

don't just do something—
stand there!



Let's say you have a friend—let's call him Chuck—who owns a shiny red convertible. Chuck takes the convertible top down right before it rains. Then, just when the sun peeks out again, Chuck pulls over to put the top back up. So what does this have to do with us? Would you believe that investors, as a group, tend to act a lot like Chuck?

classic example: the dot-com boom

Consider the dot-com era, when Internet stocks with little or no earnings were all the rage. Investors couldn't get enough. Investors plowed \$309 billion into U.S. stock mutual funds in 2000, the biggest move into stock funds in a quarter-century, according to the Investment Company Institute (ICI), the mutual fund industry trade group.

Bad timing. The Standard & Poor's 500 fell a total of 49.1% over the next three years. By 2002, many investors had had enough. Collectively they withdrew \$27.5 billion from stock mutual funds, according to the ICI, the largest shift away from stock mutual funds in 14 years.

It was like Chuck raising his convertible's top. The U.S. market stock went on to gain 29% in 2003, its strongest rally in six years.

what's going on?

Is this simply rotten luck? Or is something else going on?

It's hard to blame bad luck when this seems to happen again and again. It appears that investors add money to stocks when stocks are climbing, and sell stocks after stock prices have fallen (see table).

It seems we base our investment decisions on past performance. But as every investor knows, past performance is no guarantee of future returns. It's like driving forward while looking in the rear view mirror.

Economic historian Niall Ferguson of Harvard University chalks it up to human psychology. "When stock prices surge upwards in sync, as they often do, it is as if investors are gripped by a kind of collective euphoria," Ferguson wrote in his book *The Ascent of Money: A Financial History of the World*.

"Conversely, when investors' 'animal spirits' flip from fear to greed, the bubble of their earlier euphoria can burst with amazing suddenness," he writes.

how to guard yourself

One of the best protections against mistiming the market is to have a long-term investment plan that doesn't change with the headlines.

Another good idea is to try to be skeptical when the whole world falls in love with an investment, whether it's dot-com stocks or condos in Florida. Telltale signs of a bubble are words like "you can't lose" or "don't miss out on the investment of a lifetime."

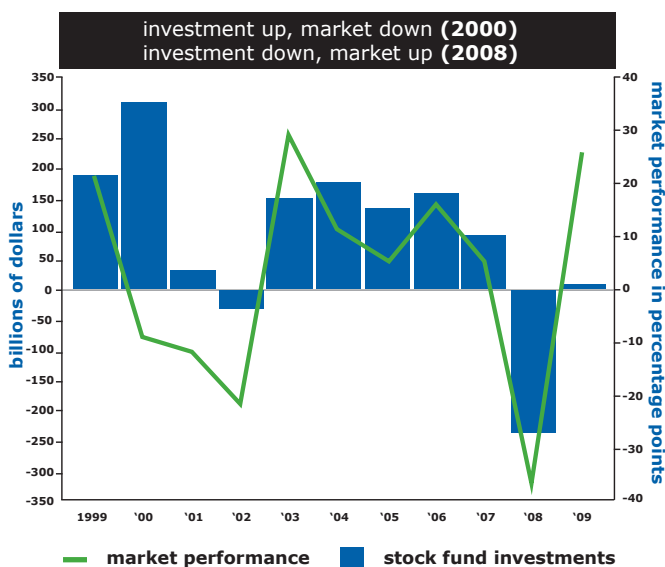
Similarly, when others are throwing in the towel after a disappointment, recall that the market will always have its ups and downs. If you leave on a down note, will you miss the rebound?

Fortunately, investors in employer retirement plans appear less likely than others to mistime the markets. True, they may suffer with others when the stock market has a big drop. But they are less likely to have just jumped in with both feet right before a decline.

That's because most retirement plan participants don't make frequent trades in or out of any particular investment. By contributing to the plan with each paycheck, they spread out their purchases and accumulate positions gradually.

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