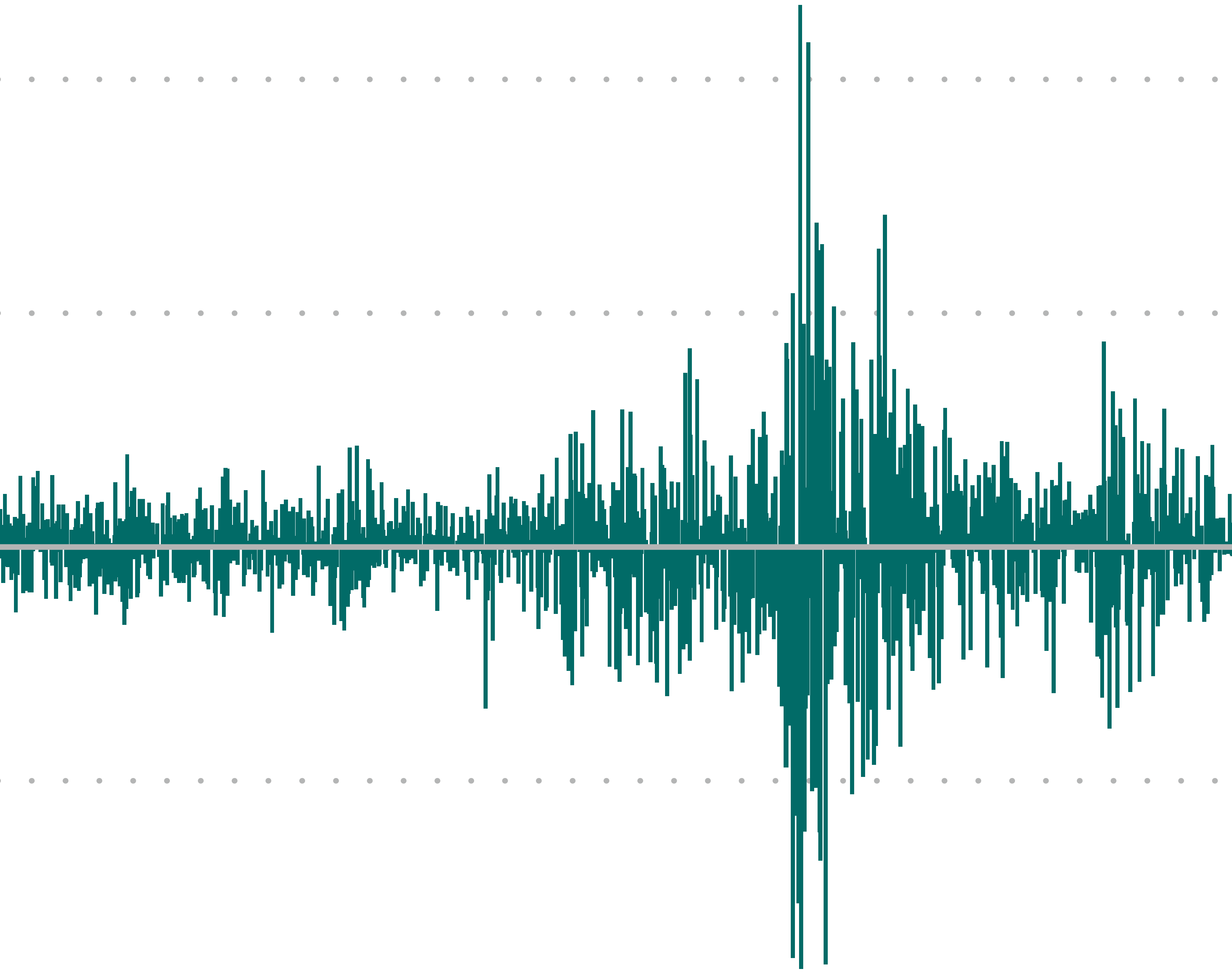
Insights from Morningstar
Investment Services

Market Volatility:
A Guide to Riding the Waves



If you’ve invested for almost any length of time, you’ve experienced at least one of those don’t-look-at-your portfolio days. The type of day where an equity market correction can leave you wondering if it isn’t better to just stash your cash under your mattress. But then again, you’ve probably also seen the rebound days, where you just wish you had more assets to place in the rising market.

