Market downturn shatters faith in stocks

Barbara Davidson / Los Angeles Times

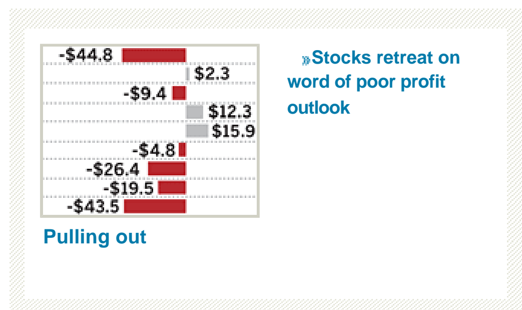
"I've realized I can't count on the market," says Danny Lockwood, a music-video producer who lives in West Hollywood. "I'm not sure I'm going to again let a significant portion of my assets ride on the stock market."

Americans who've learned to count on rising equity values to secure their retirement are seeing the possibility that the markets could fail them.

By Walter Hamilton and Ronald D. White
October 22, 2008

Reported from New York and Los Angeles -- For two decades, Danny Lockwood believed that investing in the stock market was essential for a comfortable retirement.

Like millions of Americans, the 41-year-old West Hollywood resident steadfastly poured money into mutual funds that invest in stocks. For him, a sharp decline in the value of his portfolio meant only an opportunity to add to it at lower prices.



Pulling out

»Stocks retreat on word of poor profit outlook

But after two bone-rattling bear markets in the last eight years, Lockwood is abandoning his blind faith in stocks. Fearing that the "buy and hold" advice that's been drummed into investors might not pay off in the long run, the music-video producer has been unloading some of his stock-fund holdings.

"I've realized I can't count on the market," he said. "I'm not sure I'm going to again let a significant portion of my assets ride on the stock market."

He isn't alone.

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After a yearlong slide that has pushed major stock indexes down as much as 40% from their record highs, many people are rethinking their once rock-solid allegiance to stocks, disregarding the advice of experts to stay put.

Although such a reaction is normal in a bear market, the latest collapse appears to be taking a deeper psychological toll than that inflicted by any other market turmoil in the last 25 years -- including 1987's Black Monday stock crash and the punishing bear market that followed the late-1990s Internet bubble.

"What's going on now is dramatically different than in 2000 and in 1987," said Terrance Odean, a UC Berkeley finance professor who studies the behavior of small investors. "What's different is that people have seen the possibility that markets could fail them and that they could do everything they were supposed to do -- everything they were told to do -- and still not have what they need in retirement."

Investors have yanked a net $176 billion from stock mutual funds this year, more than half of it since Sept. 1, according to TrimTabs Investment Research. The exodus may intensify as more third-quarter brokerage and 401(k) statements show up in mailboxes.

"It reminds me so much of people's reaction after an earthquake," said Michal Strahilevitz, a business professor at Golden Gate University who studies investor behavior. "You're going about your daily business, and suddenly things that were never frightening are now frightening, and bad things that seemed impossible are now possible."

Some people are taking it to extremes.

Bonnie Reyes, president of a Michigan group that sponsors investment clubs, said a neighbor recently confided that she might withdraw all her money from the stock market and keep much of it at home. She was shopping online for a vault.

"I said, 'You can't be serious,' and she said, 'Oh, I'm really thinking about it,' " Reyes recalled.

For a quarter of a century, many Americans embraced the dogma that stocks or stock mutual funds should be the foundation of any retirement nest egg. Sure, the stock market would nose-dive from time to time, but investors knew it was very likely to outperform other asset classes such as bonds in the long run. In fact, since World War II, stock prices generally took less than a year to erase their losses from a bear market (defined as a market drop of at least 20%), although in some cases recovery took as long as five years.

Many investors looked down on the safest, most conservative investments such as money market mutual funds, bank certificates of deposit and Treasury bills because they all are at great risk of losing value after inflation is taken into account.

As the population aged, the commitment to stocks didn't waver. Some financial advisors counseled clients in their 50s and 60s to keep a sizable portion of their assets in stocks, reasoning that people are living longer these days and don't want to outlive their money.

As a result, at the end of 2006, of participants in 401(k) retirement plans between 56 and 65 years old, more than 1 in 4 had at least 90% of their money in stocks, and nearly half had at least 70%, according to the Employee Benefit Research Institute.

Even now, the vast majority of investment advisors would strongly urge people not to give up on stocks, especially when most of the damage to their portfolios arguably has already been inflicted.

Most individual investors are sticking with that advice.

"For every client that says to us, 'I want to sell everything or nearly everything,' there's another client who has assets that have been on the sidelines and who is looking to establish positions at deeply discounted prices," said Jeff Morley, an executive in brokerage Charles Schwab & Co.'s client service group.

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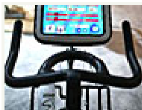

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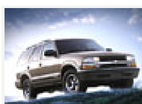

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