

## Lessons for a Volatile Market

As we review the financial markets through the end of August 2009, it appears that the economy is easing out of the three-year long recession in which we saw markets hit rock-bottom in March 2009. Significant actions taken by both the private and public sector, including asset sales and direct government intervention into the financial and automotive sectors, have helped alleviate the enormous amount of uncertainty in the markets. Recent economic data has been positive and shown signs of improvement in jobs and housing markets, raising optimism among investors. Major market indices rallied as confidence levels returned during the 2<sup>nd</sup> quarter of 2009. High-yield corporate bonds advanced in response to investors' increased appetite for risk; and the Fed continued to keep short-term interest rates at near-zero yields to provide stability to bond markets. Year-to-date through August 31, the S&P 500® Index is up nearly +15%, rebounding over +50% from the market lows set in March 2009. However, the market remains nearly -35% below its all-time high set in October 2007. In fixed-income markets, the Barclays Capital U.S. Aggregate Bond Index is up +4.62% year-to-date through August 31 and has returned nearly 8% over the 1-year timeframe.

Nevertheless, despite the current challenges and road to recovery that has taken place in the financial markets, investors should remain mindful that we have seen volatile market cycles like this before. In fact, over the past 100 years, the S&P 500 Index has declined –10% or more, on average, once per year. Declines of –20% or more occur once every three to four years (source: Ned Davis Research 2007). In other words, market declines are normal; and as we work through and recover from these recent challenges, odds are there will be others on the horizon.

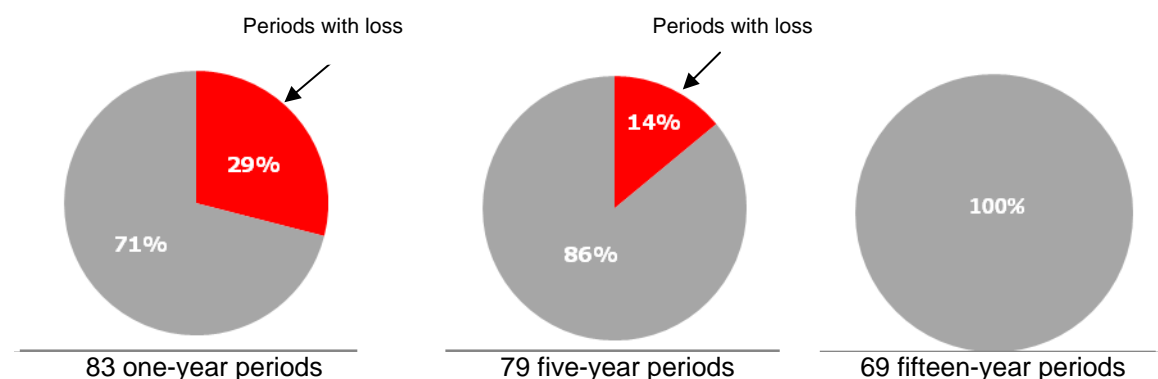
An important element to any successful investment strategy is to keep a keen focus on one's long-term investment objectives and not be swayed by the 'roller coaster' swings in the markets – either up or down. As we advance through the months of 2009, the markets have shown continued volatility as mixed economic data is released and investors react to the latest earnings reports and company forecasts. To provide some historical context, realize that from the end of the last recession and market trough on October 9, 2002, the S&P 500 Index is actually up over 25% through August 31, 2009.

With the continued volatility, investors may pay more attention to headlines and the fluctuations of the daily market closing prices versus remaining focused on their longer-term investment objectives and goals. In times like these, it is important to remember (and adhere to) a few critical, time-tested and common sense investment principles:

► **To achieve long-term investment success, short-term market volatility should be expected.**

From a historical perspective, the recent market volatility has not been out of the ordinary. The stock market rarely moves in a sustained up (or down) trend without some short-term movement in the opposite direction along the way. However, the overall *long-term* historical trend has been an upward one. From 1926 to 2008, through numerous bull markets and bear markets, stocks have provided an average annual total return in excess of 9.6%. Also, the pie charts below show that while the stock market (as represented by the S&P 500) has declined 29% of the time on a one-year basis, this percentage decreased to 14% when the time horizon extended to any rolling 5-year period. When looking at even a longer timeframe, the stock market has never produced a loss during any rolling 15-year period (1926-2008). This is no guarantee of future results, of course. However, having a longer investment time horizon can help investors in riding out inevitable short-term market downturns.

