3 Things to Do When the Markets Turn Red

Description

Last week, the TSX, Dow Jones, and NASDAQ all saw some heavy losses as many stocks saw some big drops in price. However, it's not all doom and gloom for investors, and sell-offs like these could uncover some great deals on the markets as investors are panicking.

While it's no easy task to buy at a time when everyone is selling, if you stick to value investing principles, you're giving yourself good odds for success. There are three things you should do when you see a big sell-off happening.

Look behind the reason for the bearish activity

Admittedly, this can sometimes be a challenge because there can be many different factors that impact the markets. That being said, it isn't always easy to understand the logic behind market movements, especially when you're looking at an individual stock.

A big drop in price could be the result of one big investor pulling money out, which triggers stop losses all the way down, and then you've got technical analysts that see the chart going down and they decide to sell the stock as well. Momentum has a lot of power in the markets, and it may not always take much to get the stock rolling downhill.

I'm not convinced that analysts truly know the reasons behind every stock or market movement, and sometimes they just look for reasons to justify the bearish activity. The truth is, if there is a big reason behind the markets going down, you'll know, as it'll be tied to a big news event.

It's important to know the reason for the sell-off (if there is a discernible one) because that will offer a hint as to whether or not this is the start of a big fall or if it's just a bump in the road.

Review your portfolio for any overpriced stocks

There is always the opportunity for the markets to correct themselves, regardless of how long it may take. At the start of the year, we saw speculative buys like Bitcoin and marijuana stocks suffer heavy losses. Although marijuana stocks recovered, largely thanks to news and rumours of beverage companies getting involved in the industry, there's still the opportunity for another correction along the way.

Consider a stock like **Canopy Growth** (TSX:WEED)(NYSE:CGC), which trades at a multiple of around 200 times its earnings. While investors may scoff at Canopy's large multiple today, that may not be the case weeks or months from now when better deals may be available or hype from cannabis may be dying down.

Sticking to value principles is a good way to protect yourself as much as possible from a sustained downturn.

Put stop losses in place

One way you can help stop the bleeding from any sell-off is to force yourself to put in a stop loss. If you want to wait out the market in the hope that it recovers, putting in a stop loss will help cut your losses in the event that they get deeper and can prevent you from trying to rationalize keeping a stock that's on its way down.

That being said, if it's a good value buy, then you may not want to do this, but for riskier stocks that are due for a correction, this can be a way to save what gains you've made or to avoid even steeper losses.

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Date
2025/07/06

Date Created
2018/10/17
Author
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