ONE WILD WEEK!

THE PERILS OF MARKET TIMING

The week of August 8-12, 2011, was another volatile week on Wall Street. A perfect storm of political wrangling over the debt, the Standard and Poor's downgrade, concerns over the European banking industry, and fears of a new recession resulted in four consecutive days of market fluctuations all in excess of 400 points.

A market this turbulent can unnerve even a seasoned investor but can also provide a real world example of the dangers of market timing. Using actual data from this week, let's examine how two different investors might have reacted to the market and the resulting impact to their retirement accounts.

Let's call them **Investor "A"** and **Investor "B."** To keep the math simple, let's assume both had $100,000 invested in the S&P 500 fund at the start of the week. This fund consists of stock of the 500 largest American companies traded on the NY Stock Exchange and is considered a good indicator of overall market performance. This fund is available in the Defined Contribution and Deferred Compensation plans. We can track the beginning and ending share prices for each day using the online account access. At the start of the week the price per share for this fund was $1.632271, which translates into approximately 61,264 shares for a $100,000 investment.

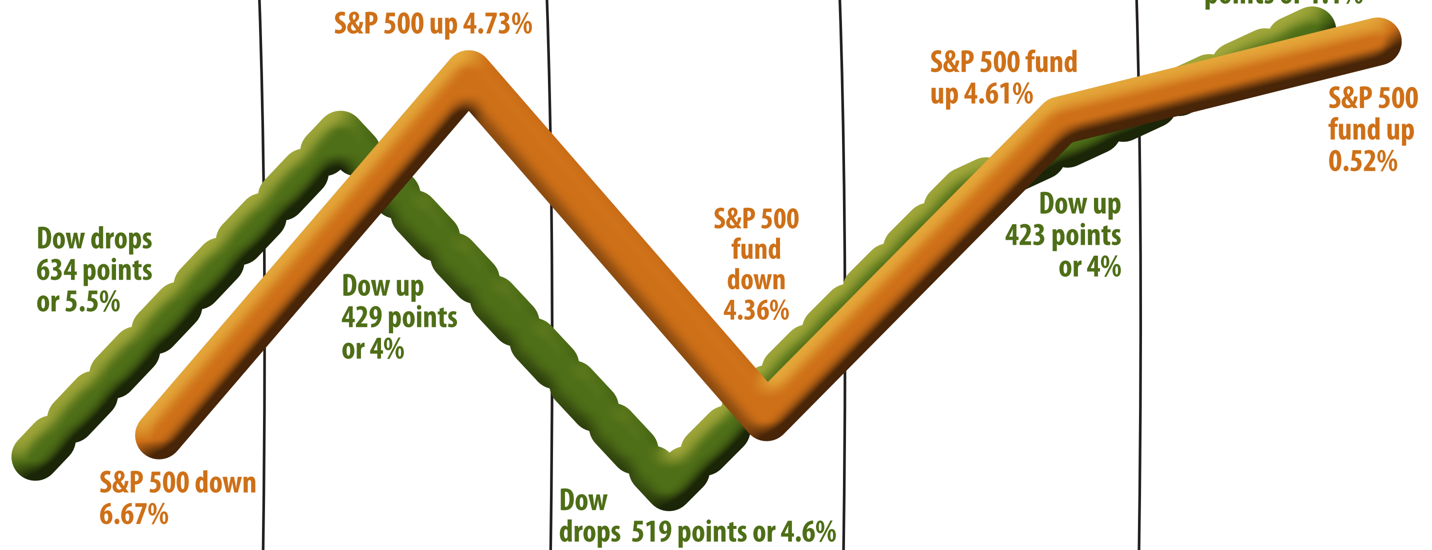
CHECK OUT THE CHART ON THE NEXT PAGE TO SEE HOW OUR INVESTORS DID.

