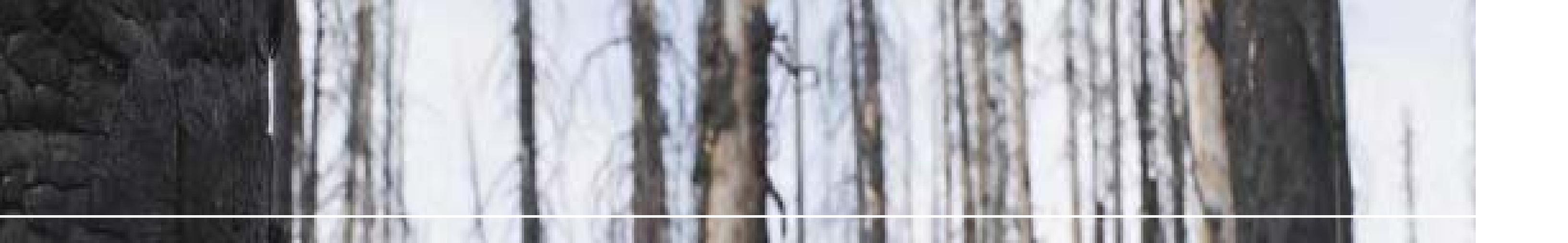
How you respond can create your next opportunity

Lincoln Financial Group®

Adjusting to the Bear and preparing for another Bull



Emerging from the Ashes

After the forest fire comes regeneration.

From the fiery lava emerges a new island.

From these natural cycles come not only destruction but also renewal.

Not a deposit	Not FDIC-insured	Not insured by any federal government agency
Not guaranteed by any bank or savings association		May go down in value

In much the same way, the market historically moves in a cycle of gain and loss, and gain again. The way that the market reacts to a particular event, regardless of whether the event's source is economic, political, or financial in nature, can be best be summed up in three historical stages:

React: A sentiment, an event, or a series of events that create a downswing in the market.

Readjust: The downside momentum slows as investors reconsider and reevaluate their reaction based on the value the of the markets' fundamentals.

Rebound: The market begins moving forward, cautiously but eventually gaining momentum, until the next event.

Steps to take forward

Lincoln Financial Group wants to help you identify strategies you can use to respond to a Bear market and prepare for the next Bull market. The first step is understanding some of the crisis events the market has faced in the past, particularly those of a financial nature, and how long it took to recover from the down turn.

Crises and Recoveries in the Dow Jones

	Reaction dates		Reaction dates loss (%)	DJIA Gain % — Months after reaction dates 1 mon.	3 mon.	6 mon.	12 mon.	DJIA recovery
Panic of 1907	2/15/07	11/20/07	-42.90	6.90	14.70	29.90	48.30	6/24/09
Market Crash of 1929	10/11/29	11/13/29	-43.70	27.30	34.10	46.00	11.80	9/17/54
JFK Assassinated	11/21/63	11/22/63	-2.90	7.20	12.40	15.10	24.00	11/29/63
Penn Central Bankruptcy	6/19/70	7/7/70	-7.10	8.00	16.00	24.90	33.80	7/16/70
Arab Oil Embargo	10/16/73	12/5/73	-18.50	9.30	10.20	7.20	-25.50	1/29/76
Hunt Silver Crash	2/13/80	3/27/80	-15.90	6.70	16.20	25.80	30.60	7/14/80
Continental Illinois Bailout	5/8/84	5/27/84	-6.40	2.30	11.50	10.10	18.30	8/31/84
Financial Panic '87	10/2/87	10/19/87	-34.20	11.50	11.40	15.00	24.20	7/31/89
Asian Stock Market Crisis	10/7/97	10/27/97	-12.40	8.80	10.50	25.00	16.90	2/6/98
September 11	9/11/01	9/21/01	-14.30	13.40	21.20	24.80	-6.70	11/9/01
Average			-19.83	10.14	15.82	22.38	17.57	

Take a look at how long it has taken the market to recover from various, particularly financial, crises in the past. What the table doesn’t tell us is when the market will recover from the current issues — however, it does show that the the market has historically recovered, even from significant events. So the lesson here is don’t panic or react by pulling out altogether.

