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Investor

Spring / Summer 2015

Live retirement to the fullest.

Portfolios that can provide income for a long and active retirement

Plus:

Losses, gains and our brains

Investing in emerging markets

At 100 years of age, Frank Fukuhara enjoys playing golf, gardening and spending time with his family.

 

Retirement provides the luxury of time to truly enjoy one's passions, but that is often only possible with proper financial planning.

Letter to investors

Everyone has their own vision of an ideal retirement. Whether it involves family, a hobby or an unfulfilled ambition, most people have things they'd like to do but can't while working 40 hours a week. Retirement provides the luxury of time to truly enjoy one's passions, but that is often only possible with proper financial planning. Investors should plan well in advance to determine the lifestyle they want in retirement – and how much income they will need to achieve it. For our cover story beginning on page 6, we spoke with American Funds investors about how – with the guidance of their advisors – they structured their portfolios to provide the income they'd need to realize their retirement dreams.

Market volatility is widely viewed as a major obstacle to achieving financial security, but the way we react to volatility can also have a profound effect on investment outcomes. So if we hope to meet our financial goals, we not only need to develop an investment plan – we need to stick with it. In our feature on page 11, we look at how investor behavior can affect outcomes and outline some simple steps to help keep your plan on track.

Another topic addressed in this issue is the evolution of emerging markets, which account for a significant portion of global economic growth. In the Q&A on page 14, portfolio manager Shaw Wagener reflects on how much things have changed during the three decades that Capital has been investing in emerging markets, and why he is excited about the investment opportunities they present.

As always, we thank you for your commitment to American Funds and wish you continued success with your long-term investment program.

Sincerely,

Timothy D. Armour
Chairman and Principal Executive Officer
Capital Research and Management Company,[SM]
investment adviser for American Funds

Robert W. Lovelace
President and Director
Capital Research and Management Company,[SM]
investment adviser for American Funds

  

American Funds Investor

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Noteworthy

Perspectives for the informed investor

Where are they now?

Persistence pays off

A decade ago, Nancy and Yutaka Kishino didn't know what the future would hold, but they were preparing for it. We profiled the couple in our 2004 Fall/Winter issue. At that time they were hard at work, diligently saving for their children's education while planning for their own retirement. Daughter Katherine was already enrolled at Pepperdine University; son Andrew was a freshman in high school. The Kishinos stressed that they wanted to save and invest enough to enable both children to complete a bachelor's degree and perhaps more. We recently checked in with them to see if they are on track with their plan.

"One of our biggest goals in life was to be sure higher education was covered," notes Nancy. "We learned that, when you're disciplined financially, you can really make it happen." Their efforts paid off. Andrew received his bachelor's from Claremont McKenna College, while Katherine chose to pursue an advanced degree in speech pathology after finishing her undergraduate studies. Much to their parents' delight, both children are happily employed in their professional fields.

It wasn't all smooth sailing though. The market's substantial decline several years ago gave them pause, but they chose to maintain their regular investment program. "We learned our lesson in 1987," notes Nancy. "That was before we met our advisor. We were inexperienced and thought we had to get out of the market. This time, our advisor urged us to be patient, and we knew she was right."

In fact, Yutaka admits, "Now one of the highlights of our year is going to see our advisor, because we see the fruits of our labor."

Thanks to their steady, prudent investing, they were also able to finance Katherine's wedding last year. Not surprisingly, the newlyweds are also American Funds investors. "We wished we had started saving much sooner, so we've passed that on to our children," says Nancy. "Both are independently investing. That's the greatest gift we could give them."

As for retirement, the Kishinos aren't interested just yet. Now 63, Yutaka still serves as an interim pastor at Lutheran churches in the Southern California area, and Nancy, 57, continues to build her business as an owner/director and occupational therapist at an outpatient rehabilitation clinic. They've also recently downsized to a smaller home with a more manageable mortgage and lower utility costs. "Now that the kids are out of the house, I feel we really have time to focus on ourselves," Nancy reflects. "We're beginning a new chapter." ■

For tips on how to save for your children's college education, go to: americanfunds.com/individual/college-savings

Market savvy

Touchdowns, home runs, goals and … investing?

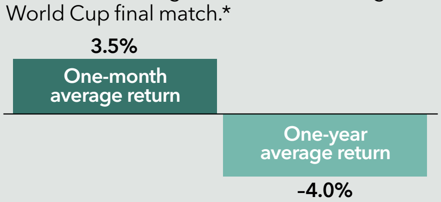
Was February's Super Bowl the highlight of your sporting calendar? Is the World Series more your thing? Or maybe last summer's World Cup finals in Brazil set your pulse racing. Whatever your sport, you've probably experienced the emotional highs and lows of supporting a team.

But could the most-watched sporting events also exert a passing influence on stock markets? Controversially, some finance professors are beginning to think so. Though the robustness of their findings is debated, a number of researchers believe that major sporting competitions are examples of "economically neutral" events that sometimes have short-term repercussions on broad market sentiment.

