White Paper

TIAA

Weathering market volatility during the COVID-19 pandemic

Insights from TIAA's Investment Management Group

Key takeaways

- Financial markets always have their share of ups and downs, but COVID-19 is driving greater-than-normal volatility.
- It's natural to be nervous during these times of uncertainty, but panic shouldn't drive your decisions.
- The good news is that the U.S. economy was strong going into this pandemic, which is what is driving the current volatility.
- The markets don't like uncertainty, and, as a result, we don't anticipate the fluctuations resolving anytime soon.
- Suggestions for investors during times of volatility:

Best practices

✓ Maintain an emergency fund.

✓ Focus on making sure your portfolio is diversified.[1]

✓ Stick with your plan. Keep in mind that your long-term goals today are likely the same as they were yesterday.

✓ Reevaluate your risk tolerance.

✓ Review your retirement income options, including guaranteed income sources such as social security, pension and fixed annuity income.[2]

Things to avoid

✕ Trying to time the market

✕ Reacting from a place of fear

Weathering market volatility during the COVID-19 pandemic

The financial markets always have their share of ups and downs—they are natural occurences in the markets. Recently, however, due to the concern regarding the global pandemic COVID-19, we have seen greater-than-normal amounts of market volatility.

This pandemic is something that most of the world has never seen, and beyond the financial implications, people's employment, businesses and, most importantly, health are all at risk. It is normal to be nervous about your savings and investments and feel uneasy about the future during extraordinary times like these.

However, we can look to the past for evidence that indicates a recovery traditionally follows a downturn.

Remember that a financial plan that's focused on your long-term goals can help you weather times of market volatility and keep you focused on your future. Historically the financial markets have proven to be resilient, and rash action in the face of market volatility may actually hurt you in the long run.

In this paper, we discuss the current state of the financial markets as well as our outlook, followed by some helpful strategies, tips and reminders for investors to consider during times of market volatility. Your TIAA advisor is also available to help answer any questions you may have about your portfolio or goals.

Current state of the markets

The volatility we are witnessing in the financial markets is driven by events and is not the result of structural excesses in the economy. Heading into this recent crisis, the U.S. economy was healthy, with low unemployment, low inflation and a consumer saving rate that was the highest in nearly 20 years. This is in stark contrast to the state of the economy in 2001 and 2008, when we also experienced turbulent market volatility.

Event-driven market volatility can often arrive quickly, but can also leave quickly, especially if the overall economy has been healthy. Depending on the extent of the downturn, businesses and consumers may be able to revert to prior behavior in short order once the pandemic has passed or is seen as being under control. Business inventories were low going into this event; when it passes, businesses will need to restock quickly, which may help make up for lost consumption.

Additionally, with the Federal Reserve's rate cuts, mortgage rates are likely to drop, creating opportunity for potential homebuyers. Existing homeowners may also have the chance to refinance their mortgages at lower rates, saving them money over the long term and freeing up income for other purposes.

The near-term outlook

In order for financial market volatility to subside, investors need to see progress on four fronts:

Health
Markets are looking for signs that the growth rate of the number of new cases in Europe and the U.S. has plateaued and is getting lower amid robust testing. This has not happened yet. More quarantines in the U.S. and Europe will make the economic data worse but should shorten the length of the downturn.

Moreover, any indication that an existing drug or combination of drugs can help patients recover would be welcome.

Market functioning and liquidity
Although the Fed has already instituted a number of programs aimed at providing financial markets with liquidity, what needs to happen in the weeks to come is for businesses and consumers to have access to that liquidity during this time.

Monetary policy
The markets want to see the Fed ramp up the pace of quantitative easing in the coming weeks.

Fiscal policy
The markets want to see a very large (multiple hundreds of billions) stimulus that would help support consumers and businesses through the period of economic weakness and its aftermath.

Our expectations

It's impossible to know the full impact of the current situation, as things are continually evolving—government regulations are changing daily.

However, some things are becoming evident:

- We may see a slowdown in consumer spending as mandatory quarantines ramp up.
- Temporary layoffs are a possibility as businesses are forced to close, either due to regulations or because of slowing business as consumer demand and habits change.
- The retail and travel sectors are likely to take the biggest hit as people avoid crowded spaces.
- There will be limited ability to continue to ease monetary policy, which could result in tighter financial market conditions.