Data source: Ned Davis Research, 10/08. The 22, 63, 126 and 253 day rate-of-change (listed as 1, 3, 6 and 12 months, respectively, in the table) is calculated from the last day in the reaction dates column. The first date in the reaction dates column indicates the start of the market reaction or the trading day prior to the event.

The Dow Jones Industrial Average is unmanaged and unavailable for direct investment. Assumes reinvestment of income and no transaction cost. Performance does not correspond with any particular investment, and past performance does not guarantee future results.

Dow Jones Industrial Average (DJIA) is a price-weighted average of the 30 most actively traded blue chip stocks and represents between 15% and 20% of the value of all NYSE-traded stocks. The DJIA is considered a general indicator of the U.S. equities market.

Responding to today's concerns

Understanding Bears and market volatility

Understanding how frequently Bear markets occur on average, and average recovery time provides a perspective on why you need to prepare your recovery plan now. Historically, most Bears last less than a year. Only 9 out of 24 since 1928 have lasted for more than 365 days. The current Bear market began on Oct. 9, 2007.

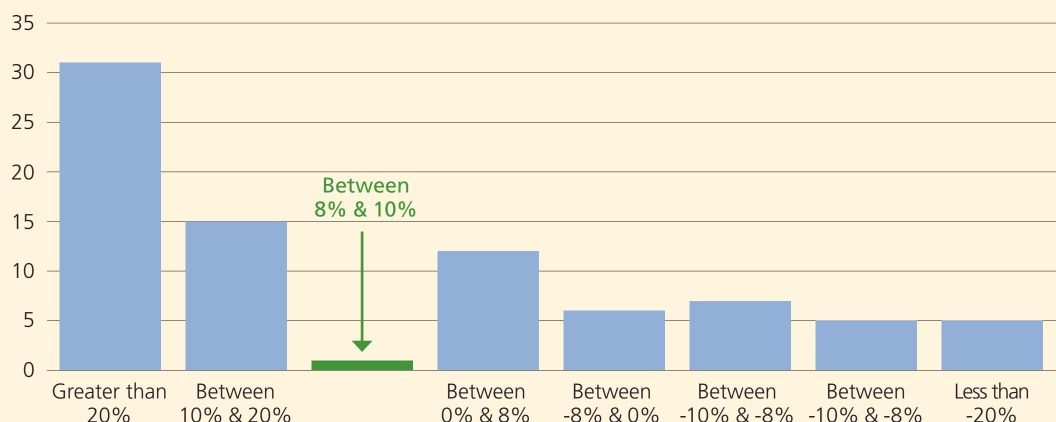
A history of market declines (S&P 500 Stock Index 1.03.1928–10.14.2008)

	Dip (5% or more)	Moderate Correction (10% or more)	Severe Correction (15% or more)	"Bear" Market (20% or more)
Number of Occurrences	270	89	38	23
Average Number/Year	3.3	1.1	0.5	0.3
Average Length	38 days	104 days	198 days	305 days
Average Decline	11.1%	19.5%	28.4%	35.3%

Data source: Ned Davis Research, 10/08

Beyond Bear markets, volatility is an ever present part of the markets, and not all of it is bad. While many investors typically expect an 8% to 10% average annual return over the years from the market, in reality the market hardly ever returns between 8% and 10% in a given year.

Ranges of Annual Returns for the S&P 500 Index (1926–2007)



Data source: Morningstar, 10/2008. The S&P 500® Index is unmanaged and unavailable for direct investment. Assumes reinvestment of income and no transaction cost.

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Ultimately, weathering the turbulence of a Bear, or any volatility, is about adhering to the most fundamental investment principles, which help you understand what you need to do for today.

S&P 500® Index measures the performance of 500 widely held, mostly large-cap common stocks weighted by market value. Prior to 1957, it was the 90 largest companies. Performance of the S&P 500 does not correspond with any particular product.

The S&P 500® Index is unmanaged and unavailable for direct investment. Assumes reinvestment of income and no transaction cost.

