Coping With Market Volatility

A long period of positive returns and low volatility for the financial markets ended in 2007, as huge losses in mortgage-related securities hit the financial services industry. As the problems worsened through 2008, a credit crisis ensued, giving rise to serious concerns about economic growth, both in the U.S. and abroad. The result: intensifying market volatility.

Times like these are difficult for all investors. But it's important to keep matters in perspective. Avoiding rash decisions, reviewing your savings and investing strategies, and focusing on your long term goals could be the key to persevering during difficult market environments.

Here are some strategies that can help investors cope with market volatility.

Recognize that market volatility is not new

Sharp market volatility is unsettling — but not new. The "crash" of 1987 saw the Dow Jones Industrial Average fall 22.6% on a single day. More recently, the "Dot Com Bubble" burst in 2000 and the NASDAQ dropped 31% in 2002.

In each of these cases, many equity investments recovered and continued to grow. When a recovery from the current downturn might occur, of course, is difficult to predict.

A long-term perspective could be appropriate in a declining market: Premature selling could prevent an investor from taking full advantage of any recovery.

As short-term fluctuations occur, be realistic in evaluating your goals and disciplined in the asset allocation that you feel is appropriate for you.

Review your investing strategy

Your retirement plan portfolio should reflect your time horizon (how long you have until retirement), your tolerance for investment risk and your personal financial circumstances. Focus on your goals, not today's news. Your objective, likely a long-term one, is to help generate the income you'll need for a retirement that could last many years.

Review your strategy regularly – at least once a year. Difficult market conditions are another occasion to review your portfolio. When you do, consider any changes based on short-term factors carefully. You'll want to feel comfortable that your short-term decisions are consistent with your long-term goals. (Keep in mind that getting out of investments – selling – after a large market decline may "lock in" losses.)

And remember some key benefits of your 401(k) plan: your pre-tax contributions are tax-deferred, reduce your current income taxes and have the potential to grow significantly during a market recovery. (*Taxes are due upon withdrawal. If you take a withdrawal before age 59 ½, you may also be subject to a 10% tax penalty.*)

Historically, equity investments have recovered and continued to grow although recovery times are difficult to predict.

Diversify

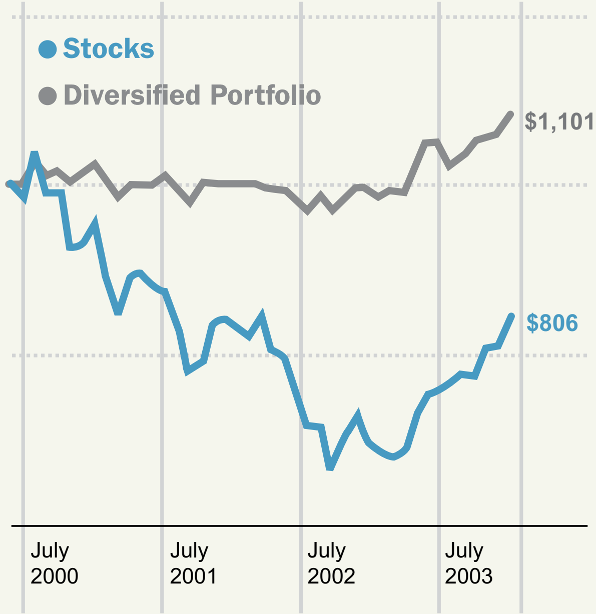
Diversification is the process of spreading your investments across the three key asset classes (stocks, bonds and cash equivalents) as well as within those classes.

How can diversifying help you? Diversification can help cushion a significant downturn in any one asset class. The same economic conditions that cause one type of asset to decline in value may cause another type to rise. While it can be an effective means to manage investment risk, it cannot ensure a profit or protect against loss.

Your retirement plan offers a variety of investment choices within the three main asset classes. A period of pronounced market volatility is a good time to ensure that your portfolio is well-diversified. As this chart shows, the evidence suggests that diversified portfolios have historically performed better than stocks through bear markets.

Diversified portfolios historically perform better through bear markets

Early-2000s bear market (July 2000–Dec 2003)



Early 2000s Bear Market: July 2000 through December 2003. Diversified Portfolio: 35% stocks, 40% bonds, 25% cash. Undiversified portfolio: stocks only. Diversification does not assure a profit or protect against a loss in declining markets. Hypothetical value of $1,000 invested at the beginning of July 2000. Results shown are based on indexes and are illustrative; they assume reinvestment of income and no transaction costs or taxes. Past performance is no guarantee of future results. Index sources: Stocks—Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the stock market in general; Bonds—20-year U.S. Government Bond; Cash—30-day U.S. Treasury Bill. Direct investment cannot be made in an index. Used with permission © 2007 Morningstar, Inc. All rights reserved. 3/1/2007 [Certain portions of this work were derived from the work of Roger G. Ibbotson and Rex Sinquefield.]

Rebalance

Market downturns can easily throw a portfolio off target. For example, your portfolio could now hold a smaller percentage of equity investments then your strategy called for just a few months ago, and a larger percentage of debt investments.

So consider rebalancing your portfolio (or adjusting your asset allocation if you believe it's appropriate). If you are still comfortable with your asset allocation, continue to rebalance your assets on a regular basis to maintain your target asset allocation (mix of stock, bond, and cash-equivalent investments).

Rebalancing can help position your portfolio for any market recovery.