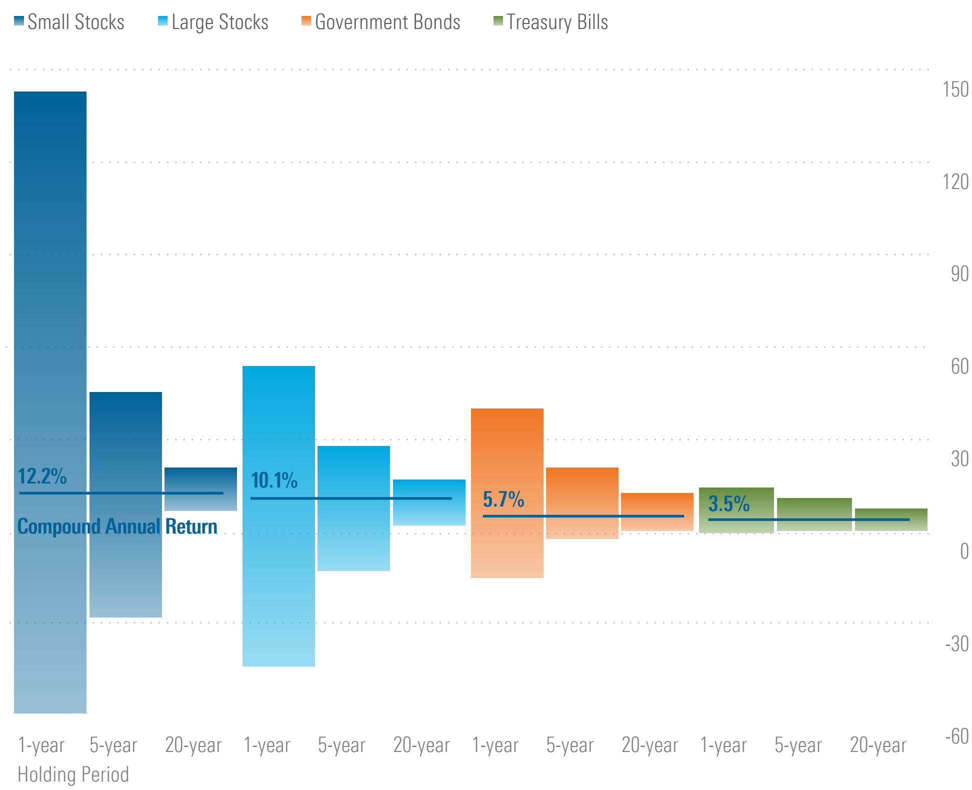
That, in short, is market volatility. Equity assets can be volatile: they may often deliver greater returns than their debt or cash counterparts, but those returns come with the risk of greater swings in value.

You can’t actually avoid volatility—it’s a fundamental part of investing. Market forces, outside economic conditions, natural disasters, and many other factors contribute to the unpredictable nature of the investment cycle. However, you can take steps to help mitigate the harmful effects of volatility. In the following pages, we’ll give you some pointers on how, with your advisor’s help, you can ride the waves of market volatility.

Focus on the long-term

At Morningstar Investment Services, we believe in investing for the long-term. Over time, the risk of equity investments losing value appears to diminish, because periods of high returns tend to offset periods of low returns. With the passage of time, these offsetting periods result in the dispersion of returns converging toward the average. In other words, while returns may fluctuate widely from year to year, holding an asset for longer periods of time can help lower the volatility you experience.

