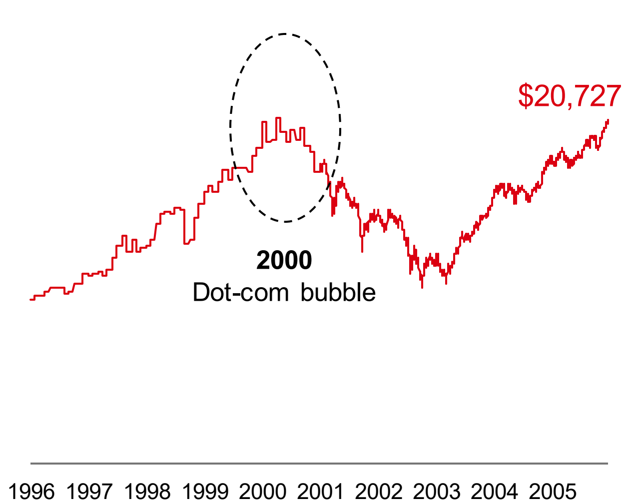
HSBC

1 Keep calm. Short-term volatility is part and parcel of the investment journey

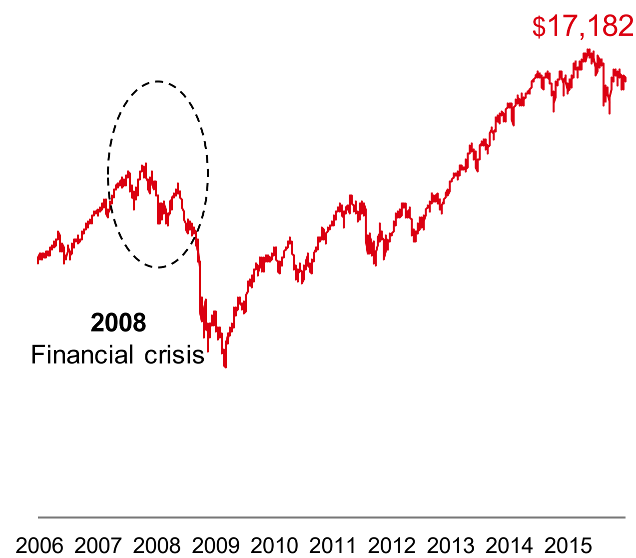
- Markets can fluctuate depending on geopolitical events, economic data release, special events or expectations on valuations and corporate earnings. It is important to remember that volatility is to be expected from time to time in financial markets.
- History does not necessarily repeat itself, but we can learn from prior lessons. Short-term volatility tends to be more prevalent in late economic cycles, but they do not necessarily derail the long-term growth in stock markets. Historically, significant recoveries occur following major setbacks including economic downturns and geopolitical events (Chart 1).
- While news-flow (such as the Coronavirus, Trade negotiations, Middle East tensions) can affect short-term market sentiment and lead to reductions in asset valuations, share prices should ultimately be driven by fundamentals over the long run. Therefore, investors should avoid panic selling during volatile periods, to avoid missing out any potential market recovery.