With World Cup finals attracting global audiences of more than half a billion people, the quadrennial tournament has become a popular case study for academics who are hunting for mysterious market effects. Next-day declines in countries whose teams have been eliminated, as well as the temporary calming of markets during big matches in soccer-obsessed countries, are among the various instances that some researchers say they've discerned through statistical analysis.

After the Cup's lifted, the outcome for stocks has appeared mixed.

Average return of the victorious nation's stocks relative to global stocks following a World Cup final match.*



*For the period 1974 to 2011; excludes when Argentina won in 1978 and 1986, due to data limitations. Analysis from Goldman Sachs Global Investment Research, using MSCI returns. Market indexes are unmanaged and, therefore, have no expenses. Investors cannot invest directly in indexes.

Other studies have claimed that daylight-saving time changes, air pollution levels and temperature may also influence the general mood of investors – even though these factors appear just as irrelevant to the long-term outlook for returns as sporting events do.

Are these findings genuine "cause and effect" or merely curious coincidences? No matter which side of the debate you're on, there remains a clear lesson for investors: It's natural for markets to go through all manner of short-lived gyrations – some of which may be of more significance than others – and remembering this fact can help you feel more settled. That's important because studies suggest that hasty decisions to exit and re-enter mutual funds can potentially hurt investment outcomes over the long run (see the feature on page 11).

So the next time the market gets bumpy, take a moment to reflect on the bigger picture. Now might be a good time to speak with your financial advisor and review your investment objectives. After all, in the long run, what do soccer goals really have to do with the pursuit of investment goals? ■

For additional information on investing in uncertain markets, go to: americanfunds.com/individual/market-fluctuations

Trends

Even the rich can run short of money (if they live long enough)

Nearly three-quarters of low-income households may run short of money by the 10th year of retirement (among people who retire at age 65).* Outcomes look brighter for the affluent, as just 2% of those in the highest income quartile are projected to exhaust their assets within a decade of leaving the work force. But even the wealthiest run the risk of burning through their savings during a lengthy retirement, according to a June 2014 Employee Benefit Research Institute (EBRI) study.

"Longevity risk" refers to the potential danger of outlasting your money. With life expectancies continuing to increase, longevity risk is becoming an even greater concern – and one that merits serious thought and careful planning.

Fortunes change for the wealthy when you look at significantly longer time frames. By the 35th year in retirement, 28% of the third-income quartile and 13% of the highest-income quartile may run short of funds. According to Jack VanDerhei, EBRI research director and author of the report, "Those in the lowest income group are the most vulnerable. … But the higher income are also at risk." Talk with your advisor about building a nest egg that will support a lengthy retirement. ■

*The study assumes 100% of average expenses (based on post-retirement income) for components such as food and housing, as well as probable costs incurred by nursing home/home health care over certain periods of time.

To learn more about saving and planning for retirement, go to: americanfunds.com/individual/retirement-savings

Living retirement to the fullest

Investors reveal how they positioned their portfolios to provide an income that allows them to enjoy a long and active retirement.

At age 100, Frank Fukuhara still enjoys playing a round of golf three times a week. Below: Frank and his wife Ihoko.

Most people who expect to be retired for decades might be concerned that their nest egg won't last long enough. Retirement shouldn't be a test of endurance, but rather an opportunity to use the luxury of time to follow your passions.

We talked to investors whose financial advisors helped them find ways to maintain a flow of income through their golden years, enabling them to relax and enjoy the freedom to pursue the activities that make them happy. After all, it's been said, "We don't stop playing because we grow old; we grow old because we stop playing."

It's better to give *and* receive: Frank Fukuhara

At age 100, Frank Fukuhara is a prime example of someone who refuses to slow down. He celebrated his century birthday in February and still enjoys a round of golf three times a week, *every* week. "Without golf," he says, "I'd be done."

Frank has spent his life taking care of himself and others. He's no stranger to hardship, having been affected personally by the Great Depression and World War II. But thanks to his hard work, positive attitude and long-term perspective, he is in a position to enjoy his later years.

Born in 1915, Frank was part of a large family in a small house on a plot of land in Los Angeles, California. "My father was a farmer, and the Depression hit us hard," he recalls. "My mother cooked potatoes 10 different ways. But we were never hungry, and there was laughter every time we were together."

Frank credits his family and a cheerful outlook for getting him through life's challenges. "Laughter is good for you!" he smiles. "You also need an active mind. My memory is still holding up."

One unpleasant memory, though, is his internment during World War II. Frank and his family were transported to Manzanar War Relocation Camp in Central California. It certainly wasn't the honeymoon that Frank had imagined, having married his first wife just seven days before they were interned. There was no privacy in their 10-foot living space, the communal bathroom was 50 feet away and everyone ate meals in the military-like mess hall.

Residents were allowed to leave the camp if they could prove they had a place to go outside the "exclusion zone" along the West Coast. When Frank's brother-in-law found work in Chicago, he sent for the newlyweds. Six months later, Frank was drafted into the U.S. Army.

