T. Rowe Price

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PHOTOGRAPH BY VALERIE LOISELEUX

KEY POINTS

- Markets may reward investors who take a long-term view.
- The longer your time horizon, the more prominent role stocks should play.
- Diversifying your portfolio can help you manage market uncertainty.

How to Respond to Volatile Markets

T. Rowe Price recommends not getting distracted from your long-term strategy.

Although market fluctuations may be unsettling, we recommend not letting short-term price swings distract from your long-term strategy.

While the temptation to shift course in the midst of market volatility is common, a better strategy may be to do the opposite. As long as your asset mix accurately reflects your financial goals, time horizon, and risk tolerance, sticking to

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your investment plan could prove rewarding over time. And, in fact, decreasing your equity allocation for fear of losing money could put you at greater risk of running out of money in retirement.

Focus on the long term

The short-term factors affecting stock prices can be difficult to determine. Over the long term, however, stock investing has provided a way for individuals to share in the growth of the world economy. Consider the returns of a hypothetical $100,000 investment in the Bloomberg Barclays U.S. Aggregate Bond Index versus the S&P 500 Index over that same 25-year time frame. If the assets had been invested in an all-bond portfolio, the value would have grown to about $379,510. If it had been in all stocks, on the other hand, the account would be worth around $1,009,880—substantially more than the all-bond portfolio.

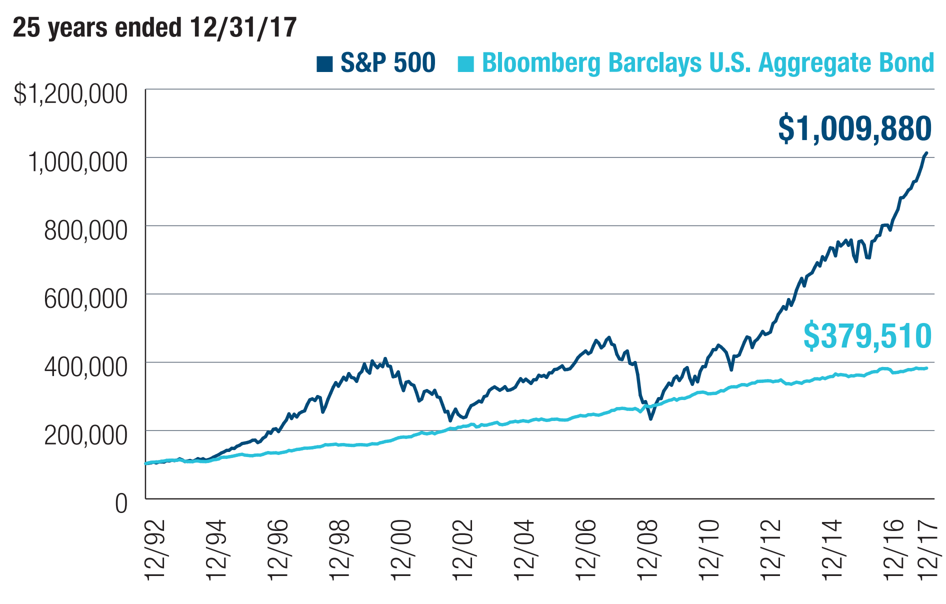
Let history be your guide

To better understand how stocks have performed over longer time periods, consider historical performance. *Past performance cannot guarantee future results;* however, if we examine the S&P 500 Index from the beginning of 1926 to December 31, 2017:

Tracking the Growth of $100,000

As of December 31, 2017

While stocks are more volatile than bonds, over the long term, stocks have offered a substantially higher return than bonds.



The chart shows an investment of $100,000 from 12/31/92 through 12/31/17. Stocks are represented by the S&P 500 Index, and bonds are represented by the Bloomberg Barclays U.S. Aggregate Bond Index. This example is for illustrative purposes only. It is not possible to invest directly in an index. *Past performance cannot guarantee future results.*

- There have been 83 rolling 10-year periods since 1926. The S&P 500 produced gains in 79 of them and losses in four—meaning the market increased in 95% of 10-year time frames.
- Stocks produced positive returns in every rolling 15-calendar year period since 1926.
- During the 63 rolling 30-year periods since 1926, the stock market's **worst** performance was an annualized return of 8.5%.

These historical returns illustrate how stocks have shown resilience and growth potential over the long term. That said, there also are important reasons to hold bonds.

If you have short- or intermediate-term goals, you can help address the risk of near-term stock market losses by having bonds in your portfolio. Bonds typically offer greater return potential than cash and greater stability than stocks, which is important for investors with nearer-term financial goals.

Build your portfolio

Your allocation should reflect your investment horizon—the time remaining until you begin to withdraw the money and the amount of time it will take to spend it—as well as your risk tolerance. The appropriate allocation for your portfolio can help maximize your growth potential without exposing you to inappropriate levels of market risk for your time horizon. In general, the longer your time horizon, the more you should hold in stock funds or other growth-oriented investments. An investor who can wait 15 years or longer to begin drawing on his or her investments might consider pursuing growth through a portfolio of mostly stocks. On the other hand, an investor who plans to start drawing on his or her investments within 10 years might consider a portfolio of 60% stocks, 30% bonds, and 10% short-term investments (such as cash or a money market investment).

