

## WHAT SHOULD I DO WITH MY 401(k)?

By Phil Zimmerman, CFP®

Prompted by a drop in the S&P 500 of over 50% from November 2007 to March 2009, your employees may be asking, "What should I do with my 401(k)?" While we are often surprised by declines (and this one is unusually severe), there have, in fact, been 12 declines of over 35% since 1929. While conventional wisdom says to stay the course, conventional emotion says, "Get me out, I can't take it anymore!" Perhaps some statistical perspective<sup>1</sup> would help.

For the 20 year period ending 12/31/2005, the S&P compound return was 11.9%, while the average equity mutual fund investor's return was 3.9%, lagging far behind the S&P and barely beating inflation. Why the lag? **Moving in and out of the market at the wrong time.** Using more recent data, let's look at the 10-year period from 12/31/1997 to 12/31/2007. The S&P 500 compound return of was 5.91%, but investors who missed the 10 best trading days in that 10 year period had an annual average return of 1.12%. Those who missed the 20 best trading days had an average annual return of -2.55%, and those that missed the 30 best trading days had an average annual return of -5.72%. What does that mean? Moving out of stock funds into money markets until it's "safe" to get back in carries an extremely high cost.

There are other ways to making this argument statistically. **Over the last 83 years, the market has had positive returns in 59 years and negative returns in 24, so it was up more than twice as often as it was down.** The distribution of returns is also useful. Five of those years had losses over 20%, five had losses of 10-20%, and 13 had losses of under 10%. Twelve of the positive years had returns of 0-8%, 5 had returns of 8-12%, 11 had returns of 12-20%, and **31 years had returns of over 20%.**

How high have the highs been, and how low the lows? The **best one-year performance was +53%**, and the **worst was -43%**. The **best 5-year average return was 28%**, and the **worst was 12%**. The **best 10-year average return was 20%** and the **worst was -0.89%**. Finally, the **best 20-year compound return was +17%** and the **worst was 3%**. Given current life expectancy of 85 years, many people will be around long enough to experience the smoothing effect of these long term trends.

Looking back at the twelve market declines of over 35%, the market is up 27.6% on average within three years of the bottom. In the current decline, the market has already risen 34% in the last nine weeks (as of mid-May 2009).

One of the most frustrating things about 2008 for investors is that even a properly diversified portfolio suffered significant declines. Asset classes that historically were not correlated (meaning they historically did not move in the same direction at the same time) behaved in very similar ways. International market performance correlated roughly 90% with the US. Value funds declined as severely as growth funds (because value funds typically are fairly heavily weighted in financial stocks, which were some of the hardest hit last year). Different parts of the bond market melted down in the spillover of the sub-prime crisis. However, just because asset allocation doesn't work **all** the time doesn't mean it won't work **over** time. Investors should have an asset allocation strategy, rebalance periodically (quarterly or annually), and modify the allocation as they get closer to retirement. While past performance is not a guarantee of future returns, "This time it's different" has rarely produced good long-term results.

<sup>1</sup> Dalbar Quantitative Analysis of Investor Behavior, July 2006.

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