Don’t Just Do Something, Stand There

What if the stock market drops and everybody else is selling? Should you rush to change your PSA and PRA investments to more conservative funds? After all, many people try to “protect what’s left” after the market goes down.

The guy who finally hits the five-hundred-to-one shot at the Kentucky Derby makes the six o’clock news. On the other hand, the plan participant who contributes a hundred dollars a month ends up with far more money after a few years.

Experienced investors have seen stock prices rise and fall many times. They know that the markets have gained value over the years despite the ups and downs that come along the way.

Do Something or Do Nothing at All

Participants already invested in stock-based funds may benefit most by doing nothing when the market goes down. Don’t panic. Letting short-term events change your long-term investment strategy may not be the best course to take. Instead, you may want to let time work for you. Both PSA and PRA are based on monthly contributions at a fixed amount—by you and Oxy. Furthermore, you decided how to invest these contributions. With dollar cost averaging, your contributions may be invested in the fund when its value is lower. When the market comes back, those contributions could be worth more.

Doing Something

Over time, market value fluctuations may have changed your investment allocations in the various asset classes and may have affected the goals that you previously set for yourself. If the market had significant changes, you should periodically review your portfolio to ensure that the current allocations still meet your investment strategy. If your portfolio has shifted due to market fluctuations you should consider realigning it to meet your previously set objectives.

The Long Haul-Diversification versus Market Timing

The investment strategy for participants in retirement savings plans should differ from

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In addition, Oxy makes significant contributions to your PRA and you may have other resources such as Social Security, other investments, personal property, and personal savings. Together, they will finance your retirement years.

This self-test is intended to demonstrate the advantages of investing uninterrupted for a long time horizon. Your actual lump sum will depend on how long you save, what you and Oxy contribute on your future income, and what return your investments generate.

Continued on Page 2
Fixed Income Investments: How Fixed Income Markets Work

You open the morning paper and read that the Federal Reserve may raise interest rates, and bond yields may go up. Then you read that the bond market is down and so is your fixed income investment option. Why don’t fixed income investments behave like the stock market? After all, when stocks earn more money, their value goes up. There are two distinct differences to consider:

**Stocks versus Fixed Income Investments**

Stocks usually earn higher returns but are riskier than fixed income investments. Here’s part of the reason why. When you own stock, you are part-owner in a company. Companies pay their owners with what’s left over after they pay their debts. When you own a fixed income investment, you are a creditor. The issuer owes you the face amount of the investment plus interest for a fixed period of time (three months, a year, five years, etc.). You get paid before the stock holder, but probably not as much. Why? Because you haven’t taken as high a risk of not getting paid. If you hold the security until it matures, you earn the interest, called the “yield,” plus your money back. Many people who hold bonds collect the interest for income and cash them at maturity.

**Interest Rates and Market Prices**

However, the market value of a fixed income security may change as you hold it over time, especially as interest rates go up and down. If face values are equal, a higher interest rate makes one fixed income security a better investment than another. Suppose the Federal Reserve raises its rates today, and the fixed income market follows suit. Any fixed securities issued before now, at a lower interest rate, will bring less value on the market. If you hold older instruments, they will be discounted if you sell them during rising interest rates.

A fixed income fund portfolio may contain many bonds and other debt instruments that were purchased in the past at different interest rates. If the portfolio holds more investments with a lower market value, then its value will diminish. If it holds more investments at a higher market value, its value increases.

**Why Invest in Fixed Income Securities?**

Since fixed income investments carry less risk of loss than stocks, many investors favor them when they need to preserve their assets for a short time. However, over time, their returns don’t do much better than the inflation rate; sometimes even less. Consequently, money held for a long time in a fixed income fund may actually lose value through reduced buying power even though its dollar amount has grown.

Fixed income funds also work well at reducing overall risk when combined with stocks. The technique is called *diversifying across asset classes*. Many investors build portfolios that contain both stocks and fixed income investment options.
Investing in Both Stocks and Bonds

Holding stocks and bonds together can serve you well, especially during major downturns in the market.

Suppose you take diversification to the next level by spreading your money among different asset classes. The PRA Balanced Strategy Funds, as well as the PSAs’ Puritan and Asset Manager: Growth Funds, draw from a variety of US and international stocks and fixed income investments. You can build PSA and PRA portfolios that contain different levels of stocks and fixed income investments. Putting your money into a variety of funds is called asset allocation. Mixed portfolios combine the return potential of stocks with some of the stability of fixed income investments.

Consider Market History

Let’s see how mixed and unmixed portfolios perform during a serious market downturn. The worst era in the 20th century occurred during the Great Depression, from 1928 to 1932. As you can see in the chart above, terrible stock market losses followed the crash of 1929. By 1932, a dollar invested in the broad stock market would have dwindled to be worth around 37 cents. During the same period, fixed income investments slowly increased their value as investors fled from the stock market and invested their money in fixed income securities. Yet, portfolios containing both stocks and fixed income securities would have recovered faster than stocks and grown larger than either stocks or fixed income instruments, especially after 1932.

Stocks are represented by the S&P 500 Stock Index, fixed income by a composite bond index consisting of the S&P High Grade Corporate Bond Index from 1928-1952. This period includes the Great Depression, World War II, and the post-war boom, but excludes the large bull markets of recent times.

The mixed portfolios demonstrate how adding fixed income securities dampened the volatile swings in stock values in the years following the crash. Over the long-term, stock and fixed income mixes generally earned much more than the all-fixed income portfolio. Interestingly, portfolios with smaller percentages of fixed income securities yielded higher returns than the all-stock portfolio.

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Preserving Principal

Let’s bring this lesson from the past into the present. Suppose you hold fixed income funds exclusively to protect yourself from a loss in value. One day you decide your portfolio hasn’t grown enough. Perhaps inflation is eating into the buying power of these savings. What if you added some stocks to your portfolio? Exposing some of your money to stocks would likely increase your return potential significantly while increasing risk only slightly.

From the Aggressive Perspective

On the other hand, suppose you invested for years in stock-based funds. Your account balance has multiplied. You're nearing retirement and don’t want to risk exposing all of your assets to sudden downturns anymore. What would happen if you put some of your money into fixed income investments? Your account may not grow as rapidly. However, during a period of negative returns, you likely would risk far less. Those who expect to retire soon or who otherwise need to add stability to a nest egg may achieve short-term stability by allocating their money toward fixed income investments.

Tomorrow...

Will last year’s bull market resume and continue for years? Or are the markets cooling off? The Great Depression’s down cycles are merely a history lesson, unless you had money invested then. No one can say what tomorrow’s market will do. However, asset allocation will continue to be a valuable tool for controlling downside risk and increasing potential returns just as it was in the past.

Like you, most long-term investors use the powers of diversification to shield their assets from the losses that happen to individual stocks and industries. You can achieve the asset allocation that’s right for you by investing your money among the various PSA and PRA funds. They are, in turn, invested in a wide range of different securities and fixed income investments.