### Stock Market Loss History (1926-2008) Source: Morningstar



*This chart is for illustrative purposes only and is not intended to represent or imply the actual performance of any specific investment. It is important to note that any investment involves risks that may result in the loss of principal and there is no guarantee that the strategies illustrated will produce positive investment results.*

► **Market timing is a losing strategy.**

No one can consistently predict what the financial markets will do and it is unproductive to try, especially over the short-term. If you are tempted to make changes to your portfolio, remind yourself that investing always comes with certain risks and that a longer-term, buy-and-hold approach has historically been a more sound and tax-efficient investment strategy. Conversely, when investors make reactionary selling decisions based on near-term market declines, they are essentially locking in those recent losses and potentially creating a taxable event. Furthermore, the decision to sell is only half of the investing equation. In order to fully benefit from a market's positive reversal, it requires the investor to actually be 'in' the market. History suggests that trying to time the decision to get back 'in' the market is the most difficult. Studies have shown that not being 'in' the market and missing just a few of the top performing days of the market in a given year can significantly hinder long-term investment performance.

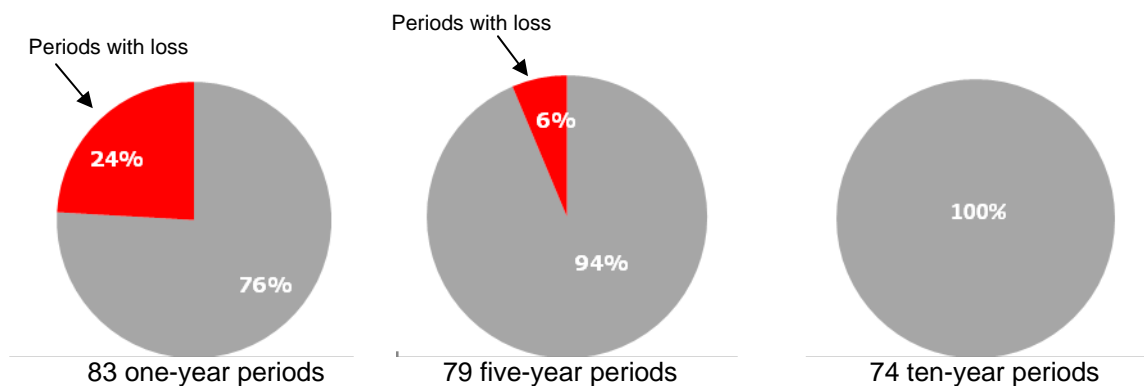
► **Maintain proper asset allocation.**

Establishing and maintaining an asset allocation mix consistent with your goals and time horizon is one of the most important elements in weathering market volatility. Because asset classes typically perform differently under different market conditions, spreading your assets across a variety of different investments such as stocks, bonds, and cash equivalents can help to reduce overall risk. Ideally, a decline in one asset class may be balanced out by a gain in another. During this recent period of equity market volatility, it might be a good time to consider the benefits of having exposure in your portfolio to a high-quality fixed income or money market investment.

*An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the fund seeks to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in the fund.*

The pie charts below show that a portfolio consisting of a 60% allocation to stocks (as represented by the S&P 500) and a 40% allocation to bonds (as represented by the Barclays Capital U.S. Aggregate Bond Index) has declined 24% of the time on a one-year basis and this percentage decreased to 6% when the time horizon extended to any rolling 5-year period. When looking at even a longer timeframe, a 60/40 blend of stocks and bonds has never produced a loss during any rolling 10-year period (1926-2008). Again, this is no guarantee of future results, of course. However, an allocation of stocks and bonds may help better weather periods of volatility and downturns in the stock market.

**Combination of Stocks and Bonds – History of Loss (1926-2008)** Source: Morningstar



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► **Invest regularly and take advantage of dollar cost averaging<sup>1</sup>.**

A downturn in the market may actually have less of an impact if you are investing a set dollar amount over regular intervals of time. Under this approach, known as dollar cost averaging, you effectively purchase fewer shares of stock or a mutual fund at higher prices and more shares at lower prices. Although dollar cost averaging does not guarantee you a profit or loss, a regular fixed dollar investment may result in a lower average price per share over time, assuming you invest through all types of markets. In other words, you may be able to lessen the impact of market volatility by establishing and following an automated investment plan.

<sup>1</sup> Dollar cost averaging does not assure a profit and does not protect against loss in declining markets. Dollar cost averaging involves continuous investment in securities regardless of fluctuating prices. You should consider your financial ability to continue purchases through periods of high or low price levels.

*Investment return and principal value will fluctuate and fund shares, when redeemed, may be worth more or less than their original cost.*

It is important to note that there is market risk involved when investing in mutual funds, including possible loss of principal.

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The S&P 500® Index tracks the common stock performance of large U.S companies in the manufacturing, utilities, transportation, and financial industries. In total, the S&P 500 is comprised of 500 common stocks.

The Barclays Capital U.S. Aggregate Bond Index is a benchmark index composed of US securities in Treasury, Government-Related, Corporate, and Securitized sectors. It includes securities that are of investment-grade quality or better, have at least one year to maturity, and have an outstanding par value of at least \$250 million.

Asset allocation does not protect against loss in a declining market.

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