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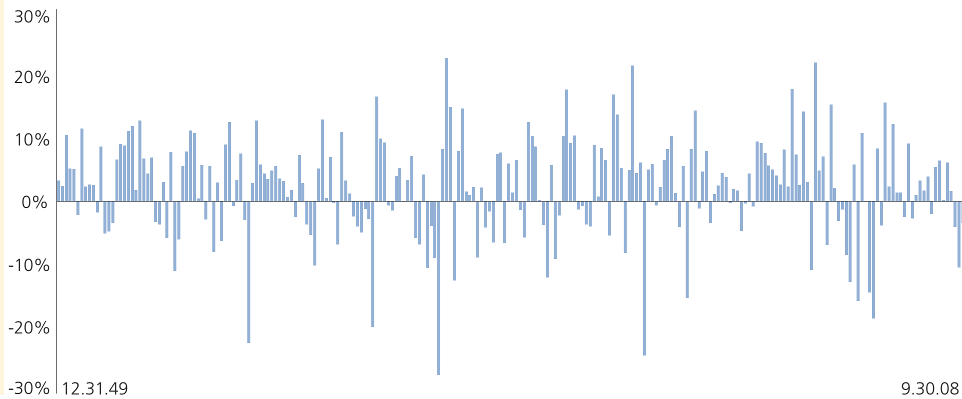
The value of a longer term perspective in the face of volatility and crises

Just as important as understanding the habits of Bear markets is maintaining a long-term perspective on market volatility, particularly in the face of a crisis. While a given time period can feel very volatile at the time, when you look at it from a longer term perspective, the volatility becomes less significant.

The tendency to focus on the negative?

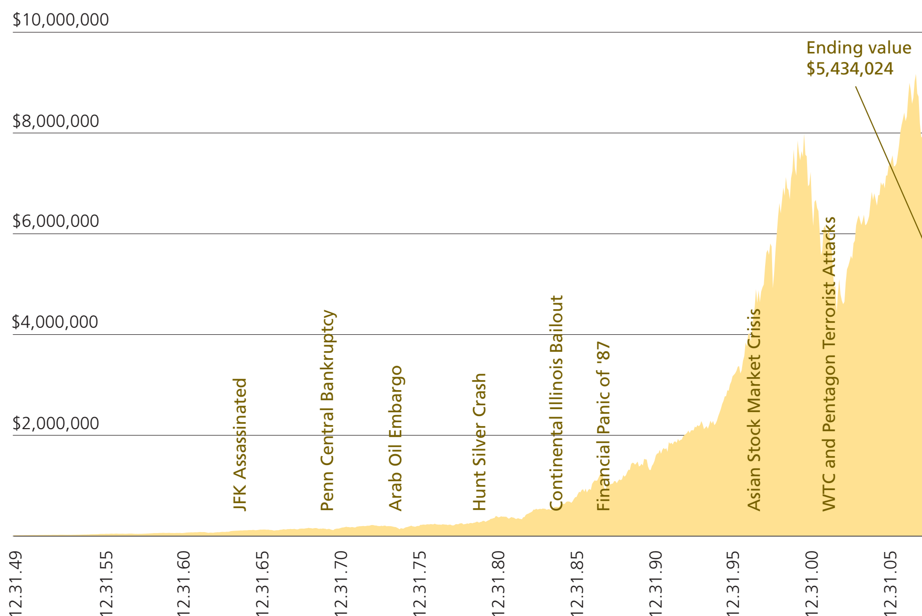
S&P 500 Index Quarterly Returns (12.31.49–9.30.08)



The fluctuation in daily, monthly, or even quarterly returns can feel especially like a roller coaster. And even though it isn't the shifts so much as their impact that matters, it's hard to always focus on that fact when facing short-term volatility.

Getting Past the Volatility and Bad News of the Moment

Growth of hypothetical $10,000 invested in S&P 500 Index (12.31.49–11.30.08)



This chart shows the same time period as the one above. While the first highlights the volatility within the markets, and potentially an investor's anxiety, the second shows the impact of that volatility and a series of crisis events on long-term growth. The chart demonstrates that despite the drop that occurred at each crisis, historically the market eventually shifted forward again.