Overall, we expect a decline in economic growth in the second quarter. The impact will be uneven across industries; firms and sectors that are mostly online may fare better.If the measures slow the spread of the virus, we believe a potential recovery could happen in the second half of the year.

What we're watching

Keep in mind, market bottoms are not single events, they are processes that can take weeks or months. However, certain changes would help indicate that we could be approaching a turning point. These can include:

- More forceful medical, fiscal and monetary policy decisions that inspire confidence
- Continued assurances that financial markets are functioning properly
- A reduction on 2020 corporate earnings expectations, which would cause a more realistic valuation in the equities market
- Signs of an economic recovery in China
- Signals of optimism being priced into fixed-income markets
- More economic data, with the understanding that it lags, to show the true impact of closures, quarantines and other measures on businesses and employees

How to manage through volatility

Regardless of the causes or duration, market volatility naturally creates concerns for investors. Opening your financial statements and seeing investments decline in value can induce stress, especially when you work hard to achieve the goals most important to you.

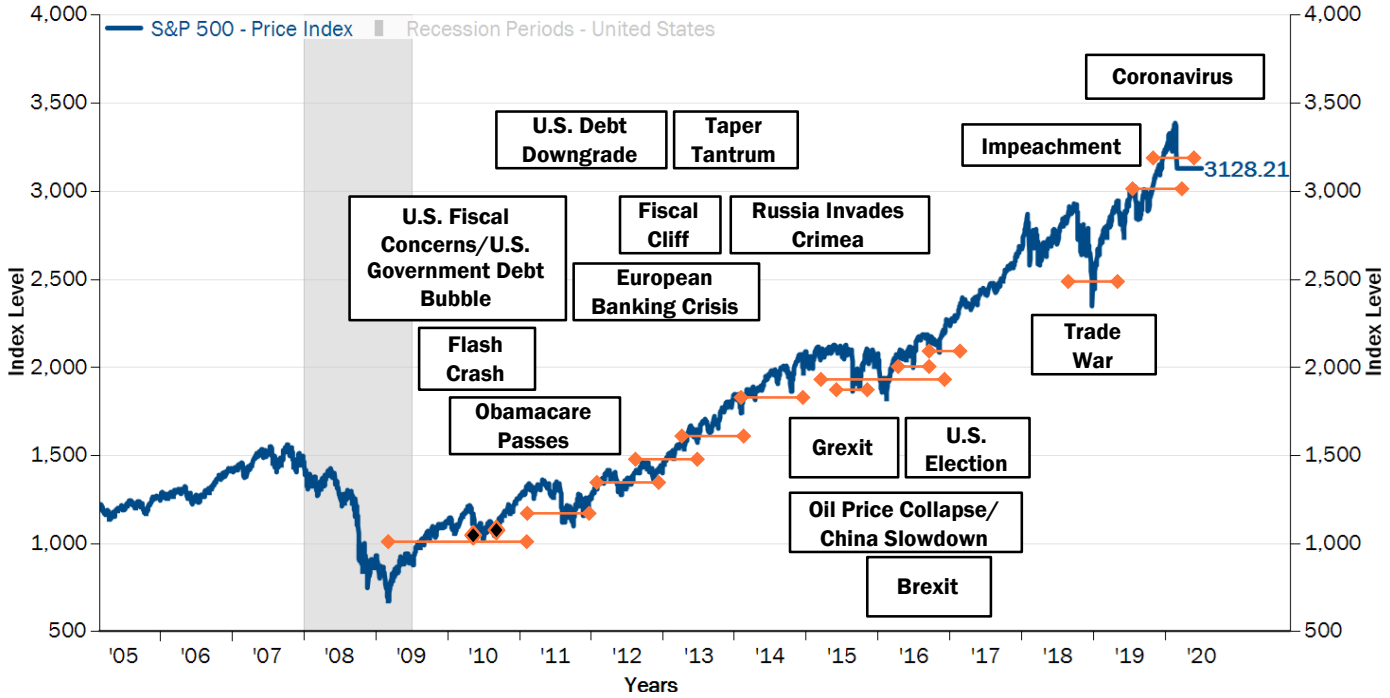
Benefits of a long-term perspective

Historically, regardless of the source of volatility, markets have proven to be resilient over longer periods of time. This suggests that investors should avoid making sudden changes to their portfolios and instead focus on diversification, staying invested and adhering to a plan that is tailored to their individual long-term goals, investment objectives and risk tolerance.

