



The Impact of Consistent Savings Rates During Bear Markets

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Introduction

Investing is an exercise in emotional fortitude, especially in times of economic upheaval and stock market turmoil. In challenging times, typical “investors” behave much more like “speculators” when trying to make investment decisions by focusing on things that are entirely out of their control (e.g. engaging in market timing, speculating on the direction of interest rates or currencies, etc.). In contrast, successful investors focus their time and efforts on the aspects of the investment process that are within their control (e.g. diversification, discipline, controlling costs, and minimizing taxes).

In his ground-breaking book *The Intelligent Investor*, famed investor Benjamin Graham (and Warren Buffett’s mentor) stated:

For indeed, the investor’s chief problem—and even his worst enemy—is likely to be himself...We have seen much more money made and kept by “ordinary people” who were temperamentally well suited for the investment process than by those who lacked this quality, even though they had extensive knowledge of finance, accounting, and stock market lore.

One other important and completely controllable aspect of the wealth accumulation process actually has nothing to do with investing – implementing a consistent savings discipline. One of the chief concerns for many investors is whether to continue to invest in a falling market which often feels like “throwing good money after bad.” In this whitepaper we will explore the economic impact of maintaining contributions during down markets, often referred to as “dollar cost averaging.”



A Look at “Bear Markets”

Bear markets are inherent to investing. They are unavoidable, and are part of the economic and market cycle. As investors, it is important to understand why the markets go through extended periods of losses, and what the best approach is during those cycles. A bear market is defined as a 20 percent loss in the value of the stock market. The approach most investors would prefer to take with a bear market is to avoid it completely. Unfortunately, this is easier said than done as there is no metric or warning signal that can tell us in advance that a bear market is approaching. In fact, a bear market is often the sign that the economy could be entering a recession.

Over the past 100 years, the U.S. stock market has experienced three extended bear markets. Some experts call these “structural bear markets” because they last for extended periods of time. The research presented by Greenspring in this whitepaper has been derived from these three periods, and we believe the findings show ample evidence as to how investors can take advantage of times like these. The three periods we researched were:



TABLE 1

The Great Bears¹

PERIOD	DATES
The Great Depression	1929-1945
The Inflation of the 1970s	1966-1982
The Current Lost Decade/Great Recession	2000-present

In each of these periods, we researched the time it took for an investor to break even from the prior peak in the market (after inflation was taken into account). As you can see for the first two bear markets we researched (Table 1), it took investors sixteen years to get back to break even. In our current bear market (which started after the tech bubble burst in 2000), the market is still 25% below its prior peak.

¹Data source: S&P 500 Index Total Returns 1926-2011.



Investment Strategies During a Bear Market

To maximize long-term wealth, how should investors change strategy once one of these periods has been entered? Some would argue that stocks should be sold, but that is typically a poor choice as investors are then selling stocks at depressed prices, with no guarantee that they will continue to drop. In fact, those investors who believe a good strategy is to sell after the market drops a certain percentage should be mindful of the research below:

TABLE 2

Magnitude of Decline² (1900 - December 2010)

PERIOD	DATES
5% or more	About 3 times a year
10% or more	About once a year
15% or more	About once every 2 years
20% or more	About once every 3.5 years

What the data in Table 2 shows is that smaller losses in the market normally do not predict a bear market. Greenspring's research suggests that the best strategy during extended bear markets is a systematic savings plan, often referred to as "dollar cost averaging." While continuing to invest when the stock market is falling may seem counterintuitive, the benefit is in its consistency and simplicity. As the stock market falls, investors who stick with a disciplined, systematic savings strategy are able to buy shares at lower prices, effectively lowering their "cost basis" (i.e. the price at which a security is purchased). This strategy lessens the amount of time it will take them to break even, and creates more wealth for the investor over the long term. The only assumption that is necessary is that at some point in the future, the stock market will regain (and hopefully pass through) its prior peak. Since this has happened during every period measured throughout history, Greenspring believes this is a reasonable assumption to make.

One of the major variables in how much value a "dollar cost averaging" strategy will create is the amount of savings an investor puts away in comparison to the initial starting amount. For the purpose of this research, we call this percentage the "Savings Rate".

²Source: Capital Research and Management Company.



Our research suggests that the larger the savings rate, the greater the impact on ending wealth during these bear markets. For example, an investor with a \$100,000 portfolio would generate far greater value during a bear market with a savings rate of 10% (\$10,000 savings per year) versus a savings rate of 5% (\$5,000 savings per year).

TABLE 3

Additional Ending Wealth³ Created by Using a Dollar Cost Averaging Plan versus Buy and Hold⁴

SAVINGS RATE ⁵ (SAVINGS AS % OF STARTING WEALTH)	GREAT DEPRESSION	HIGH INFLATION OF THE 1970S	LOST DECADE/ GREAT RECESSION	AVERAGE
5%	24%	9%	11%	15%
10%	35%	11%	16%	21%
15%	41%	12%	19%	24%
20%	44%	13%	21%	26%

Table 3 above shows the additional percentage of ending wealth (over and above contributions) those investors achieve who implement and maintain a dollar cost averaging strategy. In addition to the greater growth investors receive on their money, those who choose to use this strategy also have a greater account balance because they are adding to their accounts each month. Because higher savings rates generate significantly greater value to the investor, younger savers are in a much better position to capitalize on this strategy. Traditionally, younger savers have not generated substantial wealth, and therefore can afford to save a larger percentage of their accumulated wealth than investors who are approaching retirement, and have saved substantial sums throughout their careers. Nevertheless, both types of investors can find value in this strategy, just in varying degrees.

³Ending Wealth is calculated in real dollars (after-inflation).

⁴Data Source: S&P 500 Total Return, Consumer Price Index - 1926-2011.

⁵Savings rate is calculated by taking the initial dollar amount then increasing/decreasing it based on the CPI level.



Savings Strategy Implications

As the market moves toward entering the 12th year of the current bear market, investors should consider setting up a dollar cost averaging program. The best vehicle for this can usually be found through a workplace retirement account, such as a 401k or 403b plan. These programs allow a person to defer a percentage of their income into investments each pay period. The research presented in this paper is part of the reason these programs have been so successful.

For those investors who already contribute to one of these programs, increasing your savings rate has been shown to add substantial value, and because the stock market is still depressed, that value could be magnified when looking back on this period five, ten and twenty years from now.

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