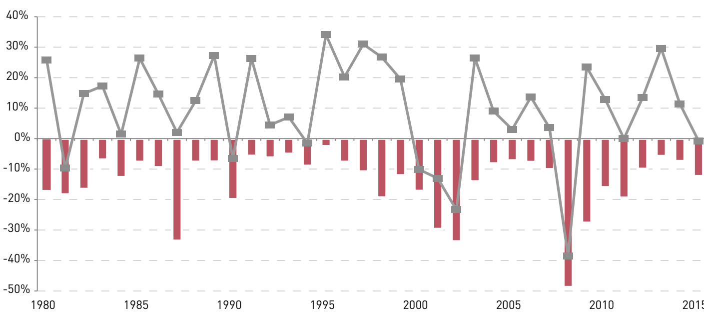
MONDAY, FEBRUARY 8, 2016

MARKET VIEW

VOLATILITY: FOUR KEY TAKEAWAYS

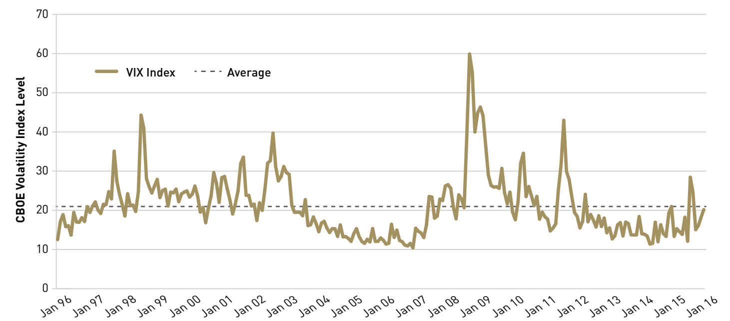
How can investors place recent equity market volatility—and its implications for portfolio performance—into a proper context?

CHART 1. THE LARGEST INTRA-YEAR DECLINE FOR THE S&P 500 INDEX, ALONG WITH THE ANNUAL RETURN
FOR EACH OF THE YEARS 1980–2015



Source: Morningstar.

CHART 2. VOLATILITY, AS MEASURED BY CBOE VOLATILITY INDEX (VIX)
FOR THE PERIOD JANUARY 1996-JANUARY 2016



Source: Chicago Board Option Exchange (CBOE).

Past performance is no guarantee of future results. The historical data are for illustrative purposes only, do not represent the performance of any specific portfolio managed by Lord Abbett or any particular investment, and are not intended to predict or depict future results. Investors may experience different results. Due to market volatility, the market may not perform in a similar manner in the future. Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment.Past performance is no guarantee of future results. The value of investments in equity securities will fluctuate in response to general economic conditions and to changes in the prospects of particular companies and/or sectors in the economy

As tempting as it may be for investors to flee the stock market during times of market volatility, a decision to do so may prove costly in the long run, and typically disregards the counsel that history provides. For this *Market View*, we asked Lord Abbett Investment Strategist Joseph Graham to provide us with four illustrations (two charts and two tables, to be exact) that make the case for staying invested.

TAKEAWAY 1: BIG MARKET DROPS DON'T ALWAYS TRANSLATE INTO FULL-YEAR LOSSES.

When markets go down, people often assume further declines are in store. As of February 5, 2016, the S&P 500® Index is off 7.85% since the start of the year and down 10.60% from its high on July 20, 2015. Yet these kinds of drawdowns are more common than one might think, as Chart 1 shows. According to Morningstar, since 1980, the average of all years was a 14.2% decline. More than half of the years since 1980 have experienced declines of 10% or more. But here's a surprising fact: In 58% of those years with a decline of 10% or more, the market actually ended up with gains for the year.

In short, the volatility we are experiencing today is a normal part of long-term investing. Intra-year, and year-over-year, returns may be up or down, but over the long term, investors who stayed invested demonstrated the sounder strategy for realizing potential gains in the equity markets.

TAKEAWAY 2: EQUITY VOLATILITY IS NOWHERE NEAR HISTORICAL HIGHS.

From our perspective, market volatility is neither a threat nor a boon to relative performance. Nor—to address a common concern among investors—is volatility particularly high. In fact, over the past year, the CBOE Volatility Index (VIX) has simply returned to more normal levels, as Chart 2 illustrates.

TAKEAWAY 3: EARNINGS WEAKNESS DOESN'T NECESSARILY SIGNAL NEGATIVE RETURNS FOR STOCKS.

Meanwhile, the deterioration in forecasted U.S. corporate earnings in recent quarters has some investors on edge. But one fact that's little recognized is that markets often rise once those lower earnings are actually reported. (See Table 1.) According to BofA Merrill Lynch, in the 16 calendar years since 1960, for example, when earnings declined, the average market gain was 11%.

