The 1973–1974 Bear Market: What Strategy Paid Off in the Long Run?

Investors today may be excused if they have fantasized about taking a trip on a time machine—so they could go back to the fall of 2007 and move their assets out of stocks and into cash, avoiding the ferocious bear market that followed.

But would that have been the best move for investors aiming to sustain a portfolio that could provide for decades of retirement income?

A new T. Rowe Price study indicates that permanently adopting a much more conservative portfolio *in advance* of the steep 1973–1974 bear market—the last big U.S. market downturn for which there is 30 years of subsequent history—would not have provided retirement investors comparative long-term protection.

That is, unless they had an equally fantastic forecasting machine to advise when to reenter stocks.

No two markets, bear or otherwise, are the same. In 1973–1974, investors in the S&P 500 Index lost almost 15% in the first year and then more than 26% in the second year. From the last market peak in the fall of 2007 through the market low on March 9 of this year, S&P 500 investors lost 57%.

Long-Term Success

The new study examined outcomes for two hypothetical investors: a 65 year old with $250,000, who retired at the start of 1973 and made withdrawals for 30 years, and a 45 year old with $75,000 at the start of 1973, who continued to invest for 20 more years and then retired and took withdrawals until the end of 2008.

For each investor, it compared the historical performance record for five asset allocation strategies: (1) the T. Rowe Price Asset Allocation Glide Path; (2) a more conservative glide path that has 10% less equities at retirement; (3) an even more conservative glide path that has 20% less equities at retirement; (4) an all-bonds portfolio; and (5) an all-cash portfolio. (Details on these portfolios are explained in the two charts.)

Comparing Strategies for the 1973–1974 Bear Market: The Retiree

The chart compares the historical performances for five portfolios for an investor who retired at 65 in 1973—at the start of a major bear market—with $250,000 in assets. She withdrew $10,000 the first year and increased the annual withdrawal by the inflation rate every year thereafter—over a 30-year retirement until 2003.

The "glide path" portfolio has a 55% allocation to equities at age 65 and declines gradually to 20% at age 95. The "less 10%" and "less 20%" portfolios have 45% and 35% allocations to equities at age 65, respectively, and decline gradually to 20% at ages 85 and 74, respectively.

Blue numbers represent the portfolio with the highest balance at that year; red numbers represent the portfolio with the lowest balance. Market indices used in this study are in the note below.

		Balance at Beginning of Year				
Year	Withdrawal	Glide Path	Less 10%	Less 20%	All Bonds	All Cash
1973	$10,000	$250,000	$250,000	$250,000	$250,000	$250,000
1974	10,880	222,744	228,192	233,688	252,336	**256,656**
1975	12,207	186,906	197,189	207,902	243,895	**265,463**
1980	18,060	253,816	256,199	258,074	266,056	**281,251**
1985	24,784	311,937	312,613	307,098	316,445	**330,120**
1988	27,156	**394,109**	388,063	371,177	391,875	312,040
1990	29,675	**437,912**	420,042	394,845	403,334	297,661
1995	35,228	**435,700**	413,962	379,497	418,493	193,659
2000	39,601	**497,093**	438,249	381,792	395,486	34,278
2001	40,943	**470,759**	412,043	353,689	378,947	0
2002	41,578	**438,713**	380,526	320,689	360,312	0
2003		**400,948**	343,287	282,684	347,612	0

Note: Each portfolio was selected without regard to past performance and is intended to illustrate the effect of alternative equity allocations on long-term performance during the time period chosen. The specific allocations of "less 10%" and "less 20%" were selected to allow for reduced equity exposure at the retirement date, while allowing the glide path to decline to 20% at age 85 and 74, respectively. The time period was selected because 1973–1974 represented the start of a bear market, and there is 30 years of historical performance available to complete the illustration of an investor's anticipated retirement period.

Withdrawals and contributions occur at the start of each year; amounts are adjusted by actual inflation after the initial year. Portfolios are rebalanced monthly. Indices used to replicate the three glide paths' historical performances are: Ibbotson Associates 30-Day Treasury Bill Total Return; Ibbotson U.S. Aggregate Bond Total Return (1973–1975) and Barclays Capital U.S. Aggregate Bond Total Return (1976–2008); World ex U.S. Bond Total Return (1973–1987) and Barclays Capital Global Bond Majors ex U.S. Total Return USD (1987–2008); S&P 500 Total Return; Ibbotson U.S. Small Stock Total Return (1973–1978); and Russell 2000 U.S. Small Stock Total Return. It is not possible to invest directly in these indices.

Source: T. Rowe Price.

The study found:

- While some may insist that an all-cash, all-bonds, or more conservative equity allocation would be better for a retiree than a higher equity allocation, those approaches did not prevail over the long term. In this study, such portfolios did not turn out to be superior to the most equity-rich portfolio—the glide path. And the most conservative portfolio, the all-cash portfolio, ran out of money prematurely for both of these investors.
- Long-term investing demands patience. "For the retiree, the strategy that looked superior in the first years after the 1973–1974 bear market—or even in the first 10 years—not only ended up being the worst but actually ran out of money," says Stuart Ritter, a T. Rowe Price financial planner. (See chart on page 16.)
- Investors who stick with a very conservative strategy to avoid all bear markets may fall behind because they don't participate in bull markets—which historically have tended to be more frequent and have a longer duration than bear markets. "Participating in bulls over the long run beats avoiding bears," Mr. Ritter says.
- Investors with higher equity allocations likely will lose more during bear markets, but they may have accumulated greater assets because of prior bull markets. In this study, the 45 year old with the T. Rowe Price glide path lost more than the other portfolios in the 1973–1974 and 2007–2008 bear markets but still ended up with far greater assets at the end of 2008 because of bull market gains in other years.

