

Crisis Behavior: Stay-the-Course Investors Move Ahead of Panic Sellers

More Investors Exited the Stock Market During Peak of Financial Crisis

Rattled by the worst financial crisis since the Great Depression and a falling stock market, an atypical number of U.S. investors liquidated either some or all of their stock holdings during the latter part of 2008.

During October 2008, the U.S. mutual fund industry saw more than \$70 billion withdrawn from equity funds—the largest monthly outflow on record (see chart).

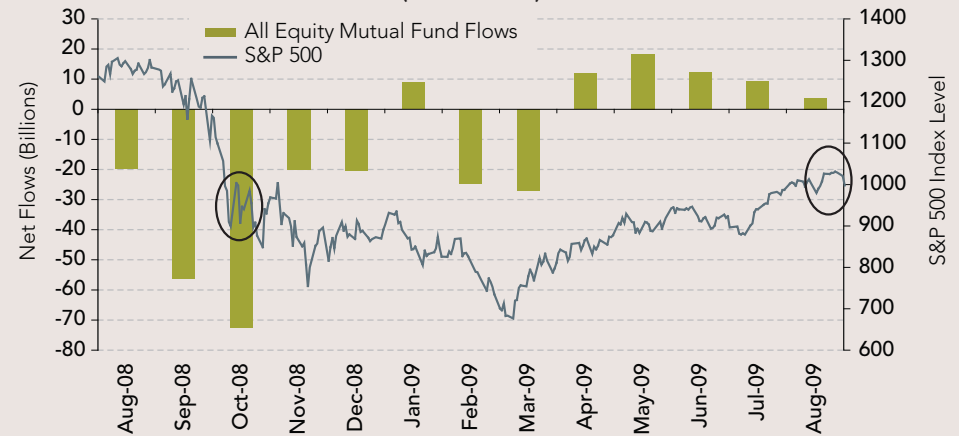
Familiar Panic-Selling Costly For Market Timers

Using aggregate equity fund flow data as a gauge for the behavior of investors who attempted to move in and out of the stock market, the massive one-month outflow in October 2008 illustrates that a higher-than-average number of investors rushed out of stocks amid the market turmoil and financial system uncertainty.

However, investors who maintained their exposure to the stock market during October 2008—and were willing to weather the volatility that took place—were better off one

Investors who stayed invested in a mix of stocks equivalent to the S&P 500 Index after it fell to new lows amid the financial crisis in October 2008 would have been up about 9% one year later, and better off than investors who withdrew a record \$70 billion from the market during October 2008 and remained out of stocks.

Equity Mutual Fund Flows vs. S&P 500 Performance (2008-2009)



Source: Bianco Research, ICI, FMRCo (MARE) as of 8/31/09.

year later for keeping their stock holdings compared to those who sold and remained out of stocks altogether.

At the end of Q3 2009, the S&P 500 Index was 9% higher than its average monthly level in October 2008—a return that is roughly the average annual long-term advance for this benchmark throughout history.¹

What's more, during the five months after the unusually large monthly outflow seen during October 2008, investors liquidated another \$83.5 billion from equity funds at even lower S&P 500 levels, including a two-month outflow of \$52 billion in February and March of 2009—just prior to the market's sudden and rapid reversal (see chart). As the market rebounded sharply over the next five months (April-to-August), money trickled back into equity funds. However, these inflows were only a fraction of the outflows seen during prior months. As a result, it's reasonable to assume that there was a greater-than-normal number of investors who either reduced their exposure or remained out of stocks near the March low point (or earlier), missing all of the market's abrupt turnaround. Further,

many investors who had sold and chose to re-enter the market were buying back in at higher price levels.

Investment Implications

An atypically large number of investors liquidated stock holdings at or below current price levels during the past year and failed to reinvest their capital in time to participate in the 2009 market rebound. The massive flows in and out of equity funds highlight the difficulty people have in trying to adequately time swings in market performance. Quite often, investors make emotionally charged portfolio adjustments that result in worse performance than if they simply had stayed invested.

Long-term investors should recall that the market periodically goes through boom and bust periods. Historically, riskier asset classes have provided higher returns relative to more conservative assets over time to compensate investors for the risk of tolerating a higher level of volatility. Thus, altering a well-thought-out allocation to stocks after a significant downturn may not be the best strategy for long-term capital.

KEY TAKEAWAYS

- U.S. investors withdrew a record \$70 billion from the stock market during the peak of the financial crisis in October 2008, and another \$50 billion near the market low during Feb/March of 2009.
- As of Oct. 16, 2009—one year after the peak in liquidations—investors who remained in the stock market had fared better than those who exited at the peak of the crisis and stayed on the sidelines.



Market Analysis, Research & Education

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Past performance is no guarantee of future results.

[i] October 2008 average S&P 500 level: 969. September 30, 2009 S&P 500 level: 1057. The long-term average annual S&P 500 Index total return from 1926-2009 is 9.8%, while the average annual price return for the same period is 5.4%. Index levels are generally quoted using price return indexes and do not include the returns from dividends. The 9% price return from average October 2008 levels through September 30, 2009 compares favorably with the long-term 9.8% total return and is well above the long-term average price return of 5.4%. Source: FactSet, Ibbotson, FMRCo (MARE) as of 9/30/09.

You cannot invest directly in an index.

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