Data source: Ned Davis Research, 11/08.

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Recognizing tomorrow's opportunities

Why is it that during a Bear market is the best time to position yourself for the next Bull? Because with most Bull markets, most of the profit comes in the beginning, usually well before anyone has realized that the market has shifted into a Bull. A Bear can shift into a Bull without notice, so be prepared.

Why prepare now?

Historically, Bulls favor the prepared. Investors who are prepared early historically benefit from it. Positioning yourself now can help you take advantage of these opportunities because you never know when a Bear will shift into a Bull and consequently, when you'll miss out on the potentially best opportunity for gains. Staying out of the Bear can mean you're not in position for another Bull.

- Number of Bull markets for S&P 500 (1.02.29–10.31.08): 24
- Average duration of a Bull Market: 2.52 years
- Return based on 1st half of a Bull: 39.0%
- Return based on 2nd half of a Bull: 16.0%

Data source: Ned Davis Research, 12/08

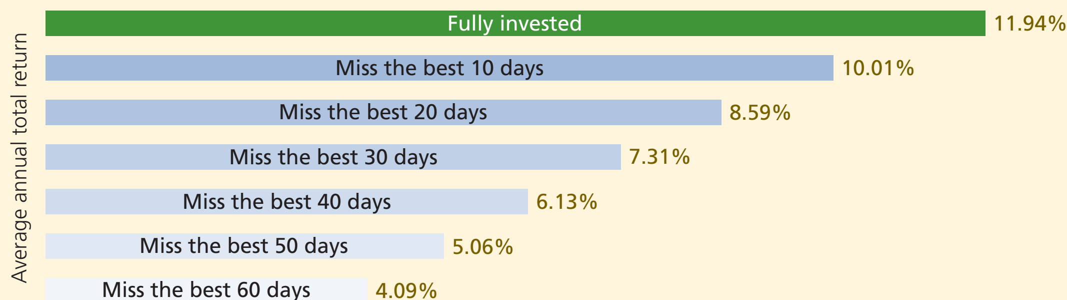
The impact of missing the best days

Many people try to time the market so that they miss the worst days, but in reality they miss most of the best. When are the best days?

- 40% are actually during Bear market
- 34% are during the first two months of a Bull market, before anyone knows it's a Bull
- 26% are during the rest of a Bull market

What happens to your return if you miss some of those best days?

Missing the Best Days (12.31.1977–6.30.2008)



Data source: Ned Davis Research, 10/08.

