5 Tips to Handle Market Volatility

In today's digitally connected world, short-term market volatility can be more prevalent thanks to the immense amount of information at one's fingertips. When dramatic sell-offs happen, it can be upsetting especially in the face of sensational headlines and negative media coverage, often challenging investors' commitments to their long-term investment plans.

Now that we are arguably in the later stage of the business cycle, further periods of volatility may lie ahead. While there is no fool-proof method to navigate market ups and downs, the following tips can help.

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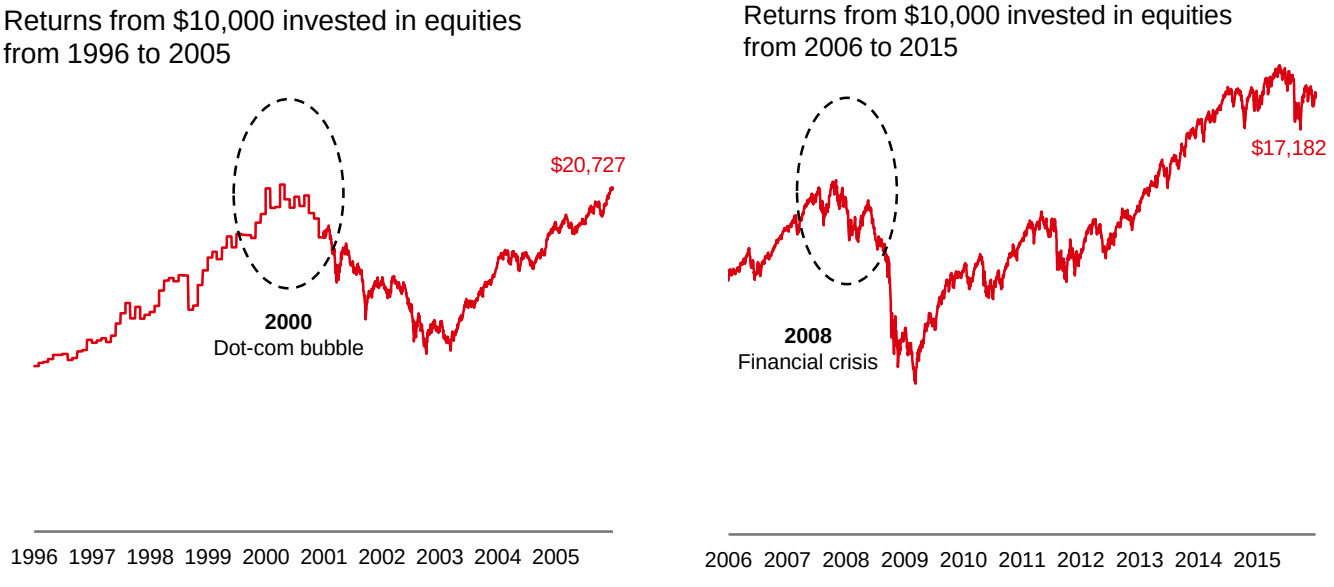
1 Keep calm.

Short-term volatility is part and parcel of the investment journey

- Markets can fluctuate depending on the news flow or expectations on valuations and corporate earnings. It is important to remember that volatility is to be expected from time to time in financial markets.
- History does not necessarily repeat itself, but it does rhyme. Short-term volatility can occur at any time, but they do not necessarily derail the long-term growth in stock markets. Historically, significant recoveries occur following major setbacks including economic downturns and geopolitical events (Chart 1).
- While headline-grabbing news can affect short-term market sentiment and lead to reductions in asset valuations, share prices should ultimately be driven by fundamentals over the long run. Therefore, investors should avoid panic selling during volatile periods, to avoid missing out any potential market recovery.

Chart 1: Financial markets have risen after the financial crisis over time



Source: Bloomberg, as at 31 December 2018. Index used: S&P500 Total Return Index.
Past performance is not an indication of future returns. The performance may go down as well as up.