> "My family is what makes my world go around."
> – Frank Fukuhara

During basic training in Virginia, an officer approached him about becoming an interpreter, and Frank jumped at the chance. "My Japanese was not very good," he laughs, "but anything to get out of that dusty, hot place!"

After the war, Frank eventually found his way back to California. "My father had the foresight to pay the balance on our land before we were taken to camp," says Frank. "His attitude was, 'They can burn the house down, but you will have a place to come back to.'"

Chuck Cornillie's dream retirement involves taking long motorcycle tours with friends.

In 1947, Frank and a younger brother, Jimmy, established a nursery business and sold plants to stores throughout Los Angeles and up the coast. "We had Easter lilies in the spring and poinsettias at Christmas," Frank says. "Jimmy managed the paperwork, and I managed the sales."

And the brothers' partnership is still going strong. They worked together for nearly 40 years before retiring when Frank was 70 and Jimmy 62. Since then, they continue to meet weekly — on the golf course.

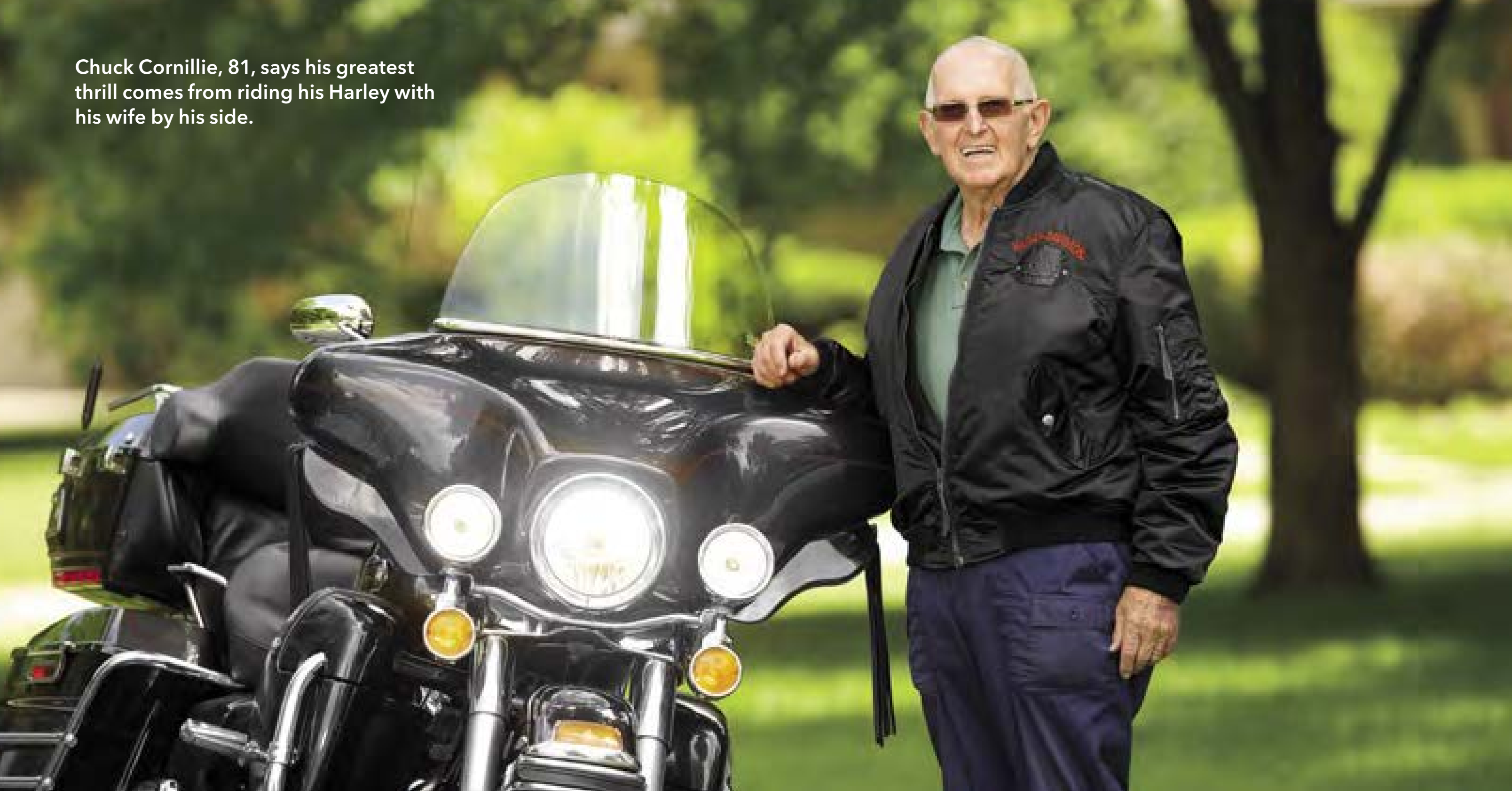
In the 1970s, the brothers had purchased an 18-acre plot near San Bernadino in the Moreno Valley. Even though the land had appreciated considerably in value, they had difficulty finding someone willing to buy it in the 1990s when the real estate market was in decline.