Markets tend to climb what's called a "wall of worry" (see Figure 1). That is, they tend to overcome obstacles in their way when you view them over the long term. So while fluctuations or periods of loss are common, over time, overall values have typically increased.

Market volatility can last days, months or years. Even in years when the market gains value overall, there can be large temporary drawdowns. Since 1980, the average intrayear drop in stocks has been 14%, even though the vast majority of years saw overall value increases.

Figure 1

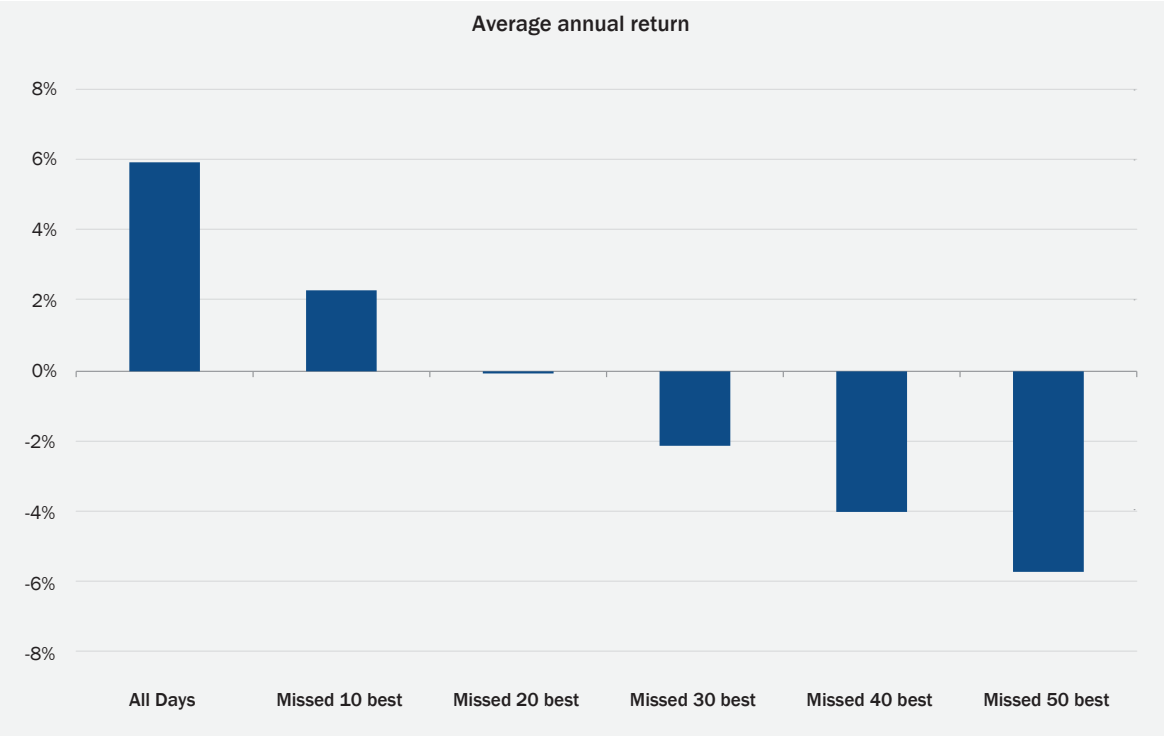


Source: Factset financial data and analytics. Data through: 26 Feb 2020.

For some investors, the natural instinct is to try to "sell before things get worse." This is a form of timing the market and is generally frowned upon by investment professionals. Market timing means moving your money in and out of investments to try to capture the highs and avoid the lows. The challenge with this is that even market experts struggle to know exactly when the highs and lows will happen, and if you begin making changes as the market goes down, you risk missing out on the gains when the market improves again.

