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How investors can respond to stock market shocks

If the threat of a large-scale outbreak of an infectious disease isn't enough to worry about, the financial implications of coronavirus is also making investors nervous.

You may have read about how the shutdown of industry across China, effectively the world's manufacturing hub, risks hurting the global economy. You may also have heard about large falls in global stock markets, in addition to the price of commodities such as oil. It feels like there's been no shortage of alarming twists.

Despite this, a market correction can even be a good thing in the long run. In this article, we share how coronavirus may impact investments and how investors can respond to market shocks.

Why does coronavirus affect stock markets?
There are a few reasons. The first is because it is impacting the ability of companies to produce goods. For example, Apple has already said that factory shutdowns in China will prevent it from getting hold of some of the parts it needs to make iPhones.

The second is in how it affects demand. For example, consumers and companies are cutting back on unnecessary travel, hurting the travel and tourism sectors. Many other sectors are also experiencing a fall in demand, such as the hospitality industry, as more organisations are encouraging staff to work from home.

The third is the impact on investors' willingness to take risk. Before the coronavirus crisis, the stock market had been performing very well and many investors were sitting on considerable profits. This was despite economic growth having been relatively weak for years.

Many investors had been uncomfortable with how far stocks had risen against this backdrop. Coronavirus has given them the reason they were looking for to bank some of those profits and reduce their exposure to the stock market.

What is the silver lining for investors?
Those with a longer investment horizon can worry less as investing is a long-term game. That is not to say someone with investments should just ignore current volatility though. There are some sensible steps to take, and there might even be opportunities for the brave.

While negative headlines about the stock market can be off-putting, investors should be grateful for them. Every dollar invested today could buy considerably more shares than it would have done at the start of the year.

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Five sensible steps to protect your investments

1. Don't panic – think long-term
It's important to make considered decisions when adjusting your investment portfolio. An emotional response will very rarely benefit your savings. By staying invested now you could benefit when the market picks up again.

2. Reassess your attitude to risk
What these episodes can usefully do is prompt a re-evaluation of how much risk we are willing to take. It's all very well charging into the stock market when it's been going up for years: these corrections remind us there can suddenly be a downside. Many of us will take some risk in the hunt for higher returns, and there are ways to moderate that risk.

3. Reassess your portfolio
Are you happy with the mix of risk? Check you are happy with the proportion of your savings that are in the stock market as opposed to cash or government bonds, and diversify if you are concerned. Some funds offer ready-made diversification by spreading across asset classes. Do your research. You could de-risk yourself by simply holding more cash in savings accounts but be aware of the effect of inflation versus interest rates.

4. Diversify your exposure to the stock market
Even within the portion of your portfolio that is invested in the stock market, be sure that it is diversified in itself. Some people have pet regions or sectors and over-reliance on them can be a set-up for big losses if things go wrong. Either diversify yourself or choose managed funds that are themselves diversified.

5. Drip-feed
By investing a regular amount each month you take away a lot of risk – it is the opposite of trying to time the market. In times of stock market falls the amount you invest will be picking up more units. This means you will ride out much of any market volatility.

Source: Schroders, March 2020