

529 Savers: Stay the Course

The world and markets continuously change but the need to consistently save persists. Whatever uncertainties may roil the markets, it's important to stick with your plan.

Highlights

- Three years ago, uncertainty surrounded the Covid pandemic; today there is uncertainty around inflation, rising interest rates and a possible recession.
- 529 savers have had to take shorter-term setbacks in stride to stay the course and keep sight of their long-term goals.
- With new uncertainties clouding the outlook, it remains important to keep a long-term view, no matter how much time you have until you start paying for college.

Current assessment

The world and markets continuously change, but the first six months of 2023 have seen rapid shifts in the landscape and asset prices.

During the first quarter of 2023, U.S. markets were positive but volatile as concerns about inflation and interest rates tugged asset prices up and down. At its first 2023 policy meeting, the Federal Reserve raised interest rates by 25 basis points, driving market rates higher while pulling down bond prices and crimping the values of rate-sensitive technology stocks. Market focus shifted dramatically in March as the sudden failure of several U.S. regional banks and the collapse of Credit Suisse shook the banking sector. Markets regrouped after the government intervened to protect depositors. The Fed, seeking to avoid further “accidents” tied to higher rates, raised rates by just 25 basis points at its March meeting.

The strong performance of U.S. equities continued during the second quarter, with most of the gains made in June. Stocks were buoyed by relief over Congress's passage of a bill to raise the debt ceiling. The S&P 500 Index notched its best monthly performance of 2023 during the final month of the period. Volatility in the U.S. bond market also continued during the second quarter. The U.S. Treasury yield curve has been inverted since November 2022 (an inversion occurs when shorter-dated Treasuries have higher returns than longer-dated Treasuries), indicating expectations of higher short-term rates and concerns about the economic impact of the Fed's aggressive rate-hike path. The Fed raised rates by 25 basis points twice during the second quarter but did not implement a hike at its June meeting. Still, Fed officials maintained a hawkish stance through the end of the period.

Further volatility in most asset classes is expected due to now-familiar headwinds: inflation that overshoots the Fed's 2% target; rate hikes that could continue for longer than initially expected; and the possibility of recession through year end (and perhaps even into 2024).

Staying the course

The one thing that doesn't change about financial markets is that they constantly fluctuate. Market uncertainty can cause a great deal of stress if you let these short-term fluctuations pull you away from your long-term educational savings plan. Generally, the best way to cope with market uncertainty is to stay the course — disregard temporary fluctuations and stick to your plan. If you're wondering what to do next, here are three key points to remember:

- Educational savings goals are predicated upon consistent investing throughout bull and bear markets, across the entire investment horizon.
- Market downturns, however disruptive, are factored into the planning process. That's why most savings plans emphasize investing fixed amounts at regular intervals, i.e., dollar-cost averaging.
- You shouldn't change your investment plan unless your long-term goals change. Before making any changes to your investment portfolio, discuss them thoroughly with your financial advisor.

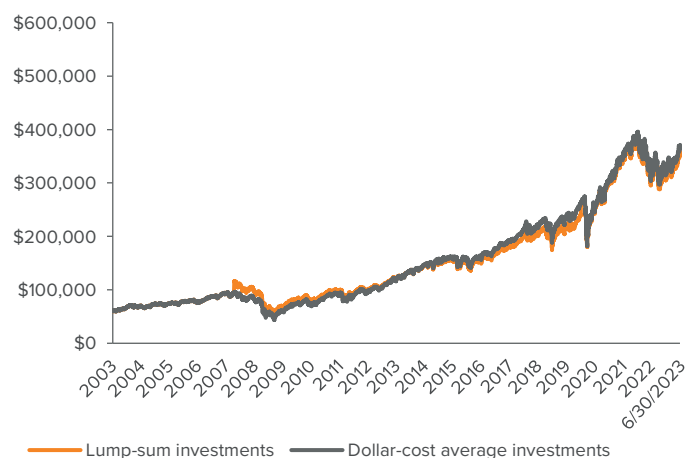
Market dislocations need not become painful events for those willing to stay the course. As the hypothetical analysis in Exhibit 1 illustrates, withholding assets or delaying contributions during downturns can cost investors over the long term. In the hypothetical analysis, Portfolios 1 and 2 start out essentially the same: both make an initial investment of \$60,000 with no contributions added until the market peak in 2007.

At this point their paths diverge: both portfolios have an additional \$40,000 to invest, but do so differently. Portfolio 1, caught up in the euphoria of the bull market, contributes \$20,000 at the height of the cycle and another \$20,000 pre-Covid. By contrast, Portfolio 2 follows a dollar-cost-averaging plan and regularly contributes the same amount to the 529 account, no matter the market environment.

By staying the course and not getting rattled during the market downturns of the financial crisis or the Covid pandemic, Portfolio 2 outperforms Portfolio 1 by about \$12,000.

Exhibit 1. Regular saving potentially delivers better results than market timing

Lump-sum investing vs. dollar-cost averaging — 20 years through June 2023



Portfolio 2 does better because of dollar-cost averaging: when markets are rising, the fixed investment amount buys fewer securities; when markets are falling the same amount buys more securities. The result over time is that the ups and downs tend to smooth out. Exhibit 1 also illustrates another important principle of long-term saving: staying invested offers potential for long-term gains despite the interruptions of market downturns. Even market timers (such as the lump sum investor in Exhibit 1) potentially can participate more fully in market gains if they keep their lump sums invested and avoid trying to time the market going forward.

It's understandable to feel some anxiety when the value of your account falls during a market downturn. Such times are precisely when it's important to keep a long-term perspective. Remember too that there's a big difference between an actual loss and a paper loss. If you can ride out the bad times and stay the course, your patience should be rewarded when the rebound happens.

Source: Morningstar Direct, data as of 06/30/23. **Past performance is no guarantee of future results.** This hypothetical example is for illustrative purposes only. It does not take into account withdrawals, fees, expenses, and taxes which would lower the results. The equity benchmark is represented by the S&P 500 Index, an unmanaged capitalization-weighted index of about 500 stocks designed to measure the performance of the broad U.S. economy. The index does not reflect fees, brokerage commissions, taxes or other expenses of investing. **Investors cannot directly invest in an index.** There are no guarantees that a portfolio which utilizes a dollar-cost-averaging method will outperform a portfolio which does not.

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