From 1999 to 2018, stocks had an average annual return of about 6% for those who remained fully invested for the entire 20 years. However, if an investor had missed only the best 10 days of the market's performance, the average annual return would have dropped to 2% (see Figure 2). In order to time the market correctly, you need to make two decisions and get them right—when to sell and when to buy. You're more likely, if you're looking at long-term returns, to have better performance by staying fully invested and weathering the volatility, rather than taking the chance of missing out on good days.

Figure 2

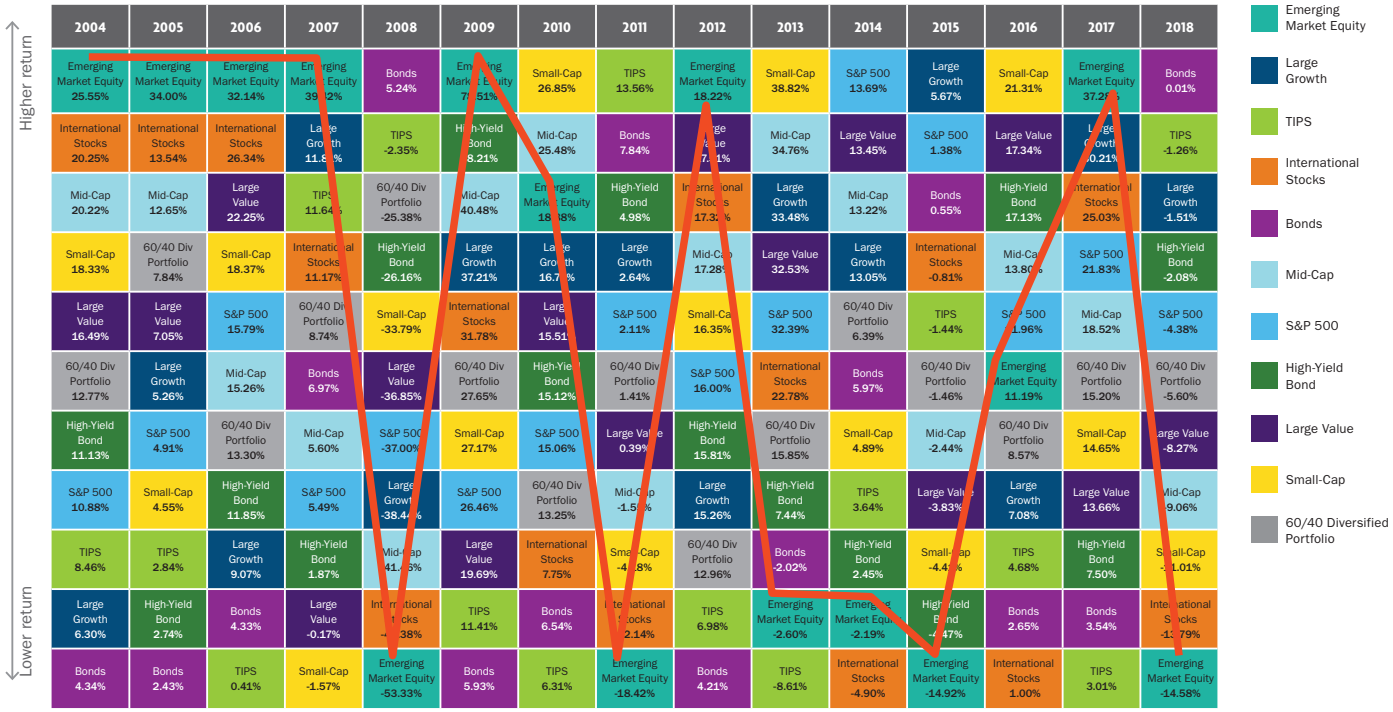


June 30, 1999-June 30, 2019. The returns are average annual over the past 20 years. The bars represent what would have happened if you'd "missed" the best 10, 20, 30, 40 or 50 days for the equity markets during that 20 year period. Past performance is no guarantee of future results. This is for illustrative purposes only, and the returns are average annual over the past 20 years. This is not indicative of any investment. An investment cannot be made directly in an index. The S&P 500 index is based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ. © 2018 Morningstar. All Rights Reserved.

Investor action items

So what should you be doing during times of market volatility? Rely on your long-term financial plan, which should be aligned with your long-term goals, and stick to the fundamentals of investing.