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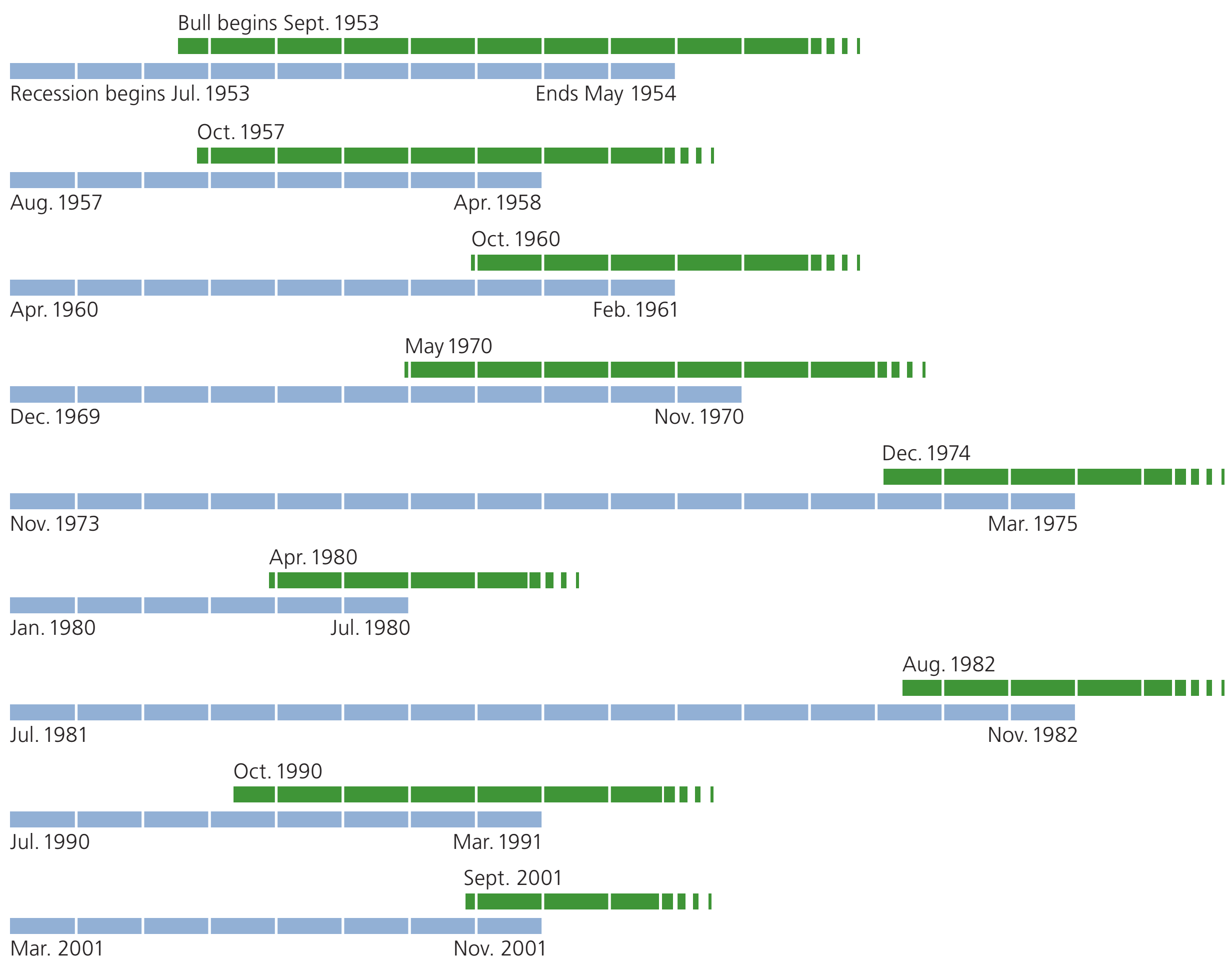
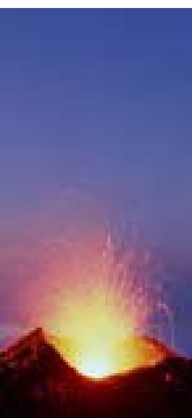
Which comes first, the economy or the market?

Contrary to popular belief, the economy and the market do not move in tandem, although they can certainly have an impact on each other. Historically what happens is that the market recovers before the economy, so if an investor waits on the economy before getting back into the market, they will likely miss the first part of the Bull.

Bulls charge before recessions end



Data source: NBER for Recession data; Ned Davis Research for DJIA data, 10/08.



Potential strategies for repositioning for another Bull

If you understand the significance for preparing for the next Bull now, what are key strategies that might be useful in a volatile market? While the answer is largely "it depends," how close you are to needing income will determine which set of principles will take greater priority.

Positioning for Income

These two scenarios demonstrate why you may need to take steps to protect your assets, if you are going to be taking income from them in the next few years.
While the exact timing of down markets doesn't have an impact on a portfolio when accumulating, the examples show that timing does have a significant effect when you are taking income.

Growing a hypothetical portfolio

- $1 million
- 3.72% average rate of return

	Portfolio 1: Down Market Initially	Portfolio 2: Down Market at End
Year 1	-20%	24%
Year 2	-12%	18%
Year 3	-8%	14%
Year 4	4%	12%
Year 5	6%	8%
Year 6	8%	6%
Year 7	12%	4%
Year 8	14%	-8%
Year 9	18%	-12%
Year 10	24%	-20%
Ending Value	**$1,440,622**	**$1,440,622**

The impact of down markets on income

If you take income now or plan too soon, you may want to discuss with your advisor different strategies to protect your assets that will be the basis for your income. Why? Because a significant drop in assets when you are just beginning to take income could have a disproportionately larger impact on your ability to sustain that income.

