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Relax, a stock market pullback was due

By ROB CARRICK

If your investment plan is sound, the best strategy for weathering the recent stock market correction – an aftershock of the 2008 financial crisis – is to maintain a steady course and not panic

August is the perfect month for a stock market correction.

Blissed out on summer, we're in exactly the right frame of mind to deal with an event that seems a lot worse than it is. Since the 2008 stock market crash, share prices have been up in five of six years. We were due for a stock market pullback.

Now that it's here, you need a strategy. How about enjoying the last two weeks of summer and leaving the markets to do what they will? Stocks may get pounded, but there's nothing happening that suggests a sound investing plan needs to be gutted.

The recent stock market declines are aftershocks of the financial crisis of 2008. The global economy tanked back then, rebounded some and then stagnated. Initially, one piece of good global economic news was that China was still going strong. Now, China's struggling to keep up its growth rate, and investors are worried about the implications for growth and corporate profits around the world.

Here in Canada, we're hit especially hard by troubles in China. Almost 30 per cent of our stock markets are tied to energy and metals, which depend on strong demand from China. A slowing China is a big reason why oil prices and the prices of energy stocks have plunged.

China's an evolving economic superpower that may need to retrench in order to deliver expected levels of growth. The stock markets won't like this, and that could mean more sharp declines to come. Thinking of timing your way around it by adjusting your holdings of stocks and bonds? Ninety-nine of every 100 investors won't get it right. Most will lock in losses by selling low and then buy back into the market long after it has rebounded off the bottom. If your portfolio is based on a sensible mix of stocks and bonds, it's built to withstand times like these.

What should change are your expectations for your investments in the next few years – it's best if you dial them down. The S&P/TSX composite index delivered double-digit total returns (share price changes plus dividends) in 2009, 2010, 2013 and 2014. The three-year average annual return to July 31 was 10.7 per cent. Until the global economy breaks out of its funk, 5 to 6 per cent is a more realistic average return.

That's before fees, mind you. In a low-return world, you'll want to keep fees low and ensure you're getting good value what for you do pay.

Fearing the kind of losses we've seen this month, a lot of investors have been holding large amounts of cash in their portfolios. We're coming to a fork in the road for cash-heavy investors – either you decide to stay safe for the long haul and accept returns that lag inflation, or you plot a way back into markets that are getting less expensive by the day. Figure out what you want to buy and set up a schedule to start building a position. Buy some every month or every quarter – that way you avoid stressing yourself about making a big purchase just before another market plunge.

What to buy? Exchange-traded funds tracking broad stock indexes are foundational portfolio builders and good ways to capture a market rebound. If you're into dividend stocks, look at companies that are financially disciplined enough to raise their dividend each year. Blue chips in this category include Canadian National Railway, Enbridge Inc., Metro Inc. and the big banks.

Stocks have been correcting so far, but don't rule out a more intense decline. I've been an investing writer through two howling stock market crashes – 2000 and 2008. About each one, I feel some regret. Why didn't I buy more when prices were down?

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