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Don't make hasty decisions when the stock market drops

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Real Money

The Rolling Stones sang *Time is on my Side* several years ago. Let's look and see if this is true for you and your investment philosophy.

Somewhere between ignoring one's monthly statements and being addicted to CNBC is a happy medium. The objective here is to develop a frame of mind that will help you maintain some equanimity through whatever the market's circumstances happen to be.

This month, most investors received their statements for the first quarter of 2001 and felt a bit uneasy. As investors, our true risk tolerance can only be determined when we face a bear market. Risk tolerance means how much pain we can endure in order to enjoy the long-term benefits of owning stocks. What exactly does "long term" mean? Jane Bryant Quinn said, "Long means long. If you genuinely-cross-your-heart hold stocks or mutual funds for the long term, ignore the daily news stories and stick to your (investing) program."

The chart below, from Ibbotson Associates, illustrates your chances of making or losing money in blue chip U.S. stocks (S&P 500) over various holding periods. Near term, stocks carry more risk than most people realized before this downturn, which began about a year ago.

This table illustrates a few points worth mentioning. First, notice how your chances of losing money decrease dramatically as you hold over the years. The longer you hold stocks, the less chance you have of losing money. Second, your chances of making money each year increase over the long haul. Third, the last column tells us that based on history, the 20 percent plus returns of the late 1990s in the stock market were abnormal. There is no doubt about it — the long-term attitude wins the game.

Whatever market strategy you use, make sure to install a system of checks and balances on your own style. For example, by using stop losses, you can cut your losses in the inevitable losers that end up in portfolios. Few people are able to admit they are wrong and move on quickly, without self-recrimination. Likewise, trimming back gains when a stock has reached target level because of rapid appreciation will force you to

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If you hold	Your chance of losing money	Chance of making money 0-10%	10-20%	20-+%
1 year	26%	18%	20%	37%
3 years	14%	28%	39%	19%
5 years	10%	31%	49%	10%
10 years	4%	42%	53%	1%
20 years	0%	37%	63%	0%

*S&P 500 stocks average, annualized monthly returns since 1926, all dividends reinvested.
Source: Ibbotson Associates

maintain diversification and take profits.

One way to make time be on your side is to try to lessen the emotional impact of the media's coverage of financial events on you. What would help you refrain from turning on CNBC-TV too often? Gardening, hiking, having tea with a friend or e-mailing someone far away are possibilities. We find that people who watch a great deal of the 24-hour financial networks tend to make less productive and more short-term based decisions. This is so because it is a natural response to want to do something when the sensory input bombarding one's cortex has a constant "crisis" quality to it.

In our culture, where most things are quickly obsolescent, it is no small feat to not think about time as being measured by the market's closing prices but by the slow and steady progress one is making towards financial security, especially when there are bumps along the way.

James Taylor sang "the secret to life is enjoying the passage of time." Building wealth through investing involves the passage of long periods of time, so try to remember that one of the main foundations of investment success is informed patience.

If you are compelled by habit, curiosity, or anxiety to look at your stock prices every day (or every hour), try looking only at how the more aggressive stocks are doing and ignore your solid, slow moving companies. These 'clunkers," more likely than not, will end up being the source of much of your long-term wealth accumulation. Having a few exciting names in your account can help you keep from trading the core positions too often.

One's ability to perceive "investment time" in a healthy way can be developed through a variety of circumstances. Making mistakes and learning from them is one way. Listening to and analyzing other investors' experiences is another. Whatever you use to further your financial education, remember not to take yourself too seriously, as the market is a great teacher of humility to everyone. Take profit in the words of one of the most successful investor of modern times, Warren Buffet. He said, in reference to people who don't clothe their portfolios with a solid overall philosophy, "It's only when the tide goes out that you learn who has been swimming naked."

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