While our two investors are ***hypothetical***, the market data and S&P 500 share prices for this week are real. *Individuals who react to market fluctuations and try to time the market can drastically damage their retirement accounts.* Both of our investors saw a reduction in the value of their accounts at week's end, but Investor B still owned the same number of shares. When shares of the S&P 500 stock return to the start of the week price, Investor B's account value will return to $100,000. In contrast, Investor A's account will be valued at $90,798.

Historically there have always been fluctuations in the stock market and it's a fairly safe assumption there always will be. How this volatility impacts your bottom line depends on how you react to these up and down swings. Investing seems easy when the market is "soaring" but a falling market is where many amateur investors lose their way.

An *educated investor* will minimize risk from these fluctuations by gradually reducing the percentage of stock in their portfolio as they approach retirement. Those with many years to go before retiring will avoid selling and instead may purchase more stock when the price is low—when stock is "on sale."

Emotionally based investment decisions are part of the reason why the Public Employees Retirement Board recently implemented an excessive trading policy (see the April 2011 newsletter). NPERS encourages participants in the Defined Contribution and Deferred Compensation plans to create a personal *long-term* investment strategy and refrain from reacting to market fluctuations. For more investment assistance, please refer to our Annual Investment Report or the Investment Education video available on the NPERS website.



MONDAY 8/8

On Monday, the market "plunges" on the first trading day since the Standard and Poor's downgrade.

INVESTOR "A"

Decides to sell their S&P 500 stocks and buy into a "safer" Money Market fund. The price per share for the S&P 500 has dropped to $1.523382 and the sale of 61,264 shares nets them $93,328 which is transferred into a Money Market fund.

INVESTOR "B"

Mows the lawn and suffers through a romantic comedy.

TUESDAY 8/9

Tuesday, the market "soars" in what is attributed to a better than anticipated report on jobless claims, a pledge by the Federal Reserve to keep interest rates low for two more years, and positive news from the European market.

INVESTOR "A"

Hoping the worst is over, Investor "A" decides to get back into the market. The end of day price for the S&P 500 is now $1.595415 and the $93,328 in the Money Market fund purchases 58,498 shares in the S&P 500.

INVESTOR "B"

Takes the spouse out for a nice romantic dinner.

WEDNESDAY 8/10

Within minutes of Wednesday's opening bell the market "plummets." Today the drop is explained as the result of a "bleak economic landscape" and fears of European debt issues.

INVESTOR "A"

Frustrated, Investor "A" decides to again get out of the market and back into the Money Market fund. The end of day price for the S&P 500 has now dropped to $1.525893, so the 58,498 shares net $89,261 to move into the Money Market fund.

INVESTOR "B"

Investor "B" drives the kids to the park and stops for ice cream on the way home.

THURSDAY 8/11

On Thursday, you guessed it: the market is "sharply higher," with the Dow jumping as much as 559 points before ending the day up 423.

INVESTOR "A"

This time Investor "A" vows not to make the same mistake again and opts to stay in the Money Market fund.

INVESTOR "B"

Finally gets the gutters cleaned and the hedges trimmed.

FRIDAY 8/12

Friday's markets show "strong gains" and the news media is reporting "the worst is over."

INVESTOR "A"

Decides to transfer back into the S&P 500. Their Money Market fund investment remains unchanged at $89,261. The end of day price for the S&P 500 is $1.604625 and they are able to purchase 55,627 shares.

INVESTOR "B"

Picks up some 1½ inch thick ribeyes on the way home from work, grills them to medium rare, and falls asleep halfway through CSI: NY.

AT THE END OF THE WEEK:

Investor "A" spent the week glued to the news, closely following market returns. Bombarded with a daily flood of media hyperbole, they succumbed to fear and panic. Investor "B" simply did nothing with their account.

INVESTOR "A"

Owns approximately 55,627 shares in the S&P 500 with a total value of $89,261.69.

INVESTOR "B"

Owns approximately 61,264 shares in the S&P 500 with a total value of $98,305.75.

NPERS
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