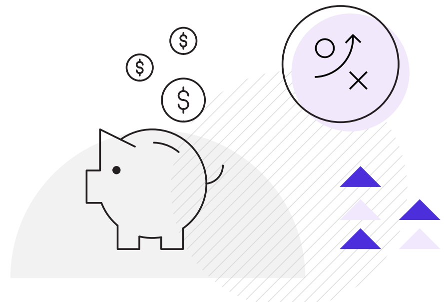
MORNINGSTAR®

The Retirement Saver's Guide to Market Volatility



With the recent market volatility due to COVID-19, we know you may have some questions around your employer-sponsored retirement account. That's why we're here to help.

Whether you're wondering why your retirement savings is being affected by COVID-19, if it's a good time to invest at all, or what might happen next, read below for answers to our most frequently asked questions.

1 What's going on in the financial markets and why is it affecting my retirement savings?

It can be hard to comprehend why a disease would affect your retirement savings. Put simply—as is often the case with major world crises or events—this virus has created a ripple effect. As communities and governments work to prevent COVID-19 from spreading, businesses and industries are being impacted by things like cancelled events and fewer people traveling, eating out, or shopping. As people around the world get sick and take time off work to recover, distribution and supply chains are disrupted, too. All of this can lead to instability in the financial markets—a.k.a. market volatility—which can impact your retirement account investments. When the value of those investments fluctuates, so does your account balance.

2 How can I position my retirement investments to minimize the effects of market volatility?

Every time we put our money in the financial markets—for example, by saving and investing in a retirement account—we take on risk. We do this because over the long-term, investing in the financial markets has been shown to outpace inflation, even when we account for past market downturns, such as the 2008 crash.[1]

While there's no way to protect our invested savings from market volatility, having a diversified portfolio with the right asset allocation for your goals and situation can help you minimize its negative effects.

Okay, but what does asset allocation mean and why is it important?

It's one of those big, fancy investment terms, but it's a good one to know considering research has shown it's an important factor that can influence investment outcomes.[2] Asset allocation refers to the balance of asset classes or the different kinds of investments—like stocks and bonds—in your portfolio. It also helps determine how much your portfolio is likely to fluctuate in up or down markets.

Different factors about your personal situation can help determine the right asset allocation for you, including age, gender, income, and when you plan to retire. In general, younger investors tend to have more stocks or equities in their portfolio which are seen as riskier investments than bonds or fixed income, exposing them to greater risk as well as the potential for greater returns.

This is because younger investors typically have more flexibility to be aggressive with their investments since they have time to recoup losses from a market downturn before they plan to retire. On the other hand, those closer to retirement generally have more conservative investments, like bonds, in their portfolio to help minimize the impact of market volatility.

What about diversification?

While asset allocation involves the balance of asset classes in a portfolio, diversification refers to the variety of investments you have from each asset class. So, if 70% of your portfolio is invested in stocks, to have a well-diversified portfolio you wouldn't want to invest that portion of your money in just one or two stocks. You would want to invest in a variety of stocks across various market sectors (such as technology or healthcare) and sub-asset classes (such as small-cap or large-cap). This way, if one sector or sub-asset class doesn't perform well one month, your investments in stocks from others are positioned to help balance things out. It's about not putting all your eggs in one basket, as the saying goes.

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3 How can I make sure I'm invested appropriately or get help with my retirement investments?

If you're worried about your retirement savings and whether you're still on track for your goals, there are a few ways to get help.

If you're a do-it-yourself investor, Morningstar.com* offers investment-specific information to help.

If you're looking for professional financial guidance but aren't interested in hiring a financial advisor, an online robo-advisor or managed accounts service can help. Through your employer-sponsored retirement account, you have access to a managed accounts service by Morningstar Investment Management. In a recent study we conducted, we found that our service helped do-it-yourself retirement savers who were not on track to meet their retirement goals become more appropriately invested with asset allocations that made sense for their needs and situation.[2] Remember that research has shown asset allocation is an important factor that can influence investment outcomes.[3]

If you're interested in learning more, check out the resources on our Insights for Retirement Savers page or reach out to a Retirement Specialist at morningstarretirement@morningstar.com to find out if you're eligible for the service.

