Managing Your Finances during the Great Recession

By Brett S. Ellen, CFP®

Sure, this isn't the first time we've faced economic uncertainty, but we are facing a once-in-a-generation confluence of events that have not only led to a severe market downturn but a ferocious contraction of the global economy born from an unprecedented financial crisis. To have an economic crisis of this magnitude occur at a time in our nation's history when a record number of people are in or within arm's reach of retirement is significant. In that sense alone, this time is different.

In fact, it's likely that we could be in a secular bear market. Secular trends are major bull or bear trends that generally last for a decade or two. Cyclical trends are minor bull or bear trends within a secular trend. With that as a possible time horizon, our planning lens must change to ensure we both protect any existing wealth while taking advantage of the eventual bull rallies that periodically occur within the secular bear market. The combination of the severity of the market's contraction and the possibility of an extended downturn means managing finances in a very different way.

While there is no general prescription that will solve the woes of all investors, there are common factors to consider when deliberating how to react to the down market. Any tactical move you make should be a function of the safety of your income stream, how much you have already saved, and framed by your life stage and goals.

There's no question that especially for those in the 20 to 30 year-old range, the down market is a buying opportunity since retirement is many decades away and portfolios have plenty of time to rebound. What's more, plummeting home values coinciding with low interest rates have created the perfect storm of opportunity for qualified first-time homebuyers.

Investors in their 40s and early 50s, too, have time on their side, and need to adopt the discipline of buying selectively in the downturn – and then selling selectively in the eventual upturn. For those who have not invested heavily in the market, it's a good time to get in. If you are ready to commit to adding funds to the market, it may be wise to use the automatic contribution option as you do with your 401(k) with your other investment accounts. However, if you already have a significant nest egg, you might consider managing that in a more conservative way than the new dollars you invest into the market. It's equally necessary to manage any existing debt to ensure you are not overly leveraged in an environment where income taxes, property taxes, and the cost of living are likely to rise.

Of course, investors in the 50 to 60 year-old group who are closing in on retirement have less time to recover from the recession's blow. According to the Employee Benefit Research Institute's recently published "The Impact of the Recent Financial Crisis on 401(k) Account Balances," 401(k) investors with more than $200,000 in account balances had an average loss of more than 25 percent from January 1, 2008 to January 20, 2009. For many, that may mean delaying retirement or taking a part-time job. For this age group, the recession combined with increasing longevity requires a shift in their focus from return on investment to reliability of income (the new ROI).

Finally, if you are already retired, it's important to keep an eagle eye on your portfolio withdrawals. Although 4% a year has been the accepted standard safe withdrawal rate, it may be prudent to withdraw less in years of substantial market declines. What's more, remember that this year your Required Minimum Distributions (RMDs) from IRAs and employer-sponsored retirement plans, including qualified pension plans, qualified stock bonus plans, qualified profit-sharing plans, 401(k) plans, 457(b) plans, and 403(b) plans have been suspended to alleviate the pain of making withdrawals from accounts that likely posted losses.

The challenges of planning and investing in this volatile environment are exacerbated by the fact that there is so much money on the sidelines. The S&P 500 was worth $7.2 trillion as of the end of January 2009. At the beginning of 2009, an estimated $8.9 trillion of cash was invested in safety oriented investments (e.g., money market funds) and not in the US stock market. (source: Leeb Capital Management, Denver Post) When those assets are pumped back into the market, the reaction could be swift and extreme. The most successful investors as the market eventually rebounds will be those who, having integrated their intellectual and emotional concerns, embraced volatility in the right way. That is, while others look for a combination of the right policy decisions or tax structure to galvanize the stock market, I encourage investors to look inward, to their own personal economy to determine what would make them feel more confident about investing.

Remember that a new direction is often the sum of multiple smaller shifts and changes. It's likely we'll see more tough times ahead, but there are steps you can take today with your financial advisor that can help you to regain your financial confidence**.** Understanding more about your goals and risk tolerance will enable you to set the right course in these challenging times. If you need motivation, it's encouraging to note that the same can-do American inner spirit we must conjure today paved the way for household names like Motorola, Hewlett-Packard, and Texas Instruments to emerge as entrepreneurial start-ups from the economic hardships of the Great Depression.(source: Bhaskar Chakravorti, Harvard Business School Working Knowledge)

About Brett Ellen and American Financial Network

Brett Ellen, founder and president of American Financial Network, is a financial planner and investment advisor representative with Securities America Advisors who specializes in wealth management and corporate benefit planning services. Additionally, Ellen established and is an active part of the Financial Solutions Alliance, a network of financial service providers from across the country that work collaboratively to address the financial and business needs of their clients. Unprecedented in his ability to serve both individual investors and corporate planners, Ellen is recognized by Securities America as their top advisor.

As a California native, Ellen believes strongly in giving back to his community. He and his firm actively support a variety of non-profit organizations. In 2008, the Muscular Dystrophy Association awarded Ellen the prestigious Humanitarian of the Year Award for his philanthropic endeavors and dedication towards making a difference. In 2001 he and his wife, inspired by their children, formed their own non-profit. TKOHelpingHands.org (Turn Kindness On) promotes community involvement and social responsibilities in young children. For more information about Brett Ellen, visit www.afn-net.com.