THE COST OF BAILING OUT

Morningstar, a leading research and investment management firm, attempted to quantify the cost of abandoning an investment strategy during times of volatility in the following chart.

The importance of staying invested – Ending wealth values after a market decline.

The chart shows a hypothetical USD 100,000 investing the stock market from 2007 to 2014, a period that encompasses the financial crisis and subsequent recovery. As the financial crisis unfolded, the market fell sharply, and at the bottom (known only in hindsight) in February 2009, the USD 100,000 was worth only USD 54,569. As the crisis and market decline unfolded rapidly, many investors were faced with steep losses in the portfolio before they knew it and had to make the decision to move to cash or risk a further decline. Since there was no sign of the crisis or market losses abating, the psychological pressure to do something to prevent further loss was immense.

For those who withstood that pressure and stayed with their investments, the market and the portfolio rebounded over the next 70 months to a new high of USD 174,425. For those who exited in February 2009 and stayed out of the markets for the next year, not believing the market recovery was genuine or rooted in economic reality, the portfolio rebounded to USD 112,340. And for those who threw in the towel, vowing never to go near the market again, they ended up with USD 54,569, or a permanent loss of USD 45,431.

The difference in ending wealth based on different decisions made at the depth of the financial crisis and market decline is staggering. For those who stayed the course, their ending wealth was USD 62,085 more than those who sold and waited a year to get back in and USD 119,856 over those who sold at the bottom and never got back in.

(Source; Morningstar Inc.)

(Text extract from article by Chad Creveling,CFA & Peggy Creveling, CFA sept 2015)