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CORRECTIONS: HOW OFTEN AND HOW SEVERE

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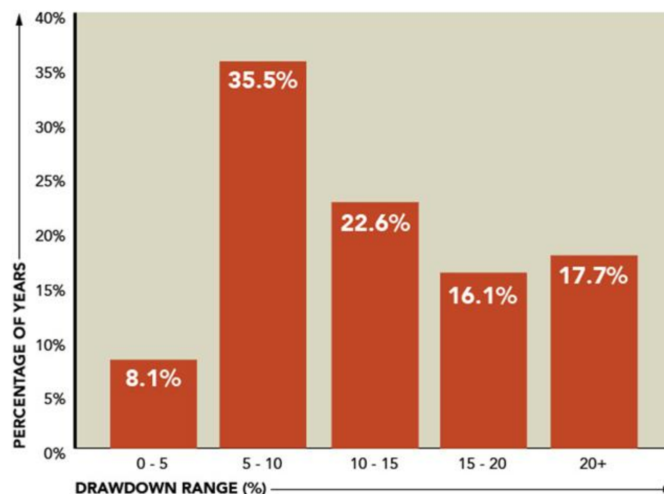
We preface this article by saying that every market selloff is different and certainly feels different when you are going through it. Furthermore, every investor has a different time horizon or set of personal objectives and risk tolerances. Nevertheless, it is important for all investors to understand the frequency and severity of market pull backs from a historical perspective in order to make more informed and less emotional decisions, especially in the midst of a period of market volatility like the current market environment.

With a hat tip to the investment consulting firm Marquette Associates, below is a chart depicting the frequency and severity of S&P 500 Index declines over approximately 62 years.

How Normal/Frequent are Market Pullbacks?

(1950 - Aug. 2011)



Simply stated, 5-10% declines happened at some point in the year about 35% of the time and market corrections of 10-20% occurred about 39% of the time. Amazingly, full bear markets declines of 20%+ happened 18% of the time. Yet despite all this volatility and in the face of economic and political risk (Korean War, Bay of Pigs, Kennedy Assassination, Vietnam War, Watergate, 1970s energy crisis, Hostage crisis, Cold War, Gulf war, Asian financial crisis, tech wreck, 9/11 attacks, Iraq/Afghanistan War, Global financial crisis etc.), $1 invested in the S&P 500 Index turned into roughly $563 over the 62 years ended December 2011 through the power of compounding.

We do realize that not everyone has 62 years to invest and that issue is addressed through proper asset allocation for your goals, risk tolerances and investment horizon. However, understanding that market corrections are to be expected, and having a framework for evaluating the severity of those declines, can go a long way towards helping you prepare for inevitable market volatility during your investing lifetime.

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