"Without adequate equity exposure, retirees are not likely to keep up with the strain on their portfolios from inflation and their increasing withdrawals," Mr. Ritter says.

The Retiree

That much is clear in the case of the 65 year old who retired in 1973.

While her cash portfolio protected her from the 1973–1974 bear market in the short run and maintained the highest balance among all five portfolios until 1985, it ran out of money in 2000—three years short of a 30-year retirement. (See chart on page 16.)

The portfolios with less equity exposure than the T. Rowe Price glide path did not provide much more protection from the long-term impact of the bear market. By 1985, in fact, the portfolio with 20% less equity exposure had the lowest balance among the five portfolios.

At the same time, patience

Continued on page 18

Comparing Strategies for the 1973–1974 Bear Market: The Saver

The chart compares the historical performances for five portfolios for a 45-year-old investor who had $75,000 in assets at the beginning of 1973 and who contributed an additional $5,000 the first year and increased that amount by inflation every year through 1992, when she retired at age 65. Then, in 1993, she began to withdraw an amount equivalent to 4% of the assets accumulated in the "glide path" portfolio and increased the annual withdrawal by the inflation rate every year through 2008.

Details of the portfolios and indices and assumptions are the same as noted in the chart on page 16. In this example, the "glide path" portfolio starts out with 85% in equities at age 45 and gradually reduces that to 34% by age 81 at the start of 2009. The "less 10%" portfolio starts with an 81% allocation to equities at age 45 and ends up at 24% at age 81. The "less 20%" portfolio starts at 79% in equities at age 45 and is at 20% at age 81.

Blue numbers represent the portfolio with the highest balance at that year; red numbers represent the portfolio with the lowest balance. See note at end of chart on page 16.

				Balance at Beginning of Year				
Year	Age	Contribution	Withdrawal	Glide Path	Less 10%	Less 20%	All Bonds	All Cash
1973	45	$5,000		$75,000	$75,000	$75,000	$75,000	$75,000
1974	46	5,440		68,760	69,488	69,872	84,112	**85,552**
1975	47	6,104		59,286	60,782	61,560	90,456	**98,280**
1980	52	9,030		**184,848**	182,299	180,778	169,025	178,861
1985	57	12,392		**422,265**	417,379	414,641	380,605	373,581
1990	62	14,838		**1,102,076**	1,052,575	1,018,305	792,102	600,051
1992	64	16,226		**1,359,014**	1,314,206	1,284,090	1,057,923	716,856
1993	65		$58,448	**1,461,193**	1,418,241	1,390,168	1,166,956	758,739
1995	67		61,532	**1,536,086**	1,476,447	1,434,089	1,156,941	686,421
2000	72		69,745	**2,550,630**	2,271,602	2,045,396	1,316,996	507,306
2005	77		78,892	**2,613,994**	2,382,209	2,199,752	1,452,340	195,262
2006	78		80,896	**2,624,338**	2,372,648	2,176,851	1,391,028	119,838
2007	79		84,196	**2,798,550**	2,494,801	2,265,937	1,389,265	40,816
2008	80		84,272	**2,868,800**	2,550,902	2,309,373	1,388,462	0
2009	81			**2,377,152**	2,203,688	2,027,512	1,291,801	0

Source: T. Rowe Price.

Continued from page 17

definitely was in order for the glide path, the most equity-rich portfolio. It was not until 1988—15 years after her retirement—that this portfolio produced the highest balance.

But by 2003, the glide path had the highest balance by a significant margin.

The Saver

Sticking with the glide-path strategy also paid off—and more quickly—for the 45-year-old investor who still had 20 years of accumulation ahead of her when the 1973–1974 bear market hit. (See chart on page 17.)

By 1980, the glide-path portfolio had the highest balance and the all-bonds portfolio had the lowest.

By the end of the study at the start of 2009, the glide path ended up with almost twice as much money as the all-bonds portfolio, more than $170,000 more than the strategy with "less 10%" in equities, and about $350,000 more than the portfolio with "less 20%" in equities.

Meanwhile, the all-cash portfolio, which shielded the investor so well from the bear market—it had close to the highest balance until 1978—eventually succumbed to lack of growth. It ran out of money in 2007, just 14 years into retirement.

"While even the most conservative investors would not likely remain all in cash or bonds forever, this study shows big differences in final balances among the strategies—and these represent very real differences in lifestyles, the ability to take a cruise, help the grandchildren through college, or pay for an unexpected medical expense," Mr. Ritter says.

"For investors who endured the 1973–1974 bear market, greater equity exposure paid off in the long run. But they had to have the fortitude and discipline to stick with the strategy through some turbulent times."

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