Reduction of Risk Over Time 1926–2014

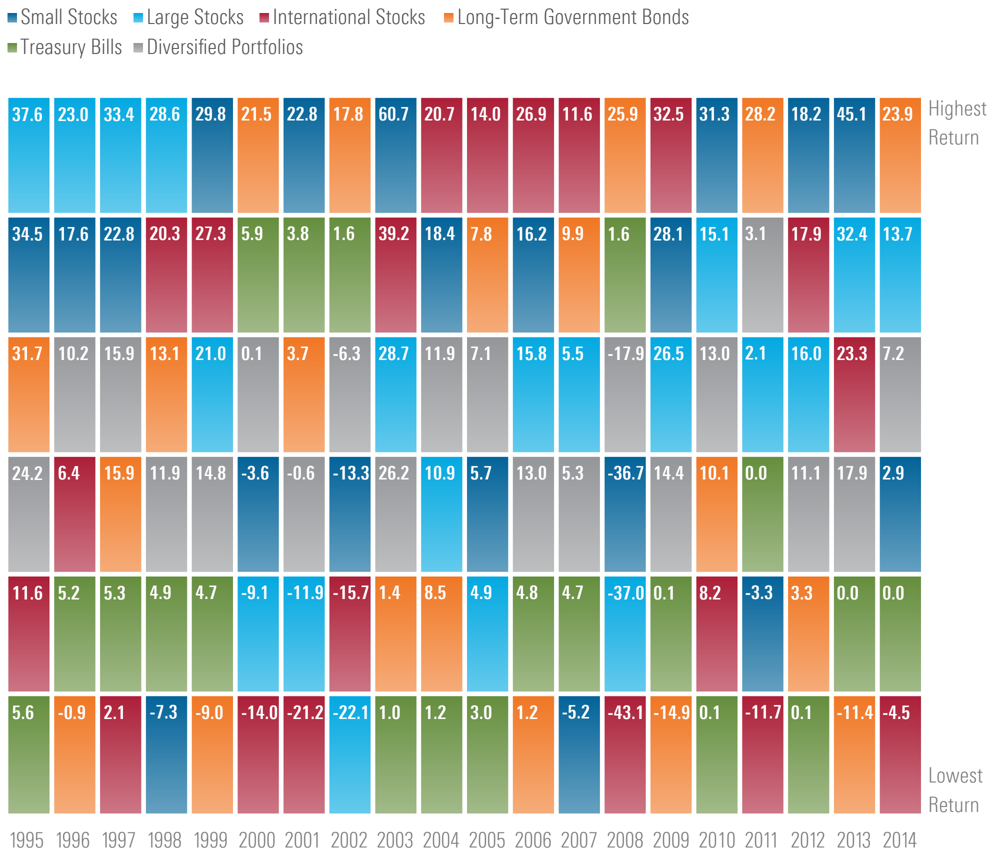


Past performance is no guarantee of future results. Each bar shows the range of compound annual returns for each asset class over the period 1926–2014. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Source: Morningstar, Inc.
See disclosures at the end for important information.

Let volatility work for you

While diversification can't prevent investments (or your portfolio) from losing value, it can help you lower the risk of a devastating loss. Because investments in different asset classes will behave differently, your portfolio may stay more predictable – when one asset class zigs, the other will zag — meaning the total effect on your portfolio should be lower than if you held more of any one of those investments. The chart below demonstrates this: the annual performance of a number of common asset classes over the past 20 years. You can see that different classes have performed better than others at different points in the market cycle. For example, in the mid 2000s, international stocks soared, while Treasury bills and long-term government bonds performed the poorest. When the market declined in 2008, long-term government bonds were a bright spot.

Annual Performance of Various Asset Classes (%) 1995–2014



Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. The diversified portfolio is equally weighted between small stocks, large stocks, long-term government bonds, Treasury bills, and international stocks (20% each). Source: Morningstar, Inc.

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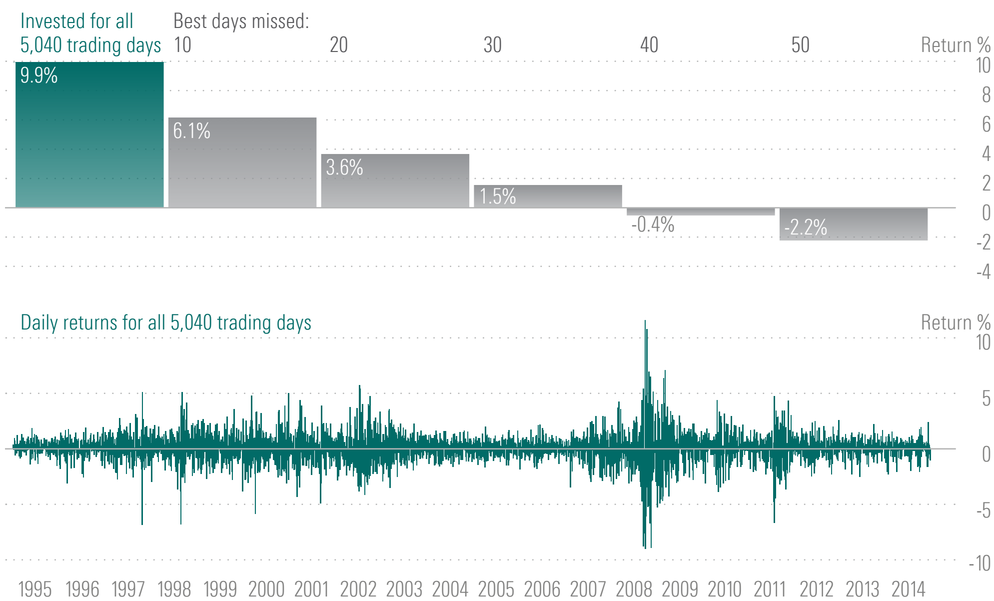
Take advantage of volatility

With proper planning and advice, it's possible to see some benefits when market volatility hits.

