FPA FINANCIAL PLANNING PERSPECTIVES

Market Volatility Shouldn't Rattle a Good Financial Plan

On February 27, 2007, the Dow Jones Industrial Average slid 416 points, the biggest drop since the market reopened after the 9/11 attacks. By early May, the market had more than made up those losses and stood at record highs.

How did you react? Did you turn off the news? Did you call your broker in a panic? Or did you call your financial planner to see if your plan was solid?

It's easy to succumb to the urge to sell if the market takes a header or buy if it's headed upwards. But sudden action is usually a mistake. In the late 1980s, Harvard psychologist Paul Andreassen made news with a research project that found that people who listened to market news actually made lower returns. Why? Because those who sold – or bought – during a market swing probably found a day later that the market was really running on hype, not fundamentals.

You pay a financial planner to devise a financial strategy that matches your risk tolerance and long-term financial goals. No, there is absolutely no way to guarantee that you'll never lose money. But if a plan truly matches you, the noise level on TV shouldn't make a difference. So the next time the Dow spikes or slides, ask yourself:

What's my plan? If you've worked with a good financial planner, you should be able to articulate those goals all by yourself or refer to an investment policy statement you made together. Much of the riskiest investing, overbuying and panic selling during the late 1990s and early 2000s could have been avoided if individual investors had sought advice for achieving *long-term* specific goals such as retirement or a college education.

What's my risk tolerance? At your first meeting with a planner, you should have discussed – and later filled out – a form asking you a number of questions about how you handle risk and what your expectations were about investment returns. You might have had to do this more than once if your risk tolerance was low but your investment expectations were high – low-risk investors can't expect the highest returns. That's part of the education process when you visit a planner.

Am I prepared to stay invested – no matter what? We all remember the "Tech Wreck" of 2000. At the worst of that downturn, investors bailed out of the stock market or drastically cut back, only to get back in after they were "convinced" that the market was rebounding. In reality, they missed out on stock market gains during the early stages of recovery, and that's costly in the long run. Of course, some investors looking for that late 20th century investment high also got into the real estate market, and they perhaps learned a similar lesson when that market started heading south two years ago.

In 2004, SEI Investments studied 12 bear markets since World War II. Investors who either stayed in the market through its bottom, or were fortunate to enter at the bottom, saw the S&P 500 gain an average of 32.5 percent (not counting dividends) during the first year of recovery. Investors who missed even just the first week of recovery saw their gains that first year slide to 24.3 percent. Those who waited three months before getting back in gained only 14.8 percent.

Am I diversified? The NASDAQ lost 39 percent of its value just in 2001, and another 21 percent in 2002. Meanwhile, real estate investment trusts, which performed poorly in 1998 and 1999 when stocks were

booming, had banner years in 2000 and 2001, performed so-so in 2002, and had an excellent 2003. Bonds also returned well during the bear market. Your planner, based on your risk profile, should have you in diversified investments that fit your goals.

Do I still feel the same way I used to about returns? Having a long-term investment plan doesn't mean make the plan and leave it to gather dust. You and your planner should decide when it's time for a review of your investment goals and your feelings about them. An annual conversation makes sense if nothing is going on, but life events like death, divorce, kids moving out and illness are good reasons to do a head-to-toe review of a financial plan.

-

May 2007 — This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by Marnie Aznar, MBA, CFP®, a local member of FPA.