



DON'T LET MARKET VOLATILITY DERAIL YOUR LONG TERM INVESTMENT GOALS



Kristine Lausin, CFP®, has been helping clients with their financial goals since 1980. A former educator, she believes in empowering her clients through information and collaboration. She has conducted seminars and classes on a variety of financial topics over the years. She especially enjoys working with women because of their openness to ideas and desire for information.

by Kristine Lausin

VOLATILITY...It is a word that strikes fear into the hearts of many investors, especially retirees and near retirees. Most investors equate volatility with loss. However, it is a normal part of the investment experience. For savvy investors, volatility can produce opportunities. For example, while the impact of the current oil situation is pervasive – it impacts the cost to pump gasoline, bring food and goods to market and produce plastic – it does not impact the cost or price of all goods and services equally. Still, investors are penalizing stock prices across the board. Although the impact is not uniform to each company, declines in stock prices are down without regard to the actual impact. This creates opportunity for investors and mutual fund managers with cash on hand to invest. Furthermore, if you are investing monthly through your 401k plan or another systematic investment program, the shares you are buying today are on sale compared with six

to twelve months ago. For the prudent investor, this should be a chance to buy more shares at lower prices.

Behavioral finance researchers tell us that investors are not totally rational beings. They sometimes act based on imperfect or incomplete information and they may misinterpret information or react to it in inappropriate ways. The recent volatility in the market has many investors asking themselves if they should sell their stock investments and bury their money in a can in the back yard. When the investing climate becomes unpredictable, we have to make sure that we do not cave in to our fears.

A study conducted by DALBAR, a leading financial services market research firm, regarding market returns and investor behavior discovered that in the 20 years ending December 31, 2006, the S&P 500 Index earned 11.8%¹. However, investors in stock mutual funds during the same period earned just 4.3% on average.² So, despite great performance in the market, investors made emotional decisions that derailed their investment goals.

Despite volatility in the market, owning stocks may be vital to a comfortable retirement. At a time when life expectancies are expanding, we have to be planning for being retired 25 years (or longer). Studies have been conducted examining various portfolio compositions. Even with a modest 5% withdrawal rate, a 100% bond portfolio has only about a 30% chance of meeting your income needs over a 25-year retirement. But a mixture of 50% bonds and 50% stocks increases those odds to 82%.

Before you consider running for the hills due to volatility,

keep these points in mind:

- While the S&P 500 has declined 34%, on average, during bear markets, since World War II, it has increased by 175% during ensuing market advances.
- If you sell your shares today, you may just miss out on the market's best performance. Missing just the top 10 trading days between January 1, 1998 and December 31, 2007, would have reduced your average annual total return from 5.9% to 1.1%. That would have reduced the return on each \$10,000 invested by more than \$6,000.
- Even in the great bull market of 1990 to 2000, the market experienced five corrections of between 10% and 20%. Any one of these might have been enough to make an inexperienced investor give up on stocks and go back to CD's.

If you are concerned about the current composition of your portfolio or 401k plan, this might be an excellent time to establish a relationship with a financial professional. Modern Portfolio Theory suggests that it's a good idea to spread the risk across a carefully selected mix of investment classes and types. This is called asset allocation. While asset allocation cannot completely insulate you from temporary losses, it can help to reduce volatility and keep you

focused on your long term goals. A planning professional can help you to find that appropriate mixture of stocks, bonds and alternative investments for your comfort level. Having a planner on your team will provide an objective sounding board for you when roller coaster markets make you want to reach for the motion sickness medication.

If your planner also understands the concepts of behavioral finance, he or she will be able to help you to develop strategies and build portfolios better tailored to your investor profile and experiences. A planner who understands what causes you pain can help you avoid painful situations and stay the course toward realizing your financial goals. This could improve your overall investment experience by reducing your anxiety—creating a more valuable and satisfying result.

¹ *The S&P 500 Index is a broad based measure of domestic stock market performance that includes the reinvestment of dividends. The index is unmanaged and cannot be purchased directly by investors. Index performance is shown for illustrative purposes only and does not predict or depict the performance of mutual funds or other investments.*

² *Source of data: DALBAR 2005, "Quantitative Analysis of Investor Behavior."*

Contact Kriss with questions or ideas for future articles at klausin@caioh.com

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