Stay invested and don't try to time the market.

Along with your advisor, you've created a long-term investing plan and chosen a portfolio that's appropriate to your level of risk tolerance. By pulling your assets out of the market when it drops, you might be limiting your gains by missing some of the best days of market returns. No one has a crystal ball that lets them see when markets will rise or fall. As the image below illustrates, by missing some of the best days in the market, you could miss out on a significant amount of returns.

Risk of Missing the Best Days in the Market 1995–2014



Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Source: Morningstar, Inc.

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Consider adding to your portfolio—or set up regular investments using a dollar-cost averaging strategy.

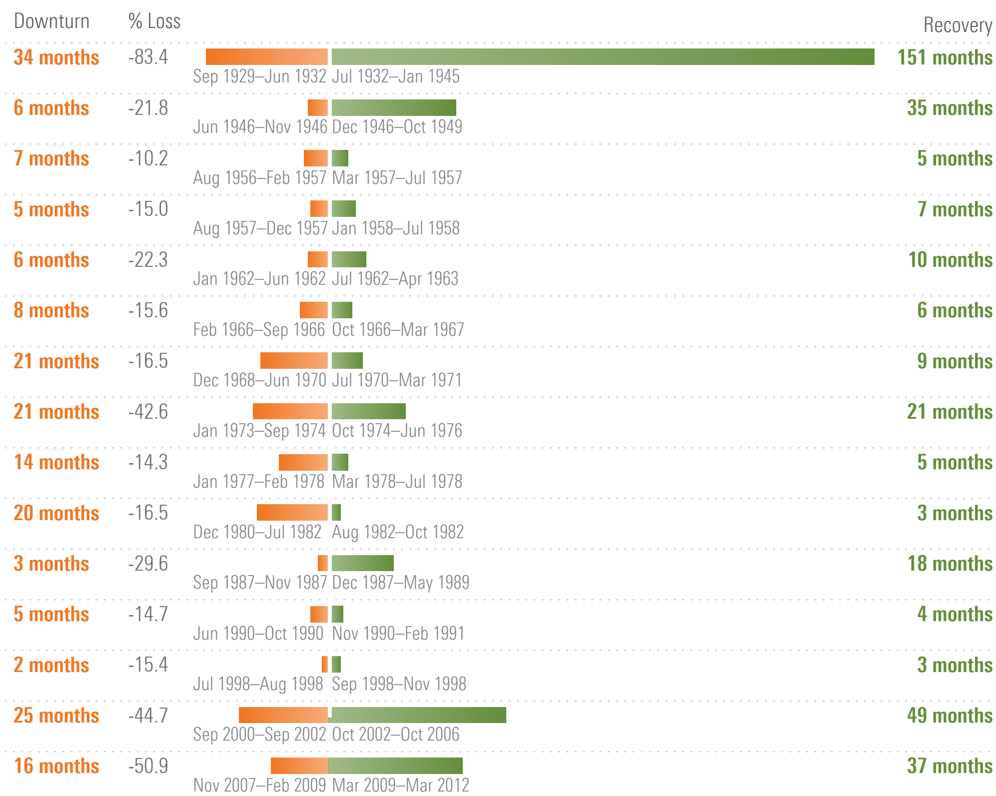
Dollar-cost averaging is simply adding a fixed dollar amount into a portfolio at set intervals—say, monthly or quarterly. The amount of money invested at each interval remains the same, but the number of shares purchased varies based on the market value of the shares at the time of purchase.

Don’t Miss the Recovery

During and after periods of volatility, it’s especially important to talk to your advisor. It’s natural for you to get nervous about your investments and think about selling certain portions of your portfolio. Your advisor is there to help you decide on the best course of action.

At Morningstar Investment Services, we monitor each portfolio carefully to make sure it stays on track to help meet its objectives, keeping you and your advisor up to date along the way.
In the depths of a downturn, it can be hard to recall the good times. However, recoveries have historically followed downturns.

Market Downturns and Recoveries 1926–2014



Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Downturns are defined by a time period when the stock market value declined by 10% or more from its peak.
Source: Morningstar, Inc. **See disclosures at the end for important information.**

Talk to your advisor

When you and your advisor first discussed your financial plan, you set goals and established the level of risk you could (and were willing to) undertake. Has anything changed? Make sure your advisor knows that so you can adapt the plan appropriately.

