Monkey or Tai Chi Master? Dealing With Market Volatility

October 22, 2014 | posted in Huff Post Money
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The practice of "mindfulness" obliges us to see reality for what it actually IS, not what we want it to be. Sometimes this can be difficult, especially when it comes to our investments. We fail to recognize that volatility IS the reality of the stock markets. During times when the direction of markets has been almost straight up (the last 37 months), or a downward plunge (2008-2009), many of us forget that straight up or down is NOT the natural state of the markets. But our forgetfulness does not change the fundamental IS. Markets are volatile. Period.

Nonetheless, it's been nearly impossible to remain mindful while markets have enjoyed a series of higher highs with only a few brief corrections since July 2011. Many pundits predicted we were at the beginning of another 20 year bull market - just like 1982! Apple's latest product launch was called "unprecedented". Alibaba's IPO priced last month and jumped HUGE right out of the gate. Social media, 3d printing, and biotechnology have all been on fire.

When things are getting really exciting and people are making lots of money, even a seasoned financial professional like me can start to wonder if I am wrong. Before too long, my monkey mind starts chattering. "Maybe disciplined diversification truly is a thing of the past." "Perhaps I am an investing dinosaur." "Should I have been all-in on the latest fad or trend?" "I mean, all these people are making more money than my clients, and the headlines keep popping, and the markets keep rising . . ." Rising right up until harsh reality hits and they come back to Earth, like they did last month.

Since market volatility IS reality, disciplined diversification requires remembering that "this too shall pass," whether markets are up or down. I often tell clients that this time is not truly different than any other time. We must always be diligent about our asset allocation and the rebalancing process. As hard as it may be to remain calm, we need to take a deep breath, and sell the thing that went up spectacularly last quarter. Then we must buy the thing that went down the most - even if it didn't decline much. You can never know when this year's top dog investment will completely collapse while the under-performer jumps up or down a teensy bit. We can't focus only on capturing the gains, either. We also need to look for opportunities to take tax losses, which can be one of the shiniest silver linings in a retreating market.

I wish investors would quit being so manic-depressive about volatility. But they won't, so I repeat my refrain of asset allocation, diversification, and rebalancing over and over again, through the markets' endless high notes and low notes, to anyone who will listen. Not everyone will. Some folks are seduced by the siren song of the latest IPO or hot sector, and can't stay grounded in reality. For example, I lost a client this year who wanted to move most of her assets into one single stock, which I thought was a huge mistake - for most investors, in general, and specifically for her long-term goals. I kept urging her to stay disciplined and "diversify, diversify, diversify", but she wanted to "make more, more, more, as quickly as possible." Now I expect she's going bananas watching her beloved stock go down, down, down.

Whether you are covering your ears right now, or not, I am here to tell you that there are really just two ways you can deal with market volatility: as a Monkey or as a Tai Chi Master.

Monkeys worry, research their investments on the internet, fret, read more internet articles, buy the investment du jour, follow the advice of media windbags, sell in a panic, and try in vain to time the markets. In other words, monkeys trade, rather than invest. They'll bounce around on a fool's errand that can lead to both insanity and poor financial outcomes for those who chase their own tails. Even if a monkey gets the trade right once, in order to be successful, you have to get each trade right twice. Every time. A fortunate few may manage to buy low and sell high with some frequency, but don't forget that if you leave enough monkeys in a room with a typewriter for enough time, they will produce Hamlet. This feat is called LUCK. And luck is not a consistent, reliable, repeatable process.

Tai Chi Masters don't rely on luck. They rely on the time-tested tools of asset allocation, diversification, and rebalancing. Tai Chi Masters don't just endure volatility. They embrace it and trust in discipline to carry them through the bumpy patches. Tai Chi Masters continue dollar cost averaging into their retirement accounts every month and remain resilient, no matter what the markets are doing. They understand that volatility can't be predicted or controlled by anyone, least of all them.

The Way of the Tai Chi Master is not an easy course to follow at first, especially with all those Monkeys chattering around you. But with practice, you can learn to accept volatility for what it truly IS: the natural state of affairs. Inevitable, like the sunrise, and just as beautiful - for volatility brings opportunities to those Tai Chi Masters who remain calm and continue investing for the long-term, while those poor Monkeys have to settle for bananas.

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