Is the NASDAQ Correction a Buying Opportunity?

Smart investors can cushion market corrections with proper diversification

About half-way through January of 2022, NASDAQ closed in correction territory (on January 19th, NASDAQ closed down 10% from its recent high on November 29th), as investors faced headwinds of multiple interest-rate increases from the Fed, surging inflation and worries about conflicts with Russia over Ukraine.

But since the index was launched in 1971, we have seen 65 such corrections – 66 if you include the one in 2022 – and many of those corrections have signaled a bear market. In fact, of the 65 corrections since 1971, 24 of them resulted in bear markets (defined as a decline of at least 20%).

Maybe It's a Buying Opportunity?

While 37% of the NASDAQ corrections led to bear markets, 63% of them didn't. And in more recent times, these corrections served as buying opportunities, with subsequent gains for those who invested.

Consider this: over the past 65 times that NASDAQ has fallen 10% from a peak, it has finished positive on average, up 0.8%, in the week after. Yes, returns over that first month are not-so-good, but when you hit the three-, six-and 12-month periods, average gains are positive.

NASDAQ Entered Correction	Three Months Later	Six Months Later	One Year Later
10/24/2018		+14.0%	+15.2%
6/3/2019	+7.4%	+16.2%	+32.0%
2/27/2020	+9.9%	+35.7%	+54.0%
9/8/2020	+16.0%	+16.2%	+40.49%
3/8/2021	+10.4%	+21.2%	TBD

Source: Dow Jones Market Data

In fact, looking at all of the NASDAQ corrections going back to 2009, the three-month, six-month and one-year performance numbers since those corrections were all positive. And investors dealt with a lot of corrections, including:

- One correction in 2010, 2015, 2016, 2018 and 2021;

- Two corrections in 2009, 2012 and 2020; and
- Three corrections in 2011.

Keep in mind that when looking at the NASDAQ corrections in 2007 (one) and 2008 (four), NASDAQ was still red three-, six- and 12-months later the majority of the time and very red for the corrections that started on 11/21/2007, 6/30/2008 and 9/15/2018.

Keep a Long-Term Perspective

After the stock market's fantastic growth in 2021, many believe a correction may be a healthy thing. Such a drop is not horribly painful, by historical standards, and smart investors can cushion such a fall.

Why is a market correction beneficial? Because it prevents another bubble from forming. Bubbles occur when stock prices get clearly out of line with the earnings potential of the underlying companies. We saw the consequence of that in the awful 2000-02 and 2008-09 market wipeouts, when some people lost half their wealth or more.

Certainly, market corrections never feel healthy when they occur. People get fearful as the market declines, the media fan the flames by giving investors reason after reason to be afraid, and worries that this is the beginning of the next crash begin to develop.

Are you thinking: "I don't think I can stomach a loss of 10%?" Then that's where the wisdom of diversification becomes apparent.

Diversification 101

Remember that the data above represents the historical performance of NASDAQ – an index comprised of about 3,000 companies.

A capable financial advisor ensures you have an asset allocation mix of stocks, bonds and cash that represents your tolerance for risk. Consequently, your portfolio likely isn't 100% NASDAQ-companies. In fact, the appropriate allocation for an average investor approaching or already enjoying retirement might be closer to only 50% stocks (and that doesn't mean 50% NASDAQ-companies).

This means that on average, your portfolio should not decline as much as NASDAQ during market downturns.

So proper diversification can bring you back to the "manageably unpleasant" range. But if not, you may need to reevaluate your risk tolerance to ensure you are not exposing your nest egg to a larger loss than you can endure.

Advice from a Financial Advisor

Whether you'll be able to wait out a market correction and rebuild your assets to your satisfaction depends upon what seems like a deluge of factors: the duration of the downward trend, the future of the market, the strength of your investments and the choices you make going forward.

With careful planning, safe, long-term investments and a cool head, however, these obstacles can be surmounted. Ultimately, you as the investor will need to examine your own situation and investments to make that call.

Although the recent correction will produce lots of fear, we've been here before.

Your financial advisor can help.