Remember, good preparation and an eye on your long-term goal can help you stay comfortable during periods of volatility. Be sure that you and your advisor:

- Avoid market timing. It’s too easy to miss the upside when you cash out after the slide
- Invest prudently after a downturn — to try to take advantage of discounts that come with volatility
- Choose well-diversified options that remain in line with your level of risk tolerance

Disclosures

The opinions expressed herein are those of Morningstar Investment Services, are as of the date written and are subject to change without notice, do not constitute investment advice and are provided solely for informational purposes and therefore are not an offer to buy or sell a security; and are not warranted to be correct, complete or accurate. Morningstar Investment Services shall not be responsible for any trading decisions, damages, or other loses resulting from, or related to, the information data, analyses or opinions or their use.

Morningstar Investment Services, Inc. provides discretionary investment advisory services to clients of unaffiliated registered investment advisors through its Morningstar® Managed Portfolios℠ program. In addition, Morningstar Investment Services also offers model portfolios to third-party advisory programs on a non-discretionary basis as a strategist.

Past performance is no guarantee of future results. The data in the charts above assumes reinvestment of all income and does not account for taxes or transaction costs.

Neither diversification nor asset allocation ensure a profit or guarantee against a loss.

It is important to note that investments in securities (e.g. mutual funds, exchange-traded funds, common stocks) involve risk, will not always be profitable, and may include possible loss of principal.

Holding stocks for the long term does not ensure a profitable outcome.

Government bonds and Treasury bills are guaranteed by the full faith and credit of the U.S. government as to the timely payment of principal and interest.

Small-company stocks are more volatile than large-company stocks and are subject to significant price fluctuations, business risks, and are thinly traded.

International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, liquidity risks, and differences in accounting and financial standards.

Indexes shown are unmanaged and not available for direct investment. Although index performance data is gathered from reliable sources, Morningstar Investment Services cannot guarantee its accuracy, completeness or reliability, except as otherwise required by law.

Reduction of Risk Over Time 1926–2014

Although stockholders can expect more short-term volatility, the risk of holding stocks appears to lessen with time.

About the data

Small stocks are represented by the Ibbotson Small Company Stock Index; Large stocks by the Standard & Poor's 90 index from 1926 through February 1957 and the S&P 500 thereafter; government bonds by the 20-year U.S. government bond, and Treasury bills by the 30-day U.S. Treasury bill.

Annual Performance of Various Asset Classes (%) 1995-2014

About the data

Small stocks are represented by the Ibbotson Small Company Stock Index; Large stocks by the S&P 500, government bonds by the 20-year U.S. government bond, Treasury bills by the 30-day U.S. Treasury bill, and international stocks by the MSCI EAFE. The data assumes reinvestment of all income and does not include taxes or transaction costs. The diversified portfolio is equally weighted between small stocks, large stocks, long-term government bonds, Treasury bills, and international stocks.

Risk of Missing the Best Days in the Market 1995-2014

About the data

Stocks are represented by the Ibbotson Large Company Stock Index.

Market Downturns and Recoveries 1926-2014

About the data

Large stocks are represented by the Standard & Poor's 90 index from 1926 through February 1957 and the S&P 500 thereafter. Downturns are defined by a time period when the stock market value declined by 10% or more from its peak, while the recovery period indicates the number of months from the trough of downturn to the market's previous peak.

Definitions

Ibbotson® Small Company Stock Index

The Ibbotson style indexes cover various market capitalization sizes including large-cap, mid-cap, small-cap, and micro-cap. The Small Company Stock Index is constructed by first selecting deciles 6-8 of the NYSE universe and then assigning similar sized NYSE Amex and NASDAQ companies to the corresponding portfolios.

S&P 500® Index

A market capitalization-weighted index of 500 widely held stocks often used as a proxy for the stock market. It measures the movement of the largest issues. Included are the stocks of industrial, financial, utility, and transportation companies.

MSCI EAFE Index

Measures the performance of the stock market in the following countries: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Italy, Japan, Malaysia, Netherlands, New Zealand, Norway, Singapore, Spain, Sweden, Switzerland and the United Kingdom.

Ibbotson® Large Company Stock Index

The Ibbotson style indexes cover various market capitalization sizes including large-cap, mid-cap, small-cap, and micro-cap. The Large Company Stock Index is constructed by first selecting deciles 1-2 of the NYSE universe and then assigning similar sized NYSE Amex and NASDAQ companies to the corresponding portfolios.

About Morningstar Investment Services

We're committed to helping financial advisors create better outcomes for investors like you. Together, we offer the professional guidance and access to strategies that can help you achieve your goals. Our model portfolios are designed to be part of a long-term investing plan that helps meet your needs at each stage of your lifetime.

Contact Us Today

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