BEARS

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With the U.S. stock market officially entering bear market territory, Bob Carnegie outlines what you can do when staring that bear in the eyes. While staying calm and staying the course are highly recommended, it doesn't necessarily mean sitting idle, read on as he points out some unique opportunities to consider in this bear of a market.

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INTRODUCTION

Having spent many summer vacations in adolescence traveling to national parks all around the country, I have been fortunate enough to see bears in the wild. Some rather large and intimidating, in fact, but luckily, it was always from a safe distance. If I do ever experience a more perilous, closer encounter, I hope to remember the crucial advice from every park ranger I have ever met: **Stay Calm.**

Whether it be a bear in the wild or a bear market, both can be unpredictable and potentially dangerous, but **maintaining composure in either scenario tends to lead to sounder, smarter decision-making and thus, a higher likelihood of escaping harm.** It requires fighting against impulsive, fear-driven reactions impelled by basic human instinct, even though it is incredibly difficult to do so in the moment.

Currently, we are in one of those moments in the stock market. Officially, the S&P 500 entered bear market territory in June after falling more than 20% from its January highs, but this bear has been sniffing around the campsite for some time. For example, the tech-heavy NASDAQ peaked last November and first entered its own bear market back in March, and similar tales could be told for small cap and international stocks as well as some individual sectors within the S&P 500. Furthermore, several of the hottest areas of the market in 2020 and 2021, including cryptocurrencies and SPACs/IPOs, were rather swiftly cut in half, or worse, earlier in the year.

A HISTORICAL PERSPECTIVE

- **There have been a dozen bear markets for the S&P 500 in the post-WWII era,** making this one lucky #13. As a reminder - the prior twelve were all temporary.

- **Each lasted anywhere from 33 days (2020) to 2.5 years (2000-2002)** with an average duration of about one year. By comparison, the average post-WWII bull market lasted roughly 5 years.

- **Stock values fell by about one-third, on average,** with the shallowest bear just dipping below -20% and the deepest reaching -57% (2008-2009). Again, by comparison, stocks roughly tripled in value during each of the ensuing bull markets, on average.

- **Typically, a new bear has occurred within a few years of the one prior,** but more recently we experienced two decade-long periods without bear markets (1988-1999 and 2010-2019).

- **Most bear markets coincided with recessions;** though, a few did not, and there were also five bear-like false alarms with declines just shy of the arbitrary -20% threshold, notably 2011 (Euro debt crisis, -19.4%) and 2018 (Fed tapering, -19.8%).

- Reassess
- Increase Contributions
- Convert to Roth IRA
- Accelerate Gifting
- Rebalance
- Reposition
- Diversify
- Harvest Tax Losses

No one knows just how grizzly this bear will be, but with upcoming midterm elections, an ongoing war in Ukraine, and the Fed intent on combatting stubbornly high inflation, it seems reasonable to expect a delayed return to previous highs, especially compared to the abrupt rebound after the last bear market in March 2020. Does that mean *The Greater Recession, The Sequel* is inevitable? Not necessarily. The 2008 Recession had unique circumstances that ultimately transformed a recession into a full-fledged global financial crisis. While admitting anything is possible, it is important to remember **not all bear markets are created equal.**

Much like an adrenaline-inducing animal encounter, bear markets can be scary. Volatile stock prices accompanied by unsettling pundit commentary and flashing red banners make it quite difficult to stay patient and calm. For those who can, however, the historical track record for "staying the course" speaks for itself. And that is because despite inevitable poor market and economic dynamics during short-term periods, **businesses, new and old, will continue to innovate, grow, and strategically steer themselves through trying times, only to be that much stronger on the other side.**

Stay Calm, Assess, Be Rational

Staying the course does not necessarily mean sitting idle. There are certainly times when doing nothing may be best, **but bear markets can also create unique opportunities**.

Consider these ideas as you focus on **staying calm, assessing the situation, and reacting rationally.**

FINANCIAL PLANNING STRATEGIES IN A BEAR MARKET

Revisit Your Financial Plan

One bear market will not typically derail a thoughtful, long-term financial plan; however, a revisit could lead into productive discussion and perhaps a sensible revision, if necessary. You should **review cash flows, reconfirm goals and objectives, and carefully reconsider your ability and willingness to take risk.** Many investors position too aggressively during bull markets and unfortunately only come to understand their true risk tolerance when the bulls eventually give way to bears.

Increase Contributions

If you have more than enough monthly discretionary income, you may want to consider increasing your retirement plan contributions **to invest more with each paycheck at suppressed market values.** Furthermore, you could consider opening or adding more funds to other tax-advantaged accounts like 529 plans. Raising 401(k) contributions by even 1-2% or adding another $100 per month to a 529 plan are relatively small changes that can have significant impact in the long run.

