

What Should You Do When the Next Market Downturn Comes?

“Should I get out of the market?”

We get asked this all the time when people start to wonder what to do when the next market downturn comes. That instinct is understandable — but it’s also where many long-term mistakes begin, and it arguably isn’t a concern right this minute.

At the time of publication, stocks are performing very well, indexes are near historic highs, and portfolios for disciplined investors have generally been rewarded over the past several years. But underneath that strength, it’s easy to see why the question keeps coming up.

A narrow group of tech and AI-related stocks has driven much of the market’s gains. Valuations are elevated by historical standards. And headlines about recessions, wars, elections, and political unrest are unavoidable. When markets are strong and uncertainty is loud, many investors start to wonder whether the prudent move is to step aside while they wait for the next shoe to drop.

It’s true that markets don’t move in straight lines and periods of strong performance are often followed by pullbacks, but that doesn’t necessarily mean a downturn is imminent.

What it does mean is that this is a good time to think intentionally about how you’ll respond if and when it happens.



When the market feels shaky, investors have three main options:

- 1. SELL OUT OF THE MARKET**
- 2. STAY INVESTED**
(and look at your portfolio less often)
- 3. BE PREPARED TO LEAN INTO THE NEXT DOWNTURN WHEN IT ARRIVES**

Understanding these paths — before emotions run high — can help you make more informed decisions based on your financial needs and personal investment philosophy when it matters most.

A quick reality check on the “experts.”

Before we talk about what you can do, it helps to be honest about what no one can reliably do: forecasting markets.

An extensive study by Phillip Tetlock tracked 284 experts over more than 20 years, analyzing 82,361 predictions across economics, politics, and markets. The result? Their forecasts were worse than you'd expect from random chance.

Another review by CXO Advisory Group of 6,000 market calls from investment gurus found they were right only about 47% of the time. Again, worse odds than those of a coin flip.

The investment industry doesn't look much better over long periods of time:

- **Over the past 10 years, more than 80% of active managers in public markets underperform their benchmarks.**
- **Individual investors as a group have historically underperformed the market by about 1.5% per year, and the most active traders have lagged by around 6.5% per year.**

This isn't a knock on economists, strategists, or market commentators; it's simply what the data shows.

Forecasting remains exceedingly difficult in more recent studies, as well. Even advanced methods, including machine learning, struggle to deliver a consistent forecasting edge, because while the tools have improved, market complexity (and noise) has also increased.

All this is to say that if the professionals with armies of analysts and state-of-the-art tools struggle to call it correctly, building your plan around anyone's predictive abilities is a shaky foundation at best.

That's why we don't build portfolios that have to be “right about the future” to work. **We build portfolios that are resilient to a range of futures.**

With that in mind, let's consider your options should turbulent times arrive in the future.

Scenario 1: Sell everything and get out

Emotionally, this one makes sense when you're watching your portfolio bounce around or if you're expecting a future market downturn, because it's uncomfortable.

Selling everything and holding cash can feel like you're doing something, but there are several problems with this approach:

1 You turn temporary declines into permanent losses

Every **bear market** in history has had one thing in common: it ended.

When markets recover, they often deliver some of their best returns coming off the lows. If you're in cash waiting for things to “feel better,” those strong early opportunities are exactly what you're likely to miss.

We've also seen that markets regularly “head-fake” investors. Since 1900, the Dow has had **5%+ pullbacks** virtually every year, but only a relatively small number of true bear markets. Short-term drops are standard, while permanent losses usually only happen when we lock them in by selling and missing the opportunity to ride the upswing.

2 Getting back in when things are smoother rarely works

This is a classic trap.

You sell when things feel scary. Then the market stabilizes, but it still doesn't quite feel “safe” yet. Then it rallies a bit, but it feels too high to buy back now. By the time the news finally feels good enough, markets have often recovered much of what they lost.

Even legendary professionals struggle with this. In the late 1990s, Fed Chair Alan Greenspan famously warned about “irrational exuberance.” Yet the market

kept rising for four more years, with annualized returns of over 20% during that stretch. Selling based on that warning would have meant missing huge gains before the eventual downturn.

The same is true today — we can say stocks have elevated valuations, or risks are rising, but no one can attach a precise calendar date to when those issues will result in market downturns.

3 The tax and cost hit is real

For taxable investors, a complete “get out” move can trigger significant capital gains taxes, especially after long bull markets. Add in potential transaction costs, and suddenly your portfolio has to earn fairly large returns to make up for these frictions.

4 Evidence shows frequent moves hurt performance

We’ve already seen that individual investors who trade often tend to underperform by several percentage points annually. That’s a considerable gap compounded over time.

Selling out of the market and trying to time your way back in is basically signing up for the behavior the research warns against.

For our clients, going to 100% cash purely out of fear of a downturn is rarely our preferred solution. You may gain emotional relief in the short term, but history has shown us time and again that the long-term math likely won’t work in your favor.

Scenario 2: Stay in the market (and stop obsessing over it)

For many long-term investors, this is quietly the most powerful strategy.

Investors find **volatility scary**, but they accept it as normal; market pullbacks are not a sign that something is broken; they’re the price of admission for long-term returns.

Unless you’re drawing heavily from your portfolio

to live on, most downturns are a temporary change in account value, not a permanent change in your financial life.

Time in the market vs. timing the market

Staying invested and simply checking your statements less often gives you the advantage of avoiding knee-jerk reactions to scary headlines, so you can keep trading costs and taxes down and give compounding a chance to work.

