The Case for Staying Invested Through Volatile Markets

Shifting investment strategies during a market downturn may be counterproductive.

Market losses can be disconcerting, and a bout of nerves now and then is inevitable—and even reasonable during these uncertain times. However, is exiting a turbulent market the best move?

“Attempting to time the market and avoid a downturn by making dramatic changes to your portfolio can cause harm to your long-term investment results,” says Roger Young, CFP®, a senior financial planner with T. Rowe Price. “This is because you have to accurately make two decisions that are likely to trip you up: when to get out of stocks and when to get back in.”

GETTING OUT: Even a well-timed Exit Doesn’t Guarantee Strong Results

The example of the last bear market is instructive. (A bear market is a decline of 20% or more in major stock indexes.) The market downturn that began in late 2007 and lasted until early 2009 was one of the worst in history, with the broad Standard & Poor’s 500 Index falling nearly 57% before it started to recover. It took over five years for the index to regain its October 2007 peak. (See “Recovery From Bear Markets.”) Surely investors who saw it coming and got out of the way did much better than those who kept funneling money into stocks.

It may not be that simple. T. Rowe Price compared two hypothetical investors: a balanced investor and a bond investor. The bond investor saw the crash coming with remarkable accuracy. Therefore, in September 2007, that investor switched an existing retirement portfolio and $500 monthly contribution entirely to bonds (and never got back into stocks). The balanced investor did not attempt to time the market and kept investing in a balanced portfolio of 60% stocks and 40% bonds. Both investors started the period with a portfolio worth $100,000.
Rather than trying to time the markets, it’s important for investors to remain focused on their long-term goals and create appropriate asset allocation strategies to achieve them.

The chart, “Different Investment Approaches,” shows that the bond investor who pulled out of stocks just before the crash did indeed fare much better—for a while. But the balanced investor benefited from the stock market recovery over the full 10-year period. In addition to the eventual growth of the initial portfolio, this investor had another key advantage: ongoing contributions when stock prices were very low in the few years following the global financial crisis.

The bond investor made a reasonable decision to “get out” in terms of the initial portfolio, but getting out of stocks for subsequent investments proved disadvantageous. And the bond investor also missed an opportunity on another decision—when to get back in.

(Fig. 1) Recovery from Bear Markets
Equity markets historically have delivered large returns in the years immediately after a bear market, with the potential to deliver double-digit average annual gains for several years. These are the average annual returns of the S&P 500 Index after declines of 20% or more (12/31/61–12/31/19).

<table>
<thead>
<tr>
<th>Market Bottom</th>
<th>Average Return After Bear Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 1962</td>
<td>1 Year Later: 38.4%</td>
</tr>
<tr>
<td>June 1970</td>
<td>3 Years Later: 19.7%</td>
</tr>
<tr>
<td>September 1974</td>
<td>5 Years Later: 17.6%</td>
</tr>
<tr>
<td>July 1982</td>
<td>10 Years Later: 13.6%</td>
</tr>
</tbody>
</table>

GETTING BACK IN: You’re Likely to Miss Much of The Recovery
Of course, some investors might be tempted to think that they will know when the downturn is over and it’s safe to get back into the market. But the duration and magnitude of bear markets have varied considerably, making it impossible to rely on guidelines such as “I’ll start investing in stocks again in a year” or “I’ll get back in after the market has fallen 25%.” Moreover, it is typically in the early stage of a recovery where the markets post particularly large gains. “Since the bottom of the market is very hard to identify at the time, investors who panic during a downturn often miss gains early in the recovery,” says Young.
Factors you can control—how much you save and how your investments are allocated—are most likely to determine how successfully you reach your investment goals.

— Roger Young, CFP®
Senior Financial Planner

(Fig. 2) Different Investment Approaches

Two hypothetical investors entered the recession that began in September 2007 with account balances of $100,000.

The bond investor predicted the coming crash and switched an entire portfolio and monthly $500 contributions to bonds (for the full investment period). The balanced investor, however, remained invested in a balanced portfolio of 60% stocks and 40% bonds, allocating monthly $500 contributions accordingly. From September 2007 to present (12/31/19), the balanced investor fared better than the bond investor.

Sources: Bloomberg Barclays and Standard & Poor’s; data analysis by T. Rowe Price. Stocks are represented by returns of the S&P 500 Index and bonds by returns of the Bloomberg Barclays U.S. Aggregate Bond Index.

Finally, it’s worth keeping in mind that corporate profit growth and stock prices often react to myriad forces, including economic factors such as interest rates and currency movements, political dynamics such as regulatory and tax changes, and the often vexing changes in overall investor sentiment. Stocks have often risen in times of war and economic turmoil, while they have declined in periods of peace and prosperity. For this reason, many seasoned investment professionals have thrown up their hands at predicting where stocks are headed over the short term.