Roth IRA Conversions

Effective timing on Roth IRA conversions can help further reduce future required distributions from a traditional IRA and the ensuing tax bills. To provide an example, whether you convert $50k of your IRA in January or December this year, the tax result is the same – that $50k will be included as income on your 2022 return. However, if you do so when your IRA balance is $400k vs. $500k, you would effectively convert a larger percentage of your IRA. Thus, if/when markets rebound, more of that growth will have shifted to the tax-exempt Roth instead of the pre-tax IRA. Additionally, if your Roth IRA is invested more aggressively than your IRA, long-term results could be further amplified.

FINANCIAL PLANNING STRATEGIES IN A BEAR MARKET

Accelerate Gifting

For those interested in lowering future estate taxes, **gifting to heirs at lower prices** can be advantageous for two reasons. First, transferring 1,000 shares of stock at a lower price puts a smaller dent in your lifetime exemption (approximately $12M currently but may be cut roughly in half in 2026), and second, it shifts all future appreciation of those 1,000 shares out of your estate, rendering it ineligible for estate tax upon your death. The latter could also be said for charitable gifting, and we would recommend consulting your advisors as there are specialized trusts and other vehicles that can help accommodate various gifting strategies.

Transfer future growth off of your personal balance sheet...

INVESTMENT CONSIDERATIONS IN A BEAR MARKET

Rebalance

If your stock allocation has drifted below longer-term targets, **you may consider shifting funds back into stocks,** preferably in phases and with an emphasis on buying stocks at discounts versus trying to time the market bottom.

Reposition

You may own stocks that have appreciated in 2022 (check energy and pharmaceutical names) or at least depreciated less than the market. **Consider trimming short-term outperformers and redirecting proceeds to underperformers.** Tread carefully around former hot pockets that have been punished most – bear markets tend to make “cheap” even cheaper. Stalwart, innovative companies with strong balance sheets and more predictable cash flows might be the safer option for now.

ADDITIONAL **INVESTMENT CONSIDERATIONS**

Bonds are back!

No, a 10-Year Treasury Bond is not offering a 10%+ yield like it did in the 1980s, but it is hovering around 3% as I write this, which is **near decade-highs and significantly improved from early pandemic levels** below 1%. Moreover, municipal bonds, corporate bonds, and preferred stocks are all offering attractive yields compared to Treasuries, sometimes by 2-3% or more, creating additional opportunities for income-focused investors.

Harvest Tax Losses

By selling a position at a loss and replacing it with a similar investment, **you can potentially lower your tax bill while maintaining your desired exposure.** This strategy can work reasonably well with individual positions and perhaps even more so at the ETF/mutual fund level where it may be easier to identify a similar replacement security. Tactically limiting / deferring capital gains can enhance after-tax returns over time, but you must understand wash sale rules. **Be sure to discuss with your advisor to learn more**.

Cash yields are back!

Cash is losing value due to inflation, and ideally you want to limit those losses by earning a higher yield. **With banks being flush with deposits and seemingly in no hurry to raise deposit rates, it is worth exploring other options.** Series I Savings Bonds, currently offering a 9.62% yield, can protect against inflation but have limitations (for more on Series I bonds, check out our recent blog post by clicking here). Other options include short-term bonds, short-term annuities, or FDIC-insured high yield savings accounts with online banks.

Discipline

If your desire to participate in a hot market got the better of you, **now may be time to reassess and shift focus to a disciplined long-term strategy.** Becoming a novice day trader can be fun and potentially rewarding while cryptocurrencies and meme stocks are increasing ten-fold in a day, but bear markets tend to let the air out of those hot pockets rather abruptly and reintroduce a heavy dose of reality.

Diversify

There are alternatives to the stock market, which can be easy to forget during lengthy bull markets. Critics may be quick to point out that stocks AND bonds have declined this year, which is generally true, but over longer periods, bonds have proven quite efficient at lowering the volatility and enhancing the yield of a portfolio. Moreover, diversification does not only refer to stocks and bonds; it also means avoiding risky concentrations in companies/industries, geographic and market cap diversification, and moving beyond the public markets into private investments (equity, credit, and real estate) where assets do not reprice every second of the day.

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WEALTH MANAGEMENT

This is not the first bear market, nor will it be the last.

Proper planning, diversification, and discipline are pivotal in helping to eliminate ill-advised, emotional, and impulsive decisions. Unfortunately, humans are emotional beings and thus, prudent investing does not always come naturally to us. While it is important to think about how to make it through this bear encounter, it is also important to seize opportunities it creates and prepare for the next market cycle. **Remember, historically, the stock market has rarely declined over a 10-year time period, and over a 20-year time period, never.**

So, stay calm, don't run, but don't fully submit to the "buy the dip" mentality pervasive in markets either. It may be a mistake to run from a bear, but it is also a mistake to gleefully follow a bear into the woods for a better picture, which based both on my financial market and national park experience, I can confirm happens much too often.

Disclaimer: The information in this paper is for information purposes only and should not be interpreted as legal, tax or financial advice. Always consult your CPA/tax advisor/attorney (or reach out to us;) to discuss your specific situation.

Past performance is no guarantee of future results.

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