Check out the resources on our Insights for Retirement Savers page to learn more about how a managed accounts service could help you reach your retirement goals.

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④ Should I take my money out of the market, or sell my investments for cash?

It's understandable that, when the markets are turbulent, you might feel that instinct to "get out while you can" so to speak. But pulling your money out of the market can actually lock in losses that you probably won't recoup unless your money stays invested when the market starts to rebound.

This practice of making investment decisions based on guesses—like selling your investments with the assumption that the market will keep going down—is commonly referred to as trying to "time the market." We don't recommend trying to time the market because studies have shown that investors tend to do poorly when they do, often selling when investment prices are low and buying when they're high.[4] Imagine paying full price for something and then returning it for the sale value—it's not ideal.

Investors who sell after the market has declined often end up missing much of the rebound since its timing can be so hard to predict. Research by Morningstar, Inc. has shown that missing the best month of returns during a year drastically reduces overall results, and in years of negative returns, missing the best month only exaggerated the loss for the year.[5]

⑤ Is this a good time to keep investing or contributing to my retirement savings?

Keep in mind that when the markets are down, so are investment prices. By continuing to invest or contribute to your retirement account, you may be taking advantage of those lower prices, which can further help to make up for any losses. Doing this can also help to balance out any higher investment costs you may have been paying when the market was up—a concept known as dollar-cost averaging.

⑥ I was planning on retiring soon. Can I still do that?

We recommend reading this article by Christine Benz[6], an employee of Morningstar, Inc., at Morningstar.com. She offers some great tips and next steps for those near retirement to help you figure out your path forward.

7 My financial situation has totally changed. How can I get help making ends meet?

On March 27, the U.S. government passed the CARES Act which offers some financial relief in a few different ways. In addition to stimulus checks for those who qualify, there are also some benefits specifically for people saving with retirement accounts.

Hardship withdrawals and loans

While we recommend viewing these options as last resorts, the CARES Acts makes it easier to take loans or early withdrawals from your retirement account if you need the money. This video from Morningstar.com[7] helps to explain some of the pros and cons.

Waived required minimum distributions, or RMDs

Normally, once you turn 72 you are required to withdraw a minimum amount from your retirement account each year—also known as a required minimum distribution, or RMD. However, the government is waiving these RMDs for 2020 if you don't need the money right now and would rather keep it invested.

8 What's going to happen next?

We expect the market volatility to continue in the coming weeks and, possibly, months. We know it can be really stressful to see your savings impacted but remember that volatility is a to-be-expected part of investing and the financial market cycle.

9 Wait! I have more questions.

We're here. Reach out to us at morningstarretirement@morningstar.com and let us know how we can help.

Market volatility is a to-be-expected part of investing and the financial market cycle.

References

[1] Based on data from Morningstar Direct and the Summary Edition Credit Suisse Global Investment Returns Yearbook 2019.

[2] **Research on The Impact of Managed Accounts on Participant Savings and Investment Decisions**
A total of 60,825 retirement plan participants were included in Morningstar Investment Management's study, "The Impact of Managed Accounts on Participant Savings and Investment Decisions". Participants were selected for use based on available information and various filters and include those participants that used the Morningstar Retirement Manager Managed Accounts service between the dates of January 5, 2007 and June 4, 2018.

In no way should any results shown be considered indicative or a guarantee of the future results of an actual retirement plan participant's portfolio with the same investment option or viewed as a substitute for an investment option recommended to an individual participant. Actual results of an individual participant may differ substantially from the historical results shown and may include an individual participant incurring a loss. Past performance is no guarantee of future results.

Morningstar Investment Management does not guarantee that the results of their advice, recommendations, or the objectives of an investment option will be achieved.

