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Riding Out the Storm

Volatility in the market can leave participants uneasy about their current investment strategy. The downturn in 2008 left many investors gun-shy and many abandoned their long-term investment strategy for the stability of a money market fund. Although fear of financial loss is understandable during times of market fluctuation, it often results in missing out on financial gains when the market returns to more normal levels. Getting out of the market at a low point and potentially missing the upswing can be extremely detrimental to retirement savings. Sticking with a long-term investment strategy is the best course of action, especially during periods of stormy volatility.

The Chicago Board Options Exchange Volatility Index, VIX, is considered "the world's barometer for market volatility", often being referred to as the "investor fear gauge". The VIX, which tracks the S&P 500, measures the expected market volatility over a 30-day period using the calls and puts of index options. VIX values over 30.00 represent a significant amount of volatility in the market due to investor fear or uncertainty, while values less than 20.00 signify less volatility in the market.[1]

On October 15, 2014, the VIX peaked at 31.06, its highest point since November 29, 2011, and more than triple the 52-week low the index reached at 10.28 this past July. The following chart shows the daily closing rates of the VIX over a one year span, illustrating the constant fluctuations in the market's volatility.[2]

Retrieved November 7, 2014 at 3:15 P.M. http://www.cboe.com/DelayedQuote/AdvChart.aspx

[1] VIX - CBOE Volatility Index. Investopedia. 7 November 2014. http://www.investopedia.com/terms/v/vix.asp
[2] VIX Historical Price Data. Chicago Board Options Exchange. 7 November 2014. http://www.cboe.com/micro/VIX/historical.aspx

With an ever-changing market environment, participants may be anxious about leaving the future of their retirement savings in the hands of the exchanges. As a Plan Sponsor, what can you tell participants to help calm their fears during periods of market decline?

1. ***Don't cease contributions when the market is doing poorly.*** This is actually the perfect time to contribute. When share prices are low, you are buying more shares than when the prices are at higher levels. This is the magic of dollar-cost averaging. Dollar-cost averaging reduces the impact of market volatility through regular, periodic investment. Keep contributing and your holdings will grow when market performance improves.
2. ***Trust your investment strategy and stay the course.*** Your personal investment strategy is based on two main concepts: time horizon and risk tolerance. Market downturns can magnify our risk aversion, so be honest with yourself and choose the right strategy at the onset. The markets change constantly, but the short term ebb and flow should not affect a long term strategy.
3. ***The market will correct itself in due time.*** A significant part of creating an investment strategy is understanding that the market will have low points and high points. Younger participants have longer time horizons to ride out potential bumps, but no participant needs their entire account balance on their retirement date. Therefore, we are all long term investors and should maintain a diversified portfolio to and through retirement. If the market is in a period of decline, evaluate your strategy knowing that the best decision might just be to ride out the storm.