Figure 3



* Source: Data derived from Morningstar Direct℠, Morningstar, Inc., 2018. All data represents total returns for the stated period. Past performance does not guarantee future returns.
** Volatility is defined as standard deviation (2004-2018); the greater the volatility, the greater the variance to the mean return of a given asset.
60/40 Diversified Portfolio assumes annual rebalancing.

1 Check your diversification.
We expect well-diversified portfolios to deliver a smoother ride than the pure equity indices, which often drive the news cycle. Your diversification should match your risk tolerance. Investments don't follow the same path or deliver the same results year in and year out. Having a diversified portfolio with a variety of investment types can improve the likelihood of achieving your goals. Look at the chart that follows various asset classes over time (see Figure 3)—the red line reflects the results of emerging market stocks. This sector performed at the bottom of all sectors one year but then followed it up with the top performance the next. If you had only invested in this sector, your returns would have varied wildly by year. However, if you had diversified those investments with other asset classes, you might have been able to offset the downward movement as market conditions changed.

2 Revisit financial fundamentals.

a. Rebalance:[3] A period of market volatility is an excellent time to rebalance your portfolio. This means checking to make sure your asset allocation remains in sync with your goals, the time available to achieve them, your objectives for return and your tolerance for risk. Market swings can throw your asset allocation out of balance, potentially impacting your risk. You can rebalance by moving money from investments that take up a greater portion of your portfolio than desired into those sectors that could

use a boost. We recommend speaking to your advisor if you have questions about or need help rebalancing your portfolio.

b. Build an emergency fund: It's always ideal to have three to six months of essential living expenses set aside in a cash reserve or savings account. This may be especially important when you can't rely on regular positive returns from the markets.

c. Keep credit card debt manageable: This may be challenging if you have a setback, such as a job loss or healthcare expenses. But keeping your debt manageable can help you through difficult times. Stay abreast of whether interest is being deferred or reduced on any of your existing debts from consumer-relief measures, as this may change which debts you put a greater emphasis on paying down.

3 Stay invested and stick to a plan based on long-term goals.

As we discussed before, removing your money from the market puts you at risk of missing out on days of growth, which can hamper your long-term returns. When we look at market downturns since 1926, we can see that they have have tended to last a shorter time than upswings in the market have (see Figure 4). You'll be missing out if you're on the sidelines when the next period of positive momentum starts. Remember that your financial plan should be set to achieve long-term goals, and the best way to do that is to stay invested and stick to your plan.

4 Find unique opportunities to turn a negative into a positive.

Although it might not be top of mind, market volatility may provide opportunities to manage your investment-related tax bill. Tax-loss harvesting is the proactive approach of selling securities to potentially reduce the tax burden of capital gains that may have been realized during the calendar year from other securities. This doesn't mean you should be exiting the market, however. Talk to your advisor about whether tax-loss harvesting may be appropriate for you, given your portfolio's performance during the year so far.

Figure 4

Market Downturns and Recoveries
1926—2018

Downturn	% Loss		Recovery
34 months	-83.4	Sep 1929–Jun 1932 / Jul 1932–Jan 1945	151 months
6 months	-21.8	Jun 1946–Nov 1946 / Dec 1946–Oct 1949	35 months
7 months	-10.2	Aug 1956–Feb 1957 / Mar 1957–Jul 1957	5 months
5 months	-15.0	Aug 1957–Dec 1957 / Jan 1958–Jul 1958	7 months
6 months	-22.3	Jan 1962–Jun 1962 / Jul 1962–Apr 1963	10 months
8 months	-15.6	Feb 1966–Sep 1966 / Oct 1966–Mar 1967	6 months
19 months	-29.3	Dec 1968–Jun 1970 / Jul 1970–Mar 1971	9 months
21 months	-42.6	Jan 1973–Sep 1974 / Oct 1974–-Jun 1976	21 months
14 months	-14.3	Jan 1977–Feb 1978 / Mar 1978–-Jul 1978	5 months
20 months	-16.5	Dec 1980–Jul 1982 / Aug 1982–Oct 1982	3 months
3 months	-29.6	Sep 1987–Nov 1987 / Dec 1987–May 1989	18 months
5 months	-14.7	Jun 1990–Oct 1990 / Nov 1990–Feb 1991	4 months
2 months	-15.4	Jul 1998–Aug 1998 / Sep 1998–Nov 1998	3 months
25 months	-44.7	Sep 2000–Sep 2002 / Oct 2002–Oct 2006	49 months
16 months	-50.9	Nov 2007–Feb 2009 / Mar 2009–Mar 2012	37 months

