



Markets Often Rebound Before The Economy

Given the extreme recent volatility of the stock market and the worsening economy, it's no wonder investors are on edge. Most have suffered significant setbacks during a recession that is already at record length and could continue for another year or more. It hardly seems like the right time to buy stocks. Yet while no one can know for sure when markets will turn around, that typically happens well before the economy gets going again.

The numbers don't lie. One recent study examined nine recessionary periods defined by the official arbiter, the National Bureau of Economic Research (NBER). According to NBER data charting recessions from 1953 through 2001, the stock market typically declines until sometime during the middle of the downturn and then begins to strengthen.

Starting at the low point of each recession and continuing until six months after its official end, the Standard & Poor's 500 stock index averaged a gain of 36%. That compares with an average decline of 21% for the S&P during a period starting six months before the official onset of each recession and ending at its low point. The average return for an entire recessionary period, including the six months before and after the actual recession, was 8%, and the average recession lasted 11 months. The positive return is due to the role of the markets as a leading indicator, meaning that by the time the recession grips the economy,

the markets are already looking forward to the eventual recovery. Similarly, much of the drop in the markets occurs in anticipation of the recession, many months before it is made official.

Throwing in the towel. Despite the hard data showing its benefits, buying stocks during the depths of a recession is bound to feel counterintuitive, particularly if you've spent months watching current holdings steadily lose value. Psychologically, it feels better to jump into the market after prices are already surging and getting out when they're falling. But it's exactly when most investors have finally given up on stocks—a situation market pros call capitulation—that the market is likely to bottom out and start climbing. Capitulation tends to happen when economic news is most dire.

Indications of things to come. In the end, of course, market movements are driven by supply and demand, and stocks won't improve this time just because they've risen under similar circumstances in the past. Still, history can provide important clues about where the economy and markets are likely to go, and economists consider the stock market a leading indicator—a preview of what may be to come for the economy.

Other lagging economic indicators reflect what has already occurred. For example, a higher unemployment rate typically develops because the economy

is struggling; when demand for goods and services slackens, companies often respond by reducing their payrolls. Similarly, inflation may keep rising for months after upward pressure on prices, reflecting an economy at its peak, has already largely dissipated.

Stock prices, in contrast, are based on what investors consider to be a company's prospects. When the economy is at its worst, the road ahead may begin to seem comparatively bright, and company earnings could start to rebound even while current statistics continue to paint a gloomy picture. And when investors finally stop selling and start buying, rising demand for stocks will push up prices.

Chances are that this time, as in the past, the stock market will strengthen well before the economy and point the way forward for investors. But keep in mind that the sample size of this study is very small; only nine recessions occurred between 1953 and 2001. Also, the current economic crisis is largely viewed as the worst since the Great Depression, so the rebound may take longer than past recessions.

As always, it's crucial to stick with a long-term investment plan that reflects your goals, timetable, and risk tolerance. We are closely following developments in the economy and investment markets and would be happy to discuss whether any adjustments to your portfolio might be in order.

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Retirement Plan Update

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HEFFERNAN FINANCIAL SERVICES
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Considerations Before Suspending a 401(k) Match

With the US into what may be a prolonged recession, many organizations have looked for ways to save cash, including the reduction or suspension of contributions to their company 401(k) plans. While suspending a matching contribution is a relatively easy and immediate way for a company to save money, it's very important to understand the potential issues around taking this action.

In a fourth quarter 2008 survey by Mercer, just 17% of respondents said that they were "likely" or "very likely" to suspend DC plan contributions. Plansponsor.com, reporting on a Callan Associates survey of defined contribution plan sponsors in February 2009, noted that 1% intended to cut matching contributions, 73% planned to continue such contributions and 20% of sponsors were uncertain as to their strategy.

However, looking at recent news headlines shows a growing trend in contribution suspension. In fact, in the first three months of 2009 more than 80 employers publicly announced that they were planning to reduce or suspend contributions to their plans. These contribution suspensions have been more common in industries most affected by the recession, including automotive, media, airlines, retail, hospitality and gambling.

Looking over an employee's working lifetime, the loss of one year's employer contribution will not have a significant impact on the employee's ultimate retirement benefit. However, the action may represent yet another incremental loss to a plan that

may already be weakened by a history of low participation rates and inconsistent investment behavior and has most recently been dramatically impacted by unprecedented market losses. In addition, suspending contributions may result in a lost opportunity to buy equities at historically low prices. These implications must be considered against the companies need to save capital.

Regulatory considerations when suspending matching contributions will of course vary from plan to plan. Employer's who maintain an IRS safe harbor design are subject to very specific rules and restrictions on suspending or reducing contributions during a plan year. Employers will need to consider whether formal plan amendments are required and whether the amendment raises any anti-cutback issues.

Plan sponsors may also want to review past employee communications to determine whether any language could be interpreted as a promise to provide ongoing contributions. Employers with collective bargained or other employment agreements in place may also be prevented from making plan wide changes to their plans. Reducing or suspending employer contributions could also impact plan nondiscrimination requirements. Employers should consider first projecting the effect of any contribution changes on the plan tests.

Even if a plan passes the non-discrimination tests with a revised employer contribution,

employers should still consider whether the timing or nature of the change favors higher paid employees.

Participants should receive notice with sufficient opportunity to change their deferral elections before changes in any matching contribution structure takes affect. Also, safe harbor designs carry specific advance participant notification requirements. Contribution changes may also be incorporated into summary plan description or summary of material modifications and all regularly distributed materials should be reviewed and updated.

Plan Sponsors whose plans offer auto-enrollment should review this feature in light of any suspended or reduced matching contributions and should update the appropriate materials. Plan that provide for true-up matching contributions at year end will also require careful consideration, with special attention given to pay and contributions that will be taken in to account when calculating the true-up.

Plan sponsors at distressed organizations may feel that they don't have the time or resources to carefully consider the effects of reduced matching contributions or to evaluate whether alternative approaches may fit the organization's long term objectives. Certainly the time invested to thoroughly consider all options could save considerable time and expense later when dealing with unexpected consequences of the decisions made today.

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Retirement Plan Update



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Stocks May Sink Further, But Wise Investors Are Buying In

During the stock market meltdown, there has seemed to be no limit to how far prices can fall. And with each new plunge, everyone wonders, "How low can stocks go?"

Nobody can answer that question, and successful investors know they don't need the answer. They realize that when valuations are at historically low levels, it's a good time to buy stocks. After all, the adage is "Buy low, sell high," not "Buy at the lowest point and sell at the highest."

Top investors such as Warren Buffett and Jeremy Grantham began buying stocks while many others were panic-selling. Neither believed the market had necessarily hit the low point of the current economic crisis. Each saw bargain prices for some securities and took that opportunity to buy, even though there was a good chance prices would fall even further before climbing higher. "I haven't the faintest idea as to whether stocks will be higher or lower a month—or a year—from now," Buffett wrote in an op-ed article in *The New York Times* (October 17, 2008). Yet he feels strongly that the purchases he makes now will pay off down the road.

Could Buffett and others have gotten even better prices if they had waited longer? As we now know in hindsight, yes. But investing is always a matter of taking calculated risks, and now, when share prices for many good companies have been beaten down so far, the calculation may show that it's time to buy.

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Quotes of the Quarter

"When stocks are attractive, you buy them. Sure, they can go lower. I've bought stocks at \$12 that went to \$2, but then they later went to \$30. You just don't know when you can find the bottom."

Peter Lynch

"Whether we're talking about socks or stocks, I like buying quality merchandise when it is marked down."

Warren Buffet

