NAVIGATING VOLATILITY
Thinking Long-Term

Should You Go To Cash Or Stay The Course?

Mutual fund investors lift returns when they remain in the market

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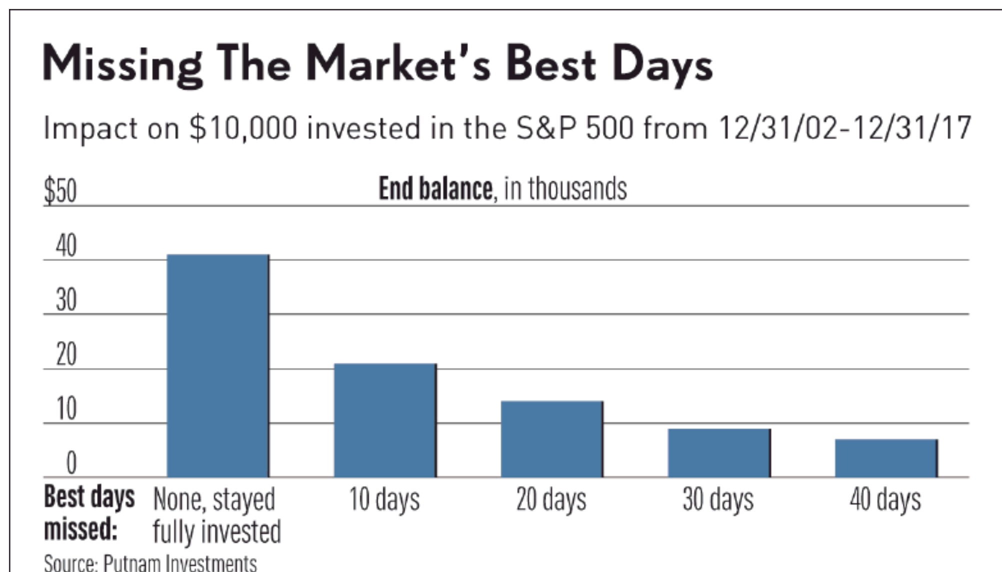

Sure, you're jittery. The market has been selling off. Very likely, you're wondering whether to go to cash from your mutual funds or stay the course.

For holders of diversified stock mutual funds with a long-term view, the answer is stay the course, based on history and strategic thinking. That doesn't mean any fear factor you're feeling is not real. Nor does it mean your funds and retirement accounts didn't painfully lose value this month.

Going to cash can be wise with individual stocks, based on the rules of a time-tested strategy that tells you when to get in and out of securities. But it's anything but wise with the diversified part of your portfolio — your mutual funds — for the average investor, especially one with a long time horizon. If you're in retirement or close to it, cashing out whatever funds you need for an upcoming major bill can be prudent.

One reason it's risky to go to cash from diversified, long-term fund holdings is individual mutual fund investors rarely get out of the market near its top, studies show. And they rarely if ever get back into the market at a good time. "People don't have crystal balls," said John Gagliardi, a regional brokerage consultant for Fidelity Investments. "They can't predict the future."

Instead of selling high and buying back in at the low, time and again they end up selling low — then buying high because they miss the often explosive start to a rally. And the market has always rallied.

Why do investors buy high? Even after a rally begins, jittery investors who went to cash after the start of market woes are still waiting on the sidelines for the market to look safe. Meanwhile, the market is piling up some of its sweetest gains.

The price for missing some of those best days is that your total returns suffer. Look what happened if you had invested $10,000 in the S&P 500 between Dec. 31, 2002 and last Dec. 31. If you stayed fully invested through the market's ups and downs, your total return was 9.92%. Your nest egg would have ballooned into $41,333.

But if you got cold feet and pulled out, what then? If you didn't get back in soon enough to benefit from rallies after

various pullbacks, and you missed just the 10 best market days during that 15-year period, your return got slashed nearly in half to just 5.03%, Putnam Investments calculates. Your end balance would have been a far more modest $20,873.

If you missed the 40 best market days, your return would have shrunk to a 2.62% loss, slashing your $10,000 to $6,716.

Bargain Hunting

Another reason not to go to cash is that you miss opportunities to buy more shares at a discount in funds you like. “I see pullbacks as buying opportunities,” Gagliardi said.

Market fundamentals remain strong, says Mark Giambrone, a manager of $1.9 billion USAA Growth & Income Fund USGRX . “We have a positive economic backdrop for corporate earnings and cash flows and consumer confidence and spending,” he said.