During that time, Frank met a financial advisor at a fundraising event in Los Angeles for Keiro Nursing Home and asked him for some guidance. He suggested gifting the property to charity and establishing a Charitable Remainder Trust. "A Charitable Remainder Trust is a win-win-win situation," notes the advisor. "There's the immediate benefit of a charitable income tax deduction and the future benefit of guaranteed annual income. Plus the charity will receive a large sum when Frank and his wife Ihoko are no longer drawing an income."

When the real estate market rebounded, the property was sold for a substantial amount. The trust was established, and the proceeds were invested in mutual funds. To strike the right balance of risk and reward for the couple, their advisor invested most of the money in equity-income funds. Their annual income, which is equivalent to roughly 8% of the account value, is based on the returns of the underlying investments. This arrangement has enabled them to live comfortably for more than two decades.

The income allows Frank to relax, pursue his passion for golf and enjoy life. Ihoko, a retired nurse, joins him on the golf course every Friday. Frank says he owes everything to the most important women in his life: his mother, first wife Fumi (to whom he was married 35 years before her death) and now Ihoko (36 years and counting). He loves spending time with his two daughters, four grandchildren and great-grandson. "My family is what makes my world go around," he says.

In addition to a legacy for his family, the Charitable Remainder Trust he established will be divided among two charities: 40% will go to the Fukuharas' local church, and 60% will go to Keiro Nursing Home, which was established to meet the needs of Japanese-American seniors who require 24-hour care. "My mother-in-law lived there for three years," Frank says, "and I have many friends who are now receiving care there." As he enjoys the independence of his active lifestyle, he's able to support those who haven't been as fortunate. And he's happy to help provide a place where Japanese Americans can live their final years in a culturally sensitive environment of comfort and respect.



Chuck Cornillie, 81, says his greatest thrill comes from riding his Harley with his wife by his side.

"The freedom, the fresh air, the sights, the smells … you can't beat touring on a Harley. It's better than riding in a convertible."

– Chuck Cornillie

The road less traveled: Chuck Cornillie

You could say that relaxing in a rocking chair isn't Chuck Cornillie's idea of retirement. He much prefers to cross the highways of the U.S. and Europe on his Harley-Davidson Ultra Classic. "The freedom, the fresh air, the sights, the smells … you can't beat touring on a Harley," he says. "It's better than riding in a convertible."

But before Chuck, now 81 years old, could enjoy an active retirement, he spent decades running a family business in the Detroit area. The J.C. Cornillie Moving Company was started in 1904 by Chuck's grandfather, who was renowned as "the strongest man in the city." Local legend has it that he once strapped an upright piano onto his back and hauled it down several flights of stairs.

The company survived the Great Depression, changed direction and grew to become one of Detroit's most respected building supply houses. Chuck learned all aspects of the business, including manufacturing, purchasing and sales. After their father retired, Chuck and his brothers took the reins, guiding the company for nearly two decades. As third-generation owners, the Cornillie brothers grew sales almost fourfold during their tenure. The family sold its stake in 2002 – nearly 100 years after its founding – and Chuck, almost 70, rode into retirement.

His father had established a profit-sharing plan for his employees. Chuck took advantage of this opportunity to save and invest, making the maximum allowable contribution annually. His wife, who worked in sales and administration for the company, also contributed to the retirement plan. As his nest egg grew, Chuck sought the advice of a St. Clair, Michigan-based financial advisor, who has guided him since 1991.

When the tech bubble burst in 2000, Chuck felt compelled to make his investment portfolio a bit more conservative. With his advisor's help, he shifted the bulk of his retirement assets into an annuity, which provides a stream of income guaranteed for life. "I'll gladly trade huge returns for some peace of mind," he says. "An annuity is steady – I can rely on it."

Chuck was introduced to Harleys by a friend in 1993. He kicked a few tires and fell in love with a bike "decked out with a lot of chrome." There was just one problem:

He didn't know how to ride. A training course at a local community college rectified that, and soon he was cruising the roads with fellow bikers. Although his wife hadn't planned on participating, she eventually joined him as a passenger and before long had a bike of her own.

Now experienced bikers, the Cornillies enjoy taking long tours with friends. They are members of the Harley Owners Group, H.O.G., which enables them to rent motorcycles around the world. They've taken the back roads through Alaska, Germany, France and Spain, always stopping to visit the small towns and sample the local flavors. On one occasion they shipped their Harleys to Portland, Oregon, and rode back home to the suburbs of Detroit. It remains one of their favorite trips.

After two decades in the saddle – even after undergoing heart valve replacement surgery in October of 2013 – Chuck shows no signs of shifting to a lower gear. The couple, who have been married 58 years, enjoy spending time with their three children and nine grandchildren. Although he has recently "retired" from playing softball and skiing, Chuck still golfs and fishes. But his greatest thrill comes from taking to the open road on his Harley with his wife by his side.

"With a lot of hard work and our advisor's guidance, we're living the life we desire."

