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Canadian Market Recovery After Financial Crises

During financial crises, stock prices suffer. However, they typically recover over time.

All values are represented in CAD. Past performance is no guarantee of future results. Returns reflect the percentage change in the index level from the end of the month in which the event occurred to one month, six months, one year, three years and five years after. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. © 2008 Morningstar, Inc. All rights reserved.

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These images illustrate the cumulative returns of a balanced (60% stock/40% bond) portfolio after five historical financial crises. In the short term, uncertainty from such external shocks can create sudden drops in value. For example, the portfolio posted a negative return one month after the October 1987 stock-market crash. Over a longer period of time, however, returns were much more attractive, and investors who stayed the course reaped considerable rewards.

Fear and uncertainty might lead investors to sell their investments during tough times, putting downward pressure on prices. Trading based on these emotions can be detrimental to a portfolio's value. By selling during downward price pressures, investors might realize short-term losses. This is compounded as investors wait and hesitate to get back into the market, possibly missing some or all of the potential recovery. The lesson here is that patience can pay dividends.

Diversification can also limit losses during turbulent market conditions. The dot-com crash in 2000 resulted in a loss for the portfolio. However, it was less severe one year and three years after the crisis. Moreover, after five years, the portfolio had generated a 28% gain. One of the main advantages of diversification is reducing risk, not necessarily increasing return, over the long run. A diversified portfolio can help mitigate extreme swings in value.

Government bonds are guaranteed by the full faith and credit of the Canadian government as to the timely payment of principal and interest, while returns and principal invested in stocks are not guaranteed. Stocks have been more volatile than bonds. Diversification does not eliminate the risk of experiencing investment losses.

About the data

Stocks in this example are represented by the S&P/TSX Composite Index. Bonds are represented by a Morningstar-calculated total return series for the Scotia Capital 10+ year government bond until December 2006 and the Citigroup Canada 10+ year government bond thereafter. Calculations assume monthly data. The data assumes reinvestment of all income and does not account for taxes or transaction costs. For the U.S. savings and loan crisis, August 1989 was chosen because that was the month the Financial Institutions Reform, Recovery and Enforcement Act of 1989 was signed into law. For Long-term Capital Management's bailout, September 1998 was chosen because that was the month the hedge fund was bailed out by various financial institutions.

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