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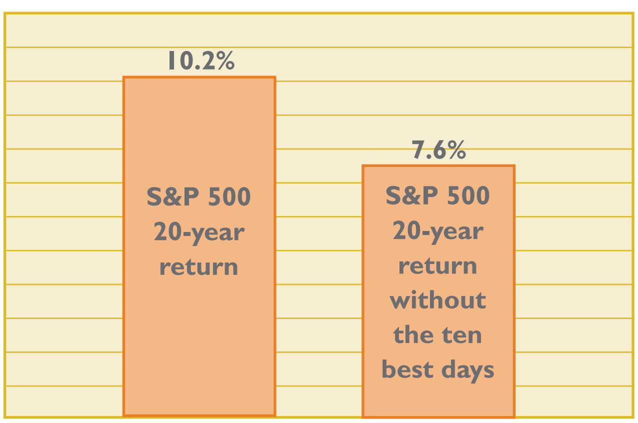
Uncertain Markets: Looking Long-Term

Headlines in financial news have been dramatic recently. Stories of struggling financial institutions and ongoing mortgage defaults are disheartening economic news. These events, combined with investor fears, have resulted in market volatility. For investors, these ups and downs in the market can be emotional events. When volatility hits, it is a good time to remember the reasons why long-term investing is a sound strategy, even when the market is down.

When markets struggle, it is tempting to desire drastic action. A natural reaction is to want to withdraw from risk. It is important to keep in mind, however, that market cycles are common. A long-term approach can help take advantage of long-term growth and mitigate the risk of short-term volatility. Drastic action can result in market timing and, ultimately, the possibility of costly mistakes. Take a look at the chart below.

What's going on?

After the housing bubble burst, ensuing mortgage defaults and dropping home values caused mortgage markets to suffer. The fallout from this, along with other factors, has impacted a number of financial institutions, which have been working hard to continue operating smoothly. The U.S. government has stepped in to help in some cases and private corporations are helping in others. By purchasing Fannie Mae and Freddie Mac, the government ensures that mortgages continue to be available and insured, providing some stability in the mortgage market. The U.S. Treasury has also made loans available to struggling institutions to make it possible for them to continue doing business while they restructure. There will likely be challenges as investors react to and the market absorbs these changes, but the ultimate goal is greater long-term stability.



Source: Bloomberg , S&P 500 returns Sept. 18, 1988 through Sept. 17, 2008, all returns expressed as total returns.

This chart is intended for illustrative purposes only; it is not intended as investment advice. Past performance is not a guarantee of future results.

If you missed only the ten best days of the stock market (as represented by the S&P 500 Index) in the last 20 years (as of September 17, 2008), your total return would be reduced from 10.2% to just 7.6%. Since there is no way to know when those days will occur, the most reliable way to capture the returns of those days is to stay invested in a diversified portfolio over the long term.

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Past Declines and Recoveries

History tends to provide us with perspective on taking a long-term approach. Extreme market swings are not strangers to the U.S. stock market, but identifying the bottom of a down market is as impossible as identifying the top of a market bubble. For this reason, staying fully invested in a diversified portfolio may be the best defense against uncertain markets.

The Case for Looking Long-Term

Market Downturns...	...and Market Recoveries
If you were invested in the S&P 500 Index between August and December 1987, you would have experienced a loss of 33%.	However, if you had remained invested until July 1990, you would have experienced 77% growth.
Between July and October 1990, there was a 19% drop in the S&P 500 Index.	But from then to July 1998, the S&P 500 Index rose 337%.
From March 2000 to October 2002, the S&P 500 Index dropped 46%.	But from then until July 2007, it experienced a total return of 113%.

Opportunity in Volatility

Keep in mind that a down market presents an opportunity as well; when investments are priced lower, investors are able to purchase a greater number of shares with the same contribution amount. This may increase the potential for taking advantage of long-term growth.

How to Help Prepare Your Portfolio for Uncertain Markets

Here are some of the ways to develop a strategy that can help defend against a volatile market.

1. Diversify your portfolio.

Diversification is one of the best defenses investors have against market volatility. When one investment is doing poorly, another may be performing better. In addition to being diversified between stable value, bonds, and stocks, diversifying across different types of stock funds, such as large company, mid-sized company, small company, and international stocks can add another layer of diversification to your portfolio.

2. Remember to rebalance.

During times of market volatility, portfolios tend to drift away from their original targets. Rebalancing is simply the process of adjusting a portfolio back to the target mix of investments — the percentage of the portfolio targeted to invest in stable value, bond, and stock investments.

3. Stick to a long-term strategy.

Your investment strategy should reflect your risk tolerance and time horizon so that you feel comfortable investing for the long term. While it's easy to become nervous during times of volatility, keep in mind the bigger picture. A long-term outlook, along with a strategy that is appropriate to your risk tolerance, will help keep you on track and avoid making costly, emotional investment decisions.