Chart 1: Financial markets have risen after the financial crisis over time

Returns from $10,000 invested in global equities* from 1996 to 2005



Returns from $10,000 invested in global equities* from 2006 to 2015

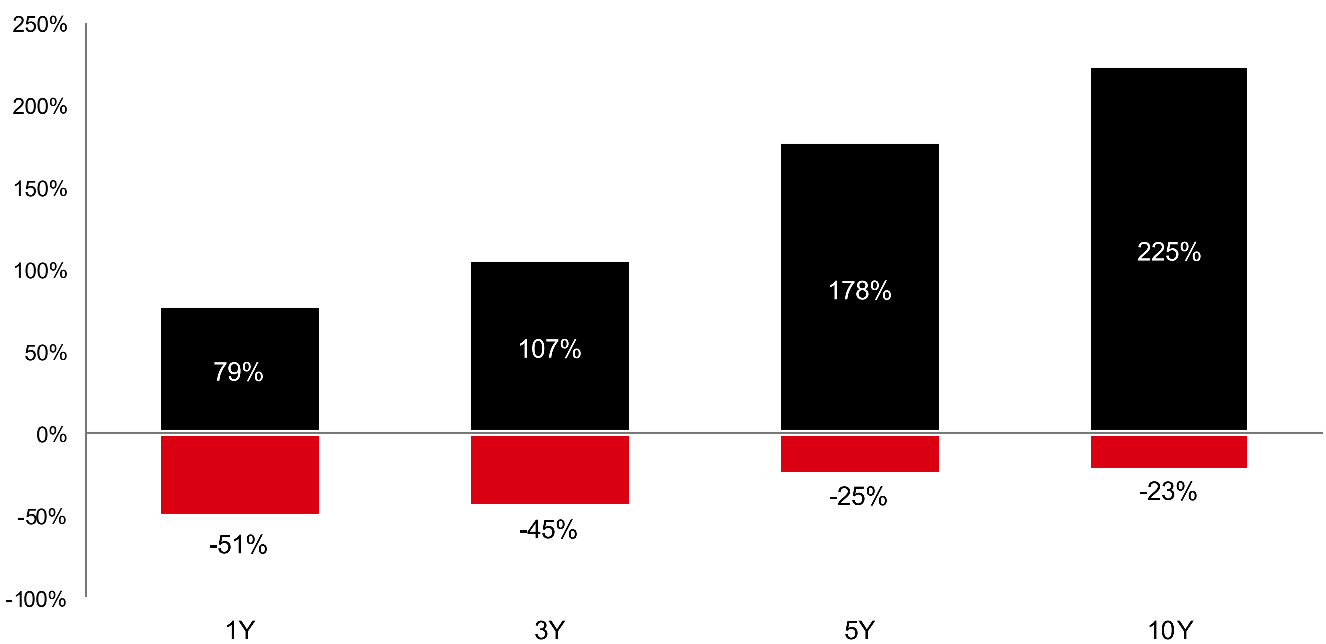


*Source: Bloomberg, as at 31 January 2020. Index used: MSCI World Total Return Gross Index.
Past performance is not an indication of future returns. The performance may go down as well as up.

2 Remain invested. Long-term investing increases the chance of positive returns

- When markets get rocky, it is tempting to exit the market to avoid further losses. However, those who focus on short-term market volatility may end up buying high and selling low. History has shown that financial markets go up in the long run despite short-term fluctuations (Chart 2).
- Though markets do not always follow the same recovery paths, periods after corrections are often critical times to be exposed to the markets. Staying invested for longer periods tends to offer higher return potential.

Chart 2: The performance range of global equities* over different time frames



The chart shows the performance of global equities (represented by the MSCI AC World Total Return Index) over different time frames between 1999 and 2019

- You can see that the longer the investment time frame, the less likely a negative return.
- For example, if you look at the 1-year bar graph (far left), this shows that performance of the index over any 1-year period between 1999 and 2019 ranged between -51% and 79%. However, for any 10-year period, investment performance of the Index ranged between -23% and 225%.
- Therefore, the longer you stay invested, the more likely you are to enjoy positive returns.

* Source: Bloomberg, as of 31 January 2020, calculated by rolling returns in USD within 1 year, 3 years, 5 years and 10 years timeframe. Index used: MSCI AC World Total Return Index. Past performance is not an indication of future returns. The performance may go down as well as up.

3 Stay diversified. Diversification can help achieve a smoother ride

- Diversification simply means '*don't put all your eggs in one basket*'. Different asset classes often perform differently under various market conditions due to their unique characteristics and correlation (or relationships to behave in a similar or opposite way at the same time) to one another (Chart 3).
- By combining assets with different characteristics, the risks and performance of different investments are combined, thus lowering overall portfolio risk. That means, a lower return in one type of asset may be compensated by a gain in another.

Chart 3: The performance of each asset class varies over time

Color legend

- EM Equity
- EMD Local
- Diversified
- DM Equity
- EMD Hard
- Global Government
- Cash
- Global Corporate
- Global High Yield
- Property

Best performing asset class in year

The best-performing asset class in one year...

2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Annualised return	Annualised volatility
9.21	78.51	19.63	8.15	27.73	26.68	15.02	1.30	16.21	37.28	2.60	27.67	8.00	31.42
3.84	60.70	18.88	5.49	18.89	7.10	8.35	0.63	11.19	22.40	2.08	21.91	6.78	20.93
-5.09	37.13	15.68	4.79	18.30	3.67	7.60	0.23	9.94	15.21	-1.00	18.42	5.52	19.38
-5.22	30.46	15.39	3.18	18.22	2.29	7.31	-0.24	9.48	12.47	-1.90	14.78	5.28	19.20
-10.19	29.99	12.50	0.27	16.76	0.29	4.94	-0.79	7.67	10.36	-4.22	14.54	5.10	12.06
-19.63	27.24	11.76	-1.14	15.83	0.22	4.23	-0.87	7.51	10.01	-4.63	14.31	4.09	11.96
-27.01	21.98	11.64	-1.75	14.63	0.07	2.53	-2.03	6.22	8.02	-5.63	13.47	3.93	10.29
-40.71	16.60	7.24	-5.54	10.92	-2.60	0.23	-3.51	4.06	5.70	-6.21	12.51	3.49	5.97
-48.16	1.01	3.36	-6.46	4.50	-5.79	-2.19	-14.92	3.75	2.14	-8.71	7.59	1.50	2.85
-53.33	1.00	0.34	-18.42	0.51	-8.98	-5.72	-14.92	0.66	1.10	-14.58	2.61	1.09	1.11

Worst performing asset class in year

Can be the worst-performing asset class in another year...