In no way should the results of this analysis be considered indicative or a guarantee of the future performance of an actual participant using Morningstar Retirement Manager or considered indicative of the actual performance achieved by an individual participant using Morningstar Retirement Manager.

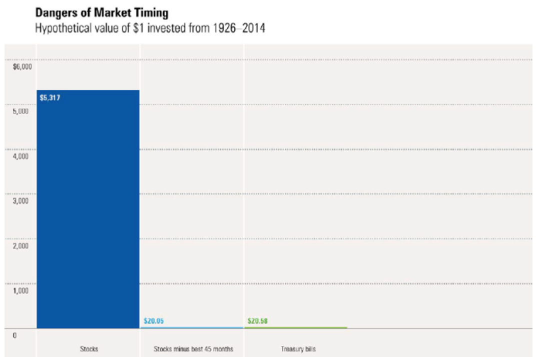
To download the full research paper, please go to: https://www.morningstar.com/lp/impact-of-managed-accounts.
For purposes of this study, a participant who is not on track is defined as an individual that has less than a 70% probability of achieving their retirement income goal prior to use the Morningstar Retirement Manager Managed Accounts service.
To measure the appropriateness of portfolios, the median absolute difference between the Morningstar Retirement Manager managed accounts service's recommended asset allocation and the participant's portfolio prior to the use of managed accounts is calculated for each participant. The managed accounts service recommendation assumes that Morningstar Investment Management uses all of the known information about a given participant and the participant is ultimately assigned to the ideal asset allocation. Using Morningstar Investment Management's Capital Market Assumptions and solving for the implied risk-aversion coefficient, the utility of the allocations for the participant's portfolios before and after using the managed accounts services are compared.

To measure risk level improvement, equity allocations for portfolios before and after a participant enrolled in Morningstar Retirement Manager were estimated. After using managed accounts, there were considerable changes in risk levels for some participants, in particular a subset of users who previously directed their own investments who had been primarily or entirely invested in fixed income prior to enrolling in managed accounts. Such participants were generally invested too conservatively and had a significant increase in their equity allocations after enrolling in managed accounts. In addition, a significant number of participants, especially older participants, ended up in more conservative portfolios after enrolling in managed accounts.

[3] Idzorek, T. (2010). Asset Allocation Is King. Tom Idzorek is an employee of Morningstar Investment Management LLC.

References

[4,5] Morningstar, Inc. data – Market-Timing Risk, Dangers of Market Timing I and II. Stocks are represented by the Ibbotson® Large Company Stock Index. An investment cannot be made directly in an index. The data assumes reinvestment of income and does not account for taxes or transaction costs.



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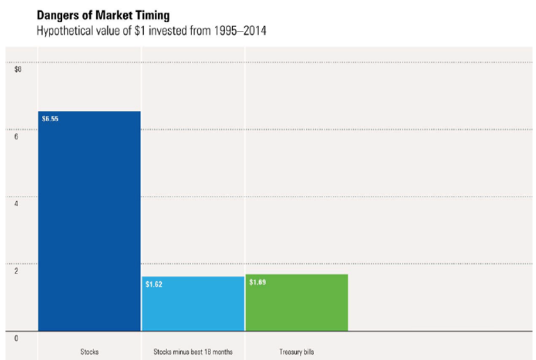

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[6] Christine Benz is an employee of Morningstar, Inc. The information in this material is for informational purposes only and has no regard to the specific investment objectives, financial situation or needs of any specific recipient. This material is intended to provide information to assist investors in making their own investment decisions, not to provide investment advice to any specific investor. Therefore, investments and strategies discussed and recommendations made herein may not be suitable for all investors: recipients must exercise their own independent judgment as to the suitability of such investments, strategies, and recommendations in the light of their own investment objectives, experience, taxation status and financial position.

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[7] See Footnote 6 for additional information. Jeff Levine, Kitces.com, Buckingham Wealth Partners, and Savvy IRA Planning are not affiliated with Morningstar, Inc. or its subsidiaries.

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