Canadian Market Recovery After Financial Crises

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During financial crises, stock prices suffer. However, they typically recover over time.

This chart illustrate the cumulative returns of a balanced (60% stock/40% bond) portfolio after five historical financial crises. In the short term, uncertainty from such external shocks can create sudden drops in value. For example, the portfolio posted a negative return one month after the October 1987 stock-market crash. Over a longer period of time, however, returns were much more attractive, and investors who stayed the course reaped considerable rewards.

Fear and uncertainty might lead investors to sell their investments during tough times, putting downward pressure on prices. Trading based on these emotions can be detrimental to a portfolio's value. By selling during downward price pressures, investors might realize short-term losses. This is compounded as investors wait and hesitate to get back into the market, possibly missing some or all of the potential recovery. The lesson here is that patience can pay dividends.

Diversification can also limit losses during turbulent market conditions. The dot-com crash in 2000 resulted in a loss for the portfolio. However, it was less severe one year and three years after the crisis. Moreover, after five years, the portfolio had generated a 28% gain. One of the main advantages of diversification is reducing risk, not necessarily increasing return, over the long run. A diversified portfolio can help mitigate extreme swings in value.

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*Courtesy of CI Investments.

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