Taking income from a hypothetical portfolio

- $1 million
- 3.72% average rate of return
- $50,000 annual withdrawal (non-inflation adjusted)

	Portfolio 1: Down Market Initially	Portfolio 2: Down Market at End
Year 1	-20%	24%
Year 2	-12%	18%
Year 3	-8%	14%
Year 4	4%	12%
Year 5	6%	8%
Year 6	8%	6%
Year 7	12%	4%
Year 8	14%	-8%
Year 9	18%	-12%
Year 10	24%	-20%
Ending Value	$567,259	$1,024,601

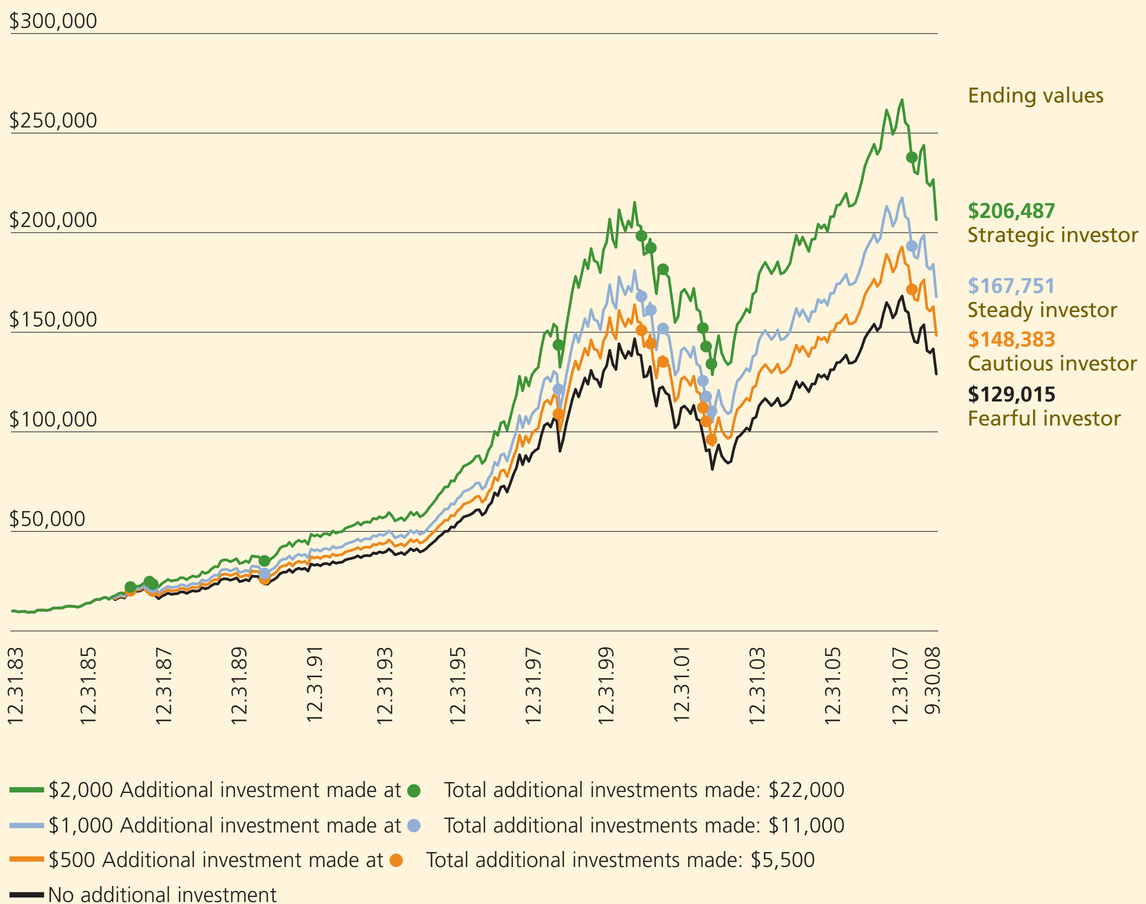
Positioning for growth potential

While market volatility can make for anxious times, it can also produce the greatest power for your investments. Historically, a long-term investment approach has outlasted the temporary nature of any particular declines. Here are two different strategies to consider if you are still accumulating:

