

How to

Find the Upside

in a **Down Market**

Helpful Insights for 401(k) Long-Term Investors

When there is a down market, it's common to be concerned about how much money you have lost in your 401(k). The truth is there are no losses unless you are actively taking money out of your account at a price below the purchase price. On paper it can look bad now, but it's the value when you withdraw those funds that matters.

The good news is that there has historically been a silver lining to down markets for long-term investors. Although past performance is no guarantee of future results, this trend can far outweigh what may look like a less than exciting 401(k) balance today.

A Look Back to Brighten your Outlook

Markets have performed well over the long-term overcoming some very rocky times. Consider these facts and figures:

- Markets recover! A 100% winning percentage in modern times:
 - Even going back to the Great Depression, there have been 14 recessions and 14 recoveries
 - In every 20 year period researched back to 1926, the US stock market has delivered a positive return²
- People who get out of stocks during down times tend to be significantly worse off than those that keep their money in the market.
 - Those that stayed in the market through good and bad times over the last 20 years earned 8.43% and that's not including dividends (based on S&P 500 benchmark)¹
 - In comparison, 401(k) savers that pulled out of stocks and missed the 30 best days over the last 20 years only experienced 0.59% growth (see the chart on page 3).¹

No one knows how future markets will behave; yet understanding how long-run market returns have previously played out can provide you some perspective as you determine your road. Here are four insights to help keep your long-term goals on track:

Avoid the Herd: Buy Low, Sell High

Most everyone wants to buy low and sell high. Unfortunately the reality is that people tend to put a lot more money in stocks during up markets and take money out during down markets. There is a natural tendency for overconfidence when market returns are on a significant rise. But fear can take hold quickly when markets drop.

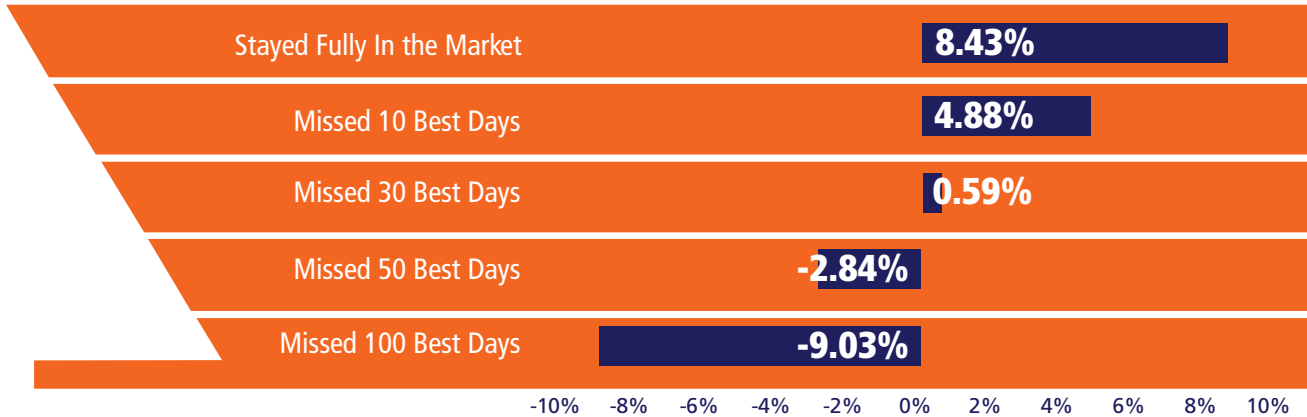
This behavior of putting more in the markets during good times and pulling back in bad is exactly opposite to what we want to do—buy low, sell high. It can be a real killer to you achieving your long-term saving goals.

Missing a Few Days is a Big Deal

Markets often rise and fall quickly and trying to time the market is pretty much impossible. Here's a recent twenty year example of how sticking with your plan can deliver solid rewards versus pulling out of stocks and getting back in when the market "settles":

S&P500 Market Returns from 12/31/1988 to 12/31/2008¹

Price-only performance



¹ Source: Thomson Investment View. This chart is for illustrative purposes and is neither an actual investment nor the performance of a specific fund. And of course, the view of the past by no means guarantees future gains.