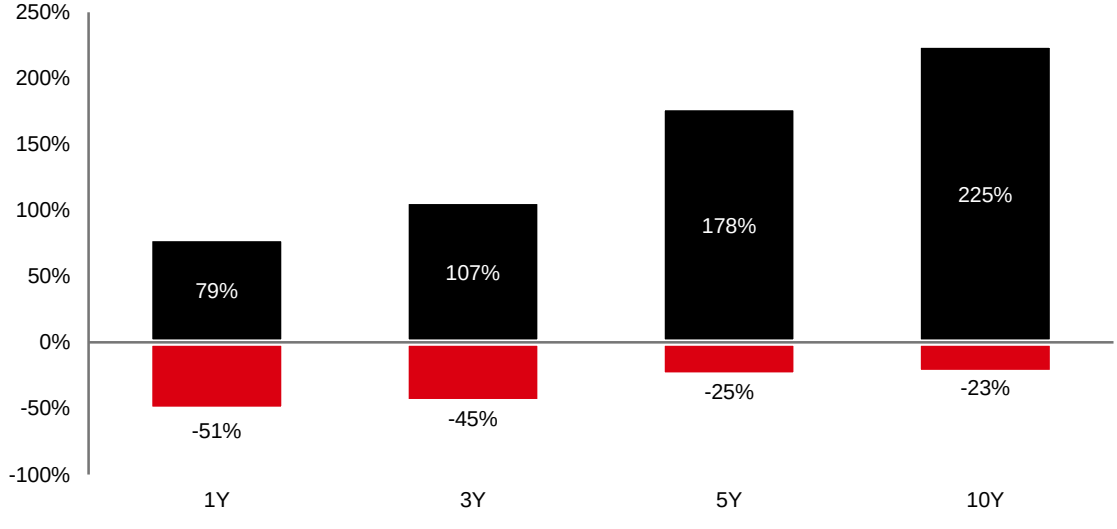
Remain invested.

2

Long-term investing increases the chance of positive returns

- When markets get rocky, it is tempting to exit the market to avoid further losses. However, those who focus on short-term market volatility may end up buying high and selling low. History has shown that financial markets go up in the long run despite short-term fluctuations (Chart 2).
- Though markets do not always follow the same recovery paths, periods after corrections are often critical times to be exposed to the markets. Staying invested for longer periods tends to offer higher return potential.

Chart 2: The performance range of global equities over different time frames



Source: Bloomberg, as of 31 December 2018, calculated by rolling returns in USD within 1 year, 3 years, 5 years and 10 years timeframe. Index used: MSCI AC World Total Return Index. Past performance is not an indication of future returns. The performance may go down as well as up.

3 Stay diversified.

Diversification can help achieve a smoother ride

- Diversification basically means ‘don’t put all your eggs in one basket’. Different asset classes often perform differently under various market conditions (Chart 3).
- By combining assets with different characteristics, the risks and performance of different investments are combined, thus lowering overall portfolio risk. That means, a lower return in one type of asset may be compensated by a gain in another.

Chart 3: The performance of each asset class varies over time

Best performing asset class in year

2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Annualised return	Annualised volatility	
39.4	9.2	78.5	19.6	8.2	27.7	26.7	15.0	1.3	16.2	37.3	2.6	7.3	32.0	Global high yield corporate bond
18.1	3.8	60.7	18.9	5.5	18.9	7.1	8.4	0.6	11.2	22.4	2.1	6.5	22.3	Emerging market government bond (hard currency)
9.1	-5.1	37.1	15.7	4.8	18.3	3.7	7.6	0.2	9.9	15.2	-1.0	6.3	18.7	Diversified
9.0	-5.2	30.5	15.4	3.2	18.2	2.3	7.3	-0.2	9.5	12.5	-1.9	5.3	17.9	Developed market equity
6.4	-10.2	30.0	12.5	0.3	16.8	0.3	4.9	-0.8	7.7	10.4	-4.2	4.9	12.2	Emerging market equity
5.7	-19.6	27.2	11.8	-1.1	15.8	0.2	4.2	-0.9	7.5	10.0	-4.6	4.7	11.7	Emerging market government bond (local currency)
5.6	-27.0	22.0	11.6	-1.8	14.6	0.1	2.5	-2.0	6.2	8.0	-5.6	4.4	9.7	Global corporate bond
3.2	-40.7	16.6	7.2	-5.5	10.9	-2.6	0.2	-3.5	4.1	5.7	-6.2	4.2	5.3	Property
1.7	-48.2	1.0	3.4	-6.5	4.5	-5.8	-2.2	-14.9	3.8	2.1	-8.7	3.9	2.6	Global government bond
-7.4	-53.3	1.0	0.3	-18.4	0.5	-9.0	-5.7	-14.9	0.7	1.1	-14.6	1.6	1.9	Cash

