

Surviving in the Recession May Require Some Permanent Changes

By Brett S. Ellen, CFP®

A friend of mine who works at home and always considered a cleaning service a necessary expense and a boost to her paid productivity recently decided it was a luxury she could no longer afford. With the value of the family's 529 college savings account plummeting, the \$2,500 a year to rid her home of dust bunnies seemed better saved for the looming \$50,000 college bill. Across the nation, others are making similar budget decisions. This year, families who once enjoyed two major vacations a year are staying home this summer to spruce up the house and yard, work they likely paid someone else to do just a few years ago.

Collectively, these cost-cutting decisions amount to a prudent reaction to a serious economic shift and what some are calling an economic reset. As we deal with the shock dealt by the market, the current landscape is so different that quick or temporary adjustments won't do. Rather, our shared angst is laying the foundation for deep, long-term change. With the severity of the financial crisis having rocked consumers to their core, the days of frivolous expenditures may be gone for good. In fact, Americans say that even after the recession ends, their spending will return to just 86% of pre-recession levels, which equates to an approximate 10% drop, or more than \$1 trillion annually, in GDP, according to a new survey by AlixPartners LLP. On the savings front, the survey revealed that once the recession ends, Americans plan to save 14% of their total earnings, with the replenishment of their 401(k) and other retirement savings their biggest long-term concerns. In the end, this financial crisis may be recorded as a "generation-changing moment" where investors chose risk management over risky business.

To help adjust to and even prosper in this "reset" economy, I suggest the following:

1. **Focus on your personal economy.** As irrational exuberance has morphed into pervasive gloom, the same investors who thought the market would never go down now think it will never rebound. Of course, these emotional extremes lead to poor decisions. Accordingly, rather than fret about the big picture, concentrate on what you need to do to feel more secure in this volatile market. Financial decisions can be taxing even in good times, but the extreme stress caused by the recession can impact our critical thinking ability by triggering our brain's most primal flight or fight response. Unfortunately, those instinctive reactions that enabled man to survive in the jungle create trouble in the financial realm because they often elicit quick, emotional reactions that override rational, long-term planning.

So, rather than make what you perceive as a quick fix portfolio move, lengthen your perspective by reviewing your investment process and long-term goals. Instead of reacting to sensational headlines, run some real numbers to determine where you stand. Anything you can do to feel more in control as the market gyrates out of control will enhance your ability to make sound decisions. As you think about the right move to make, you might try considering how you'd advise a friend who's in your situation because it's easier to be rational about someone else's money. Or, if you're having trouble making a decision, it might help to choose a future "decision day" and mark it on your calendar.

Remember, good decision making happens when you feel confident in your current position. With unemployment soaring as the market slides, it's more important than ever to maintain an adequate emergency fund. In fact, rather than the traditional three months of expenses, I suggest people have eight months in an accessible, liquid account -- more if the recession puts your job at risk. Naturally, it's also crucial to limit your credit card debt.

2. **Reassess your asset allocation.** Especially when the stock market is down, you need to evaluate your investment objectives, and understand how they relate to your risk tolerance and your investment timeline. In the wake of the recession, many investors are deciding their portfolio requires additional building blocks. For instance, investors who were over-weighted in equities are looking to cash, real estate, and even alternative investments for the beneficial diversifying role they could play.

Also, whereas decades ago, investors began with equities and then built a defensive wall with fixed income and cash, many investors close to retirement now lead with the need to protect their nest egg. No longer able to count on an up market and rising home values, risk management has center stage. If you first make allocations to cash and fixed income to provide a line of defense, it likely will be easier to commit to the longer time period required to potentially profit from your equity investments. At the same time, younger investors are hearing that the down market presents an unprecedented buying opportunity. Of course, there's no bell at the bottom, but a lot of good companies on sale right now. While 75% in equities might not be advisable, it could be a good time for younger investors to increase their equity exposure from 20% to 40%, or in some cases 40% to 60%.

3. **Think long-term.** Nowhere is patience more necessary than in the real estate market. Just a few years ago, if you were transferred to a new city you figured you'd call home for a few years, job one was to buy a home. After all, you could sell it later more than the purchase price. Times have changed. Although bargain basement prices and tax credits are carrots dangling in front of renters, the recession has changed the real estate playing field. Big picture, just as "flipping," where a buyer would purchase a home, invest a little sweat equity, and sell at a tidy profit just months later, has gone out of vogue, so, too, has the home financing market transformed. Today, if you are in the market for a mortgage, you need a secure job and must be ready to meet lenders' strict income and credit requirements. You may also have to come up with a higher down payment than was required just a few years ago. Also, in today's down market experts suggest you should buy a home only if you intend to live there for seven to ten years. In fact, even television commercials produced by the real estate industry combine optimistic assessments such as "Now is a good time to consider buying a home" with sobering disclaimers like "On average, a residential home appreciates in value over 10 years." Of course, the same longer time horizon is necessary with equities."

As Jeff Immelt, chief executive officer of General Electric Co. said to a shareholder group earlier this year, "If you think this is only a cycle, you're just wrong. This is a permanent reset. There are going to be elements of the economy that will never be the same, ever."

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.

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