Source: Morningstar

Advice for those in or nearing retirement

If you're in or nearing retirement, you have unique concerns, because you don't have the luxury of watching the market recover over time. Market performance in the early years of retirement can impact the longevity of your investment portfolio. This time of volatility is an opportunity to work with your advisor on a strategy to ensure your investments can weather the turbulence and allow you to have income for many years of retirement.

1 **Consider your drawdown strategy.**
If you're currently taking income from your portfolio, it's important to know which account type and investment you are drawing down from. Withdrawals from investment accounts in a negative-return environment come at a greater cost, because the distributions further reduce the value of your accounts. Work with your advisor to find the best opportunities.

2 **Reassess income options.**
Having enough sources of guaranteed income in your portfolio to cover essential expenses may minimize your worry during times of market volatility. Social Security is likely one source, but annuities may be another option that provides guaranteed income and keeps you from having to draw down your investment accounts.

3 **Reevaluate your risk tolerance.**
Your advisor can help you modify your asset allocation to align with how comfortable you are with risk. Be careful to not be overly influenced by today's market. Being too conservative can also be a form of risk. Inflation is currently low, but medical costs continue to increase, so if you have many years of retirement ahead of you, you should keep the long term in mind, not just the short-term goal of avoiding losses.

Advice for those saving for retirement

If you're still several years away from retirement, the most important piece of advice to remember is that you have the luxury of time on your side. While it's natural to be concerned about investment losses in the short term, sticking to your financial plan with an eye on your long-term goals is what's most important, and, as we previously discussed, over time the market has shown a tendency to be resilient—even after times of challenge.

1 **Continue to contribute to your workplace retirement plan.**
If the market goes down, your regular contributions buy you more shares of your investments. That means you own more if they begin to rise in value. This money should be for your long-term goals, not short-term goals such as buying a car or paying educational expenses.

2 **Diversify your investments.**
As we mentioned earlier, during times of market volatility, a diversified portfolio may provide you with a smoother ride than one that is heavily dependent on a certain asset type. Now may be a good time to check with your advisor to make sure your portfolio aligns with your long-term goals and time horizon. Remember that diversification is about types of assets—domestic equities, international equities, bonds, real estate, etc.—and not just about having multiple investment accounts or owning different equities within the stock exchange.

3 **Make sure your portfolio matches your risk tolerance.**
Things can change quickly in turbulent markets. Make sure your investment portfolio accurately reflects your risk tolerance to help you reach your long-term goals.

In closing

The current market volatility related to COVID-19 is nearly unprecedented in recent history. We are in a time when our health and well-being are our No. 1 concern in the near term. The volatility in the markets adds another layer of concern for many investors.

We believe the best course of action is to avoid the tendency to make rash, emotional decisions, and instead trust in the value of a long-term plan built on the pursuit of your goals. Your unique circumstances—your proximity to retirement or your financial health—may dictate certain changes in your financial life.

Work with your advisor to be sure you're keeping time-tested fundamentals in mind. The history of the markets may give you confidence that, over time, you may be able to remain on track to achieve your financial goals.

[1] Diversification is a technique to help reduce risk. It is not guaranteed to protect against loss.

[2] Any guarantees are backed by the claims-paying ability of the issuing company.

[3] Rebalancing does not protect against loss or guarantee that an investor's goals will be met.

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Before rolling over or consolidating assets, consider your other options. Compare the differences in investment options, services, fees and expenses, withdrawal options, required minimum distributions, other plan features, and tax treatment. Speak with a TIAA consultant and your tax advisor regarding your situation. Learn more at TIAA.org/reviewyouroptions.

Before making any changes to your financial plan, it is important to keep in mind that the tax status and tax benefits of products can change depending on how you use them and how and when the funds are accessed. There are generally strict rules for tax-deferred and tax-free accounts and they are generally not as liquid as taxable accounts. Before you make any changes, consider all tax and financial implications so you can determine which products are suitable for you.

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