More Shares in Downtimes, More Rewards in Good

The great thing about 401(k) plans is that each pay period most of us contribute a specific percentage of our paycheck into our plan. When the markets are down, your money is buying a greater quantity of shares. When the markets are up, your money purchases fewer shares. This is called dollar-cost averaging. Because you get more shares when markets are down, you tend to be better off down the road. Consider this example of how it can work for you:

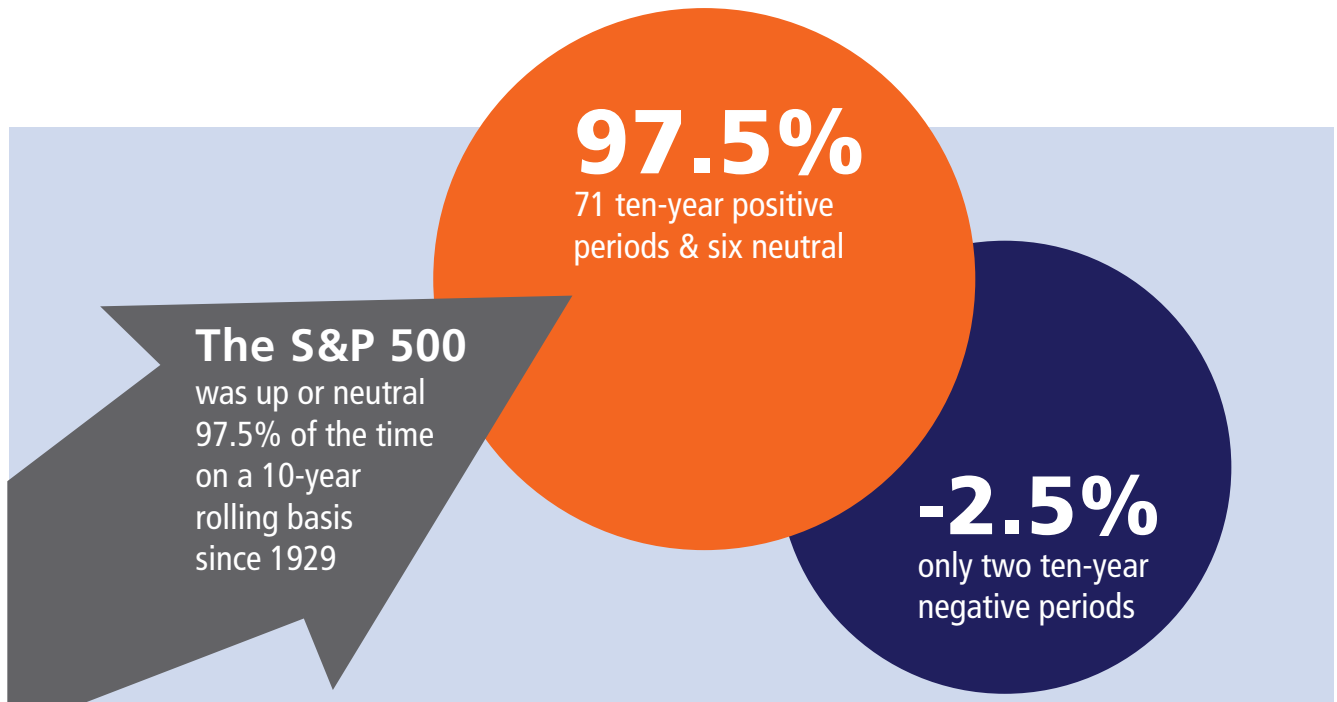
Period	Amount Contributed	Fund Share Price	Shares Purchased
1 (Market High)	\$500	\$100	5
2 (Market Low)	\$500	\$50	10
3 (Recovering Market)	\$500	\$75	6.67
Totals	\$1,500	\$75 average price	21.67
Value	\$1,625.25	21.67 shares at \$75	
Unrealized Gain	\$125.25 or 8.35%		

By sticking with your investing plan in this scenario, you are 8.35% better off even though the market has not come close to exceeding the previous market high.