Worst performing asset class in year

Source: Morningstar, HSBC Global Asset Management, data as at 31 December 2018. All returns in USD, total return.
Indices used: MSCI World Index; MSCI Emerging Market Equity; JPMorgan GBI-EM Global Diversified; Bloomberg Barclays Global Aggregate Corporate Bond Index; ICE Bank of America Merrill Lynch Emerging Market Bond Index; ICE Bank of America Merrill Lynch Global High Yield, Citi World Government Bond Index, FTSE EPPRA/NAREIT Listed Property Index, ICE LIBOR 3 Month
Bond indices are hedged, excluding emerging market government bond local currency (i.e. global government, global corporate, global high yield, emerging market government bond hard currency). Equities are unhedged.
Past performance is not an indication of future returns. The performance may go down as well as up.

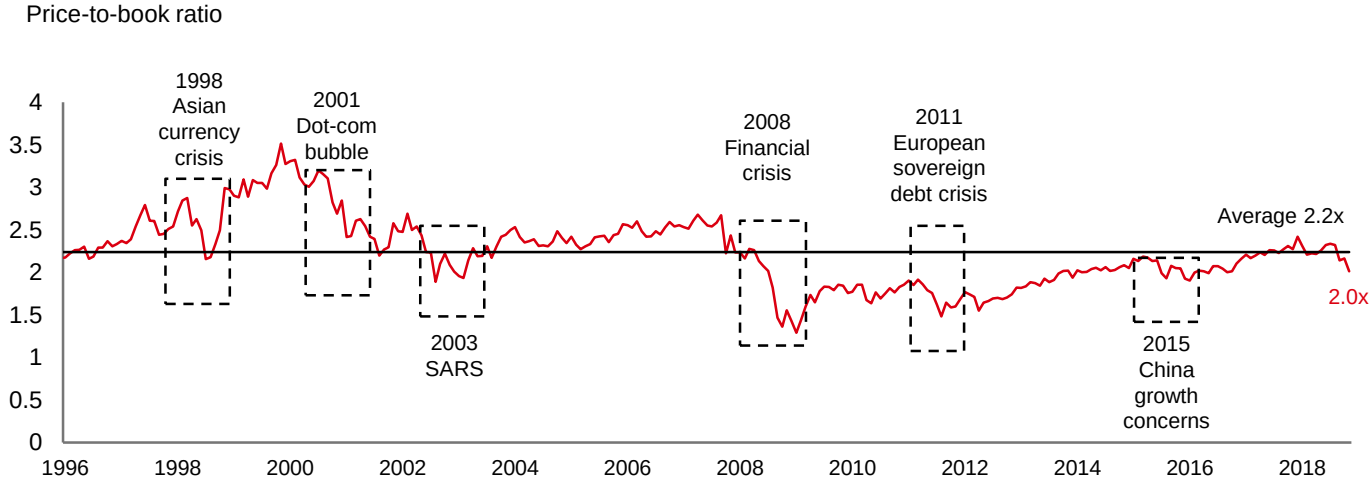
Take advantage.