Keep in mind that past performance cannot guarantee future results. But these historical returns show that stocks have proven resilient in the past and have generated positive returns over the long term.

Considering Your Asset Allocation Strategy

Rather than trying to time the markets, it’s important for investors to remain focused on their long-term goals and create appropriate asset allocation strategies to achieve them. The strategy you choose should be based in part on your tolerance for risk, as any strategy can be effective only if you can remain committed to it—even during challenging market periods. Time horizon is another essential consideration when establishing your asset allocation because short-term market risk becomes less of a factor the longer you hold an investment.

Identifying the appropriate allocation for your portfolio can help provide the growth potential to achieve your goals at a level of risk that’s comfortable. “Factors you can
control—how much you save and how your investments are allocated—are most likely to determine how successfully you reach your investment goals,” Young says.

In general, the longer your time horizon, the more of your portfolio you should hold in stocks. Historically, equities have offered the highest returns of any major asset class while also being more volatile than other types of financial assets. The reason: You’ll have enough time to recover from the short-term losses that result when the stock market dips. A portfolio that holds stocks and bonds can reduce volatility while preserving return potential. (See “Risk Versus Return.”)

(Fig. 3) Risk Versus Return
Over the past 30 years, a diversified portfolio would have offered 82% of the return of an all-equity portfolio (large-cap stocks) with about 64% of the volatility.

(Source: Zephyr StyleADVISOR; data analysis by T. Rowe Price. The equity portion of the diversified portfolio includes 36% large-cap stocks, 12% mid- and small-cap stocks, and 12% international stocks; the bond portion includes 21% investment-grade bonds, 10% short-term bonds, 6% high yield bonds, and 3% international bonds. The historical performance is based on the following indexes to represent these asset classes: Bloomberg Barclays U.S. Aggregate Bond Index—investment-grade corporate and government bonds; Bloomberg Barclays 1–3 Year U.S. Gov’t/Credit Bond Index—measures the performance of investment-grade corporate debt and sovereign, supranational, local authority, and non-U.S. agency bonds that are U.S. dollar denominated; Bloomberg Barclays U.S. High Yield Bond Index—total return performance benchmark for fixed income securities having a maximum quality rating of Ba1 (as determined by Moody’s Investors Service); Citi World Global Bond Index non-U.S.—market capitalization-weighted index consisting of the government bond markets: S&P 500 Index—500 large-cap U.S. stocks; Russell 2500 Index—measures the performance of the small- to mid-cap segment of the U.S. equity universe; and MSCI EAFE Index—the stocks of about 1,000 companies in Europe, Australasia, and the Far East. Allocations are considered static and are rebalanced monthly. The time period chosen is based on the availability of the indexes. Diversification cannot assure a profit or protect against loss in a declining market. Volatility is measured by standard deviation, which is the variation of returns for each asset class.

Looking Beyond The Short Term
While it may be tempting to make changes to your investment strategy when markets are volatile, doing so may be harmful in the long run. Emotional responses to market conditions can lead you astray. Instead, focus on how much you save and keep a long-term perspective on your investments.
**Additional Disclosures**

MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed, or produced by MSCI.

Frank Russell Company (Russell) is the source and owner of the Russell index data contained or reflected in these materials and all trademarks and copyrights related thereto. Russell® is a registered trademark of Russell. Russell is not responsible for the formatting or configuration of these materials or for any inaccuracy in T. Rowe Price Associates’ presentation thereof.

Source for Bloomberg Barclays index data: Bloomberg Index Services Ltd. Copyright © 2020, Bloomberg Index Services Ltd. Used with permission.

**Important Information**

Stock prices can fall because of weakness in the broad market, a particular industry, or specific holdings. Fixed-income securities are subject to credit risk, liquidity risk, call risk, and interest-rate risk. As interest rates rise, bond prices generally fall.

This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular investment action. The views contained herein are those of the author as of February 2020 and are subject to change without notice; these views may differ from those of other T. Rowe Price associates.

This information is not intended to reflect a current or past recommendation, investment advice of any kind, or a solicitation of an offer to buy or sell any securities or investment services. The opinions and commentary provided do not take into account the investment objectives or financial situation of any particular investor or class of investor. Investors will need to consider their own circumstances before making an investment decision.

Information contained herein is based upon sources we consider to be reliable; we do not, however, guarantee its accuracy. Index returns include reinvestment of dividends and capital gains. Investment fees and account expenses are not included. Investors cannot invest directly in an index.

**Past performance cannot guarantee future results.** All investments are subject to market risk, including the possible loss of principal. Diversification cannot assure a profit or protect against loss in a declining market. All charts and tables are shown for illustrative purposes only.
T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

To learn more, please visit troweprice.com.