REASSESSING RISK TOLERANCE AFTER A MARKET SELL-OFF AND REBOUND

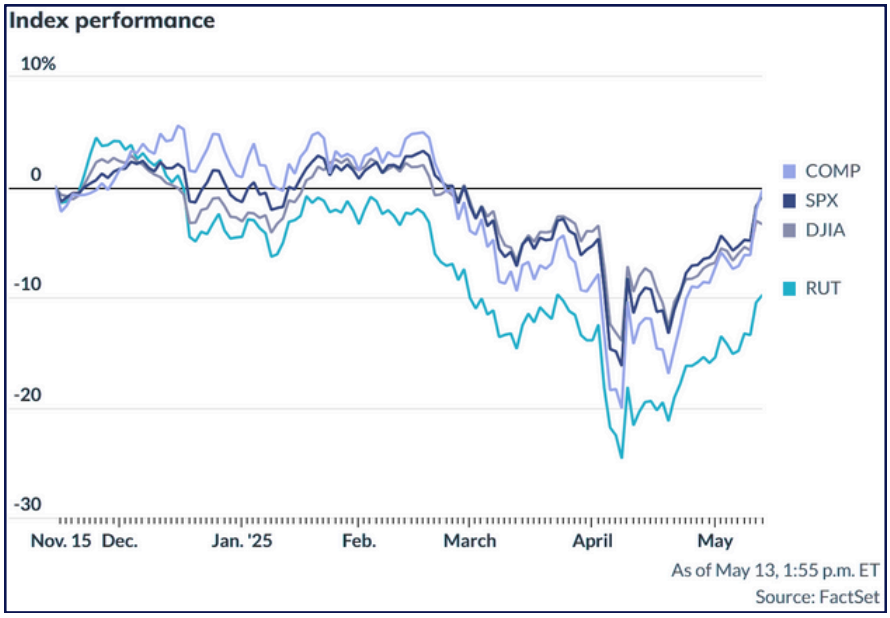
Market volatility is an inevitable part of investing. After a sharp sell-off and subsequent rebound, investors often find themselves grappling with a mix of relief, confusion, and renewed anxiety. These emotional swings can reveal a lot about an individual's true risk tolerance - sometimes exposing a misalignment between their investment strategy and their actual comfort with market ups and downs. Or sometimes just confirming that their strategy, risk tolerance, and time horizon are perfectly aligned, despite the obvious short term discomfort.

How do you know which, and whether or not such a misalignment exists?

The chart below illustrates what we have all experienced in the market in just a few short months. Understanding your true risk tolerance and level of comfort with your investment strategy does not come from asking “what happened and why”, “what happens next”, or “what do we do now?” But it may come from how you felt at the trough. Were you “this too shall pass, I'm in this for the long haul”, or were you “I'm not going to do anything now, but I don't ever want to be here again.”

If you were the latter, there is likely a need to reassess the alignment of your investment strategy with your risk tolerance, whether or not you have the ability to achieve your goals with less risk, and, perhaps you now have the opportunity to do so without being in a panic or firesale as you make appropriate adjustments.

Nov 2024 thru May 12 2025



Why it's crucial to reassess your risk tolerance after such events, and how to do it wisely.

Market Swings Test Your True Risk Tolerance

Many people estimate their risk tolerance in stable times, often during bull markets when optimism is high. However, the real test comes during a significant market downturn. If you found yourself panic-selling at the bottom, or even surviving a gut-wrenching urge to do so (promising yourself you'll wait for the rebound), or obsessively checking your portfolio, those could be a signs your portfolio was too aggressive for your actual risk capacity.

Conversely, if you remained calm, or even saw the downturn as a buying opportunity, you might be more risk-tolerant than you thought, which opens the door to potentially adjusting your strategy.

What Changes in a Sell-Off and Rebound?

1. **Portfolio Value Fluctuations:** A steep decline followed by a fast recovery can distort your asset allocation. Stocks may have initially dropped more, and subsequently bounced back stronger than bonds or cash, altering your intended mix.
2. **Behavioral Insights:** How did you react during the downturn? Did fear lead you to sell? Were you overzealous in buying the dip? Was the discomfort enough to lose sleep over it even if you did not succumb to your fear? These behaviors are clues about your true tolerance.
3. **Life Circumstances:** Market events often coincide with or trigger life changes (job loss, retirement reconsideration, or a change in financial goals) which can all affect your ability and willingness to take on risk. If a down payment on a home was due during this period, for example.

How to Reassess Your Risk Tolerance

1. Reflect on Your Emotional Response

Ask yourself:

Was I comfortable staying the course?	Did I make any rash decisions?	Did I lose sleep over market movements?

2. Review Your Investment Objectives

Goals evolve. Are you still investing for long-term growth, or have your needs shifted to capital preservation or income? Would a similar decline without an immediate rebound significantly impact your plans? Your risk tolerance should align with both your psychological comfort and financial objectives.

3. Rebalance Your Portfolio

If the rebound skewed your asset allocation, or, if you are recalibrating your risk tolerance, now may be a good time to rebalance. This will bring your portfolio back in line with your risk profile and investment goals.

4. Consult a Financial Advisor

An advisor can help you interpret your responses and behavior during the downturn and adjust your plan accordingly. They can also stress-test your portfolio under different scenarios to see how it holds up. Most importantly, if you have an advisor, is he or she attuned to your needs and aligned with your goals?

Adjusting Without Overreacting

The key is balance. Don't let short-term volatility completely dictate your long-term strategy, but do use it as a valuable learning opportunity. If you're too conservative, you might miss out on growth. If you're too aggressive, you might subject yourself to volatility beyond your risk appetite.

Conclusion

A market sell-off followed by a rebound is a powerful emotional and financial stress test. Rather than ignoring the experience, thankful that it resolved itself, or rushing to "correct" your portfolio, take the time to reassess your risk tolerance. Use what you've learned, remember how you felt, and make sure to align your investments more closely with your actual risk tolerance now that its been tested. It's no longer a theoretical or hypothetical "what if" scenario - you just experienced "what if!"

We can help!

Please contact us for a complimentary portfolio review.

For more information, please contact us: (617) 488-9320 or at contact@purefiwealth.com

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