#1 Buying low creates a long-term opportunity

If you are primarily interested in growing your investments instead of creating income, consider using the down market as an opportunity to "buy low," according to the adage "buy low and sell high." Look at the impact of various additional amounts that are added each time a drop of 7% or more occurs in a single month, after an initial hypothetical investment of $10,000 into the S&P 500® Index.

Finding opportunity in declining markets



Data source: Ned Davis Research, 10/08.

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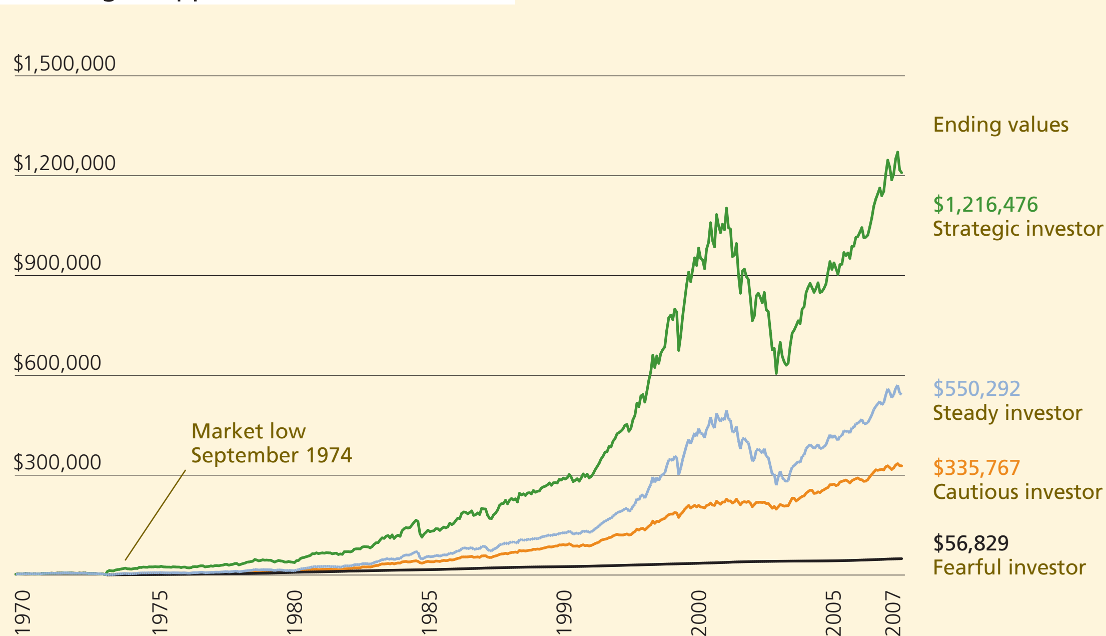
#2 Staying with the market

If you are considering getting out of the market, look at the impact to your long-term goals that the various degrees of either getting out versus increasing your investment may have. It may help you decide to what degree and where you shift your assets to best achieve your goals.

This chart compares four different approaches to market investing during a historical Bear market (January 1973–September 1974). It assumes an initial investment of $10,000 made on December 31, 1970, by four hypothetical investors.

- Strategic investor: Kept assets in the market and invested $10,000 more during the market low of September 30, 1974.
- Steady investor: Kept assets in the market without any changes.
- Cautious investor: Shifted 50% of assets out of market into the U.S. 30-day Treasury Bill Index during the September 30, 1974 market low.
- **Fearful investor:** Shifted assets out of the market and into the U.S. 30-day Treasury Bill Index during the September 30, 1974 market low. Financial goals may not be reached.

Reacting to opportunities in the market



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U.S. Treasury bills (T-bills) are guaranteed by the U.S. government and generally have lower risk-return characteristics than equities. Indexes are unmanaged and unavailable for direct investment. Assumes reinvestment of dividends and no transaction costs.