4

Market downturns may create opportunities

- Don't be passive in the face of market declines. When market sentiment is low, valuations tend to be driven down which provides investment opportunities (Chart 4). In rising markets, people tend to invest as they chase returns, while in declining markets people tend to sell. When investors overreact to market conditions, they may miss out some of the best-performing days.
- Though no one can predict market movements, the times when 'everyone' is overwhelmingly negative often turns out to be the best times to invest.

Chart 4: Global equities trade cheaper during economic crises



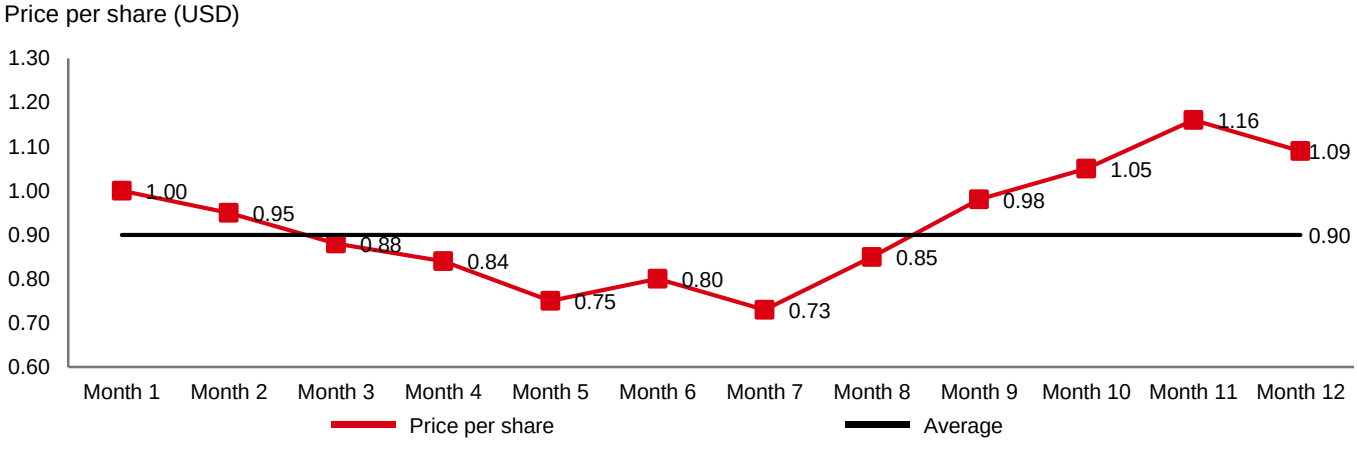
Source: Bloomberg, MSCI AC World Daily Total Return Index, data as of 31 December 2018. Past performance is not an indication of future returns. The performance may go down as well as up.
Note: Price to book ratio (P/B Ratio) is a ratio used to compare a stock's market value to its book value. It is calculated by dividing the current closing price of the stock by the latest quarter's book value per share. A lower P/B ratio could mean that the stock is undervalued.

5 Invest regularly

despite volatility

- Investing regularly means continuous investment regardless of what is happening in the markets.
- When investors make fixed regular investments, they buy more units when prices are low and less when prices are high. This will smooth out the investment journey and average out the price at which units are bought (Chart 5). It thus reduces the risk of investing a lump sum at the wrong time, particularly amid market volatility.
- The longer the time frame for investment the better, because it allows more time for investments to grow (the compounding effect).

Chart 5: Dollar-cost averaging helps smooth the effects of market movements



The chart shows what happens to USD1,000 invested monthly vs a lump-sum investment of USD12,000. After a year, the total amount invested is the same, but the total shares purchased and the cumulative value are higher for monthly regular investment (dollar-cost averaging). Average cost per share for dollar-cost averaging is cheaper than lump-sum investment (USD0.90 vs USD1.00) in this hypothetical example. Please note that dollar-cost averaging may not always outperform lump-sum investment.

Source: HSBC Global Asset Management. This information is for illustrative purposes only and does not relate to any investments. The figures and rates are purely hypothetical.

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