



INVESTMENT REPORT FOR PLAN PARTICIPANTS

Oops: Mistakes That Stunt Account Growth

If you want your retirement plan account to grow, you can't afford to let simple mistakes cause a slowdown.

Panic Selling

No one knows in advance when stock prices will fall. But declines in market values are unavoidable when you invest in stocks. What should you do if you see your plan account balance shrinking sharply? One reaction might be to cut your losses by selling in a panic. But that could be a big mistake.

The reason: You may find yourself on the sidelines if the market eventually recovers, as it has after past declines. Studies have shown that much of the stock market's past growth has often occurred during short periods. If you're not invested in stocks during a similar period that may occur in the future, you may stunt your account's long-term growth.

Instead, know your risk tolerance and limit your stock allocation to an amount you can live with through declining markets.

Recovery Times after Major Stock Market Declines

	Decline of S&P 500 Stock Index ¹	Length of Decline in Months	Recovery Period in Months
1990	20%	3	6
1987	34%	4	19
1980-82	27%	20	5
1976-78	20%	18	18
1973-74	48%	21	70
1968-70	36%	18	23
1966	22%	8	10

Source: Leuthold Group



Starving Your Account

Contributing too small an amount on paydays is another mistake that can stunt your retirement account's growth. The amount you contribute can make a big difference in the growth of your retirement savings. Try to increase your contribution gradually until you reach the annual maximum amount that your plan allows.

Investing Too Conservatively

The stock market can be a scary place to invest when prices are dropping. But letting the short-term risks of owning

stocks make you invest your retirement account too conservatively could also be a mistake. Stocks have a history of earning returns that have beaten inflation. If you emphasize lower risk investments, such as cash equivalents, your account's growth may be too small to meet your retirement goals.

Investments measured by: ¹S&P 500 Stock Index, an unmanaged index of the stocks of 500 major corporations; ²Lehman Brothers Government/Corporate Bond Index, an unmanaged index of investment grade corporate and government bonds with maturities of one year or more; ³Merrill Lynch 3-Month T-Bill Index, an unmanaged index that measures returns of three-month Treasury Bills. Past performance does not guarantee future results. Your investment returns will be different. Investment cannot be made in an index.

Compare the Short- and Long-term Returns of Major Asset Classes

	1 Year (2000) Total Return	3 Years (1998-2000) Average Annual Total Return	5 Years (1996-2000) Average Annual Total Return	10 Years (1991-2000) Average Annual Total Return
Stocks ¹	-9.10%	12.26%	18.33%	17.46%
Bonds ²	11.85%	6.21%	6.24%	8.00%
Cash Equivalents ³	6.36%	5.50%	5.41%	4.96%

Source: Russell Data Services

Watching the Federal Reserve

The Federal Reserve is a news-maker. When it changes interest rates or its chairman speaks, the U.S. economy watches and listens. And you should pay attention, too, because what the Federal Reserve does may affect your retirement plan investments.

Controlling Economic Growth

The Federal Reserve's Open Market Committee sets monetary policy. The Committee works by adjusting two interest rates — the federal funds rate and the discount rate. Banks charge the federal funds rate on short-term loans they make to each other. The Federal Reserve charges the discount rate on its short-term loans to banks. The Open Market Committee pushes the federal funds rate higher or lower by selling or buying government securities, and it sets the discount rate directly.

Stimulating or Slowing Growth

Interest rate changes are important news because they can stimulate or slow the overall economy. If the Fed raises rates, banks must pay more for money they use to make loans. So, they charge their borrowers

more interest. Borrowing that costs more slows the economy's growth over time. If the Fed cuts rates, the banks pay less and, in turn, charge lower interest rates. Less costly loans free money for other uses, which stimulates economic growth.

Influencing Stock Prices

Changes in interest rates affect the bond market and can also have an impact on the stock market. In general, higher borrowing costs decrease company earnings. And earnings are an important influence on stock prices. News of an actual or expected rate change sometimes has an immediate effect on stock prices. For example, prices on the NASDAQ stock market rose after interest rates were cut in January 2001.

