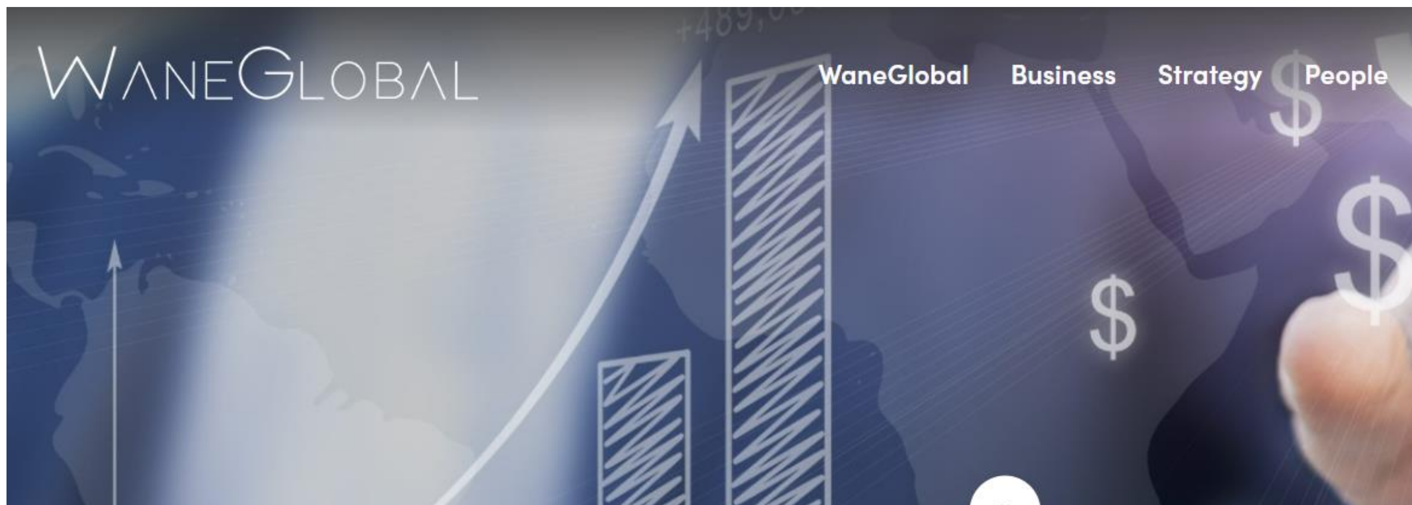

4 Tips for Navigating a StockMarket Correction

Since the arrival of COVID-19, the U.S. public equity market has suffered two market corrections, one of which is currently underway. Understandably, market corrections can spook investors because a bear market typically follows them. In addition, with talks of a recession right around the corner, the public equity market currently seems like a problematic sea to sail.

This article hopes to provide a clear picture of market corrections, why they occur, what it means for the public equity market, and how investors can better understand (and even bene t from) a bear market.

Stock market corrections: What are they, and how are they used?

According to Forbes Advisor, a stock market correction is "a sustained decline in the value of a market index or the price of an individual asset. A correction is generally agreed to be a 10-20% drop in value from a recent peak. Corrections can happen to the S&P 500, a commodity index, or even shares or your favorite tech company."

Market corrections can occur for a variety of reasons. At first glance, market corrections infer that investors are more motivated to sell than to buy, a shrinking or slowing economy, a lack of trade momentum, or a 'black swan' event like the COVID19 pandemic, Russian-Ukraine war, or global supply chain constraints. When some or all of these occur, stocks previously traded based on their local 'supply and demand' level tend to return to baseline. For example, fewer investors purchase once considered 'high-demand' stock, driving the stock 'supply' back to equilibrium. As a result, companies with falling stock are at greater risk of being purchased at a lower market valuation.

What events led to the current market correction?

Since the market plunged at the beginning of the COVID-19 pandemic, it witnessed a meteoric rise to an all-time high on the S&P 500 and Dow Jones in early January 2022.
Since then, it has begun to fall, going in and out of the bear market territory.

In August 2022, the U.S. economy saw its most significant in faction increase in 40 years, to a troubling 8.9%. Although prices have continued to rise, salaries have failed to keep up with in

fation, despite a strong employee market, making people change their consuming and saving habits.

Stimulus plans from the Trump and Biden administrations poured new money into the markets through 2020 and 2021. The in ux of cash gave rise to an uptick in consumption, including stock purchases, making the market surge to an all-time high in an otherwise fragile economy. Because people were purchasing more, companies had to navigate unprecedented demand while encountering worldwide supply chain bottlenecks. These bottlenecks made company performance more volatile, leaving investors unsure whether to buy or hold positions in them.

