

Tough times never last

There really is no way around it..... **equity markets are cyclical** . In some years, we have a rising market, and in others, a declining one - all of which are a normal part of market activity. Though, historically, stock markets have trended upwards, which is why stocks have proven to be good investments over the years, the market does retrench more than the average investor would like. However, believe it or not, corrections in the markets are healthy!

What is a market correction?

A market correction is defined as a decline in the value of stocks, usually 10% or more over several days. As the terminology implies, it is a downward adjustment to a market's valuation of assets from previously higher levels. Market corrections vary in degree, cause and duration.

Nature's way

But how could declining equity prices possibly be of any benefit? The same way earth tremors relieve built up stresses in the earth, and reveal "flaws" in resistant architecture, sharp market sell offs, (often called corrections), relieve imbalances that build up in a rising market. These corrections reveal "flaws" or "irregularities" in the market's pricing of assets. In some cases, the longer the market goes without these corrections, the greater the imbalances that are built up within the market. Consequently, the more severe the correction when it takes place; equivalent of a major earthquake on the Richter scale! Similarly, the timing of stock market sell offs is as unpredictable as that of earthquakes.

Understanding that market corrections eventually happen and staying focused on long term goals can potentially help you through unpredictable times

Stock market corrections could either be short, lasting only a day or two, such as the Dow Index's 500-point drop in October 1987, a matter of weeks or be a prelude to a lengthier downturn such as the 1929 crash, and the subsequent 3-year bear market during which the Dow lost over 80% of its value.

What moves equity prices?

Stock market movements come about as a result of the influences or interpretations given by analysts or investors to several factors such as economic, political and fiscal or monetary policy changes in different countries. A combination of these forces results in significant volatility and unpredictability in equity prices, depending on the skewness of the consensus interpretation of an event or indicator.

The following are a few helpful points to consider in minimising the effects of a falling market and, if borne in mind, will help keep an investor focused during turbulent times:

Think long term: Over the long term, as against the short term, it is important to realise that inherent risks associated with investing in the stock market, while still present, are considerably reduced. The last option in dealing with corrections is "bailing out", particularly

when it has already taken place. Rather, investors should focus on long-term goals and remember that rising markets, historically, have more than compensated for down years.

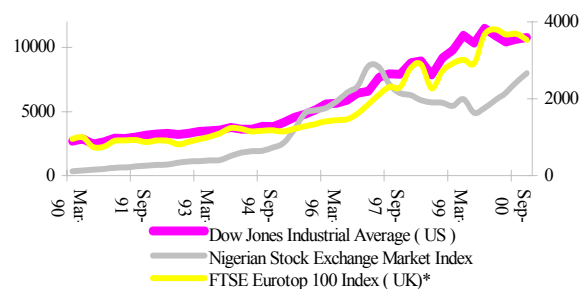
Remember the golden rule of diversification: A diversified portfolio both in terms of regional holdings and asset classes such as equities, bonds, other interest bearing investments and illiquid assets such as arts and antiques, will cushion the impact of a market correction. These assets should be weighted to suit individual risk tolerance and reflect investment objectives. As the saying goes, "do not put all your eggs in one basket".

Invest regularly: Maintaining the discipline of regular contributions is important and awards you the benefit of averaging cost. This strategy allows an investor to spread out the average cost per unit of buying mutual funds and individual stocks, reducing the risk of buying at the wrong time and increasing your exposure for the upturn.

Maintain a financial plan: As with other aspects of life, you need to establish a plan to attain financial goals. Be sure to ask yourself what your objectives are, how much risk you can tolerate, and when you need your money. Remember to fine-tune your plans as personal preferences and economic circumstances unfold and change.

Buying opportunities: It is important to consider down markets as prime buying opportunities. There is no better time to make a purchase than when you discover a "sale".

To conclude therefore, we stress the fact that though stock market gyrations in the short term are distressing, the typical direction for stock markets remains upward as shown in the graph, which charts the quarterly performance of some major market indices over the last ten years.



Still distressed? Don't be. It is definitely better to be in the market than out of it. Focus on how far the market has come, rather than how far it has corrected.

* FTSE 100 index scale on the right