3 Strategies for Managing the Risks Associated With Volatile Markets

Description

It has been an unnerving year for investors as growing fearfulness over the outlook for commodities and the global economy has driven market volatility to near-record levels. Even so-called safe haven stocks such as banks and utilities have gyrated wildly as investors stampede for the exits on every piece of bad news and then flock back into the market on the slightest fragment of good news.

In times like these, investors can feel overwhelmed every time markets take a turn for the worse, causing them to liquidate their positions–usually at a loss.

Nonetheless, investors can manage the risks that market volatility poses with these three simple strategies.

Now what?

Firstly, don’t panic and change investment strategies.

One of the biggest mistakes investors make is to get caught up in the heat of the moment, lose sight of their original investment strategy, and sell out of the market.

Doing so will crystallize losses, and investors miss any upturn in sentiment that can cause solid reputable stocks to appreciate in value over the long term.

For long-term investors (one of the most consistent paths to investment success), it should be recognized that their greatest asset is in fact time.

You see, what goes down often bounces back just as quickly. A good example of this is the performance of **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS) over the last year. Between April 29, 2015 and August 24, 2015, its share price plunged by 17% in value, only to recover by 13% between then and October 29, 2015. It then lost 18% in value by January 20 of this year, but since then has bounced back to now be up by 18%.

Notwithstanding those wild gyrations, Bank of Nova Scotia has performed well over the last decade; its market value has grown by an impressive 39%.

The lesson here is that over the short term, stocks gyrate quite wildly, but over the long term, quality stocks appreciate in value and deliver solid returns for patient investors.

Secondly, diversification is an important tool for managing market risk.

Diversifying a stock portfolio across industries, economic sectors, and even countries can be a good tool for managing risk. This is because economic downturns can be localized in nature, impacting only one economic sector–as now being witnessed in the energy patch–or being restricted to a single economic region.

By diversifying their stock investments, investors are able to offset many of the risks associated with a single company, industry, or economy and better manage the volatility associated with stock markets.

Finally, market dips created by rising volatility provide the opportunity to acquire quality stocks at a discount.

Rather than being concerned about timing the market, long-term investors are more worried about the wealth they can generate over time. One of the best ways to maximize this is to purchase quality, reputable dividend-paying companies such as **BCE Inc.** (TSX:BCE)(NYSE:BCE) that are trading at a discount to their fundamental value.

Over the last decade, BCE's stock price has experienced considerable volatility, but it has still delivered a return of 125% for investors over that period and, more importantly, consistently rewarded investors with a regular dividend payment that now yields 4.5%.

So what?

The fundamental lesson for investors is that they shouldn't be fearful of market volatility. Instead, they must remain focused on their long-term strategy and embrace volatility as an opportunity to enhance their portfolios by making further quality additions at the right price.

After all, it was renowned investor Warren Buffett who once famously said, "Be greedy when other fearful."

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