– Doug Martin

Navigating an active retirement: Doug and Jan Martin

Before Doug and Jan Martin sold their home, car and worldly possessions, they met with their financial advisor. He helped them reposition their portfolio to withstand the market's storms. "With a lot of hard work and our advisor's guidance," says Doug, "we're living the life we desire."

And what a life it is. They embarked in the spring of 2014 on a multiyear journey to explore North America's waterways aboard "Day Dreams," their Kadey Krogen 39-foot trawler. They could be characters in an adventure novel. Others might see them as modern day maritime explorers, not unlike Magellan and Shackleton. In reality, they are modest folks who lived frugally, saved conscientiously and are now enjoying life on their own terms.

Doug began boating as a child in Toledo, Ohio, and had a job washing boats by the time he was 14. He paid his way through college pumping gas and, following graduation, began his career

Jan and Doug Martin enjoy a night on the town at Chicago's Navy Pier.

The Martins have embarked on a multiyear journey to explore North America's waterways on their 39-foot trawler.

as a civil engineer. He worked in Michigan and Pennsylvania before returning to the Toledo area to join a national construction company. Involved primarily with automotive projects, Doug loved coordinating with clients and guiding ideas through the design stage to completion. Eventually he became a vice president, overseeing a range of projects across the country. Jan, Doug's wife of 37 years, also built a successful career, working as both an ER and construction site nurse before settling into a long stint as a school nurse.

Their vacations were spent at sea, usually exploring the Great Lakes. They enjoyed themselves, but yearned for more. "You can only see so much in two weeks," Doug laments. Their dream was to retire early, around 60, and travel the seas full-time.

To test out their retirement lifestyle, the Martins took leaves from their jobs and began a four-month trip circumnavigating Lake Superior, which Doug refers to as "the grandest of the Great Lakes." They traveled 2,400 miles, visited national parks, walked the untouched wilderness and watched a variety of animals enjoying their natural habitats. They were determined to make this their lifestyle in retirement.

Realizing that pensions alone couldn't fund their retirement, Doug began investing in his company's 401(k) plan as soon as it was offered. He consistently "maxed out" his annual contributions, took full advantage of his company's matching program and made "catch up" contributions when he reached age 50.

About 12 years ago, Doug was introduced to a Philadelphia-based financial advisor who suggested he begin to supplement his workplace retirement plan by making regular, systematic investments into growth-oriented mutual funds. Every few years their advisor would perform a quantitative retirement planning analysis to ensure they were on the right track.

Following retirement, Doug's advisor encouraged him to consolidate the bulk of his assets into an IRA. His current asset mix is designed to meet the dual challenges of longevity risk (i.e., outliving his assets) and market risk. About half of his portfolio is divided among three equity-income funds, which seek income by investing primarily in dividend-paying companies. These funds tend to be less volatile than growth-oriented funds and provide a degree of balance. About 20% of his portfolio is in a mix of bond funds to add some stability and income potential. The remainder is in growth funds, which seek to keep pace with inflation.

After retiring in June 2014, the Martins began their long-anticipated journey. They plan to spend the next few years navigating the Great Lakes and Atlantic coast – a first for the couple. They have a simple strategy – spend the spring and summer in the north, then head south for the colder months.

The Martins are well-prepared for stormy weather, both financially and nautically. Their advisor sought to structure their portfolio to withstand market volatility, and the Martins diligently track forecasts in order to circumvent harsh seas. "The Great Lakes can be something to reckon with when the winds start blowing and the thunderstorms kick up – you really have to respect the Lakes," Doug says. "You can't outrun a storm, you just have to ride it out."

To see videos of American Funds investors, go to: youtube.com/americanfunds

Losses, gains and our brains

It can be difficult to resist the urge to jump in and out of investments, especially when markets are volatile. But emotional reactions to short-term market shifts can negatively impact long-term returns. We take a closer look at this phenomenon and offer three strategies to help keep your portfolio on track.

What do you rate as the biggest potential obstacle to achieving your long-term financial goals? At one time or another, almost everybody worries about stock market volatility. You might be surprised to learn, however, that the way an investor *reacts* to challenging market conditions can also play a crucial role in determining whether individual investment plans stay on track.

For some investors, recent U.S. stock market volatility may have brought back memories of those jittery feelings during the financial crisis of 2008–2009. If media talk of market corrections and a jump in the "fear index" makes you want to hoard cash under the mattress rather than remain invested, don't despair. It just means you're human.

As portfolio manager Jim Rothenberg explained in our last issue: "At times of market volatility, investors often react by making short-term decisions that can have long-term consequences. … That's especially true during a downturn, when they have a natural tendency to sell

Looking for the exit, dropping anchor and running with the herd

The ups and downs of stock markets are often echoed in the highs and lows of emotions at the time. In recent decades, researchers have concluded that psychological factors can significantly influence investment outcomes. Below are three examples:

- **Loss aversion.** A loss causes a greater amount of unhappiness than the happiness prompted by a gain of a similar amount. In our last issue, Jim Rothenberg made the following observation: "Behavioral studies suggest that people prefer avoiding losses to making gains. The loss of a $100 bill is likely to create greater unhappiness for a person than the amount of happiness resulting from a $100 windfall."

