

Financial Decisions in the Current Down Market

I've received numerous calls from clients on what to do with their retirement savings due to the current economic conditions we find ourselves in. Many have seen their IRA's or 401(K) greatly reduced due to falling prices in the market. Quite naturally it is very disturbing to see years of growth erode away overnight. Calls have come in from every age group, from those who have many years until retirement to those who have already reached retirement. Regardless of which age group you find yourself in, the following discussion represents the soundest advice that I believe applies for long term financial decisions in a down market cycle.

1. How did we get here?

Today's market volatility was created by a crisis of confidence following the bursting of inflated real estate values. The inflated values came about during a prolonged period of lax lending practices coupled with historically low interest rates. Those lending practices allowed subprime borrowers to purchase homes without adequate safeguards that they could make their payments. And those mortgages were then used to create something called "mortgage backed securities" that were sold to investors.

By late 2007, after millions of subprime homeowners had defaulted on their loans, it became clear that billions of dollars in subprime mortgages were at risk. Since these mortgages were behind securities that were sold on the open market, this shortfall affected investors around the world. Eventually, fears of default on other types of loans, both consumer and commercial, began to rise.

In 2008, the stock prices of many large financial companies fell as their credit ratings were lowered because they were holding these "troubled" assets and liquidity tightened. Beginning with the collapse of Bear Stearns last March, several major institutions have been threatened with bankruptcy, causing an international crisis of confidence in the markets.

After several attempts to correct the problem through the year, on October 3rd the Federal Government passed the [EMERGENCY ECONOMIC STABILIZATION ACT OF 2008](#) (reported in last month's newsletter). This law, the largest taxpayer intervention since World War II, is designed to stabilize the tightening credit markets in the US economy. This law is composed of two primary sections:

Section I: \$700 billion appropriated to purchase "troubled assets" in the credit market.

Section II: \$150 billion appropriated for tax relief through a 2008 Alternative Minimum Tax (AMT) patch, an extensive package of tax extenders, energy incentives, disaster relief, and more.

While it is reported that the credit markets are beginning to show some evidence of thawing, the uncertainty of how long it will take to reinstate growth in our economy is continuing to negatively affect the markets. We now see ourselves facing what is called a "bear market".

1. How should I adjust my retirement portfolio?

When markets are falling, the tendency is to move out of stocks. Then when the market goes back up, investors want to own stocks again because of the growth they provide. Following those emotional impulses causes investors to “sell low” and “buy high”. That’s the opposite of what you want to do. Volatile markets can climb as quickly as they fall. Remember, unless you move your savings out of stocks by selling, all you have realized is a “paper” loss in a market down turn. Selling those stocks in a down market turns those “paper” losses into “actual realized” losses.

I recommend that you step back, take a deep breath and maintain your commitment to your long range objectives during a down market. Don’t let your emotions overrule your good judgment during this time.

The current market volatility affects all participants regardless of their age. The following are some planning strategies for your specific age group:

Many years before retirement

1. Continue contributing to your retirement plan and IRA and increase contributions if you can.
2. Remain invested in an age-appropriate asset allocation
3. Regularly rebalance your portfolio back to your targets.

Nearing Retirement

1. Try to be flexible about your future plans and continue working a few more years if possible.
2. Maintain a well-allocated portfolio that is appropriate for your time horizon
3. Continue contributing to your retirement plan and to a taxable emergency fund if you expect to need more liquidity.
4. Regularly rebalance your portfolio back to your targets.

In Retirement

1. Try to be patient and focus on the long term. (You may have decades of retirement ahead of you).
2. Maintain a well-allocated portfolio that is appropriate for your time horizon.
3. Cut back on unnecessary spending.
4. Try to adjust what you are taking from your investments. (Suggestion: don’t increase your withdrawals for inflation if you are able to cut back on your expenses).
5. Regularly rebalance your portfolio back to your targets.
6. Consider taking a part-time job for a few years or consider a reverse mortgage to offset the need to draw on your savings.

Diversification for all ages

Maintaining the right asset allocation (how you spread your savings among stocks, bonds, and money market/stable value investments) and the right diversification within those asset classes is important to achieve your long term savings objectives. This requires re-balancing your portfolio periodically to bring it back to your target allocation. Unless you are proficient in this area or employ the services of a financial planner, an alternative solution would be to shift your retirement assets into a target-dated retirement program offered by most of the major fund families such as Fidelity, T. Rowe Price, or Vanguard. These investment plans are highly diversified and professionally managed to become more conservative over time.

2. How do I avoid overreacting?

When the market swings through extreme highs and lows, it's natural to feel like things are out of your control. But there are some important decisions that are always within your control—and they can have a big impact on your long-term financial standing.

- a. Make a plan based on your time horizon and stick to it! This diversified strategy will help you weather the market's ups and downs and stay focused on your long-term goals.
- b. Try not to dip into your retirement account for loans and withdrawals (if offered by your plan) when times are tough. You'll need that money down the road, so it's important to let it keep working for you.
- c. Reduce spending wherever possible.
- d. Keep contributing to your retirement plan.
- e. Don't let your emotions determine your investment decisions. Remember, to keep a long-term perspective and maintain your investment strategy through all market conditions.

Till Next Time,

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