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Economic upheaval shakes faith in stocks

By Walter Hamilton and Ronald D. White
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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, Calif., 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.

But after two bone-rattling bear markets in the past 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.

After a yearlong slide that has pushed major stock indexes down sharply 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 University of California at 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 tens of billions of dollars from stock mutual funds this year.

"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.

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"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.

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

As the population aged, the commitment to stocks didn't waver. Some financial advisers 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, more than 1 in 4 participants in 401(k) retirement plans between 56 and 65 had at least 90 percent of their money in stocks, and nearly half had at least 70 percent, according to the Employee Benefit Research Institute.

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

But for many, this time is different.

"What's really scaring investors today is whether this mega-meltdown will take 25 years to get back to even," said Sam Stovall, chief investment strategist at Standard & Poor's.

Nerves are frayed, in part because most people aren't used to grueling bear markets. One reason stocks became so popular in the 1980s and '90s was that the stock market did unusually well in that period. In that context, the bear market of 2000-02 could be explained away by some investors as a fluke triggered by wild speculation in risky technology companies.

"Even after the tech boom, there was definitely this notion that stock market investing was, to a certain extent, easy money," said Maria Crawford Scott, editor of AAIJ Journal, a publication of the American Association of Individual Investors. "That notion has definitely ended."

The timing is significant: Many investors had barely recovered from the 2000-02 downturn when the current one began in October 2007. They now are 10 years older than they were at the heyday of the Internet boom. And if they've kept contributing to their 401(k) or other retirement accounts, as most people have, they're staring at far larger losses than they were six years ago.

"Whereas, in the beginning of this decade their account balances might have just hit six figures, now they may be in the \$200,000-to-\$250,000 range," said Jack VanDerhei, research director at the Employee Benefit Research Institute. "A 10 percent drop at \$250,000 has a much bigger psychological impact on them than a 10 percent drop at \$100,000."

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