How to Save for College in a Volatile Market With Rising Inflation

T. Rowe Price financial planners provide perspective for investors in 529 savings plans.

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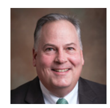

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KEY INSIGHTS

- Understandably, investors in 529 savings accounts are anxious during times of market volatility and high inflation.
- Making drastic shifts in your investment strategy could be detrimental in the long run.
- Enrollment-based portfolios are managed to become more conservative over time.

Volatile financial markets paired with rising inflation can be stressful, and they can feel especially unsettling to parents who are seeing the balances in their 529 college savings plan accounts decline. According to the Bureau of Labor Statistics, inflation reached a high point from June 2021 to June 2022 at 9.1%, but college tuition and fees have stayed about the same since September 2019. T. Rowe Price's Judith Ward and Roger Young, CERTIFIED FINANCIAL PLANNER™ professionals, discuss their perspectives on college savings—not only as planners, but also as parents.

Most 529 savings plans are broadly diversified, and the typical enrollment-based portfolio is managed to become more conservative as a child approaches college age. But these features have not spared the portfolios from the impact of the market downturn in 2022. With most major asset classes being battered, even more conservative, bond-heavy portfolios have been affected.

The temptation in challenging circumstances is to change your strategy in the belief that doing so will secure the financing of your child's education. Ward and Young understand that impulse, especially Young, who has a child in college. But he also understands the risks. "While this market may be driving you emotionally to pull everything out or make dramatic changes to your strategy, it's better to stick to your plan," says Young.

Furthermore, Young says, "For most people with kids not yet in college, typical recovery time for an age-based portfolio is generally within your time horizon through college graduation."

The Risks of Dropping Out

In a troubling market environment, you may feel pressure to take all of your assets out of your 529 account, but pulling out of a 529 plan can be a

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particularly damaging move. Investors in a 529 plan can get significant tax benefits that they could lose altogether. And because of those potential benefits, the Internal Revenue Service has rules about taking a distribution from a 529 plan. In most cases, if you withdraw money from the account for anything except education expenses, you must pay a 10% penalty on any earnings, along with any applicable income taxes.

In many 529 plans, it's also possible to move assets to a portfolio dominated by cash or short-term bonds. This option may seem appealing in the midst of market turmoil, but it also has risks for parents who still have many years until college expenses come due. Pulling out of equity markets when they are at a low point effectively locks in your losses while preventing you from benefiting from any future upswings in the market that can help you recover previous losses. As Ward explains, this is especially true in the early days of a market recovery.

"In environments like this," she explains, "we typically can anticipate significant market gains on the heels of the downturn, but it is almost impossible to predict when that will happen. Missing the upturn can seriously limit your ability to recover." In addition, inflation tends to cut into the purchasing power of your savings. Fortunately, there are ways to help preserve it. Returns on stock investments generally tend to beat inflation rates over the long term, so it's important to have an appropriate balance of equities in your portfolio.

History Class

Market upswings are as unpredictable as declines, and history has shown that a significant amount of the long-term return available from investing in stocks comes immediately after a significant decline. The graph on the next page shows that, after market corrections (defined as a drop of at least 10%), the stock market typically recovered in three to six months. For two of the three bear markets (defined as a decline of at least 20%), stocks were back to their prior levels within four to five years. In 2020, the pandemic shock occurred over a shorter time period, and stocks returned to prior levels within five months.

Trying to time the market can result in two types of losses. First, converting stocks to cash after they have lost value can lock in those losses. Second, if you wait too long to get back in to the market, you could miss out on potential gains when the market rallies.

Though not all recoveries have been the same, the broad historical pattern has been clear: Investors who maintained their exposure to stocks during a market downturn tended to get better results once the market recovered.

