Sensible Money Management Helps You Feel in Control During a Crisis

Financial Planning in Today's Market

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Since we have to submit this column well in advance of publication, the extent of the coronavirus outbreak and subsequent stock market and economic damage that took place in February through spring 2020 is still uncertain at the time of our writing. But it is obvious 2020 is already a very different year than 2019 for planners and investors.

After enjoying the second decade in U.S. history without a bear market, it's fair to say almost everyone anticipated some kind of market correction. Few if any anticipated the coronavirus or the rapidity of the market decline as it spread worldwide. Certainly, it appears that we'll have a recession as a result of this virus.

We don't know what this recession and bear market will look like longer term, but we do know there are some actions you should consider with respect to your financial plan and your investments during this uncertain time. In other words, how can we turn lemons into lemonade?!

Rebuild Your Cash Reserves

We have always recommended keeping three to six months' expenses on hand in a cash reserve. Having such a good stock market for so long may have lulled you into thinking you need less in reserve. Unfortunately, this market decline reminded us all of the reason we should have this reserve on hand to meet ongoing expenses. This way you avoid having to sell investments at low prices to pay your bills.

If your cash reserve isn't as high as you would like, we recommend you look at your last few credit card bills and bank statements to identify any areas where you can temporarily cut back spending to rebuild your reserves.

Put Excess Cash to Work

In the past, investors who bought during a bear market were rewarded over the long term because they were able to invest when assets were "on sale." Of course, emotionally this is easier said than done, as often the lowest point in the markets when prices are most attractive is also the point of maximum fear.

If you're fortunate enough to have some cash on the sidelines, talk to your financial planner about strategies for investing in a downturn. In volatile markets, with large swings up and down day-to-day, one good approach to this kind of market is "dollar-cost averaging."

Dollar-cost averaging simply means spreading your investments over a set period of time, usually in equal amounts. So rather than investing all at once, you invest a certain amount of your investable cash over a period of time. This can help mitigate some of the risk of bad timing. For instance, you could invest 20% each month over the next five months. If you set the investment to happen automatically on the same date each month, you can also eliminate the temptation to "wait" for the right day each month, or to trade on emotion. The key to dollar-cost averaging is that it runs like a program, thus avoiding the emotions that come with a bear market.

Rebalance

If you don't have cash on hand, but still want to turn the decline to your advantage, take a look at your current asset allocation. If you owned a portfolio with an allocation of 60% stocks and 40% bonds heading into the downturn, the allocation may be closer to 50/50 after a significant market decline. If the prior allocation was appropriate to your objectives and risk tolerance, then it likely remains so in a bear market. Rebalancing back to your target allocation means you'll be likely be sell-

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ing bonds and buying stocks, when stocks are on sale.

Increase Retirement Savings Contributions

There is a saying that the stock market is the only place that people don't buy when things go on sale! Sad but true. If your income is stable and your cash flow is positive, we recommend increasing your contributions to your company's retirement plan to the maximum you can contribute. By doing so you will be investing when the prices are low, thus reaping the rewards over the long term. Regular biweekly or monthly contributions to your retirement plan work the same way as dollar-cost averaging, steadily investing over time without regard to current market sentiments.

Tax-Loss Harvesting

Due to the market decline, you probably have some positions showing a loss. Even if you still think the long prospects for these companies look good, you can execute a tax-loss harvesting strategy to turn those paper losses into tax deductions. In order for a loss to be allowable on your return, you have to remain out of the position, or a substantially similar one, for 31 days.

The most straightforward way to harvest the losses is simply to sell the shares and then buy them back in 31 days. But if you take this approach you run the risk that the price could move up while you are out of the position and you miss out on the gains. There are two ways you can mitigate some of that risk.

First, after selling the position you can invest the proceeds in a similar company or fund, which could move in similar fashion to the one you sold. That way, if the market moves up you still participate in those gains. Alternatively, if you have cash available you can double up your current position by buying an equal number of shares to what you currently own. Then 31 days later, if you still have a loss in the original position, sell these shares. In this case, it's crucial that you instruct the custodian to sell the specific lot of shares showing the loss. Without instruction, many custodians will default to "average cost" accounting, which would spread the sale equally between all your shares and not maximize your tax loss.

Required Minimum Distributions (RMDs)

The $2 trillion stimulus package passed in March includes a provision that allows individual retirement account (IRA) holders subject to required minimum distribution rules to skip their distribution for 2020. If you can afford to skip your RMD, you should consider doing so for 2020. This will reduce your tax burden and it will allow you to avoid potentially selling investments during a downturn to fund the distribution. If you do need to take the RMD to support your living expenses, consider carefully which investments you sell to fund the distributions. If possible, you should avoid selling the investments with the largest declines in order to give them time to recover.

Roth IRA Conversions

As you may know, the ability to contribute to a Roth IRA is limited by your income. Above certain income thresholds, you lose the ability to make an annual contribution to a Roth IRA. But everyone, regardless of their tax bracket, is eligible to convert an existing RA account to a Roth IRA. The trade-off is that you must pay income tax on the amount converted in the year of conversion. If you have the ability to pay the additional tax, a market decline is a great time to consider a conversion. With the account value lower due to the market pullback, the amount of the conversion and thus the tax burden, will be lower. You will then have assets that grow tax-free in the Roth IRA, and are tax-free upon withdrawal after age 59½.

Conclusion

Your financial plan is based on the assumption that we will experience both good and bad markets. One of the most difficult things to deal with in a time of market declines is the feeling of lack of control. None of us has the power to will the market to recover. We do have control over our own lives and focusing your energy on factors you can control is a more productive use of your time than watching the markets. This is a good time to talk with your planner about how you might strengthen your financial position when markets are in turmoil.

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Ms. Armstrong can't answer individual inquiries, but welcomes suggestions for future article topics.