Putting market volatility into perspective

Any sharp decline in the stock markets is often accompanied by dire newspaper headlines, often with the words turmoil or crisis. But a more accurate word would be *normal*.

While market declines are bound to be unsettling, here is some information to help put these events into perspective:

Volatility is a normal part of investing. A look at Chart 1, which represents the long-term performance of the S&P/TSX Composite Index, shows that fluctuations are simply par for the course. Even significant declines are not unusual. There were seven declines exceeding 25% on the Canadian market from 1964 to 2014.

Market declines have been followed by even greater recoveries. Chart 1 shows that the market eventually recovered from its declines and posted greater gains. In other words, the stock market moves in short-term cycles but the long-term trend is up. In fact, the S&P/TSX Composite Index has produced an average annual return of 9.3% over the 50 years ending July 31, 2015.

Why is that? A rising market reflects the growth of the economy and the wealth creation and increasing value of the companies that make up the market.

(over)

Long-term growth

S&P/TSX Composite Index, 1965-2015

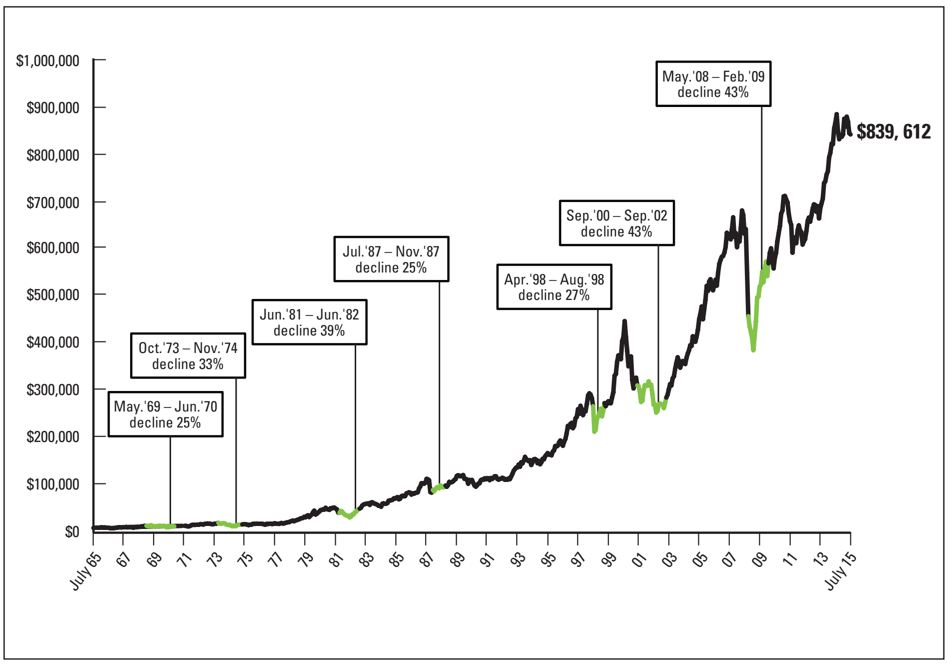

Chart 1: If you could have invested $10,000 in the S&P/TSX Composite Index in July 1965, it would have grown to $839,612 in five decades. This growth was not achieved without volatility.

Source: Globe HySales, TD Newcrest, CI

Market declines have been buying opportunities. Given the stock market's rising trend, market declines have been an opportunity for long-term investors to buy stocks at lower prices. Newspapers never say, "stocks are on sale."

Equities outperform over the long term. Despite short-term fluctuations, Chart 2 shows that equities have provided much greater returns over the long term than the other asset classes – bonds and cash. Equities (including mutual funds that invest in equities) are your best choice for preserving your purchasing power by keeping your returns ahead of inflation. This means that stocks should be part of most long-term investors' portfolios.

Diversification helps to provide more stable returns. While equities have outperformed over the long term, bonds and cash provide more consistent short-term returns. As a result, a well-diversified portfolio will have lower volatility than an all-equity portfolio. In addition, diversifying within asset classes – by holding global as well as Canadian equities, for example – is also beneficial.

Relative long-term performance of the asset classes

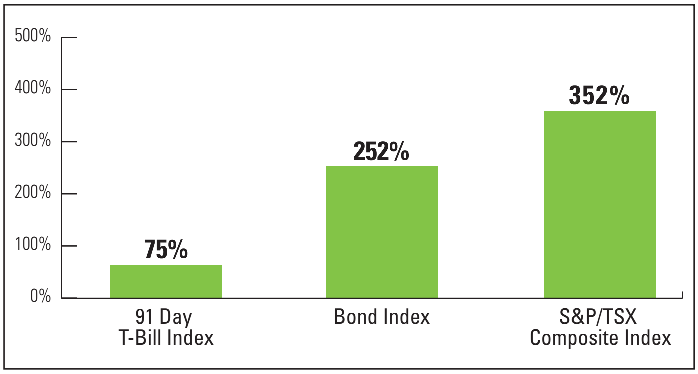

Chart 2: This chart shows that equities, as represented by the S&P/TSX Composite Index, have posted the strongest cumulative returns over the 20 years ending July 31, 2015, out of the three asset classes – equities, bonds and cash (represented by 91-day Treasury bills).

Source: Morningstar. Bond index is the Bank of America Merrill Lynch Canadian Government Bond Index.

If you have questions about these concepts or your investments, please contact your financial advisor.