Dollar cost averaging won't assure a profit or protect against loss. Investment experience will vary with stock selection and changing market conditions.

The Success of Long-Term Investors

What we have seen is that over the long-term of 10 and 20 years, the market has produced more than double the returns of other investment options such as bonds and cash. Over the last 80 plus years, stocks have delivered 10%, bonds 5%, and cash 2%.² Stocks have played an important role in outpacing inflation and delivering generous returns to long-term savers.



Let's take a deeper look at the US stock market using the S&P 500 as a benchmark. An amazing 71 times the market was positive on a 10-year rolling average since 1929³. Over 20 year periods, it's been positive 100% of the time.

Take a look at your situation and determine an appropriate amount of your long-term savings to place in stock funds, bonds, and cash. Stick with your plan through good times and take advantage of the "bad". This approach will help you stay on track and achieve your goals with confidence.

Want our take on volatile markets—when stocks make big swings up and down—just give this a read: [Volatile Markets and Your 401\(k\)](#)

To learn more about investing, we suggest starting with our Savings Guides:

- [5 Rules for Creating a Sound Investment Strategy](#)
- [6 Rules for Making Smart Investment Choices](#)

Want more insights? Give these books a read:

Burton Malkiel, *A Random Walk Down Wall Street*

Bill Bernstein, *The Four Pillars of Investing*

Bill Shultheis, *The Coffeehouse Investor*

FAQs

1. How Much Do I put in Stocks vs. Bonds?

A general rule of thumb to start as you consider your long-term goals is using your age as a guide for how much to have in stocks versus bonds. For example, if you are 30, you'd put 70% in stocks and 30% in bonds. A 50 year old, might have a 50/50 split.

2. I'm near retirement, what can I do in down times?

Even if you're 60 years of age or more, having some broadly diversified stock funds in your portfolio is a good thing. Most people expect to live 20 to 40 more years giving you time to ride out a down turn. Keep in mind, it's more important for you to have revenue generating assets like bonds and cash to cover at least 5 years and help your stock holdings persevere a down market.

3. Down markets are rare, right?

Actually, down markets and recessions are normal occurrences with any economy. Since 1852 in the U.S. there have been 32 contractions and expansions of our economy. Expansions have averaged 38 months in length and contractions 17 months according to the National Bureau of Economic Research⁴. And the good news is rising markets have historically been more common and outperformed down times.

4. Will markets always recover from a downturn?

Unless you believe the whole economy will go into reverse and is never coming back, markets can be expected to recover in the future. To be certain, there are no guarantees with the markets. But, let's just say we believe in American ingenuity to create and build, which ultimately leads to growth.

2 Source: Ibbotson Associates, a subsidiary of Morningstar Inc. The numbers referenced reflect returns for the S&P 500, U.S. government bonds, and cash from 1926 through 2006. It's important to remember that investing in stocks, bonds, and even money market instruments involves risk. Markets are unpredictable and may or may not act in the future the way they have in the past, there are no crystal balls anyone has found yet. Investing over time does not assure a profit or guarantee against a loss.

3 Source: InvestmentView and Standard & Poor's (S&P), a division of The McGraw-Hill Companies, Inc. Ned Davis Research, Inc. has a similar study that shows every 20 year period is positive between 1926 and 2006. And yes again, do keep in mind past performance is no guarantee of future results.

4 US Business Cycle Expansions and Contractions available at <http://www.nber.org/cycles.html>

And while we're footnoting charts and the like that mostly discuss the stock markets and the risks involved, do keep in mind that investments in bonds are subject to interest rate, credit, and inflation risk. Diversification does not ensure a profit or protect against a loss in a declining market, but most experts agree, it sure does help.

Do these disclaimers have you scared yet? Don't be. Do some homework and build your plan so you are making the moves that put you in the best position to reach your goals.

401(k) plans are: Not FDIC insured • Not Bank guaranteed • May lose value

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