How to Rise Out of a Market Crash Richer Than Before

Description

The markets are in turmoil once again, just a day after Monday's dead cat bounce, following a surprise U.S. Fed rate cut that sent shivers down the spines of investors. When a previously hawkish Fed chair like Jay Powell, who's shown reluctance to cut rates in the past, delivers a 50 basis points rate cut quicker than expected, many are going to wonder if things are as bad as they feared.

Step one: try not to panic

Embrace the newfound volatility — it can be an ally to those who can temper their emotions.

Given the massive rise in volatility over the past week (quadruple-digit moves in the **Dow Jones Industrial Average** have become the norm), the stomachs of investors are being put to the test. Before you think about checking out of the markets entirely, consider the fact that such off-the-charts volatility goes both ways.

We could easily see another record-breaking up day like on Monday, so the real risk to investors isn't the rise in volatility, it's the temptation to try to time one's entry or exit from the markets.

All it will take is missing one big up day, and your annual returns will likely be doomed to trail the market. Depending on news relating to the viral epidemic, stocks could rise or fall by 5% in a day, so don't bet on the outcome of a binary event if you're not one to gamble on coin tosses. Instead, try to view this market correction as an opportunity to take advantage of the market's now inefficient pricing of stocks.

In times of ridiculous volatility, the market has a tougher time pricing stocks at a level that's close to their intrinsic value range, opening up a window of opportunity for do-it-yourself (DIY) stock pickers to pick up shares of unfairly hit businesses that are priced at considerable discounts to their intrinsic value range.

When the degree of market efficiency suddenly goes down, DIY investors who can keep their cool (step one) and spot stocks that have been unfairly dragged down will be the ones that come out of the market crash (or correction) richer than before.

Step two: buy stocks that are cheap relative to the new set of risks

You could do well over the long run by purchasing an index fund like the **TSX Index** gradually on the way down. In times of panic, however, it's better to have a preference for stocks that you believe have been unfairly dragged down.

Stocks have been selling off across the board, but some are less vulnerable to the disease outbreak than others. It's these stocks that are likely easier to spot as "underpriced," as they don't require you to predict the outcome of a dire exogenous event that could get worse.

Like in the Financial Crisis, stocks that are most at risk (such as banks) could stand to take on "double damage" and fall harder and faster than that of the market averages. We're at the cusp of a potential biological crisis and rather than the banks taking on double damage, we have travel and leisure stocks that could continue to lead the downward charge.

While a stock like **Air Canada** may have the most upside in the event of a global COVID-19 spread deceleration, it could also face amplified damage should things be as bad (or worse) than feared.

You don't need to be a hero by jumping into the hardest-hit stocks to come out of this crash in better shape than you entered it, especially if we're in the early innings of a protracted downturn. All it takes its picking up stocks of less-correlated names like **Fortis** as they sell off alongside the broader markets.

Step three: hope for the best, but prepare for the worst

After a 13% drop in the U.S. equity markets, you should think about buying stocks, but don't get too greedy and exhaust your cash reserves. You may need more dry powder should stocks get knocked into a bear market.

Buy a little now, buy a little later, and keep it going until these tough times pass and the rebound begins. That way, you'll come out of the downturn a richer investor!

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Date
2025/08/13
Date Created
2020/03/05
Author
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