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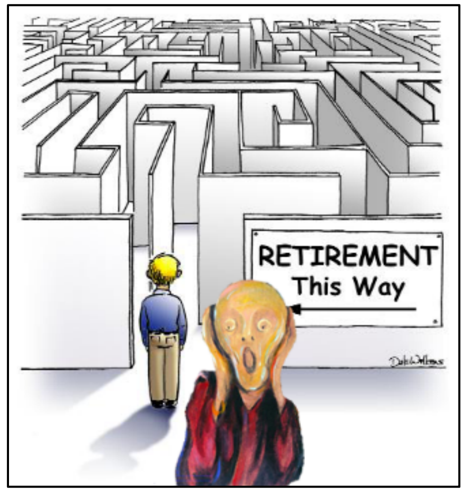
Buy? Sell? Panic? Navigating a manic market

Navigating the Retirement Maze



"October. This is one of the peculiarly dangerous months in which to speculate in stocks. The others are July, January, September, April, November, May, March, June, December, August, and February."

– *Mark Twain (1835 – 1910)*

The persistent gyrations of the stock market the past several months probably have you reaching for the Dramamine. You listen to a parade of talking heads giving you their prognostications about where they think the market is headed, and read articles that talk about half a dozen factors contributing to the present market turmoil. So you begin to wonder whether this six-year bull market that finally gave you back everything that it took away in 2008-09 is going to once again disappoint. Your true love – a climbing stock market that has been taking you towards retirement nirvana – might once again break your heart with a … gasp! … correction.

Lately, the S&P 500 is behaving like an EKG of investor emotions, and it seems to be indicating that the patient might be approaching cardiac arrest. My treatment for this particular condition? Turn off CNBC, make a hot cup of tea, breathe deeply, and follow me as I lay out a game plan to alleviate your market angst.

It's all about your time frame

Think about the lifetime of your entire investing career, from that first deposit you made into a 401(k) plan, to your final retirement withdrawal. From that perspective, several months represents only a tiny sliver of it. If you still have another 20-plus years before needing to tap your retirement savings, just let it ride. The currently misbehaving market that is upsetting you today will look like a tiny blip years from now. Corrections happen. The stock market doesn't just go straight up. It meanders up and down as it grows over the years. That 9.7 percent average annual growth rate the S&P 500 has experienced the past 84 years – the one that turned a single dollar into $2,900 during that time – has had a few significant losses along the way before recovering and resuming it's upward long term trend. If you have a long enough time horizon, let the market do its thing.

On the other hand, if you will need to tap some of your portfolio over the next five years – retirement income, a new house, college tuition – that portion should be parked in investments that have limited downside. The S&P 500 index has only had three down years in a row twice over the past 86 years – the last time was 1939-1941 – but it can take many more years to fully recover from market corrections. To ensure that you're not selling market positions at a loss to raise cash to spend, keep those funds in money market or near equivalents like short term investment grade bonds. Leave most of the rest in stocks.

US forecast: Tepid at best

I don't want to upset all those Jeremy Siegel "Stocks for the Long Run" fans out there, but if you're expecting the US markets to continue cranking out 10 percent annual returns any time soon, prepare to be disappointed. Research Affiliates, an investment management firm, recently took seven commonly used methodologies for measuring market valuation and forecasts to predict what returns over the next decade might look like. Their conclusion? The results showed real (after inflation) market growth of between 0.5 and 3.5 percent per year, compared to the past century's average of 7 percent per year. (Note: 7 percent compounded over a decade would double your money, whereas 0.5 and 3.5 percent produce gains of 5 and 41 percent, respectively.)

So why the discrepancy? Well, if you take a look back to 1982, the 18-year bull market that followed produced an almost 20-times gain in the S&P 500, or 17 percent per year compounded. This level of stock price growth isn't sustainable long term. As a result, on average we've been in a sideways market for the past fifteen years, and could continue for ten more.

Prescription: Diversify

One of the known behavioral tendencies of investors is called "home bias," where the majority of one's investments are in their home country. The US market makes up about half of the combined global markets, yet according to the National Bureau of Economic Research, the portfolio of the typical US investor has 90 percent of their portfolio invested in domestic companies.

So be a tiger, not a sheep. I'm not referring to tenacity here, but rather the ability to break from the herd and behave differently than everyone else. Have a significant percentage of your portfolio outside of the US market, say around 30 to 40 percent. Also, consider including other investments that aren't highly correlated to the US indices, such as real estate, timber and commodities. (The latter two are currently in a slump, so it is a classic "buy low, sell high" scenario today.)

Finally, set your expectations accordingly. While we can't go back to the "roaring '80s and '90s," there is still significant upside left in the markets if you spread around your investment bets, and manage your spending based on hitting singles the next ten years. Though not as impressive as home runs, that's how you'll win the retirement game.

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