

## Maintaining your investment strategy during periods of market turmoil: October 10, 2008

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When equities are falling sharply on a daily basis—as they often have done in the last few weeks—and members of the media are broadly telling investors to “get out of the stock market now” without knowing your individual circumstances, it is very easy to feel discouraged and decide to “cut your losses” by abandoning stocks and stock funds for good. Unfortunately, that decision may significantly undermine your ability to achieve your long-term financial goals, such as retirement or saving for your child’s college education.

### **I Plan to Sell All of My Stocks. Why Should I Consider Otherwise?**

Before making a decision that could have long-lasting repercussions, investors may want to consider several reasons for maintaining investments in equities or funds that invest in equities. Keep in mind, of course, that *past performance cannot guarantee future results*, and it is impossible to predict what may occur.

- **Stocks Offer Superior Long-Term Return Potential.** In today’s low interest rate environment, FDIC-insured bank accounts and many fixed-income investments—which are relatively stable places to invest versus stocks—cannot compete with the long-term performance potential of equities. According to Ibbotson Associates, the S&P 500 Index in the 40-year period ended September 30, 2008—during which time there were many economic and stock market downturns with varying durations and intensity—produced an average annual return of 9.72%.<sup>1</sup>

The S&P 500 Index is an unmanaged 500-stock index of mostly large-cap U.S. companies that represent a broad spectrum of the U.S. economy.

- **The Current Bear Market May Be Nearing a Bottom.** In the 10 bear markets (declines of 20% or more) that have occurred since the end of World War II, the S&P 500 Index, on average, declined 32% over a period of 16 months<sup>2</sup>. In the current bear market, the S&P 500 Index returned about -22% in the one-year period ended September 30, 2008, and has fallen approximately 36% from its October 2007 peak through October 7, 2008<sup>2</sup>. So, by historical standards, we could be near the bottom of this downturn. (Source: Standard and Poor’s Equity Research)
- **Recoveries from Market Bottoms Can Happen Quickly.** In the rebounds from the 12 bear or near-bear markets (declines of 20% or more) since 1957, the S&P 500, on average, recouped one-third of its losses in just the first 39 days after the bottom. Longer-term performance after bear markets has also been strong. For example, in the 12 months following the end of the 2000-2002 bear market, the S&P 500 returned about 22%<sup>2</sup>. During the three years after that downturn, it returned about 15% per year<sup>2</sup>. Also, following the brutal 1973-1974 downturn, the S&P 500 advanced 32% over the next year and 15% per year over the following three years<sup>2</sup>. Of course, not all markets have reacted equally. (Source: Monthly S&P 500 Index returns)
- **You Could Miss the Market’s Best Days.** Stock market rallies, especially in a bear market, may be brief, sudden, and unpredictable. According to a T. Rowe Price study using data from Ned Davis Research, a continuous investment in the stock market (as measured by the S&P 500 Index) for the 10-year period ended December 31, 2007, would have returned 4.22%. If that seems mediocre, consider the returns in the table below if the investor missed a relatively small number of days out of that period because of market timing.

<b>The Price of Being Out of the Stock Market (12/31/97 to 12/31/07)</b>	
If you missed this number of the best days...	...your return would have been
0	4.22%
10	-0.48
20	-4.07
30	-7.15
40	-9.74

Source: Ned Davis Research. Analysis: T. Rowe Price. Data shows average annual returns based on price movements only and do not include reinvested dividends or compounding. The performance shown is that of the S&P 500 Index. This chart is for illustrative purposes only, and does not represent the performance of any specific security. Investors cannot invest directly in an index. Past performance cannot guarantee future results.<sup>2</sup>

- **Stock Valuations are Currently Very Attractive, in Our View.** As of September 30, 2008, the S&P 500 Index's forward price/earnings (P/E) ratio was about 12.3. The forward P/E was also low near the bottom of the 1973-1974 bear market (8.5 as of September 30, 1974) and near the end of the 2000-2002 bear market (15.6 as of September 30, 2002). Historically, when this valuation measure is low, it means that stocks in the S&P 500 appear undervalued and may represent a good long-term investment opportunity. (*Source of data: Strategas Research Partners*).

A price/earnings (P/E) ratio shows the "multiple" of earnings at which a stock is selling. It is calculated by dividing a stock's current price by its current earnings per share. For example, if a stock's price is \$60 per share and the issuing company earns \$2 per share, the P/E ratio is \$60/\$2, or 30.

Historically, the best strategy for many investors has been to have some assets in stocks over the long term to help keep ahead of inflation and protect their purchasing power, rather than trying to time market swings. Not even professionals are consistently successful at predicting the direction of the overall market.

This is not to say that investors should have all or even most of their assets invested in stocks at all times. Every portfolio should be diversified to suit the investment goals, time horizon, and risk profile of the individual investor. However, it does mean that stocks can be an integral part of your long-term financial plans.

All mutual funds are subject to market risk, including possible loss of principal. Unlike bank products, mutual funds are not insured or guaranteed by the FDIC.

*This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular action. The opinions and commentary do not take into account the investment objectives or financial situation of any particular investor or class of investor.*

*The views contained herein are as of October 9, 2008 and may have changed since that time.*

T. Rowe Price Investment Services, Inc., Distributor.

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<sup>1</sup> Data shows average return data that includes reinvested dividends and compounding.

<sup>2</sup> Data shows average annual returns based on price movements only and do not include reinvested dividends or compounding.