TFSA Investors: Why a Market Rebound Could Be as Sharp as the Market Crash

Description

TFSA investors found themselves in some pretty volatile times. Stocks take the stairs on the way up and the elevator on the way down. But in times of sudden panic, don't be surprised to see stocks take the elevator back up given the off-the-charts volatility. That means if you sell your stocks, you could get hurt that much harder relative to past market meltdowns.

While it's a good idea to re-balance your TFSA and take a more risk-off approach, make sure you don't panic sell stocks based on how beaten up they are. Because if the underlying business is still sound, and the long-term thesis is still intact, it's these such stocks that could have the most room to run in a rebound.

Remember, volatility goes in both directions.

What's with the off-the-charts volatility of late?

A global pandemic is enough to cause mass hysteria. But add the rise of passive investing into the equation, and the wild market swings stand to be severely exacerbated.

Dr. Michael Burry, the man behind *The Big Short*, warned everybody that there's a bubble in passive investing. While I wouldn't necessarily call it a bubble, as the components of index funds were never trading at levels that'd be considered bubbly, I would be on alert of the implications of the profound rise of passive investing.

Passive investors don't see their index funds as pieces of businesses. They see it as an easy way to get in and out of the markets altogether. In a way, index funds are both a blessing and a curse, especially for passive TFSA investors.

This is arguably the first significant panic we've had in an era where passive investing has become so popular. And it's led to more pronounced single-day moves, with the circuit breaker being triggered on what seems like the daily!

Passive investing also has major liquidity problems and could be a major reason why we suffered a cash crunch amid the market turmoil.

How TFSA investors can take advantage of the rise in volatility

Passive investing isn't going anywhere. When the panic is over, and the coronavirus is eradicated, they'll buy up index funds in droves. And that could lead to something unprecedented — a market rise that's as sharp, if not sharper, than a downturn.

Circuit-breaker breaking moves in panics have become the new norm. Fortunately, for stock pickers, that's a good thing because it allows us to spot individual businesses that are priced at considerable discounts to their intrinsic value.

How to react to the sudden market crash?

Don't sell your index funds. They're still great for the long term. Don't sell anything unless you're in the right state of mind. But if you consider yourself a passive investor, do adopt a more active approach so you can grab the bargains and steer clear of toxic stocks that could lead the charge lower.

Look to high-yield dividend stocks that suddenly became too cheap to ignore. Think about the Canadian banks or utilities like **Fortis** that shouldn't have sold off in a market that's anything close to being rational.

Foolish takeaway for TFSA investors

It's time to get active with your TFSA. As we've witnessed over the past few weeks, safe havens aren't as safe as they used to be, and wild swings in the market have the potential to move in either direction. Record-breaking declines followed by record-breaking rallies are the new norm. As such, there's never been a better time for TFSA investors to be active.

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