M&G Insights

M&G Investments

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# Tempted to sell when markets are down? Think carefully.

With equities continuing to be volatile on the back of rising interest rates, inflation and fears of a looming global recession, you may well be tempted to switch out of your equity investments and into assets that have experienced more stable relative short-term performance (such as cash and bonds). While this may seem like a sound approach, it's important to understand the impact that short-term actions could have on your long-term investment returns. In this article, we consider the potential consequences of switching when markets are down.

## A loss is only a loss when you lock it in

Let's start by looking at a practical example to explain the concept of locking in your losses.

Say you invested R100 in equities. The stock market has a terrible year and your investment drops by 10%. At this point it is only worth R90, **however *you haven't actually lost any money,*** as the value of your investment has only decreased on paper (also referred to as a paper loss). The next year the market rebounds, and your investment is now worth R110. Again, **you haven't actually made any money since the value has only increased on paper** (also referred to as a paper profit).

Your investment journey demonstrates three very important investment principles:

1. If you sold your investment when the market was down, you would have locked in (or realised) an actual loss of R10.
2. Selling at the wrong time would have resulted in your missing out on the opportunity for subsequent gains when the market recovered.
3. You were better off simply doing nothing and allowing the market to run its course.

# Investors aren't always logical

One of the basic principles of investing (or any financial transaction, for that matter) is to buy low and sell high. While this certainly seems logical, it's often the case that, as human beings, investors do exactly the opposite when markets underperform, selling their investments out of fear of further declines in value.

This is especially true at times when returns have been disappointing for a long time. What's more, when markets recover and are on a roll, people tend to buy assets with the hope that the short-term performance will continue into the future. Unfortunately, what typically happens is that they end up investing after the price has been pushed up higher than what the asset is worth. **Essentially, they sell low and buy high**.

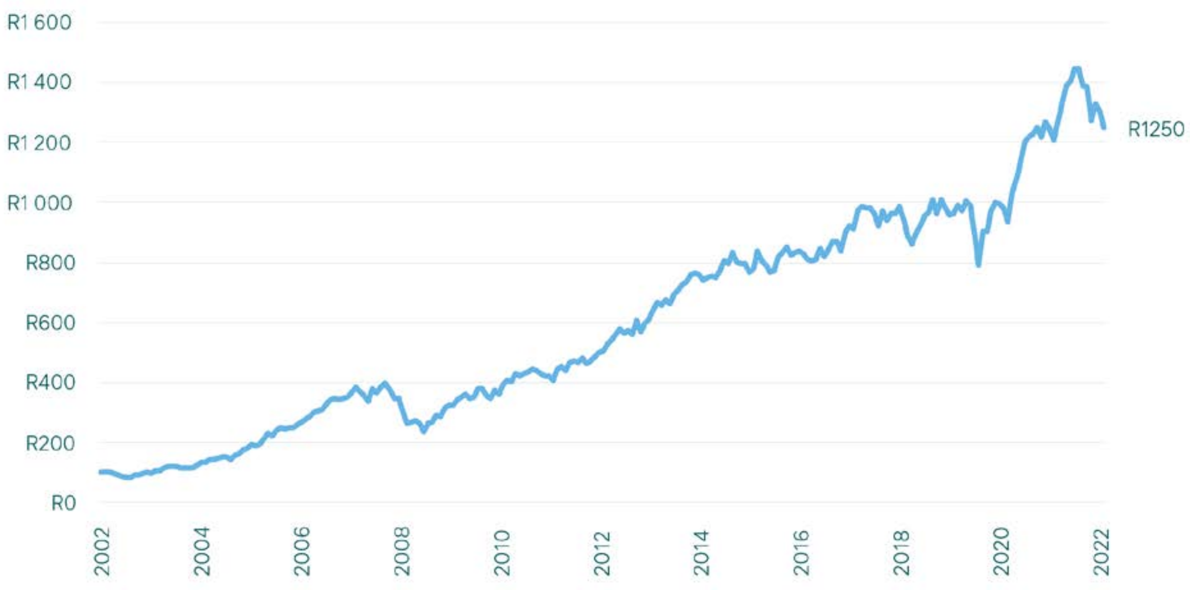
***"The stock market is a device for transferring money from the impatient to the patient" – Warren Buffett***

If you were to apply this irrational behaviour to our example above, you would have sold your investment at the bottom for R90 (thereby losing R10) and bought back into the market at R110 (which is R20 more than what you sold out for). The combination of selling low and buying high would have left you R20 out of pocket, which works out to 20% of your initial R100 investment.

# The trick is to be patient and avoid acting out of emotion

The graph below shows what R100 invested on the FTSE/JSE All Share Index 20 years ago would be worth today. As you can see, there were many times when the market lost ground and the temptation to sell would have been strong. However, what the graph also indicates is that the long-term trend is clearly upward, suggesting that by simply doing nothing and staying the course, your investment would have continued to grow. The lesson here is to be patient, remove emotion from your investment decisions and remain invested when markets are volatile.

Graph 1: R100 invested in the All Share Index (TR) over 20 years




Source: Morningstar

In conclusion, Warren Buffett said it best with the words: “The stock market is a device for transferring money from the impatient to the patient”… and we couldn’t agree more.

If you would like some more insights into our views on the market, personal finance, and the outlook for our funds, please visit the

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