COLORADO PERA®

# Perspectives

THIRD QUARTER 2010

## Tell Us What You Think

The 2010 Colorado PERA 457 Plan survey is now available online. Please take a moment to complete the survey about the Plan located on the front page of the Colorado PERA 457 Plan Web site at **www.colorado457.com.** If you would like to request a paper version of the survey, please contact the local service center at **303-737-7710** or **1-800-838-0457.**

## The Big Three

When you make investment decisions, like how much of your 457 Plan account to invest in stock funds, bond funds, and/or cash investments, there are three important concepts to consider: volatility, market timing, and rebalancing. Understanding each of these can help you make educated decisions that will give you the best chance of reaching your long-term savings goals.

### 1. Volatility

Volatility is a measure of how sharply an investment's value can rise or fall in the short term. Since the fall of 2008, investors have experienced firsthand, sometimes painfully, how volatile the stock market can be.

But volatility measures only short-term risk. Longer term, the picture is very different for the three asset classes. Historically, the longer stocks are held in a portfolio, the less volatile their performance. Since 1926, stocks have not lost ground over any 20-year period. And over the past 30 years, stocks have realized an 11.2 percent annualized return, outperforming bonds (8.4 percent) and cash (5.5 percent).[1] (Past performance is not a guarantee or prediction of future results.)

***The upshot:*** The more time you have before you need to withdraw your money—10 years or longer—the greater the percentage of your assets you may consider investing in stocks.

### 2. Market Timing

Trying to out-guess the market—thinking you know which way the stock market is about to move and buying or selling accordingly—is called market timing. However, there's no evidence anyone can time the market with precision. Furthermore, there are regulations in place that discourage and prevent investors from timing the market with short-term trading of mutual funds. Some investments may even impose redemption fees, and/or transfer restrictions, on certain transfers, redemptions, or exchanges if assets are held for less than the period stated in the fund's prospectus or other disclosure documents.

During a market downturn, it may be tempting to cash out of stocks and jump back into the market later when times are better. However, a recent study by market research firm DALBAR, Inc. found that fund investors dramatically lag the broad market, primarily because they choose the wrong times to jump into and out of stocks.[2] For the 20 years ended December 31, 2009, DALBAR reports that investors earned an average annual return of just 3.2 percent, compared with 8.2 percent for the S&P 500® Index.[3] With that in mind, you may stand to earn potentially stronger returns over the long run if you simply stay invested, rather than try to time the market.

*(continued on reverse)*

1 Ibbotson Associates, is a subsidiary of Morningstar, Inc. Stock return is based on the S&P 500. Bond return is based on the Intermediate-Term Government Bond Index. Cash return is based on the 30-day Treasury bill. Returns represent the 30-year period through December 31, 2009.

2 DALBAR, Inc., "2010 Quantitative Analysis of Investor Behavior."

3 S&P 500® Index is a registered trademark of Standard & Poor's Financial Services LLC, and is an unmanaged index considered indicative of the domestic Large-Cap equity market. A benchmark index is not actively managed, does not have a defined investment objective, and does not incur fees or expenses. Therefore, performance of a fund will generally be less than its benchmark index. You cannot invest directly in a benchmark index.

4 Access to KeyTalk and the Web site may be limited or unavailable during periods of peak demand, market volatility, systems upgrades/maintenance or other reasons.

# The Big Three *(continued from previous page)*

## 3. Rebalancing[5]

When the market shifts, the way your investments are allocated, or divided, among stocks, bonds, and cash can change. Rebalancing means adjusting your portfolio to achieve the asset mix that's appropriate for your time horizon and comfort with risk.

Rebalancing may help manage risk by preventing overexposure to a single asset class. After a prolonged market downturn, for example, an unbalanced portfolio may be top-heavy in bonds. If you have too little invested in stocks, you won't benefit fully from any rebound—potentially making your portfolio more conservative than you intended and reducing its long-term returns. ***The solution:*** periodically compare your portfolio's target asset allocation (the mix you originally established) with its current allocation. You may need to rebalance. To increase a stock allocation, consider redirecting contributions from bond funds to stock funds until your ideal allocation is restored. A growing number of retirement plans, including the Colorado PERA 457 Plan, automatically rebalance funds if you request it.

5 Rebalancing does not ensure a profit and does not protect against loss in declining markets.

# Keep Your 457 Plan Account Growing

As an investor, you have likely encountered three types of risk: market risk, interest-rate risk, and inflation risk. The following will help you learn to minimize their impact on your 457 Plan account.

## Market risk: Diversify[6]

You're probably most familiar with this risk—the chance that your investments (particularly stocks) can lose value because of a decline in the market. However, by diversifying, owning a mixture of stock and bond funds (including funds that invest in a mix of U.S. and international stocks) as well as cash investments, you may increase your chances of having at least one investment performing well at any given time.

## Interest-rate risk: Include short-term bonds

Bonds, particularly long-term bonds, are vulnerable to interest-rate risk—the possibility that currently low interest rates could rise. Generally, when rates rise, bond prices fall. Your best defense (in combination with stock funds and cash investments) is a short-term bond fund, because interest rates are less likely to substantially change in the short term.

## Inflation risk: Minimize cash

Over time, cash investments can lose their purchasing power. This likelihood that the value of your money won't keep up with the prices of goods and services is called inflation risk. Inflation has hovered at its lowest level in decades, but you shouldn't disregard its potential long-term effects. Consider keeping only assets you'll need within a couple of years in cash (i.e., a money market fund).

*An investment in a money market fund is neither insured nor guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the fund seeks to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the fund.*

6 Diversification of an investment portfolio does not ensure a profit and does not protect against loss in declining markets.

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