
Can the Market Make You Rich?

There was a time, not long ago, when owning a stock portfolio was seen as a ticket to riches: Flush retirement accounts could be built on a foundation of stock market returns. Just a small initial investment required.

The extraordinary bull market that spawned that belief is gone. But the sentiment remains – many investors still believe the bulk of their retirement accounts is going to come from market returns.

Here's the reality: Your contributions matter much more than investment returns. The returns from stocks, bonds, commodities and other assets can help grow your wealth and protect it from inflation, but they alone don't have the power to make you rich. That power is yours.

Key points

1

Over their financial lifetimes, investors should expect the majority of their portfolio value to come from contributions rather than investment returns.

2

The idea that returns will be the foundation of investors' portfolios came from those who witnessed the history-making bull market of 1982 to 1999. But you shouldn't base your retirement strategy on the arrival of another 20-year bull market – it may not happen again in your lifetime.

3

Prudent financial planning calls for basing your portfolio on factors you can control – contributions, withdrawals and asset allocation. You can't control market returns.

4

Your financial advisor can help you create an investment strategy that is grounded in risk management and focused on your goals.



Bottom Line

- Even in healthy market environments, portfolios are built on contributions rather than market returns.
- This is true in all but the longest, strongest bull markets.

1

Contributions matter

The chart below illustrates various scenarios for a household earning \$100,000 a year and investing 10% – or \$10,000 – of that income annually.

Household Income – \$100,000 (fixed)			
Savings Rate – 10% per Year (invested monthly)			
Market Return per Year	12%	6%	-2%
10-Year Time Horizon			
Ending Portfolio Value	\$193,615	\$137,249	\$90,551
% Value from Contributions (Household contributed \$100,000 total)	52	73	100
% Value from Market Returns	48	27	0
20-Year Time Horizon			
Ending Portfolio Value	\$832,623	\$386,959	\$164,677
% Value from Contributions (Household contributed \$200,000 total)	24	52	100
% Value from Market Returns	76	48	0

Note: For simplicity, these scenarios assume consistent returns for every year. Actual market returns are highly variable from year to year, which would negatively affect a portfolio's ending value when compared with consistent returns. Also, the household income and savings rate do not assume any adjustments for inflation.

Say the market returns 12% a year for 10 years – which many investors today would consider a roaring bull market. This household's investment portfolio would contain \$193,615 at the end of that decade. Despite this scenario's healthy market returns, less than half of the household's portfolio – 48% – was earned by the market. Most of that portfolio represents the \$100,000 that was contributed by the household over the 10-year period.

In a more modest, but still healthy, market – returning 6% a year for 10 years – contributions become even more important. Some 73% of the household's portfolio comes from contributions in this scenario. And, of course, when the market's losing money, contributions count for everything, and the portfolio's end value is less than what the household put in.

What if you have more time on your side? Would a longer investment timeframe make a difference? Yes, but not as much as you might think.

Let's stretch out the investment timeframe for this household to 20 years. At the end of two decades, these investors will have contributed a total of \$200,000 to their portfolio. If the market returns 6% per year for 20 years, the household's contribution still accounts for more than half of the final portfolio – 52%.

It's only when we devise a once-in-a-lifetime scenario – 12% returns per year for 20 years – that market returns represent the bulk of the portfolio, at 76%. This is a precarious scenario – all it takes is one major market correction to upend the effect of market returns and rebalance the portfolio's value between returns and contributions. We've experienced such major corrections twice this decade.

Bottom Line

- The bull market of 1982 to 1999 skewed perceptions of the role of market returns in a portfolio.
- Prudent financial planning means building your portfolio based on factors you can control.

2

Bred on a bull market?

So, if simple math shows us that most portfolios are built from contributions, not market returns, why does the belief persist that returns are the key to retirement?

It's because so many people witnessed the great bull market of 1982 to 1999, which brought incredible stock market returns for almost two solid decades with historically low volatility. Those 18 years returned, on average, 19% a year, as measured by the Dow Jones industrial average. But as you've heard before, past performance is no guarantee of comparable future results.

Those years represent one of the greatest bull markets ever recorded. While you may hope that we see another such market in our lifetimes, you shouldn't base your retirement portfolio on that hope. Prudent financial planning means building your portfolio based on factors you can control. Market returns are completely out of your hands.

3

What can you control?

Bottom Line

- You can't control investment returns, unless you invest completely in cash.
- You can control the level of your contributions, the timing and amount of withdrawals and your asset allocation.
- Building a nest egg depends largely on your contributions.

The only way to exert any control over your portfolio's returns is to invest completely in cash such as a bank certificate of deposit (CD) or a money market account. While cash returns can change for example, when interest rates change, you know what those returns will be. This can help you reduce uncertainty and avoid losses. The trade-off is that you limit your potential for growth.

The primary factor you can control in any portfolio is your contribution level. It can be very difficult to save money, especially when unemployment is an issue for so many people. But as we've seen, contributions are crucial.

Let's revisit the example of the household that invests 10% of its \$100,000 income per year. Even if the market returns 12% per year, the ending value of that portfolio over 10 years is \$193,615. The sobering fact is that financial goals such as college savings and retirement can be expensive, especially with the reality of rising health care costs, and \$193,615 may not last very long.

The most reliable ways to build your investment portfolio are to invest more and to invest over a longer time horizon. If you can't find a way to carve more money out of your budget for your retirement portfolio, you may need to consider working a bit longer and delaying your withdrawals from your investment account. That said, many life events are unexpected, such as illness, so keep in mind that your investment time horizon is not completely in your control.

The final element to consider is your asset allocation – how much of your portfolio is in stocks, bonds, commodities, cash and other asset classes. Your asset allocation and underlying investments are the primary means by which you can control portfolio risk.

While there is no asset allocation formula that can guarantee a profit or eliminate the risk of loss, your financial advisor can help you construct an allocation with the appropriate balance of return potential and risk exposure for your unique situation and financial goals.

Can the Market Make You Rich?

Factors You Can Control

- Contributions
- Timing and amount of withdrawals
- Asset allocation

Factors You Can't Control

- Time horizon
- Investment returns

Bottom Line

Your financial advisor can help you construct an investment plan grounded in risk management and focused on your goals.

4

Rethinking risk

Basing your financial strategy on the arrival of another historic bull market is extremely risky. You need to make sure you have a plan that you can live with if market returns turn out worse than expected.

Your financial advisor can help you construct a financial plan that allows for maximum contributions and build an asset allocation that is appropriate for you. These measures will give you more control as you work toward your financial goals.

Consider the investment objectives, risks, and charges and expenses carefully. For this and other information about AIM funds, obtain a prospectus from your financial advisor and read it carefully before investing.

Note: Not all products, materials or services available at all firms. Advisors, please contact your home office.

The Dow Jones industrial average is the price-weighted average of 30 actively traded blue chip stocks.

This information does not reflect the performance of any specific AIM fund.

All data provided by Invesco Aim unless otherwise noted.

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