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## Smart Actions to Consider in a Bear Market

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Bear markets can be extremely unpleasant for investors and this one is no exception. We can't control the markets but we **can control our reactions to it**. There are a number of opportunities that a bear market provides; we highly recommend that you take advantage of them.



1. **Roth IRA conversion:**

The best time for a Roth conversion is when your account value is down. Since the conversion will create taxable income, you would prefer to convert during a bear market than during a bull market. Watch out for income limits that prevent conversion (currently the modified adjusted gross income limit is \$100,000 for both married and single persons – the limit is removed in 2010).

2. **Reduce concentrated holdings / diversify:**

Many people have been fortunate with employee stock options and now hold a large portion of their investable assets in one stock. Prudent investing

requires that your portfolio be diversified and no one stock should be more than 5-10% of the total (and less is even better). One of the reasons investors don't diversify is because they may owe such large capital gain taxes on the profits. But during a bear market, you will have an opportunity to diversify at a much lower tax cost. With the after-tax proceeds, you can buy more of other stocks that have also suffered in price than you could have bought when the bull was charging.

You are generally better off diversifying during a bear market than during a bull market.

3. **Realize your losses for tax purposes:**

The bear presents us with losses on our holdings. If you sell you create a realized loss for tax purposes. You can use this loss against gains you may have in this year or in future years until all the losses have been used up. In addition, you can deduct up to \$3,000 of capital loss against regular income each year. When you sell a security, it's a wise idea to buy a replacement (something similar) so you won't miss out on any market advances. If you want to buy back the same security, you must wait 31 days or your loss is voided (due to the wash-sale tax rule).

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Don't take small losses if the transaction costs of selling then buying back wipes out the advantage of recognizing the loss.

The potential tax losses in your account are worth nothing unless you realize them, then they take on economic value.

4. **Rebalance your portfolio:**

When the bear ravages, it changes the value of the holdings in your portfolio significantly. This usually means that you are no longer near your target asset allocation. It may be time to rebalance – sell the asset classes that are over target and buy the ones that are under target (**sell high, buy low**). Consistent rebalancing can lead to above market returns.

Studies have shown you'll do better by checking your portfolio's balance often and then take action only when the current allocation is outside your rebalance range. A reasonable range is 20% so if your target is 8% then your actual % allocation is unacceptable if greater than 9.6% and less than 6.4%.

5. **Stay the course with your investing plan:**

One of the most devastating mistakes investors can make is to sell out at or near the bottom of a bear market thinking they can get back in before the market recovers. Just think about this for a moment ... you are selling too late! Therefore, you will likely also be buying too late. If you miss the recovery you will damage your overall portfolio returns significantly and permanently.

6. **Have confidence in the stock market:**

The U.S. stock market has a long history of bull and bear markets. Historical data supports an expectation that a bull market has always followed a bear market. Continue to maintain a long-term perspective.

7. **BUY!**

What better time to be accumulating securities than when they are cheap? Be sure to keep safe your emergency reserve (3 to 6 months of living expenses) and near-term needs (larger expenses you can foresee for the next 3 to 5 years) but beyond that, consider investing available cash. But don't buy too fast because the average bear lasts about 15 months.

8. **Planning on upgrading to a more expensive home?**

If you already had plans to buy a more expensive home, a bear market in real estate can be an excellent time because your target home has likely lost more \$ than your current home. For example, if your target home is \$1.5 million and your current home is \$1 million, then a 20% fall in residential real estate market means your target home costs \$300,000 less while your current home may sell for only \$200,000 less.

9. **Remodeling:**

Downturns in the economy can be a cost-effective time to schedule remodeling since many carpenters, electricians, and some plumbers may be looking for work. Negotiate especially hard! Get at least 3 quotes, and once you make a decision, ask if

they can accept 10% less if you start right away.

**10. Buying a car:**

Only do this if you need to replace your car in the next year or so -- when the economy appears to be in a tailspin, automobile salespeople are more likely to negotiate. Negotiate hard.

**11. For retirees and others taking money from your investments:**

If there's any way possible, reduce your expenses so that you are not forced to sell as much of your assets while their value is so low. For example, postpone that big trip until after the market recovers. This may allow your assets to last longer and may also help you feel a little better about all the negative news.

**12. Planning for retirement soon?**

If you are employed in a stable environment, then waiting for a stock market recovery before retiring can be better for the longevity of your assets. However, the analysis of this situation depends on your exact situation and can be complex. Consider having your retirement plan updated before making a final decision.