New Investors: 2 Things to Never Do During a Bear Market

Description

If you started investing post-2008, odds are that you've had a smooth time sailing. Aside from a minor bear market in 2018 and a short-lived crash in March 2020 during the COVID-19 panic, stocks and bonds have both been trending upwards due to low interest rates and explosive tech growth.

Recent events have changed this, though. High inflation, a hawkish Federal Reserve board, and the threat of four interest rate increases in the near future have rattled markets, sending bond yields soaring (bond prices down), and tanking some growth stocks by as much as 50%.

If you're down on your investments and worrying — don't. In the short term, the market noise might be scary, but maintaining a long-term perspective will help you ride it out. In the meantime, try and avoid these two mistakes.

Don't panic sell

You see it on the news: the major indexes are down over 25% from their peaks. Stocks are in free fall. Everyone you know is selling their stocks and moving to bonds or cash "until the worst is over." Every day you look at your portfolio, you're seeing it lose money.

You might be tempted to sell now before you lose any more and wait until the market has bottomed out to buy back in for the reversal. Don't. This literally never works. Timing the market and trying to "call the bottom" is a folly. You're more likely to sell and realize a loss, and then miss the rebound with cash sitting on the sideline.

The lesson here is to stay invested. Refer back to your investment policy statement and remind yourself to stay the course and stick to your asset allocation. If all else fails, turn off your brokerage app and take a breather. Your portfolio will recover. If you have extra money though, consider dollar-cost averaging to buy the dip.

Don’t catch a falling knife

Yes, speculative tech stocks, penny stocks, and cryptocurrencies are fun. They can offer the potential for a massive gain … or a complete loss. For this reason, they tend to do horribly in a bear market, tanking much more than blue-chip stocks or a balanced portfolio of stocks and bonds.

I know everyone says, “buy the dip.” I counter with, “buy the dip IF the investment is solid.” Doubling down on a poor pick amounts to burning money. It’s a classic example of a sunken cost fallacy. On risky assets like the ones described above, there is a good chance the dip turns into a decade-long slump — or worse, delisting.

For this reason, I prioritize value and quality over sheer growth potential for long-term investments. Picking stocks that appear to be cheap relative to their fundamentals and with profitability and good business practices is the way to go. If you want excitement, go to the casino.

The Foolish takeaway

Your first bear market will be scary. Our bias towards loss aversion causes us to feel the effects of losses (even unrealized ones) more than gains. Keeping these tips in mind can help you keep calm, maintain a long-term perspective, and weather even the most volatile market movements.

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