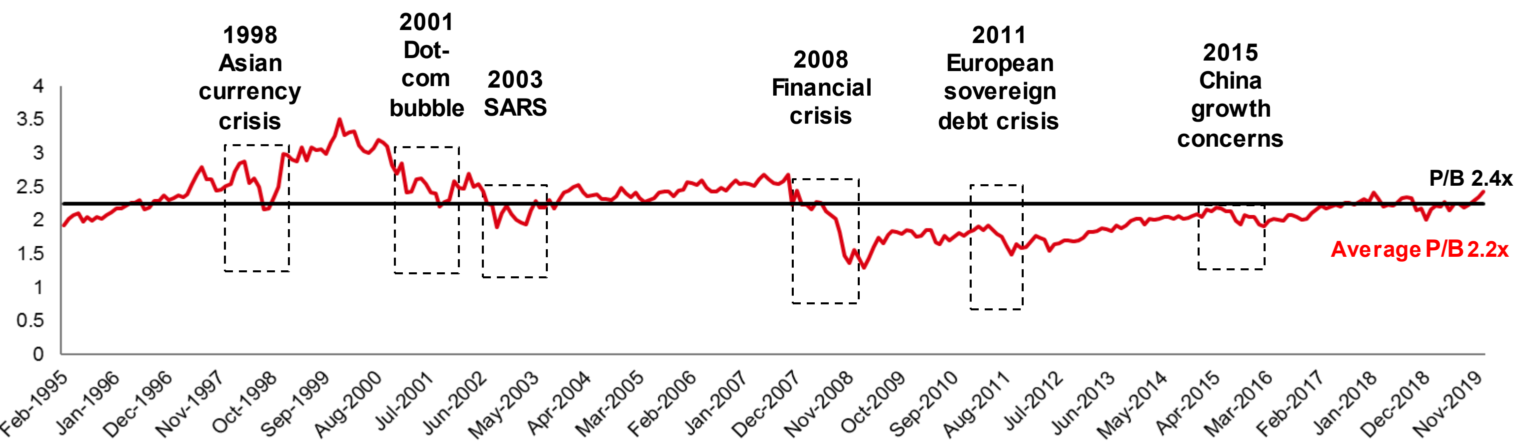
Source: Morningstar, HSBC Global Asset Management, data as at 31 January 2020. All returns in USD, total return.
Indices used: MSCI World Index; MSCI Emerging Market Equity; JPMorgan GBI-EM Global Diversified; Bloomberg Barclays Global Aggregate Corporate Bond Index; ICE Bank of America Merrill Lynch Emerging Market Bond Index; ICE Bank of America Merrill Lynch Global High Yield, Citi World Government Bond Index, FTSE EPPRA/NAREIT Listed Property Index, ICE LIBOR 3 Month
Bond indices are hedged, excluding emerging market government bond local currency (i.e. global government, global corporate, global high yield, emerging market government bond hard currency). Equities are unhedged.
Past performance is not an indication of future returns. The performance may go down as well as up.

4 Take advantage. Market downturns may create opportunities

- Don't be passive, or follow the 'herd' mentality in the face of market declines. When market sentiment is negative, valuations tend to be driven down to attractive levels, which often provides investment opportunities (Chart 4). In rising markets, people tend to invest as they chase returns or for the fear of 'missing out', while in declining markets people tend to sell. When investors overreact to market conditions, they may miss out some of the best-performing days.
- Whilst no one can predict market movements, during periods when 'everyone' is overwhelmingly negative often turns out to be one of the best times to invest.