TABLE 1. EARNINGS PER SHARE AND S&P 500 INDEX PRICE RETURN IN YEARS WITH NEGATIVE EARNINGS GROWTH SINCE 1960

YEAR	EPS GROWTH	S&P 500 PRICE RETURN
1960	-3.5%	-3.0%
1961	-2.4%	23.1%
1967	-4.0%	20.1%
1970	-11.2%	0.1%
1975	-10.5%	31.5%
1980	-0.8%	25.8%
1982	-15.8%	14.8%
1985	-3.4%	26.3%
1986	-2.7%	14.6%
1990	-7.6%	-6.6%
1991	-17.8%	26.3%
1998	-1.6%	26.7%
2001	-20.8%	-13.0%
2007	-3.5%	3.5%
2008	-27.3%	-38.5%

Source: Standard & Poor's, FactSet, and BofA Merrill Lynch.

Past performance is no guarantee of future results. The historical data are for illustrative purposes only, do not represent the performance of any specific portfolio managed by Lord Abbett or any particular investment, and are not intended to predict or depict future results. Investors may experience different results. Due to market volatility, the market may not perform in a similar manner in the future. Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment.

TAKEAWAY 4: MARKET TIMING MISSES THE MARK.

Simply put, uneasy times can be great times to invest. Unfortunately, investor behavior is often ruled by emotion, leading to panicked decisions and investor returns that lag asset returns. The poor results of market timing were made clear by Morningstar in a study published in 2014. The company looked at a fund's stated return and then adjusted it for inflows and outflows to derive asset-weighted investor returns, a measure more closely aligned with how the typical investor fared. The results are shown in Table 2, and depict significant shortfalls across seven major fund categories.

Arguably, one of the most important things financial advisors can do for their clients is help them bridge the returns gap highlighted in Table 2 by encouraging them to stay invested. Advisors can provide a target, a long-term allocation plan that includes regular rebalancing, and access to experienced investment managers who have navigated past periods of volatility. In subsequent *Market Views*, we will examine the benefits of a number of investment options that equity investors would do well to consider in this market environment.

TABLE 2. ASSET-WEIGHTED AND AVERAGE TOTAL INVESTOR RETURNS BY MORNINGSTAR MUTUAL FUND CATEGORY

FOR THE 10 YEARS THROUGH DECEMBER 21, 2013

Fund Category	Average 10-Year Total Return (%)	Asset-Weighted 10-Year Investor Return (%)	Returns Gap (%)
U.S. Equity	8.18	6.52	**-1.66**
Sector Equity	9.46	6.32	**-3.14**
Balanced	6.93	4.81	**-2.12**
International Equity	8.77	5.76	**-3.01**
Taxable Bond	5.39	3.15	**-2.24**
Municipal	3.53	1.65	**-1.88**
Alternative	0.96	-1.15	**-2.11**
All Funds	7.30	4.81	**-2.49**

Source: Morningstar.

The historical data are for illustrative purposes only, do not represent the performance of any specific portfolio managed by Lord Abbett or any particular investment, and are not intended to predict or depict future results. Investors may experience different results. Due to market volatility, the market may not perform in a similar manner in the future.

Past performance is no guarantee of future results. The value of investments in equity securities will fluctuate in response to general economic conditions and to changes in the prospects of particular companies and/or sectors in the economy. The value of an investment in fixed-income securities will change as interest rates fluctuate and in response to market movements. As interest rates fall, the prices of debt securities tend to rise. As rates rise, prices tend to fall. International investing involves risks, including risks related to foreign currency, limited liquidity, less government regulation and the possibility of substantial volatility due to adverse political, economic or other developments.

IMPORTANT INFORMATION

Investing involves risk, including the possible loss of principal. The value of investments in equity securities will fluctuate in response to general economic conditions and to changes in the prospects of particular companies and/or sectors in the economy. Statements concerning financial market trends are based on current market conditions, which will fluctuate. There is no guarantee that markets will perform in a similar manner under similar conditions in the future. No investing strategy can overcome all market volatility or guarantee future results.

Earnings per share (EPS) represents a company's earnings divided by the number of shares outstanding. EPS can also be computed for an index such as the S&P 500.

The CBOE Volatility Index® (VIX®) is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices.

The S&P 500® Index is widely regarded as the standard for measuring large cap U.S. stock market performance and includes a representative sample of leading companies in leading industries.

Indexes are unmanaged, do not reflect the deduction or expenses, and are not available for direct investment.

The opinions in *Market View* are as of the date of publication, are subject to change based on subsequent developments, and may not reflect the views of the firm as a whole. The material is not intended to be relied upon as a forecast, research, or investment advice, is not a recommendation or offer to buy or sell any securities or to adopt any investment strategy, and is not intended to predict or depict the performance of any investment. Readers should not assume that investments in companies, securities, sectors, and/or markets described were or will be profitable. Investing involves risk, including possible loss of principal. This document is prepared based on the information Lord Abbett deems reliable; however, Lord Abbett does not warrant the accuracy and completeness of the information. Investors should consult with a financial advisor prior to making an investment decision.

Copyright © 2016 by Lord, Abbett & Co. LLC/Lord Abbett Distributor LLC. All rights reserved.

Lord, Abbett & Co. LLC | 90 Hudson Street | Jersey City, NJ 07302-3973 | T 1.888.522.2388 | lordabbett.com

MV-02-08-16