How to Trade the Excessive Panic

Ouch…

After a 10,735-point run higher on the Dow Jones Industrials in just over a year, the index plunged more than 1,500 points in two days in early February 2018.

It also wiped out $1 trillion of value with it.

Granted, there are fears that the Federal Reserve, now under Chairman Jerome Powell, could accelerate interest rate hikes and potentially slow our red-hot economy. The only reason we didn't see this threat under former Fed boss, Janet Yellen was because inflation didn't post a significant threat.

In fact, inflation stayed under the 2% annual target rate for quite some time.

However, with a tighter job market, higher wage growth and the idea that tax cuts could accelerate growth, there were concerns of higher inflation at the time, which could lead to higher interest rates. If, for example, inflation soared above 2% – which was the chief concern – the Fed would be forced to quickly accelerate hikes to tighten credit and stop inflation threats.

That fueled a big part of the fear in the market.

And two, the 10-year Treasury bond did run to 2.85% from its 1.37% low in July 2016.

> However, even at "2.85 percent, the 10-year's yield is simply back to where it was four years ago," notes Adviser Investments, as quoted by The Washington Post. "It's not setting some kind of record other than its rapid ascent."

While some analysts argued that stocks were "fully valued" at the time, or that we "could easily see a 10 to 20 percent correction sometime this year," as noted by The Washington Post, others "see the decline as an opportunity given that corporate earnings are rising…"

> "I'm not worried about this move. This is all a Fed move," said Joe LaVorgna, chief economist for the Americas as Natixis, as quoted by CNBC. "If you don't think there's inflation and you don't think the Fed's going to be as aggressive as the hawks would have you think, this equity sell-off should be bought."

We've seen worse crises and fears, though. Markets are resilient.

So what's the best thing to do after a drop of this size?

Tip No. 1 – Don't panic.

If you panic, you sell. And if you sell, you miss the potential for the recovery rally. We have to remember that economists are still bullish on U.S. economic growth going forward.

Tip No. 2 – Consider buying the dip.

Wait to see where the market begins to show signs of catching support and recovering. Also, be sure to wait for signs of a higher move to avoid buying into head fakes. We also have to remember that the U.S. economy is still strong. GDP growth, unemployment, consumer spending, and tax reform could fuel higher highs.

There are a few ways we can do this.

- One, buy to open the DIA April 20, 2018 245 calls
- We can even hedge our long positions with ETFs, as well, including the Pro Shares Short S&P 500 ETF (SH), the Pro Shares Ultra Short S&P 500 (SDS) and even the Pro Shares Short Russell 2000 (RWM).

Tip No. 3 – Do nothing and wait for the storm to blow over.

It may take some time for investors and traders to feel confident in buying again. If you're most comfortable waiting for the possibility of a resumed rally, do so. It's your money. Take your time. But remember, markets are resilient and can snap back quickly, too.