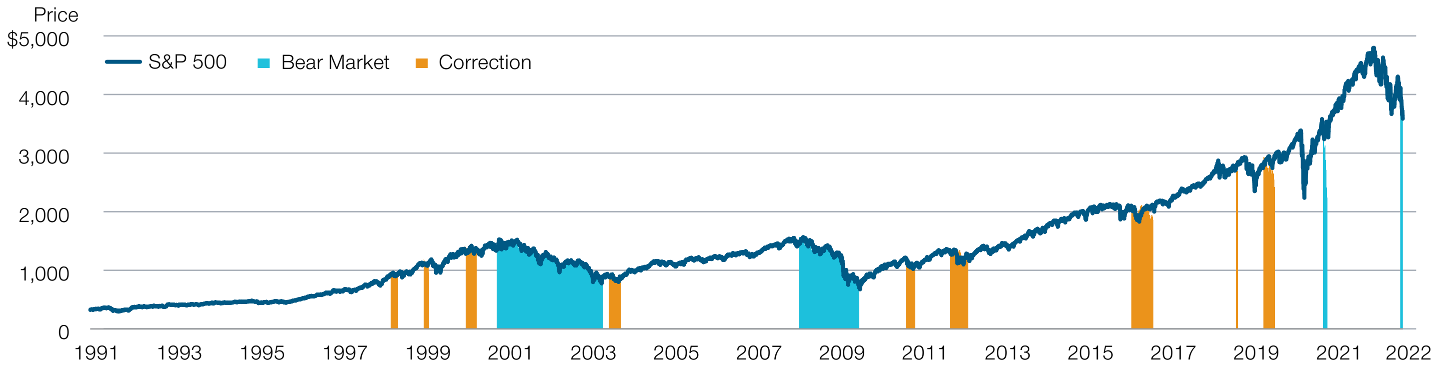
Dealing With Near-Term Tuition Bills

The circumstances may be a bit different if your child will be attending school in the next couple of years. Even though some portfolios are designed to become more conservative as time passes, you will still have some equity exposure along with holdings in bonds. What's the right approach if the tuition bill is coming soon?

One option, says Ward, is to direct new contributions to the most conservative portfolio so that you have choices when it is time to pay tuition.

Another option is to shift money needed for imminent college bills to a more conservative portfolio within the 529 lineup—one dominated by cash or short-term bonds—to help guard against further declines. Of course, most enrollment-based portfolios are designed to shift asset allocations to more conservative investments as the child nears college age. Keep in mind, the rules of 529 plans allow only two investment changes for a particular beneficiary during a calendar year.

(Fig. 1) Bear Markets and Corrections, January 1991–September 2022



Event	Date	Duration	% Drop	Recovery	% Cumulative Gain After Trough: 1 Year	3 Years	5 Years
Tech Bubble Crash	4/7/00–10/9/02	2.5 years	-48.77	5 years	33.73	52.86	101.50
Pre-Iraq War	11/27/02–3/11/03	3.5 months	-14.71	2.5 months	38.22	60.37	64.93
Global Financial Crisis	10/9/07–3/5/09	1.5 years	-56.39	4 years	66.83	99.89	174.53
Greek Debt Crisis/Flash Crash	4/15/10–7/2/10	2.5 months	-15.61	4 months	30.83	57.84	103.09
Debt Ceiling Debate/S&P Downgrade	4/29/11–10/3/11	5 months	-19.39	3 months	32.00	79.03	96.61
Post QE/China Growth Slowdown	8/10/15–2/11/16	6 months	-13.07	4 months	27.29	48.15	114.12
Jan/Feb 2018 Correction	1/26/18–2/8/18	0.5 months	-10.16	6.5 months	4.92	51.71	N/A
Q4 2018 Sell-Off	9/20/18–12/24/18	2 months	-19.78	4 months	37.10	101.00	N/A
Coronavirus Shock	2/19/20–3/23/20	1 month	-33.93	5 months	74.78	N/A	N/A
Ukraine Crisis	1/3/22–9/30/22	9 months	-25.25	N/A	N/A	N/A	N/A

Past performance cannot guarantee future results.
Drop is based on the percentage drop from the highest market index value just prior to the correction to the lowest market index value. Recovery is defined as the length of time for the market to return to the previous highest market index value, rounded to the nearest number of months.

This chart is for illustrative purposes only and does not predict or project the performance of any specific security. Investors cannot invest directly in an index. All investments involve risk, including possible loss of principal.

Sources: T. Rowe Price and S&P.

Stay on Track

While the cause of the current economic and market backdrop is unique, there have been a few historical precedents. A good way to help get your college funding back on track is to prepare properly for the market's recovery. It's worth remembering why your enrollment-based portfolio has stock exposure in the first place—because over the long term, stocks historically have outperformed every other asset class and given investors the best opportunity to grow their assets faster than increases in tuition and other college-related expenses.

Keep in mind, if general inflation has affected how much you're currently able to contribute to your child's 529 account, consider asking your relatives to contribute as a birthday, graduation, or holiday gift. The **GoTuition®** gifting portal is an online tool that makes it easy to ask friends and family to contribute to a child's 529 plan. Learn more or open an account today by visiting troweprice.com/college.

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Be sure to review any 529 college savings plan offered by your home state or your beneficiary's home state, as there may be state tax or other state benefits, such as financial aid, scholarship funds, and protection from creditors that are only available for investments in such state's plan. Please note that the plan's disclosure document includes investment objectives, risks, fees, charges and expenses, and other information that you should read and consider carefully before investing.

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