

The correct response: Do nothing

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Let the bad times roll, baby.

After more than four brilliant years of returns, the stock markets are plunging. What a relief.

Investing in stocks is about making money over the long term, with the up years outweighing the down ones that intrude every now and then. Since early 2003, however, we've only seen the markets soar. Sure, there have been missteps, but stocks have always moved quickly higher again.

This mayhem of the past few weeks is different. It may not signal the arrival of the sort of protracted slump that gets called a bear market, but it does qualify as what investing pros call a correction. In other words, a serious but necessary pullback that smarts.

The correct response is to do nothing, and the word from investment advisers is that most investors seem to understand this.

"Some of my colleagues in the office here have had clients call them saying they want to bail out," said Greg Holohan, an adviser with ScotiaMcLeod in Markham, Ont.

"But the vast majority of people understand this is one of those things that will happen from time to time and that eventually everything will iron itself out."

Not that the short term won't be painful. Yesterday, the benchmark S&P/TSX composite index was down a shocking 585 points, or about 4.5 per cent, before limiting its loss to 1.5 per cent.

While some experts see the markets on the rise again later this year, others see the potential for losses of 20 to 40 per cent from the peak level of 14,646 reached last month. By the end of trading yesterday, the index was down to 12,848.

Falling stocks are really just a symptom of broader problems in global financial markets. It all begins with soured mortgage loans made to Americans with substandard credit ratings.

These mortgages were packaged into securities purchased by hedge funds and banks which, it turns out, own a lot of similar investments based on things like credit card and car loan debt.

Concern about the solidity of these investments has created an environment of fear and uncertainty in which it's natural to dump stocks. If you feel the urge to sell, fight it.

"Don't sell into a seriously down market," said Liz Lunney, senior vice-president and portfolio manager at Fiduciary Trust Co. of Canada, a division of the mutual fund company Franklin Templeton Investments.

"Don't realize those losses. If you had an appropriate plan to begin with, then hold to it."

An appropriate plan means a mix of stocks, bonds and cash tailored to your age, risk tolerance and investing goals.

Of course, some investors started with a plan and then let it slide as they watched their stock holdings balloon in the past few years.

There's extra reason to be concerned about an over-exposure to stocks if your holdings are heavy on energy and mining stocks.

These sectors drove the Canadian market in the past few years, but they've suddenly gone cold as a result of fears that problems in financial markets will somehow lead to slower global economic growth.

Mining stocks as a group have plunged almost 25 per cent in the past month, although they remain up about 500 per cent in total over the past five years.

Ms. Lunney said her firm's take is that global growth will remain strong, even if it does taper off a bit. And what if you still want to pare down an overabundance of energy and mining stocks? She suggests you wait until the market stabilizes rather than fleeing at the earliest opportunity.

Enough talk about playing defence. In a falling market, the savvy investor looks for opportunities to buy at cut-rate prices rather than sell.

A quick shopping guide for bargain-hunting investors: Look for stocks that pay dividends, especially those like the banks that regularly increase their dividends.

Remember that while pessimism rules the market right now, good companies will prevail. "Ask yourself this," said Gavin Graham, chief investment officer at Guardian Group of Funds. "Is Royal Bank of Canada going to be in business in three week's time, will you be buying gas at Imperial Oil or drugs at Shoppers Drug Mart? You're now able to buy the shares of some of these stocks at prices we haven't seen in two and even three years."

An opportunity to hunt for bargains is just one of the positives to come out of the stock market's decline. The other is that an inevitable correction is finally under way after a very long winning streak. What a relief.

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