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World Crisis and the Stock Market: Learn From History, Prepare for the Future

The brutal attack on the United States on September 11, 2001, was unlike any the nation has ever endured. It exacted an enormous toll of human suffering and commercial destruction. The subsequent closing of the stock market for four days was also a new experience — it was the longest trading has been halted since the start of World War I.

But this is not the first time a national or global crisis has sent shudders through our economy and our financial markets. Putting recent events in some historical perspective may help the millions of Americans whose financial future is closely tied to the stock market cope with the economic challenges and stock price volatility they may face in the near term.

Market Realities

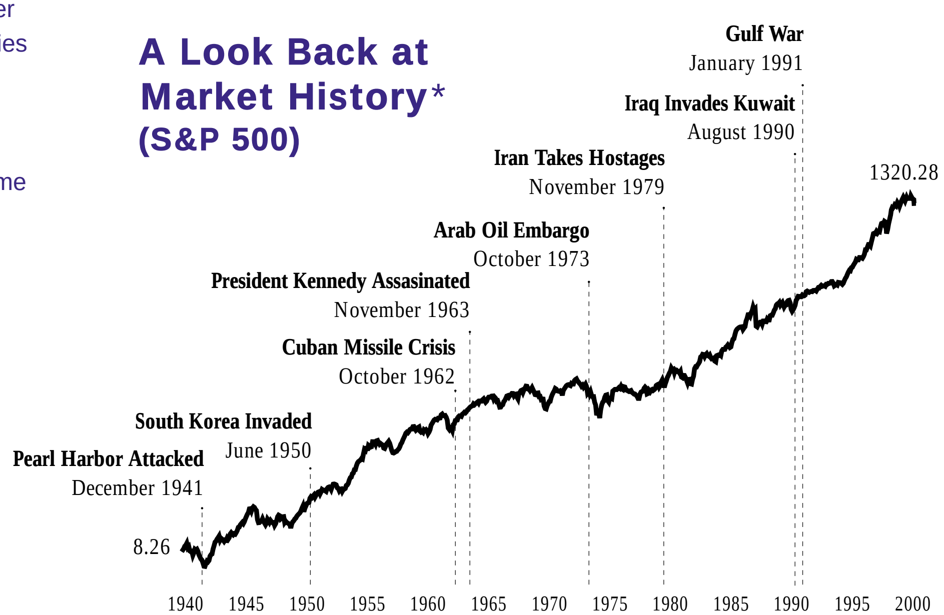
There's no doubt that the attack on the United States puts more stress on an economy already struggling through its first sustained slowdown in a decade. Many economists believe the impact on consumer confidence and industries such as tourism and insurance will push the United States into a recession for the first time since the early 1990s.

Not surprisingly, when the stock market reopened on September 17, 2001, stock prices fell sharply — the S&P 500, for example, fell 4.92%.*

All of this leaves some investors asking serious questions, including "Should I sell my stock investments?" Before deciding, they may want to consider the impact other major crises have had on the market and, more important, the stock market's long-term trend.

While past performance does not guarantee future results, investors who have stayed in the market during turbulent times have eventually been rewarded (see chart). For example, in the five months following the attack on Pearl Harbor — which ushered in the United States' involvement in World War II — the S&P 500 declined almost 17%. But by the time the war ended in 1945, the index had advanced 62% from its level on December 7, 1941.*

A Look Back at Market History* (S&P 500)



**Source: Standard & Poor's. Based on price returns, excluding reinvestment of dividends. The S&P 500 is an unmanaged index considered representative of large-cap U.S. stocks. Individuals cannot invest directly in any index. Past performance is no guarantee of future results.*

On June 26, 1950, the day after North Korea invaded South Korea, the S&P 500 fell 5.38%. When the Korean War ended in July of 1953, however, the index was almost 30% above its level the day of the invasion.

Or consider a more recent example: On August 2, 1990 — the day Iraq invaded Kuwait, which ultimately led to the Gulf War — the S&P 500 embarked on a three-month decline of 13.5%. But one year after the initial invasion, the S&P 500 was 10.16% higher than it was on August 2, 1990.

Coping With Uncertainty

Dealing with crises such as the September 11 attack requires more than historical perspective. You should also consider these suggestions:

• Talk with a financial professional before you act. He or she can help you separate emotionally driven decisions from those based on your goals, time horizon, and risk tolerance. Researchers in the field of behavioral finance have found that emotions often lead investors to read too much into recent events even though those events may not reflect long-term realities. With the aid of a financial professional, you can sort through these distinctions, and you'll likely find that if your investment strategy made sense on September 10, 2001, it still makes sense today.

• Organize and review your financial records. Events like the attack on the United States highlight the importance of knowing where your assets are and maintaining organized financial records. Keep in mind that despite the destruction in the heart of New York City's financial district, the nation's financial systems were up and running in a matter of days and your securities accounts were safe even when the stock exchanges were closed. While you cannot trade investments or access your assets during a market shutdown, securities firms maintain backup facilities and have contingency plans to help them service customers when trading resumes.

• Practice buy-and-hold investing. As we've learned over the past year, the only certainty about the stock market is this: It will always experience ups and downs. That's why it's important to keep emotions in check and stay focused on your financial goals. A buy-and-hold strategy — making an investment and then holding on to it despite short-term market moves — can help. The opposite of buy-and-hold investing is market timing — buying and selling investments based on what you think the market will do next. Market timing, as most investment professionals will tell you, is risky. If your predictions are wrong, you could invest when the market is on its way down or sell when it's on its way up. In other words, you risk locking in a loss or missing the market's best days.

Take Your Time

The assault on America was traumatic for people across the country and around the world, and it will take time for any sense of normalcy to return. It will also take time to rebuild and to sort out the impact on the economy and the markets.

As experienced market watchers will tell you though, time may just be an investor's greatest ally. Use it to your advantage by sticking to your plan and focusing on the future.

Four Tips for Dealing With Market Turmoil

- Implement a well-thought-out investment plan — and then stick with it. That way you'll be in the market when conditions improve.
- Do not make investment decisions based on short-term market drops or gains. Instead, evaluate how an investment fits into your overall financial strategy.
- Look at a market decline as a buying opportunity. Some stocks may be undervalued following a broad market decline, allowing you to invest more in high-quality companies.
- Talk with a financial professional. He or she may have been through volatile periods before.