- **Anchoring.** An investment decision based on irrelevant information, such as a market index reaching an arbitrary level that has some emotional resonance.

- **Herding.** Copying the behavior of other investors, such as investing in a rising market – possibly in pursuit of a "hot" investment trend – even though valuations appear unjustifiably high.

investments rather than stay invested and hopefully benefit from a market upturn."

Often, the human instinct is to jump on the bandwagon when an investment has done well and cut your losses when it has fared poorly – resulting in buying high and selling low (see sidebar on previous page). Myriad studies have confirmed that emotion can push investors into making decisions that, unfortunately, diminish investment outcomes. For example, research firm Morningstar® found that, for the thousands of mutual funds it tracks, those that comprise the "U.S. equity category" suffered the largest outflows of investor money in 2012, only to record the highest return of any category in 2013.

Every little bit of return helps

Jumping in and out of mutual funds – as opposed to staying put – may result in investors earning somewhat lower annual returns. Even a small difference can have a big impact on longer term results. For example, a hypothetical initial investment of $100,000 that earned an annual return of 5% each year for 30 years would have an end value of just over $432,000 – more than $100,000 greater than would be the case with a 4% annual return.

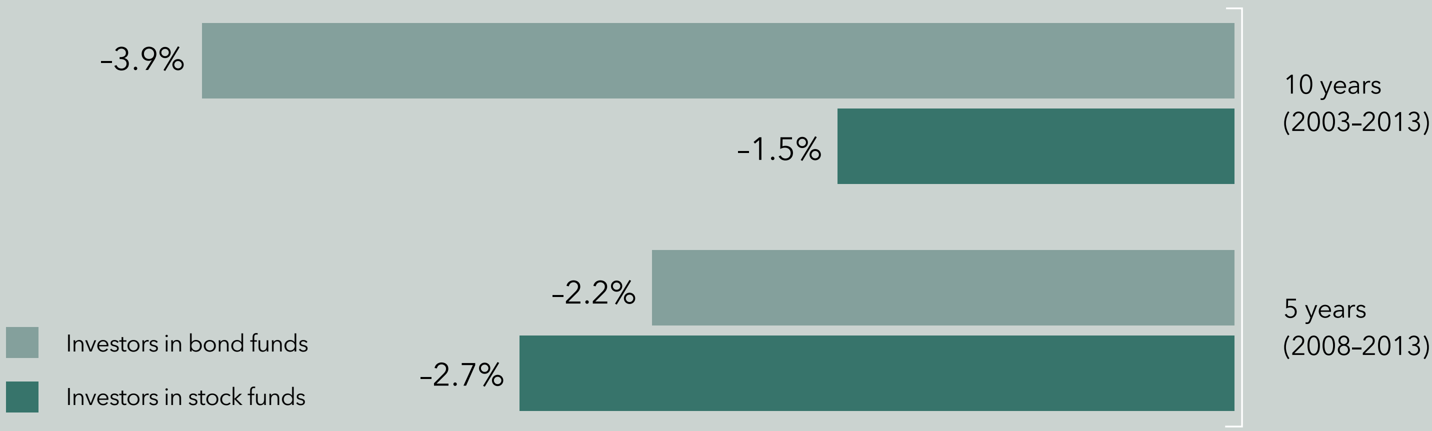
How much did that hurt?

One way to begin to measure the extent to which investor behavior – in terms of exiting and re-entering mutual funds – may hurt returns is to answer the question: How have returns earned by actual investors in mutual funds compared to those of the broad market?

The chart below seeks to do just that – showing estimates (from research firm DALBAR) of the "gap" in returns experienced by actual mutual fund investors in

For an "average" investor, the tendency to exit and re-enter mutual funds may result in diminished returns.

DALBAR's most recent estimates of the relative returns (average annualized) earned by actual U.S. equity and bond mutual fund investors, compared to those of the stock and bond markets*



*Stock and bond market returns are represented by Standard & Poor's 500 Composite Index and Barclays U.S. Aggregate Bond Index, respectively.

Average equity investor and average bond investor results are calculated using data supplied by the Investment Company Institute. Investor returns are represented by the change in total mutual fund assets after excluding sales, redemptions and exchanges. This method of calculation captures realized and unrealized capital gains, dividends, interest, trading costs, sales charges, fees, expenses and any other costs. After calculating investor returns in dollar terms, two percentages are calculated for the period examined: total investor return rate and annualized investor return rate. Total return rate is determined by calculating the investor return dollars as a percentage of the net of the sales, redemptions and exchanges for each period. The indexes are unmanaged and, therefore, have no expenses. Investors cannot invest directly in an index.

Source: Quantitative Analysis of Investor Behavior, 2014. DALBAR, Inc.

recent years. The time frames presented span some particularly turbulent times (notably, the 2008–2009 financial crisis and recession) during which mutual fund investors ran for the exits in droves.

DALBAR's analysis suggests that the gap could amount to as much as a few percentage points of annual return on average. That might not sound like much, but in the long run it's possible that earning a consistently smaller annual return could have a meaningful impact due to the cumulative effect of compounding.