One study of individual investors’ accounts found that those who traded less — and held more diversified portfolios — did better than the active traders who were constantly trying to “do something.”

Diversification is key



Staying invested doesn’t mean staying invested in anything at any price.

We’ve already lived through an era where putting it all into the hottest sector looked brilliant until it didn’t. In the 1990s, large-cap growth and tech stocks had spectacular gains. But from 2000-2010, those same kinds of stocks lost money on average, while more diversified portfolios, including value stocks, smaller companies, and international markets, held up much better.

The tech-heavy NASDAQ index lost nearly 80% from its peak in the early 2000s and took many years to recover, whereas more diversified U.S. stock indexes recovered much faster. A balanced portfolio of stocks



and bonds bounced back even sooner.

Today's AI and mega-cap darlings are the newest characters in the same story. They may keep running for a while (market cycles can last much longer than we expect), but building your entire future around a narrow slice of the market is a risk, not a strategy.

You prepare to handle downturns by evaluating your investment strategy:

Build a globally diversified stock portfolio, allocate sensibly to value, small-cap, and international stocks, add bonds, and other "boring" assets to dampen volatility, and create a plan you can stick with through the ugly parts.

Scenario 3: Lean into the downturn

This is where things get interesting, and where a lot of our work happens behind the scenes for clients.

There's no way around the fact that **downturns are uncomfortable**, but they're also when some of the best opportunities show up.

Tax-loss harvesting

One of the most powerful tools in a selloff is tax-loss harvesting.

The basic idea is that you sell an investment that's down and realize the loss. You then immediately buy something similar (but not identical) so your portfolio stays invested in the same general market area. By doing this, you haven't changed your long-term exposure; you've just locked in a tax asset.

You can use those realized losses to:

- **Offset current capital gains**
- **Offset modest amounts of ordinary income**
- **Or carry forward indefinitely to offset gains in future years**

In other words, you're using volatility to reduce your lifetime tax bill without giving up on your long-term investment plan.

We routinely implement this for clients during periods of market stress. It doesn't show up in short-term performance numbers, but it can make a meaningful difference over time.

Rebalancing

Market downturns rarely hit all asset classes equally.

If stocks fall sharply while bonds, cash, or other diversifiers hold up better, your portfolio drifts away from its target mix. A disciplined rebalancing process will sell some of what has held up (the “winners”) and buy more of what has fallen (the “losers”).

That sounds emotionally backwards, but mathematically it’s sound. You’re buying more shares at lower prices and positioning the portfolio to benefit more when the eventual recovery arrives.

Historically, some of the strongest returns in markets occur in the early years of a crisis. Having more stock exposure at those moments, because you rebalanced when you leaned into weakness, can accelerate your recovery.

Tilting toward segments that are genuinely cheap

Downturns and late-cycle conditions often create large valuation gaps across markets.

As the research shows, U.S. large-cap growth (especially tech) has dominated returns for much of the past decade and has become expensive. While other segments (such as value stocks, smaller companies, and international/emerging markets) have historically been additive, especially after long periods of underperformance.

For truly long-term investors, that’s not something to fear. It’s an opportunity.

Similarly, factor-based strategies that tilt toward high-quality, value, momentum, and low-volatility stocks have shown improved risk-adjusted returns over time. Combining these factors can help smooth out performance across different market environments.

Using alternatives carefully to manage risk

Stocks and bonds aren’t the only tools in the box.

We also consider select alternative investments that have reasonable expected returns, show low correlation to stock and bond markets, and have historically held up relatively well in past downturns.

Examples include certain types of private real estate, alternative credit, managed futures, and catastrophe

bonds, among others, implemented through vehicles that allow us to carefully evaluate their structure, fees, and liquidity.

It’s important to note that we don’t consider any of these approaches as a silver bullet. They’re designed to potentially reduce volatility and drawdowns without giving up too much return. And while it’s not always fun when you’re in it, over the long term, it’s often where the real value of a disciplined process shows up.

Should you get out when the next market downturn comes?

Of course, when our clients ask us this, we look at their time horizon and spending needs, **tax situation**, tolerance for volatility, and their financial mix, but for most long-term investors, our answer is:

“Probably not. But you should get more intentional about how you’re in it.”

That might mean:

- **Reducing an overly concentrated position in a single stock or sector**
- **Adjusting your overall risk level so you can sleep at night without bailing out at the bottom**
- **Broadening your diversification beyond today’s winners**
- **Putting a plan in place for strategies like rebalancing and tax-loss harvesting during downturns**
- **Accepting that volatility is simply part of the journey**

Most importantly, it means focusing on the levers you can control, like your allocation, behavior, costs, and taxes, instead of following the economic headlines.

The song “Mr. Bojangles” by Jerry Jeff Walker came out of what was a terrible day for him, spent sitting in a New Orleans jail cell. Yet that difficult moment ended up creating the royalties that likely supported him more than all his other albums combined.

Market downturns can feel like your “jail cell” moments as an investor. They’re uncomfortable and never show up at a convenient time. But history shows that, handled thoughtfully, they can also be the episodes that set you up financially for years to come.

You don't have to love volatility, and you don't have to predict recessions or elections.

What you do need is a plan that doesn't panic when the market dips, and instead, quietly turns those bad days into long-term opportunities.

Your situation is unique. Before making any significant changes (especially around selling out of the market), **talk with a qualified advisor** who understands your whole picture.

To learn more about Armbruster Capital Management and our investment philosophy, contact us at (585) 381-4180 or info@armbrustercapital.com. You can also schedule a **time to talk** with one of our advisors through our website.

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