THE MARKETS

DOW JONES ▼ 41.34/9,778.86 | NASDAQ ▲ 5.18/2,138.04 | RUSSELL 2000 ▼ 1.91/615.97 | S&P 500 ▼ 3.64/1,064.66

Learning lessons from stock plunge

Diversification, portfolio rebalancing are among tips to help safeguard investments

By Eileen Ambrose

The Baltimore Sun

Early last September, most of us couldn't imagine how bad things were going to get.

But the failure of investment bank Lehman Bros. a year ago sent stocks into a free fall that lasted months and wiped out nest eggs.

The market appears to have hit bottom in March, with the Dow Jones industrial average rising more than 45 percent since then. We're less afraid to open our 401(k) statements. And many of us are adjusting to the new reality that we will have to work later into our golden years, save more and spend less.

So, reflect on what investment lessons the past year provided:

Diversification works, mostly

So many asset classes lost ground last year that some people proclaimed diversification dead. That was premature.

"We learned last year that diversification doesn't solve all the problems," said David Wyss, chief economist for Standard & Poor's.

Nevertheless, by spreading money across stocks, bonds, commodities and real estate, you stand a better chance.

Rebalance regularly

Annually rebalancing your portfolio wouldn't have prevented losses last year, but may have limited the pain.

"Rebalancing is absolutely critical to manage your risk," said David Stepherson, portfolio manager with Hardesty Capital Management in Baltimore.

Ideally, you decide what percentage of your portfolio should be in stocks, bonds or cash based on when you need the money (and your stomach for risk). Then at least once a year, you rebalance the portfolio to return it to the original mix.

Never be hands-off

Target-date retirement funds have been an answer for investors who don't want to make the tough choices. You select a fund with the date closest to your expected retirement, and a professional manager makes the investment decisions for you based on that time frame.

But as stocks tanked, many older workers suffered steep losses and discovered the funds held more stock than they realized. You need to look at the fund's mix of stocks and bonds, how that will change over time and whether the strategy fits your appetite for risk.

Keep it simple

Even Wall Street firms got burned by investments they didn't understand. Avoid complex investments that can disguise high fees or risks.

Be skeptical

Investors felt so lucky to invest with Bernie Madoff that they never asked questions.

"Healthy skepticism isn't the worst thing," said John Coyne, president of Brinker Capital in Philadelphia.

Work longer

Retirement experts for years have advised workers to delay retirement because of longer life spans. They're now listening.

Less debt, more savings

The financial crisis is turning us into savers. The personal savings rate in the second quarter this year reached 5 percent, compared with 1.8 percent two years earlier. And July marked the 10th month in a row that credit-card debt fell.

You can bank on these ideas

Reading Eagle

Terry L. Morris

Jay R. Kemmerer

Because they were learned the hard way, the lessons to come out of the economic travails of the last 12 months or more likely will not be forgotten any time soon.

Jay R. Kemmerer, president of Penn Street Fund Inc., Wyomissing, said one lesson came in the case of Lehman Brothers, which collapsed in September 2008.

"I think looking back, everyone realizes now that the government probably should not have left it fail, because of a major ripple effect on a worldwide basis," Kemmerer said. "And that created panic and fear. People were taking money out of the banks and that led to more instability. So the lesson is: Let something like that occur, and it's going to have a worldwide ripple effect."

Kemmerer blamed a culture of greed for the failure to rein in highly leveraged deals, and paraphrased Warren Buffett, who said: "I don't know why the banks came up with new ways to lose money when the old ways were working so well."

Another lesson, he said, is that some sort of oversight is needed to ensure that history does not repeat itself.

"We don't ever want to have another Lehman situation, because everybody gets hurt in the end," he said. "Hopefully, we did learn something from this."

Terry L. Morris, senior vice president and senior equity manager at National Penn Investors Trust Co., Wyomissing, said the market's roller-coaster gyrations should have taught investors another valuable lesson: Don't panic.

"People tend to react to what they see," Morris said. "Sometimes they overreact. I think one thing investors maybe have learned is not to panic about some of these things we've seen. If you had panicked out, say, in March, well, the market's up 52 percent since March. I think the lesson is: Stick with your long-term plan, stick with quality and don't panic."

People also have learned the importance of doing their homework, Morris said.

"If you'd stuck with quality all the way, you'd be down, but not as much as the overall market," he said. "Stick with what you know."