Once you have chosen an appropriate asset allocation that seeks to balance growth potential and market risk, you can take steps to help manage business and sector risk. Business risk refers to the possibility that a particular company will encounter difficulties, leading to a stock price decline. Sector risk is the chance that negative factors could affect a particular industry or segment of the financial markets.

Business and sector risk can take many forms. Politics, economics, and even the weather can influence the day-to-day performance of an individual company or an entire sector. (For example, the decline in oil prices has had a major impact on energy-related stocks.) You can help reduce these risks without giving up the potential for solid returns by not only spreading your investments among different market sectors, but also diversifying among a variety of stocks within those sectors. That way, your overall returns aren't heavily dependent on any single stock, industry, or sector. In the stock market, you want to diversify between domestic and international stocks. You also want to diversify your bond exposure between international and domestic securities—and bonds with different credit qualities and maturities. Diversification cannot assure a profit or protect against loss in a declining market.

Whether you are developing your first investment plan or reviewing an existing one, avoid the temptation to time the market—making a decision to buy, hold off on buying, or sell—based on recent market performance. History shows that attempting to do so can undermine an otherwise sound investment strategy. Research firm Dalbar, Inc., has found that equity fund investors' average returns consistently lag the market by wide margins, largely because investors tend to enter and exit the market at the wrong times. It's very difficult to time the market because the market's behavior is far too complex for anyone to anticipate. Investors may get out of the market thinking they'll avoid a downturn, but instead end up missing gains.

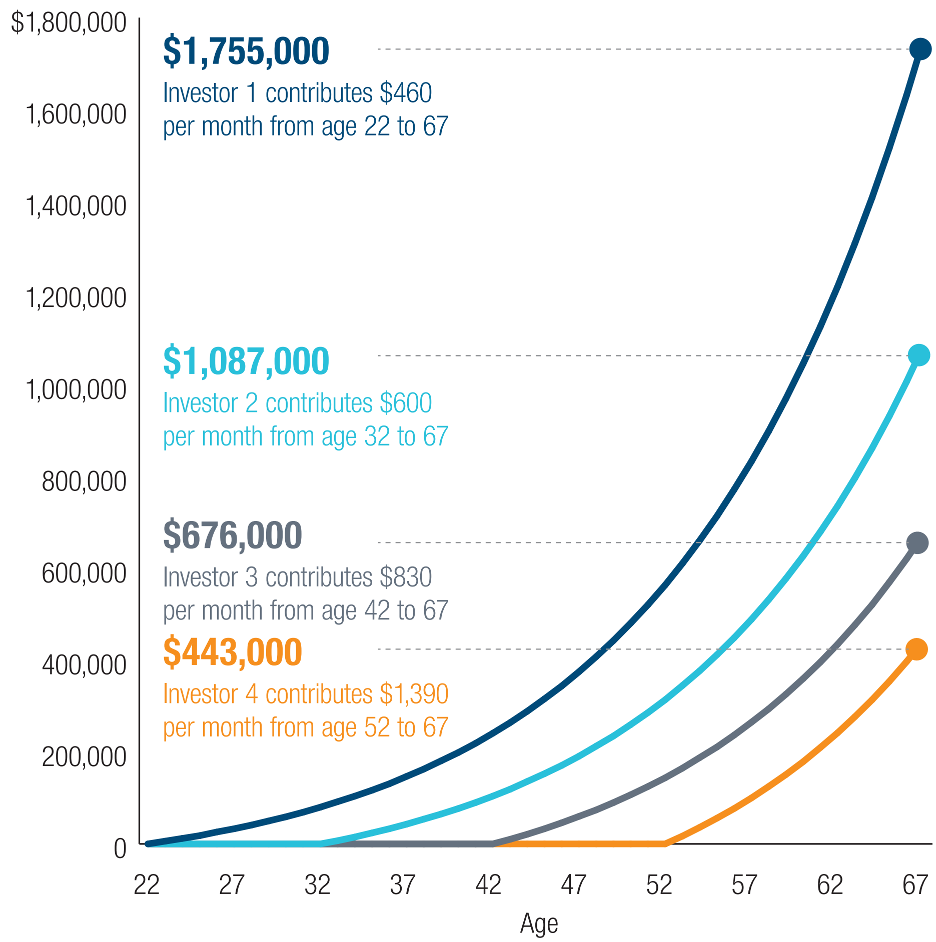
Market rallies can happen quickly. If you choose to sell equity holdings following a decline, you risk missing out on the potential for a powerful initial surge. Moreover, if you pull out of the market and happen to miss some of its best days, you may miss out on the recovery altogether.

Adhere to a plan

When managing your investments, look beyond the volatility of the moment and focus instead on adhering to your strategy. Continue to save and invest, and maintain an investment mix that is appropriate for your time horizon. These are the variables you can control—and they are the most likely to determine whether you succeed at reaching your investment goals. ■

Time: An Investor's Greatest Resource

With consistency, even modest investments can grow significantly over time. Four individuals start investing at different ages, and they each set aside a total of $250,000 in tax-deferred accounts over the course of their careers. The potential for greater compounding over time means Investor 1 could contribute only a third of what Investor 4 does every month and yet have four times as much in savings by age 67.



Assumes 7% annual return in a tax-deferred account. Investment returns are not guaranteed. This chart is for illustrative purposes only and does not represent the performance of any specific security. Withdrawals from tax-deferred accounts are subject to federal and possibly state income taxes.

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