Between an increase in individual spending, heightened consumer demand, an ambitious stock market, rising in ation, and a slowing economy, the market could no longer sustain itself. And thus, private equity companies must now contend with a less welcoming market.

What this means for the public equity market

When a market correction is in place, one of two things can occur: either the market stabilizes itself and returns to its growth trajectory, or it continues to fall and enters what is known as a bear market. A bear market can be de ned as a market decline of more than 20% from a recent all-time high. Since its peak in January 2022, the S&P 500 has entered bear market territory, falling 23% in late September 2022.

Today, the current bear market symptoms do not bode well for stock investors. The recent interest rate increase by the U.S. federal government could trigger a recession. As a result of higher interest rates, companies will be less inclined to borrow money for debt payments or growth strategies, making stock market performance more volatile.

Over-valuated companies will be some of the biggest losers due to market correction. Tech companies such as Amazon, Alphabet (Google's parent company), and Tesla have recently seen major hits to their stock prices. Amazon, Alphabet, and Tesla witnessed their market value plummet by 39%, 27%, and 45%, respectively, in 2022. In a bear market, these stock prices are likely to be less volatile and with fewer rapid surges. Unfortunately, this means lower shareholder yields, which can ultimately drive companies to make di cult decisions like budget cuts and layo s.

Currently, investors have reason to be wary. With the recent interest rate increase by the federal government and the expectation of more to come later in 2022, an economic decline seems imminent. As a result, investors will become more riskaverse, likely purchasing fewer stocks or selling more stocks to gain quick access to capital. However, it's also important to note that the 'winners' of the bear market will be pro table companies with valuations independent of the stock market.

However, despite the seeming doom and gloom of a market recession, there is good news. Historically, stocks return to a positive trajectory after a market correction or a bear market. The typical lifecycle of a market correction is four months, whereas a bear market is 359 days on average. This trend means that though times are not the best for public equity investors, the market will eventually bottom out, and the uptrend cycle will begin again.

How can companies and investors leverage the current market status?

The rst step to surviving and thriving in a market correction is not panicking. Companies and investors shouldn't sell on the spot as soon as prices drop. Here are four tips public equity investors should consider when navigating a market correction:

Treat dollar-cost averaging as your friend. This practice consists of investing the same amount of money in target security at regular intervals over a certain period, regardless of the security's price. This practice aims to lower the share's average cost and reduce the volatility's impact on a given portfolio.

Market corrections also present opportunities for investors to buy more shares of a given index or a range of di erent stocks at a lower market price. This practice is known as averaging down. As a result, the lower initial cost of the investment will make up for any loss once the nancial market recovers, giving investors a winning yield.

Another riskier option is to leverage market correction for public equity gains by going short on an entire index fund or individual stocks that appeal to investors. Since a

correction is happening, these indexes or stocks will lose value. And because the market is becoming bearish, said funds or stocks might continue to fall. Spread bets and CFDs (contracts for di erence) are some of the best ways to short the market and leverage a market correction because spread bets and CFDs can be used without investors having to sell their existing share investments. As mentioned previously, shares will lose value in market corrections as the market declines from its previous peak.

These two nancial derivatives also hedge investors' exposure to risk while keeping investment positions open. The future gains that might come from the short positions taken o set the risk of loss on share investments until the market recovers and develop a new upward trend.

Leveraging a market correction can provide investors with nancial bene ts in an otherwise poor economic landscape – but they don't come without risk. There is always the possibility of a correction turning into a bear market, leading to further price decreases. So always know your risk tolerance before engaging in these practices.

For more risk-averse investors, making pro ts during these times is critical. Having a well-diversi ed portfolio and turning away from high-yield, high-risk stocks such as technology for more stable ones like consumer staples or value stocks to hedge some of the risk

Market corrections create opportunities for well-positioned investors

The last few years have proven to be di cult for investors and companies alike. Being able to understand what market corrections are, how they happen, and what to do when they are happening can prove a vital tool to keep a oat in di cult economic times. Market corrections can help investors better understand their portfolio composition, what the real risk of a given stock is if they were overvalued, which perform best during tough market times, and all In all, help their investment strategy become more robust in the long run.

Market corrections also o er an opportunity for those who are willing to take the risk to be able to leverage diferent types of securities for an eventual pro t, to buy goodperforming overall stocks at a low average price, and to come out of a losing situation on the winning side of the market.

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