Of course, other factors also influence the stock market, including political, economic, and corporate developments, both in the U.S. and worldwide. So, you can't expect the price of any specific stock or portfolio — or even the overall market — to necessarily rise or fall in sync with changes in interest rates.

Controlling Inflation

The prices of goods and services can increase if the economy's rapid expansion causes a shortage of labor and other resources needed by businesses. That's why the Fed strives to balance growth and inflation when setting interest rates.

For example, the Fed may decide to counteract rising inflation by trying to slow economic growth through an increase in interest rates. But, if prices are stable or dropping, the Fed may choose to stay with current rates or to stimulate growth with a rate reduction. Usually, the Fed adjusts rates in gradual steps to avoid shocking the economy with a large change.

Speaking Out

Public statements by the Chairman of the Federal Reserve may also affect the investment markets. For example, you may remember Chairman Alan Greenspan's warning about the stock market's "irrational exuberance." It was big news when he said it in 1996, and a worldwide dip in stock prices followed.

Make a Quick Estimate of Investment Growth

When you want to take a look ahead at the *possible* growth of an investment, you don't need a specialized calculator, the Internet, or a complex mathematical formula. Instead, you can always get an accurate estimate quickly by using *the Rule of 72*.

Simple Division

With one simple division, you can find the number of years that *any* investment would take to *double in value* at *any* annual rate of return that you want to assume. Just divide 72 by the return you've chosen. Your answer will always be the time

period you would need to double your money.

For Example

Assume you have a \$10,000 investment in a portfolio of large company stocks. What would happen if your portfolio grows 8% each year? Dividing 72 by eight tells you that after nine years your investment would be worth about \$20,000. After nine more years (18 total), your investment would grow to \$40,000.

The Rule of 72 is also useful for comparing investments. What if your investment earns 6% instead of 8%?

Dividing 72 by six shows your \$10,000 investment would double in value every 12 years. That means that after 27 years of earning a 6% annual return, you would still need nine years to reach \$80,000.

The Rule of 72 is based on compounding a fixed rate of return over a period of time. However, most investments generate fluctuating returns so the period of time in which an investment can double cannot be determined with certainty.

Alligators in the Sewer: Bond Portfolio “Facts”

The myth that alligators live in the sewers of big cities just doesn't go away. The following “facts” you may have heard about bond portfolios or funds seem to have the same sticking power even though they're clearly not true.

Bond Portfolio Returns Are Always Lower than Stock Portfolio Returns.

Over time, stocks have outperformed bonds, but that's if you compare the long-term average annual returns of these two investment types. A look at the detailed record shows a different picture. During

some periods, bond returns have been higher than stock returns. Of course, past performance doesn't guarantee how an investment will perform in the future.

The Government Guarantees U.S. Treasury Bond Portfolios against Losses.

The federal government does guarantee that it will pay the interest on its bonds and repay principal at maturity. But a government bond portfolio may still lose money. Bond prices usually fall when interest rates rise. A bond portfolio's overall value may drop if the values of its individ-

ual bonds fall. Thus, you could lose part of the money you invest in a bond portfolio if you redeem your shares at a time when they're worth less than you paid for them.

Bond Portfolios Pay a Fixed Income.

Many of the individual bonds that portfolios hold do pay interest at a fixed rate. But different bonds pay different rates. And the managers of a bond portfolio frequently sell some of the portfolio's bonds and buy others. So, the fund's dividend to its shareholders moves higher or lower, as the combined interest earned on all the portfolio's investments changes.

Check Your Knowledge of Retirement Investing

See how well you know your retirement investment facts. Are the following statements *true or false*?

As a general rule, the more risky an investment is, the less its potential for gain.

False. Investors are willing to buy investments with more risk because those investments also offer the chance of better earnings. Without the higher potential rewards, investors would choose the safer alternative.

You may reduce overall risk by investing in funds or portfolios holding different types of securities.

True. Diversifying investments is an effective strategy for protecting retirement savings against market declines. For example, if you are 100% invested in stock portfolios when stock prices drop, you may lose a lot of money. If you also own bond and money market portfolios, any positive returns they earn could help offset your stock losses.