If high school math is a distant memory, here's a quick reminder: By compounding, we mean that relatively small differences in the annual return earned by two investors may ultimately lead to substantial differences in the value of their investments over a longer period (see box on previous page).

Close the gap, one step at a time

Investing in actively managed funds that emphasize a longer term approach can, we believe, help investors remain focused on their goals. With that in mind, here are three steps to help prevent a gap in your returns:

- **Consult a financial advisor.** An advisor can help you define long-term financial objectives and suggest investment choices that he or she feels may provide the best chance of achieving your goals – given your time frame, risk tolerance and broader financial position.

- **Recognize that some active managers have consistently added value.** Taken as a whole, active equity managers in the U.S. have not consistently outpaced Standard & Poor's 500 Composite Index. However, there are some who have consistently added value over a variety of market cycles; looking for persistency can be useful when trying to identify these managers. In simple terms, persistency means having a track record where, if a manager outpaced the market in a given period, he or she tended to outpace in the subsequent period as well. Arguably, a track record makes a more convincing case for skill if it includes a lengthy history of persistency over a variety of investment horizons. Evidence of persistency could give you more confidence about remaining invested with a manager through market ups and downs.

- **As much as possible, think of volatility and market corrections as a natural part of investing.** If you find yourself fixating on the negative, remember this fact drawn from analysis published by market data and research firm S&P Capital IQ: In the 69 years following the end of World War II, Standard & Poor's 500 Composite Index experienced 12 bear markets lasting an average of 14 months. During the same period, there were 11 bull markets (excluding the one considered to be ongoing at the time of their most recent analysis in March 2014), but with an average duration of 54 months. To put in context the overall positive trend for U.S. stocks (without, it should be noted, adjusting for inflation), the S&P 500 entered the 1950s at a level of less than 20 points and began 2014 above 1,800 points.

Scientific understanding of why humans think in certain ways and how our brains are wired to do so (see above) is developing rapidly.

However the science evolves, it's clear that making short-term investment decisions based on emotion can have major consequences down the road. When you're a long-term investor, it's often best to look past near-term ups and downs.

"Market volatility can be unsettling, but it may also have a silver lining," says portfolio manager Carl Kawaja. "My experience is that difficult market conditions have often created attractively priced opportunities to invest in companies that our research indicates have well-managed businesses with good prospects." ■

The market went down. My anterior insular cortex must be active.

Damaged a joint or taken a serious knock in the past decade? If so, chances are your doctor has sent you for an MRI. In recent years, a related imaging technology – functional magnetic resonance imaging, or fMRI – has begun helping economists and neuroscientists relate behavioral tendencies to activity in specific parts of the brain. For instance, some researchers have suggested that the anterior insular cortex plays a pivotal role in risk aversion. Intriguingly, this region appears to be active in many people when they anticipate pain, as well as when they make risky choices. From a neurological point of view then, investor loss aversion could be viewed as another manifestation of our natural instinct to try to avoid physical pain.

For more advice on keeping your emotions in check during turbulent markets, go to: americanfunds.com/individual/staying-the-course

Investing in emerging markets can pay dividends

Many emerging markets companies are stronger than they were a decade ago and offer considerable investment opportunities.

Emerging markets account for a substantial portion of global economic growth and should continue to grow over the coming decades. About 90% of emerging markets companies also pay dividends, providing investors with a wide range of opportunities to generate income.

This year, American Funds combined more than a quarter-century of emerging markets experience with its long-held tradition of investing in dividend-focused companies by launching American Funds Developing World Growth and Income Fund.℠ This new offering in the American Funds growth-and-income lineup aims to capture long-term growth prospects in emerging markets by investing in firms that have consistently paid meaningful dividends over time.

Here, portfolio manager Shaw Wagener talks about the benefits of gaining exposure to growth in emerging markets and the significance of global research in finding strong companies that pay dividends.

What's changed in emerging markets since you began investing there three decades ago?

We started investing in developing countries in the 1980s. The World Bank's International Finance Corporation (IFC), which encourages private-sector development, was looking for a way to open these markets to foreign investors. They selected us to invest in a global emerging markets fund. At that time there were only a handful of investable countries in emerging markets. For the most part, opportunities were limited to large utilities providers or state-owned telephone companies or oil firms. There were very few private enterprises.

One of my fondest early memories is of an experience I had visiting China in the early 1990s. We traveled across the border from Hong Kong into Shenzhen on a dirt road with big potholes. When we reached a certain point, we had to get out of the car and walk through immigration. The car then met us on the other side, and we continued on to Shenzhen. On that first trip, we climbed seven floors in a seemingly bombed-out building outside the city to visit a pencil factory. That was the largest company I saw. When I contrast that to the types of investable companies based in China today, I'd have to say that the IFC's vision has made a huge difference. Now we have many companies to choose from across the emerging markets.

