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Four Potential Investment Strategies in a Stock Market Correction

Investors had largely ignored COVID-19 for over a month, but now emotions have started to get the better of cooler heads, and markets have reacted. Extreme fear has taken over. Unfortunately, emotional trading can quickly unravel sensible long-term wealth building plans.

Our friends at Ensemble Capital recently published a thoughtful opinion piece on COVID-19, which echoes our view that while the course of the current outbreak is impossible to forecast, *"in all likelihood, the economic impact of Coronavirus will fade over time, just as it did for every one of the virus outbreaks of the past."*

In early 2016 we wrote an article on potential strategies during a market correction, which we stress test during uncertain times, like today. We want to share these thoughts again, because as history has frequently shown, sometimes panicking less than somebody else can be a source of alpha.

Don't just do something, sit there
During periods of heightened volatility, investors often feel an overpowering urge to be doing something. But this is not necessarily the best course of action. The temptation to sell this and trim that can be overwhelming as the hype around the latest scary headline reaches a fevered pitch. More often than not, the most intelligent and rational decision is to simply do nothing during a market correction.

Don't just sit there, do something
Of course, that does not mean that doing nothing is the best strategy. But it can potentially protect investors from emotional trading which can be counterproductive. However, if you can make sound business judgements in times of distress, value can be added by doing something. Corrections often represent good opportunities. Here are some "do something" alternatives we consider, listed from best to worst.

- **"Compounders"** – Consider fast growing, high quality companies that are run by strong operators and have favourable long-term prospects. These types of companies are responsible for the vast majority of the market's long-term returns. These companies still often trade at a substantial discount to their intrinsic value during a correction. Such companies allow investors to potentially "double dip". Once as the stock price returns to a more sensible valuation and a second time as the underlying business value keeps compounding thereafter and the stock price follows along.
- **"Close the Discount" stocks** – Consider average quality companies with share prices suffering from a negative short term event. Gains may be had, particularly with cyclical stocks, if bought during periods of extreme sector challenges.
- **Steady blue-chip stocks** – A relative safe haven during corrections, many blue-chip companies already dominate their respective industries and have limited ability to grow with limited potential for mispricing. Extraordinary corrections like the 2008/2009 period can push prices down. A good place to find shelter from the storm, but with modest compounding potential, not the ideal long-term investment option, in our opinion.
- **Raise cash** – Sometimes people sell stocks in order to raise cash during a correction which can be the equivalent of buying high and selling low. But if a stock is overvalued, then selling makes sense and you can put the proceeds to work in better valued, long-term opportunities.

It is helpful to remember that sound investing isn't so much about you against everyone else, but rather you against your own human nature in doing the wrong thing at the wrong time. This is when you need to remain disciplined, because your lifetime results as an investor will be mostly determined by what you do during turbulent times.

PenderFund[1]
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[1] Adapted from two articles by Felix Narhi, CFA, Pender's Chief Investment Officer.
CIO's Commentary Q3 2018 & Potential Strategies during a Market Correction

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