Stock Market Correction

Dear Dr. Per Cap:

2019 was another great year for the stock market. I'm thrilled that my 401k balance is up but I keep hearing that the market is due for a "correction". What exactly does that mean?

Signed, Hoping to Retire Soon

Dear Hoping

Yep, 2019 was another banner year for Wall Street. The S&P 500, a leading stock index that many investors use to gauge the overall market, finished the year up nearly 30%. That extends the current *bull market*, a prolonged period in which stocks continue to rise, to more than ten years - making it the longest bull market in modern stock market history.

So, the big question that's been on every investor's mind for the last few years is - how long will it last? That's where the term *correction* comes in. A stock market correction is a drop of at least 10% from the market's most recent peak. Here's an example. On January 16th, 2020 the S&P 500 closed at a record high of 3,329 points. That means a correction occurs if the index drops 10% or about 332 points. However, should the S&P 500 peak again, in fact it already has, then it will need to lose more than 332 points to trigger a correction. Because the actual number of points required for a stock market correction is always relative to its peak.

We actually saw a correction in February 2018 when the market dropped more than 340 points or roughly 12% from a then record of 2,870 points set the previous month. And while 2018 ended up being a down year for stocks, the trend over the past decade has been so overwhelmingly positive that most investors didn't fret much.

The real concern is what happens if a correction is prolonged – say six months or more before it bounces back. Moreover, what happens if it drops a lot more than 10%? Well if the market drops low enough for a long enough period it will go from being called a bull market to a *bear market*. And that's the major fear. The last bear market occurred after the financial crisis of 2008 when the S&P 500 closed the year down 37%. Ouch!

I'd need a crystal ball to tell you if a big stock market correction is coming in 2020 or when the bull market will finally end. In fact no one knows -not even the big shot investing pros on Wall Street. But if you're concerned, and every wise investor should be, now is a good time to review the holdings in your 401k plan to make sure they are properly diversified to suit your needs. This means, as I've stated before in this column, maintaining a healthy balance of stocks and bonds. Remember that if you want to play it safe you should increase your bonds or fixed income investments while lowering your exposure to stocks or equities.

One strategy is to subtract your age from 100 and place that percentage of your total investments in stocks and the rest in bonds. So a sixty-five-year-old person would invest 65% of her holdings in bonds and 35% in stocks. Keep rocking toward retirement!

Ask Dr. Per Cap *is a program funded by First Nations Development Institute with assistance from the FINRA Investor Education Foundation. For more information, visit www.firstnations.org. To send a question to Dr. Per Cap, email askdrpercap@firstnations.org.*