Market timing is a strategy that involves buying investments as soon as values start rising after a decline and selling them just before a decline starts.

True. Market timing sounds like

an excellent strategy, but even professionals have great difficulty following it successfully because the markets are unpredictable. The problem is you can't tell exactly when prices have bottomed out and whether falling prices are the beginning of a general market decline. Any price drop may simply be a short-term change.

Looking at a portfolio's past results can show you its future performance.

False. You can never tell any investment's future returns from its past performance. Superior results last year do not affect this year's performance. But a strong performance track record during different periods and market conditions can demonstrate that the portfolio's managers are skillful investors. Therefore, they *may* be able to continue achieving outstanding results.

The S&P 500 Stock Index can tell you how well the domestic stock market is performing overall.

True. This index measures the price changes of 500 large company stocks that represent most of the total market value of U.S. stocks. Within the S&P 500, companies with more issued and outstanding stock have

more “weight.” So, the importance of each stock is the same in the index as it is on the stock market.

You can tell a portfolio is a poor performer if its returns don't match the S&P 500 or another comparable index.

False. The performance of a portfolio and a benchmark index won't be the same for three reasons:

- They won't hold the same securities (unless the portfolio is an index portfolio designed to match the performance of a specific index).
- An index doesn't have a portfolio's investment management, recordkeeping, and other expenses.
- A portfolio may keep some assets in cash in order to pay for portfolio shares that investors redeem, and the returns on the cash investments may reduce its overall return.

When you decide whether a portfolio that has below-index results is a poor performer, you have to look at how much the returns differ over various time periods and whether the lower returns make a pattern.

An Investor's Sure Things

Predictions about the investment future flow like Niagara Falls, but they are all speculation. The few things an investor can be certain of include the following three observations.

1. Market-beating Returns Aren't Guaranteed.

Have you ever reviewed lists of top-performing funds or portfolios over different time periods? One conclusion pops out as you look at the data: *The winners keep changing.*

Each year, some portfolios perform better than others. And some do better than the overall market, while others don't.

You shouldn't expect most stock portfolio results to match the overall market. Unless a portfolio is designed to track the results of a specific market index, the portfolio's investments are not the same as those that the index measures. Different investments mean

different results. Also, a market index does not have an investment portfolio's overhead — management and trading costs.

The wide year to year variations in the performance of investment portfolios make it clear that there are no advance guarantees when you invest.

2. Risk Can Be Managed.

You can't be sure your investments will beat the market, but you can control the risk of investing by using a diversification strategy.

Simply invest in:

- Many different securities by owning funds or portfolios that each hold a number of investments
- A mix of portfolios that invest in different asset types, such as stocks, bonds, and cash equivalents
- If possible, a mix of portfolios within the stock category that

Three Performance Lessons

A \$1,000 stock investment* would have grown to \$1,210 during 1999 and then shrunk to \$1,100 during 2000. *Stock prices are always volatile.*

A \$1,000 stock investment* would have grown to \$41,247 during the 30 years ending 12/31/00. The same investment in intermediate-term government bonds would have grown to \$11,558. *The long-term growth of stocks has been higher than that of other investment types, such as bonds.*

Over an 11-year period, only 51.7% of the stock funds studied by a well-known economist had above-average returns two years in a row. *An investment's performance history never predicts its future.*

*If returns matched the S&P 500 stock index, an unmanaged index of the stocks of 500 major corporations.

invest in different types of stocks, such as large company, small company, and international stocks

Investing in a range of securities and investment types may prevent you from suffering large losses if one part of your mix drops in value, yet also preserve opportunities for making gains.

3. Time Builds Savings.

Compounding is the process of earning money on the amounts you invest and on the returns your investments generate. Compounding can deliver steady growth over time. The possibilities are dramatic, as the chart shows. But remember, while compounding itself is a sure thing, earning the investment returns that compound is not. With stock and bond portfolios or funds, losses are always possible, no matter how long you may own an investment. And you can expect your returns to vary from year to year, unlike the steady investment returns that are used to show the power of compound investment returns in hypothetical illustrations.

How Time Builds Retirement Account Balances

