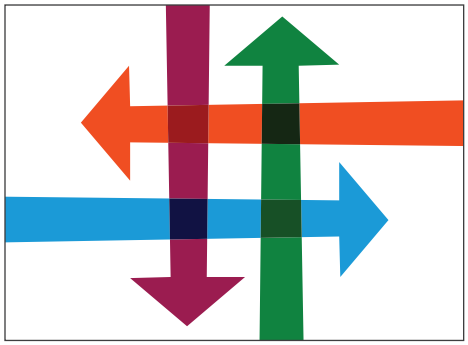
Managing volatility

Investing for your retirement



When the market is making big waves

Keeping cool may be hard to do when the market is making big waves. It may be useful to have strategies in place that prepare you both financially and psychologically to handle market volatility. Here are 11 methods investors may wish to use to prevent themselves from making hasty decisions that could have a long-term impact on their ability to achieve financial goals.



Words to ponder

"Investors should remember that excitement and expenses are their enemies. And if they insist on trying to time their participation in equities, they should try to be fearful when others are greedy and greedy when others are fearful."
– Warren Buffett

"Most of the time common stocks are subject to irrational and excessive price fluctuations in both directions as the consequence of the ingrained tendency of most people to speculate or gamble ... to give way to hope, fear and greed."
– Benjamin Graham

"In this business if you're good, you're right six times out of ten. You're never going to be right nine times out of ten."
– Peter Lynch

1. Having a game plan

Having predetermined guidelines that recognize the potential for turbulent times can help prevent emotion from dictating decisions. A core-and-satellite approach combines the use of buy-and-hold principles for the bulk of your portfolio with tactical investing based on a shorter-term market outlook. Diversification may also be used to try to offset the risks of certain holdings with those of others. Diversification may not ensure a profit or guarantee against a loss, but it can help balance your risk in advance. If you're an active investor, a trading discipline may help you stick to a long-term strategy. Some investors decide to determine in advance to take profits when a security or index rises by a certain percentage, and buy when it has fallen by a set percentage.

2. Tracking portfolio composition

When the market goes off the tracks, knowing why a specific investment was originally made can help investors evaluate whether their reasons still hold, regardless of what the overall market is doing. Understanding how a specific holding fits in a portfolio can help investors determine whether a lower price might actually represent a buying opportunity.

If you don't understand why a security is in your portfolio, you may want to find out. You may be able to use that knowledge when the market goes south to help you determine whether to reaplace your current holding with another investment.

3. Everything is relative

Most of the variance in the returns of different portfolios can generally be attributed to their asset allocations. If you've got a well-diversified portfolio that includes multiple asset classes, it could be useful to compare its overall performance to relevant benchmarks.

Even a diversified portfolio is no guarantee that you won't suffer losses. But diversification may mean that if the S&P 500 drops 10% or 20%, your overall portfolio may not be down by the same amount.

4. This too shall pass

The financial markets are historically cyclical. Even if you wish you had sold at what turned out to be a market peak, or regret having sat out a buying opportunity, you may well get another chance at some point. Even if you're considering changes, a volatile market may be an inopportune time to turn your portfolio inside out. A well-thought-out asset allocation is still the basis of good investment planning.

5. Learning from mistakes

Anyone can look good during bull markets; smart investors are produced by the inevitable rough patches. Even the best investors aren't right all the time. If an earlier choice now seems rash, sometimes the best strategy is to take a tax loss, learn from the experience, and apply the lesson to future decisions. Expert help may be able to help prepare you and your portfolio to both weather and take advantage of the market's ups and downs.

6. Playing defense

During volatile periods in the stock market, many investors reexamine their allocation to such defensive sectors as consumer staples or utilities (though like all stocks, those sectors involve their own risks, and are not necessarily immune from overall market movements). Dividends may also help cushion the impact of price swings. According to Standard & Poor's, dividend income has represented roughly one-third of the monthly total return on the S&P 500 since 1926, ranging from a high of 53% during the 1940s to a low of 14% in the 1990s, when investors focused on growth.

7. Continuing to save

Even if the value of your holdings fluctuates, regularly adding to an account designed for a long-term goal may help cushion the emotional impact of market swings. If losses are offset even in part by new savings, your bottom-line number might not be quite so discouraging.

Dollar-cost averaging involves investing a specific amount regularly regardless of fluctuating price levels. Investors who use this technique may be getting a bargain by buying when prices are down. However, dollar cost averaging can't guarantee a profit or protect against a loss. To use dollar-cost averaging, investors must also be prepared to continue purchases through market slumps. The return and principal value of your investments will fluctuate with changes in market conditions, and shares may be worth more or less than their original cost when you sell them.

8. Cash cushions

Cash can be the financial equivalent of taking deep breaths to relax. It can enhance investors' ability to make thoughtful decisions instead of impulsive ones. You may wish to consider having resources on hand to prevent having to sell stocks to meet ordinary expenses or a margin call. Having a cash cushion coupled with a disciplined investing strategy may leave an investor positioned to take advantage of a downturn by picking up bargains.

9. Having a road map

In a diversified portfolio, the strong performance of some investments may help offset poor performance by others. Even with an appropriate asset allocation, some parts of a portfolio may struggle at any given time. Timing the market can be challenging under the best of circumstances; wildly volatile markets can magnify the impact of making a wrong decision just as the market is about to move in an unexpected direction, either up or down. You may wish to consider reviewing your asset allocation before making drastic changes.

10. Looking in the rear-view mirror

If you're investing long term, it may help to review overall progress. Though past performance is no guarantee of future returns, of course, the stock market's long-term direction has historically been up. With stocks, having an investing strategy is only half the battle for investors; the other half is being able to stick to it. Even if an investor is able to avoid losses by being out of the market, will they know when to get back in? Patience may be useful in down markets.

11. Taking it easy

If you wish to make changes in your portfolio, you may wish to consider testing the waters by redirecting a small percentage of one asset class to another. You may wish to put any new money into investments you feel are well-positioned for the future, but leave the rest as is. If you want, you also have the ability to set a stop-loss order to prevent an investment from falling below a certain level, or have an informal threshold below which you will not allow an investment to fall before selling. Even if you need or want to adjust your portfolio during a period of turmoil, you may wish to enact those changes in gradual steps. Taking gradual steps may help spread your risk over time, as well as over a variety of asset classes.

Diversification, asset allocation, and dollar cost averaging can't guarantee a profit or eliminate the possibility of loss. All investing involves risk, including the potential loss of principal, and there can be no guarantee that any investing strategy will be successful.

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