Adviser Edge

Short-term volatility in context

What should investors do when markets get bumpy?

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CATEGORY: LATEST NEWS

Key takeaways

- **Expect markets to experience periods of volatility**
- **Humans are wired to feel the pain of financial loss more acutely than the pleasure of financial gain**
- **Simply sitting tight and riding out short-term volatility is usually the right thing to do**

Investing in the stock market gives us the best chance of achieving 'real' or inflation-beating returns on our capital. Taking an appropriate level of risk is often necessary to help us achieve our long-term financial goals. While the future is unknown, historically higher risk has meant higher rewards over the long term. When we invest in the stock market, we experience that risk as volatility in the value of our investments. In other words, values may fall as well as rise over time.

Why does volatility occur?

When we invest in stock markets, corporate or government bonds we are exposing ourselves to market forces. These forces will drive prices down or up depending on a wide range of factors.

Politics, government policy, inflation, interest rates, supply and demand, and even sentiment (how the market or investors view a company, for example) can influence markets positively or negatively.

History tells us that over time, markets tend to rise. However, depending on the circumstances at the time there can be periods where values fall. Sometimes those periods of declines can be a few days, weeks or even months. However, historically, markets have always risen in the long term.

This volatility, and ensuring you have time for your investments to recover from falls in value, is why investing in stock markets should not be seen as a short-term exercise. Typically, you should expect to invest your money in the stock market for five years or longer.

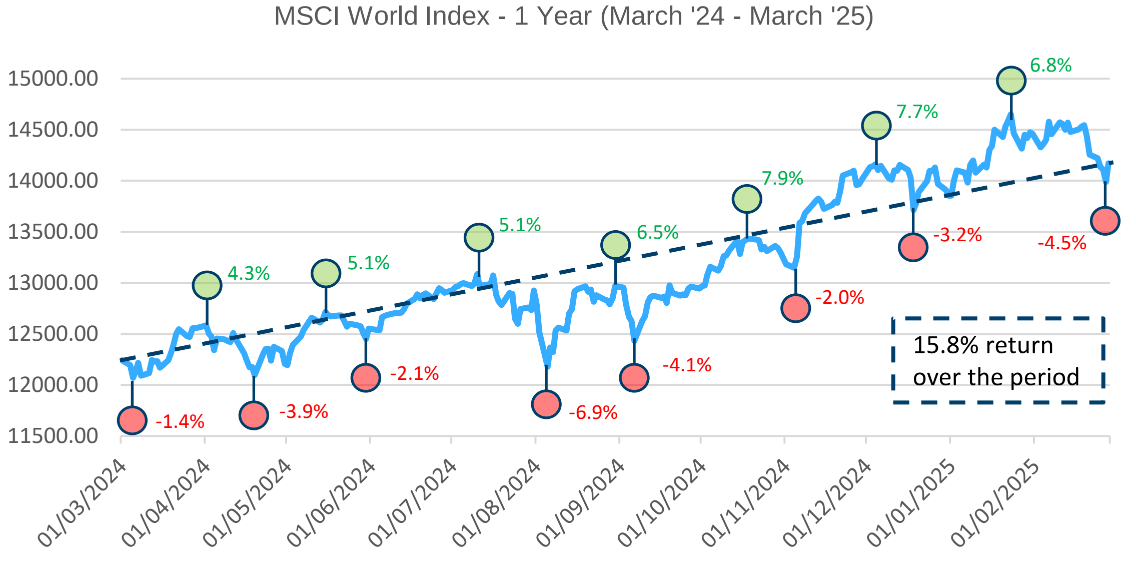
Emotional reactions in volatile markets can cause investors to make short-term decisions that can prove costly in the long run.

Experienced investors recognise that tolerating short-term volatility is the price paid in the hope of better long-term gains.

Short-term volatility in context – what should investors do when markets get bumpy?

The chart below illustrates the movements over a 12-month period of the MSCI World Index. This widely followed index tracks around 1,500 stocks across 23 developed countries. The MSCI World Index is widely used as a benchmark for global equity markets.

We have indicated 15 peaks and troughs across a 12-month period, between 1 March 2024 and 28 February 2025, to illustrate the multiple occasions markets move up and down, sometimes by several percentage points in a short period. What's important, in terms of context, is to consider the performance over the whole 12-month period. In our example, the MSCI World Index returned 15.8% overall. Source: Lipper, March 2025.



We feel the pain of losses more acutely than the pleasure from financial gains.

In cognitive science and behavioural economics, there is strong evidence to suggest that humans experience a stronger emotional response to a financial loss than they do to an equivalent financial gain. This is described under what is known as loss aversion theory.

When we invest, it's important to recognise this cognitive bias in order to reduce the risk of making emotional decisions about our short-term position that may not be in the interests of our long-term goals.

If we allow ourselves to react by selling investments that have fallen in value, or move our investments into cash, for example, we can turn a loss that exists only on paper into a real loss and potentially miss out on significant gains when markets recover.

Online access to investment accounts and investing apps make it easier than ever to monitor investments continuously, and to make snap decisions. However, evidence suggests that excessive trading seldom produces better results.

If time is on your side, sitting tight and riding out short-term volatility is often the right thing to do. Speak to your financial adviser if you are concerned about needing to access your investments in challenging markets.

When building sand castles on the beach, we can ignore the waves, but should watch the tide
~ Edsger Dijkstra

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