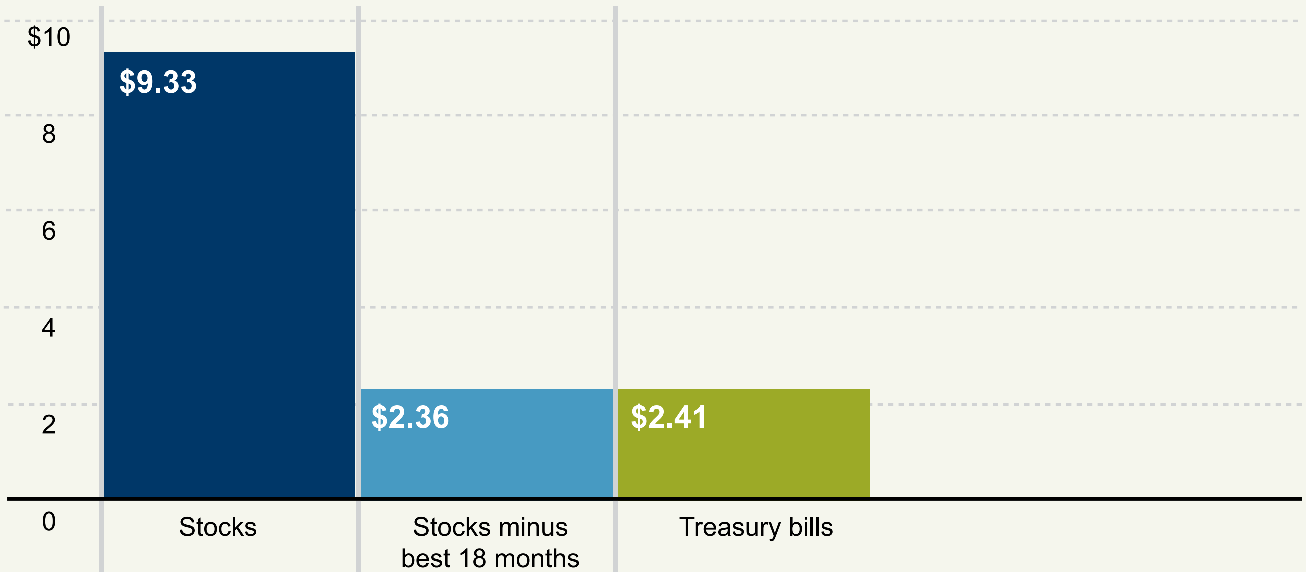
Understand the dangers of "market timing"

Market timing is the practice of frequently moving in or out of the markets in an attempt to realize quick gains from market ups and downs. But no one can predict market downturns or recoveries with any assurance.

Investors who attempt to "time the market" run the risk of missing at least some periods of exceptional returns. This image illustrates the potential "worst case" risk of attempting to time the stock market over the past 20 years – and what might have happened if the investor missed out on the periods of greatest upturns in prices during that time.

Market timing can be an unreliable and hazardous practice. Missing only a fraction of time can have a profound impact on value.

Hypothetical Value of $1 Invested From 1988-2007



Dollar cost averaging does not assure a profit or protect against loss in declining markets. Such a plan involves continuous investment in securities regardless of their fluctuating prices. Investors should consider their ability to continue their purchases through low-price periods. Results shown are based on indexes and are illustrative; they assume reinvestment of income and no transaction costs or taxes. Past performance is no guarantee of future results. Index sources: Stocks—Standard & Poor's 500® , which is an unmanaged group of securities and considered to be representative of the stock market in general; Cash—30-day U.S. Treasury Bill. Direct investment cannot be made in an index. Used with permission. 3/1/2007 [Certain portions of this work were derived from the work of Roger G. Ibbotson and Rex Sinquefield.]

Consider dollar cost averaging

Dollar cost averaging – like diversification – is a basic investing principle. It refers to investing the same amount at regular intervals. Automatic retirement plan contributions from your paycheck make it easy.

Investing the same dollar amount each period will buy more shares of an asset when the price is low and fewer shares when the price is high. The result: the average purchase price is lower than the average market price over the same period. This lowers the risk of purchasing assets at their peak.

Dollar cost averaging brings a discipline to investing that can elude many investors. With dollar cost averaging, investors make regular, timely investments in different market environments. Because you invest a regular dollar amount, a market decline presents an opportunity to purchase more shares at favorable prices. As long as you purchase shares at a regular time interval and with the same dollar amount, you can achieve the benefits of dollar cost averaging.

Dollar cost averaging does not ensure a profit or protect against loss in declining markets. Dollar cost averaging involves continuous investment regardless of fluctuating prices. Investors should consider their financial ability to continue purchases through periods of low price levels.

What's next?

No one can predict the short-term direction of the markets or how soon an economic recovery may begin. Factors such as investor psychology, global political events, unexpected economic conditions, interest rates and inflation can drive markets in any direction.

Most downturns are short-lived, but some have lasted for several years. Investors who have employed a diversified portfolio and maintain a long-term perspective may have a better likelihood of meeting their goals.

How Merrill Lynch Can Help

Want to learn more about time-tested investment strategies?

Log on to Benefits Online® at www.benefits.ml.com. Select the "Advice & Planning" tab and take advantage of the tools and information under "Investing" that can help you develop and maintain an investing strategy appropriate for you.

Time to review or change your investments?

Log on to Benefits OnLine. Under your Retirement Plan tab, select "Current Elections" and follow the prompts.

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