Value of advice and a strong company

Difficult times are best approached with experience and expertise.

The Mathematics of Catching Up

To break even after a loss, you actually need a positive return that is greater than your previous loss. All the more reason to consider using professional money management during difficult markets.

Accumulation

	-5.00% decline	-10.00% decline	-15.00% decline	-20.00% decline
Gain required to recover	5.26%	11.11%	17.65%	25.00%

Taking income

	Gain required to recover			
	-5.00% decline	-10.00% decline	-15.00% decline	-20.00% decline
4.00% withdrawal rate	9.89%	16.28%	23.46%	31.58%
5.00% withdrawal rate	11.11%	17.65%	25.00%	33.33%
6.00% withdrawal rate	12.36%	19.05%	26.58%	35.14%

The Value of Advice

An advisor can help highlight your options, discuss the strengths and weakness of each, and then help you create an approach that takes into account your needs and individual profile as well as adjusting for current market conditions. Advisors can help you whether you are trying to create wealth, protect it, or create income.

The value of professional expertise

Advice for your investments doesn't just come in the form of a personal advisor. By using professional money managers, you have their expertise and insight working for you:

- Many have been through similar turbulence in the market and have some wisdom about how to approach it.
- All focus on what's going on in the market and on understanding what the best opportunities are.
- Most have additional resources, such as research and analysts, to help them get a clearer picture before making decisions.

In a difficult market, professional management can make a difference in how quickly you make progress toward you goals.

The strength of Lincoln Financial

Just as finding a good advisor is critical, so is partnering with the right company, a company that has a history of integrity and stability. Lincoln Financial Group and its affiliates have more than a century-long heritage of delivering on our promises.

Lincoln Financial Group® affiliates have long been recognized for their disciplined financial and risk management. Throughout our history—and through vastly changing economic climates—this approach has served us well and has never been more critical than it is today. Because we've had unwavering financial discipline since 1905, we're strong enough to deliver on our promises today as well as tomorrow.

	The Lincoln National Life Insurance Company	Lincoln Life & Annuity Company of New York
A.M. Best	A+ (2nd highest of 16)	A+ (2nd highest of 16)
Fitch	AA (3rd highest of 21)	AA (3rd highest of 21)
Moody's	Aa3 (4th highest of 21)	Aa3 (4th highest of 21)
Standard & Poor's	AA (3rd highest of 21)	AA (3rd highest of 21)

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Making your next steps

The checklist below highlights topics to consider and discuss with your financial advisor so that the two of you can assess and then decide the best strategies for your portfolio to minimize the long-term impact of volatility while taking advantage of appropriate opportunities as well.

Checklist of potential responses and strategies to discuss with your advisor

- ☐ Review asset allocation of your assets
- ☐ Review product allocation of your assets
- ☐ Review goals and risk profile
- ☐ Discuss any needs to protecting assets
- ☐ Discuss any needs to protecting income
- ☐ Discuss how rebalancing your fixed income assets can provide opportunities elsewhere
- ☐ Discuss the need for reallocating assets in your 401(k) or other retirement plans
- ☐ Discuss different ways to reposition for another Bull

React, Reassess, and Reposition

While down markets can be a significant disruption to your portfolio, they are not only part of the natural market cycle but can also be sources of opportunity.

Work with your advisor to determine the opportunities that exist for you today so you can pursue your goals tomorrow.

A tradition of integrity

At Lincoln Financial Group, we have a 100-year heritage of helping people find solutions to their financial challenges—with the same honesty, integrity, and responsibility that you'd expect from our namesake. It's a legacy that we proudly and respectfully continue each day. We believe our continued commitment to strength and stability is indispensable to who we are and critical to your confidence in us. We pride ourselves on being able to identify and deliver sophisticated financial strategies and product solutions for the creation, protection, and enjoyment of wealth. We are committed to helping clients redefine their retirement because we don't believe retirement is an end—it's an opportunity for everyone to start doing what they were meant for all along.

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