It's not just that we have a greater breadth and variety of companies, but even more importantly, they have a much higher quality of management. Many entrepreneurs have built substantial businesses that are not only thriving in local emerging markets economies – they are competing on a global level by exporting goods and services.

Past results are not predictive of results for future periods.

Investing outside the United States involves risks, such as currency fluctuations, periods of illiquidity and price volatility, as more fully described in the prospectus. These risks may be heightened in connection with investments in developing countries.

Position: Chairman of Capital Group International,℠ Inc. Also serves on the Capital Group Companies Management Committee.

Investment experience: 33 years, all with Capital Group.

Education: Bachelor's degree cum laude in international relations from Claremont McKenna College. Also holds the Chartered Financial Analyst® designation.

What makes you optimistic about long-term growth prospects in emerging markets?

Apart from the fact that many of these economies have opened up – with governments fostering competition and encouraging entrepreneurs to create businesses and grow – I believe that people around the world are striving for a better standard of living. My fundamental optimism has less to do with government policies or overriding macroeconomic factors. It's more about the reality that people in emerging markets want to be successful and enjoy a higher quality of life, just like their neighbors in developed markets.

How does the fund address investors' fears about emerging markets?

People are sometimes reluctant to invest in emerging markets because the headlines can be scary: They may highlight problems in a particular region or company that don't necessarily apply to the broader emerging markets. Volatility is often a concern.

Developing World Growth and Income Fund tries to manage these fears. We invest in companies that pay meaningful dividends over the long term and tend to be higher quality firms. I think it's a very efficient way for investors to gain exposure to the tremendous growth potential in emerging markets with less volatility while still diversifying their investments.

Describe your approach to assessing the quality of emerging markets companies and the importance of having a dividend-focused management.

In general, companies that routinely pay significant dividends tend to allocate capital efficiently – they recognize that they're using shareholders' money and try to pay out anything that won't be used to generate a return. The concept of being very cautious about capital allocation is a very important aspect of being a successful business. As we started to explore dividend culture in emerging markets, we discovered that consistently strong dividend payers tend to be better investments over time; these companies are generally well-managed and often generate higher returns because they're actually making sure that any return on the capital they invest in the business is fairly high.

I think we're breaking into a new area with this fund. It provides an opportunity for American Funds investors to gain exposure to rapidly expanding areas of the world with the potential for a more comfortable pattern of returns than is usually associated with a standard emerging markets fund.

How would you describe Capital's experience in emerging markets investing?

When we were chosen by the World Bank in the 1980s, we approached this investment opportunity the way we do all others: with comprehensive research and the desire to understand what drives these companies, their competitors and their respective industries. That's how we invest.

Our advantage is that we've been doing this for almost 30 years. We've also been investing in emerging markets debt since the early 1990s. Unlike many firms, our fixed-income and equity analysts travel together and share insights. Adopting a global perspective as an investor is essential when you consider just how integrated the world has become. While emerging markets are the specific focus of American Funds Developing World Growth and Income Fund, we find it beneficial to draw from the range of perspectives and knowledge the analysts in our global research group provide. One of the biggest risks to businesses in emerging markets is what's happening outside their borders; the more information we have, the better positioned we are to make effective investment choices.

What's your current view on emerging markets?

There are a number of reasons to be excited about emerging markets. One is that emerging markets stocks haven't done as well as developed market equities in the last few years, particularly in the United States. As a result, they present a good value for investors. Many emerging markets companies are stronger and more competently managed than they were a decade ago, and offer considerable investment opportunities. Quite a few are thriving, world-class firms. Stock prices have come down for a number of well-run emerging markets companies, and valuations look attractive compared with many companies in developed markets. ■

For more information on investing in emerging markets, go to: americanfunds.com/individual/emerging-markets

The American Funds Advantage

Since 1931, American Funds, part of Capital Group, has helped investors pursue long-term investment success. Our consistent approach — in combination with The Capital System℠ — has resulted in a superior long-term track record.

Aligned with investor success

We base our decisions on a long-term perspective, which we believe aligns our goals with the interests of our clients. Our portfolio managers average 27 years of investment experience, including 22 years at our company, reflecting a career commitment to our long-term approach.[1]

The Capital System℠

Our investment process, The Capital System, combines individual accountability with teamwork. Each fund is divided into portions that are managed independently by investment professionals with diverse backgrounds, ages and investment approaches. An extensive global research effort is the backbone of our system.

Superior long-term track record

Our equity funds have beaten their Lipper peer indexes in 91% of 10-year periods and 96% of 20-year periods. Our fixed-income funds have beaten their Lipper indexes in 54% of 10-year periods and 57% of 20-year periods.[2] Our fund management fees have been among the lowest in the industry.[3]

[1]Portfolio manager experience as of December 31, 2014.

[2]Based on Class A share results for rolling periods through December 31, 2014. Periods covered are the shorter of the fund's lifetime or since the comparable Lipper index inception date (except SMALLCAP World Fund, for which the Lipper average was used).

[3]On average, our management fees were in the lowest quintile 70% of the time, based on the 20-year period ended December 31, 2014, versus comparable Lipper categories, excluding funds of funds.

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