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Market correction may be in order

By Jill Schlesinger   April 10, 2017

There have been four stock market corrections (a decline of 10 percent or more from the recent high) during the current eight-year bull market.

According to research dating back to 1900, corrections have occurred about once a year on average and have lasted on average about 115 days. Over the past 30 years or so, the S&P 500 has seen 21 corrections.

Talk is increasing that correction number five of the second longest bull market on record is just around the corner. If you are a long-term investor, you should be rooting for a correction. After all, wouldn't you rather buy stocks at a 10 percent discount?

The reason most often cited for the potential decline is the unwinding of the so-called Trump Trade, which has driven up U.S. share prices by about 10 percent since the election. The rally has been attributed to three potential Trump administration policies:

Individual and corporate tax reform: Investors, especially those with higher incomes, are likely to redirect savings into the markets. Businesses would be expected to use their newly found tax savings to reward shareholders in the form of bigger dividends.

Infrastructure spending: It doesn't matter whether it's private or public funds, because $1 trillion in spending will likely provide a boost in sectors like construction and materials.

Loosening of regulations: For many industries, such as banking and energy, these changes are expected to amount to huge savings. But after President Trump's stinging defeat on health-care legislation, investors are now questioning the ability of the administration to enact these policies. And given that valuation levels show that stocks are more expensive than their historical averages (companies in the S&P 500 are trading at an average of 21.5 times the past 12 months of earnings, above the 10-year average of 16.5, according to FactSet), now might be the perfect time for the stock market to take a breather.

Whether or not we do get a correction this time around, there will be a time when markets slump. When they do, keep these guidelines in mind:

Keep cool: Stick to your game plan and avoid making changes. As Benjamin Graham said in “The Intelligent Investor,” his 1949 masterpiece: “The investor's chief problem — and even his worst enemy — is likely to be himself.”

Maintain a diversified portfolio and rebalance: To prevent emotional swings from robbing your performance, adhere to a diversified portfolio that spreads out your risk across different asset classes, such as stocks, bonds, cash and commodities. The hardest part of clinging to the plan is living with certain parts of your portfolio underperforming at times. The payback will come, when market events turn those previous dogs into champions.

Keep a healthy emergency reserve fund: Bad luck can occur at any time. That's why it's important to have ample emergency reserve funds (six to 12 months of expenses for those who are employed and 12 to 24 months for those who are retired).

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