Chart 4: Global equities trade cheaper during economic crises

Price-to-book ratio



Market downturns may create opportunities

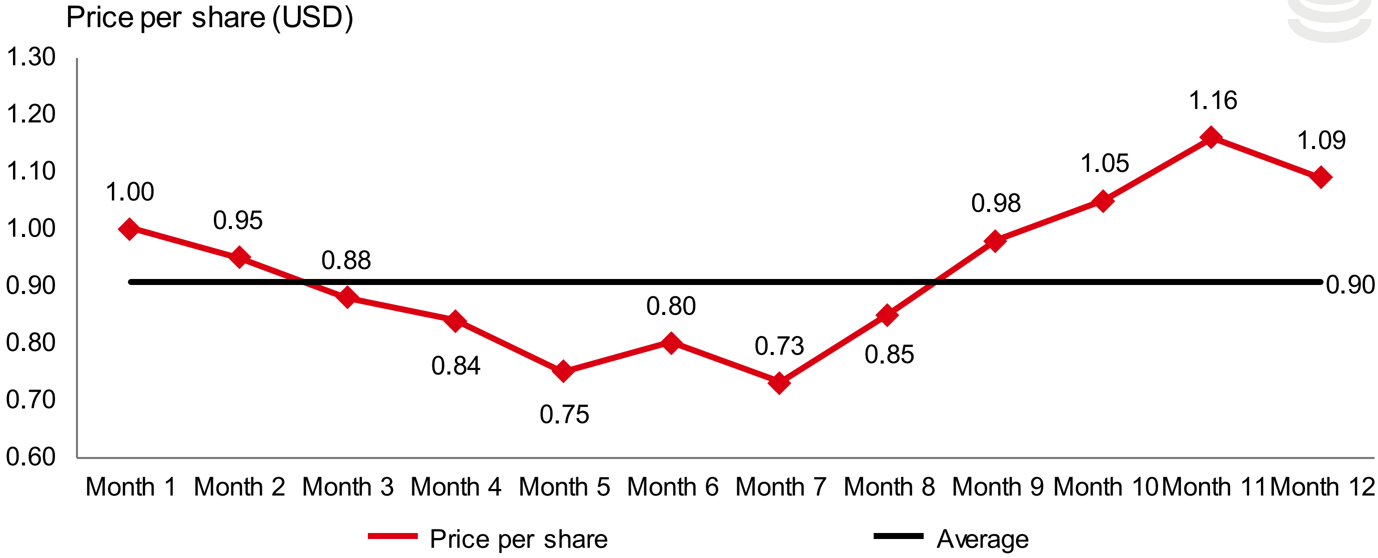
- Price to book ratio (P/B Ratio) is a ratio used to compare a stock's market value to its book value (the company's assets minus liabilities). It is calculated by dividing the price of the stock by its book value per share. A lower P/B ratio could mean that the stock is undervalued.
- This chart shows that high levels of selling during economic crises drive valuations down, which can provide buying opportunities.
- Sometimes, company valuations are at their lowest during these times because 'everyone' seems to have a negative view.
- Opportunities can arise when market sentiment is the lowest (all the news is negative). For example, between Nov 2008 – Mar 2009, the valuation reached its lowest point over this period at 1.28x. This preceded a lengthy period of positive returns.

Source: Bloomberg, MSCI AC World Daily Total Return Index, data as of 31 January 2020
Past performance is not an indication of future returns. The performance may go down as well as up.
Note: Price to book ratio (P/B Ratio) is a ratio used to compare a stock's market value to its book value. It is calculated by dividing the current closing price of the stock by the latest quarter's book value per share. A lower P/B ratio could mean that the stock is undervalued.

5 Invest regularly, despite volatility

- Investing regularly means continuous investment regardless of what is happening in the markets.
- When investors make fixed regular investments, they buy more units when prices are low and less when prices are high. This will smooth out the investment journey and average out the price at which units are bought (Chart 5). It thus reduces the risk of investing a lump sum at the wrong time, particularly amid market volatility.
- The longer the time frame for investment the better, because it allows more time for investments to grow (the compounding effect).

Chart 5: Dollar-cost averaging helps smooth the effects of market movements



USD	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 7	Month 8	Month 9	Month 10	Month 11	Month 12	Total
Price per share	1.00	0.95	0.88	0.84	0.75	0.80	0.73	0.85	0.98	1.05	1.16	1.09	
Monthly contributions	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	12,000
Shares purchased	**1,000**	**1,053**	**1,136**	**1,190**	**1,333**	**1,250**	**1,370**	**1,176**	**1,020**	**952**	**862**	**917**	**13,261**
Cumulative value of shares	1,000	1,950	2,806	3,679	4,285	5,570	6,083	8,083	10,319	12,056	14,319	14,455	14,455

- **The chart shows what happens to USD1,000 invested monthly.**
- More shares are purchased when prices are lower, and fewer shares are purchased when prices are higher.
- This approach can help you stick to an investment plan, while reducing the impact of short-term market movements on your portfolio vs a lump sum investment of the same amount.

Source: HSBC Global Asset Management, 31 January 2020
This information is for illustrative purposes only and does not relate to any investments. The figures and rates are purely hypothetical.

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