

KEEPING A STEADY FOCUS ON INVESTING DURING DOWNTURNS

Following a two-year rebound in stocks from the bear market lows in March 2009, market volatility has recently risen considerably. Investors have had lots to worry about, including the struggle to reach a debt limit and deficit reduction agreement in Washington. So what does the prospect of continued volatility and uncertainty mean for your retirement savings strategy?

By focusing on your long-term objectives, and understanding some strategies that can help you cope with market volatility, you can make informed decisions to help keep you on track toward your retirement goals.

Recognize that market volatility is not new:

The markets, and your investments, typically rise or fall every day. But “market volatility” refers to substantial fluctuations in the overall market, generally during short periods. These sharp market fluctuations are not new. In October 1987, the Dow Jones Industrial Average plunged 22.6% in a single day. But it regained its lost ground in about two years, and by 2000 was more than four times the level at which the 1987 decline had begun. In 2002, the Dow dropped by 23% from early March to early October. Five years later, it had risen by 78% from its low of October 2002 and hit a record high of over 14,000 on October 9, 2007. The bear market that began in November 2007 saw the Dow drop to under 6,500 by March 2009. Then the Dow rallied to finish the year at about 10,000. By late April 2010, the Dow was back over 11,000, and then it dropped to below 10,000 in June before rebounding above 12,000 in early 2011.

No one can predict how long it might take the market to return to previous highs. However, retirement is generally a long-term goal and it makes sense to keep a long-term perspective as you save and invest. If retirement is far off, you may see more bear or bull markets by the time you retire. In the short term, your progress may seem bumpy. But stay focused on the long term, continue to contribute to your employer’s plan and make sure your investment strategy matches your goals, time horizon and personal circumstances. The steps described in the following paragraphs can help you invest for the long term.

Review your investing strategy:

Your retirement plan portfolio should reflect your time horizon (how long you have until retirement), your tolerance for investment risk and your personal financial circumstances. Focus on your goals, not today’s news. Your objective, likely a long-term one, is to help generate the income you’ll need for a retirement that could last many years. And remember that even in down markets, you don’t actually realize a loss (or a gain) until you sell an investment.

Review your strategy regularly- at least once a year. Difficult market conditions are another occasion to review your portfolio. When you do, proceed carefully before making changes based on short-term factors. You'll want to feel comfortable that your short-term decisions are consistent with your long-term goals. And remember these key benefits of your 401(k) plan: Your pre-tax contributions are tax-deferred, reduce your current income taxes, and have the potential to grow. (Taxes are due upon withdrawal. If you take a withdrawal before age 59 ½, you may also be subject to a 10% additional federal tax.)

Diversify your investments:

Diversification is the process of spreading your investments across the three key asset classes (stocks, bonds and cash equivalents) as well as within those classes. Diversification cannot ensure a profit, and it cannot protect against losses- especially when the markets are dropping. But it can help cushion a significant downturn in any one asset class and be an effective means to manage investment risk. Your retirement plan offers a variety of investment choices within the three main asset classes. A period of pronounced market volatility is a good time to ensure that your portfolio is well diversified.

Rebalance to stay diversified:

Volatile markets can easily throw a portfolio off target. For example, a sharp decline in the stock market may mean that stocks are now a smaller percentage of your portfolio's value. At the same time, bonds or cash-equivalent investments could represent a larger percentage. Review your portfolio and consider rebalancing to maintain your intended asset allocation (mix of assets). Continue to rebalance on a regular basis. This can help your portfolio take advantage of potential future growth.

Understand the dangers of market timing:

When stocks are dropping, some investors may be tempted to move heavily into conservative investments, then move back into more aggressive investments when the market recovers. But trying to time the market in this fashion can have consequences. Investors who attempt to time the market run the risk of missing at least some periods of exceptional returns. (An unsuccessful market timer who missed the best 13 months of returns in the last 20 years would have lower returns than Treasury bills.)

Consider dollar cost averaging:

Dollar cost averaging is another basic investing principal. It refers to investing the same amount in a particular asset (or assets) at regular intervals. Automatic retirement plan contributions from your paycheck make it easier. Investing the same dollar amount each period will buy more shares of an asset when the price is low and fewer shares when the price is high. The result: the average purchase price is lower than the average market price over the same period. Dollar cost

averaging brings a disciplined approach to investing. With dollar cost averaging, investors make regular, timely investments in different market environments. Because you invest a regular dollar amount, a market decline presents an opportunity to purchase more shares at favorable prices. As long as you purchase shares at a regular time interval and with the same dollar amount, you can achieve the benefits of dollar cost averaging.

What's Next?

No one can predict when the economy and/or the markets may recover. Some downturns prove to be short-lived, but some have lasted for several years. Having a diversified portfolio, and a long-term perspective, could mean a better likelihood of achieving your goals.

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