Opportunities During Market Downturns

We are in the middle of a market correction and many investors are asking, what should I do now? For investors who did their homework ahead of time the answer is do nothing. Markets move faster and further than investors can react, and history has taught us that you cannot consistently time markets. A diversified portfolio based on your personal risk tolerance is the best defense against a knee jerk emotional response after the fact. Over the past several years most of our clients have been encouraged to reduce their equity exposure. After a record-breaking bull market run can anyone really say that the current market downside volatility is a surprise?

Nobody likes a market downturn, but market downturns are normal and when they happen there are several planning opportunities you should consider. One of those opportunities are harvesting investment losses for tax purposes. If you sell an asset for less that your paid you can deduct up to $3,000 on your federal income taxes each year.

Additionally, you can offset other tax gains which makes perfect sense if those other gains were short term capital gains which are taxed at your highest incremental tax rate. A $3,000 loss would reduce your tax bill by $1,000 if you were in the 32% tax bracket. Further any amount greater than $3,000 can be carried forward to the next tax year. Caution, you cannot repurchase the same security you sold within 30 days or the losses are disallowed.

For those near or in retirement who have a traditional IRA and are in the lower tax brackets, conversion of a portion or all your traditional IRA to a Roth IRA during a market downturn can be an excellent idea. This is especially true when you fund the Roth by transferring securities in-kind. You should transfer those assets in your traditional IRA which went down the most (stocks) and then when the market recovers the appreciation is tax free and not subject to required minimum distributions in the future. For example, if your traditional IRA which was valued at $15,000 declined to $10,000 and you converted the entire IRA to a Roth you would report taxable income of $10,000 in the year of conversion. When the market recovers and your Roth increase back to its original value of $15,000 the entire amount is now income tax free.

Lastly consider rebalancing your portfolio when market downturns occur. When stocks decline often other holding like bonds go up in valuer as investors seek safety. Sell some of your bonds at a profit and purchase the assets that have gone down in value. Then as the market recovers you will benefit from the additional shares you purchased at a discount.

Most importantly remember to stay calm and ignore the news whose job it is to magnify everything to draw attention to themselves so they can sell advertising. Unless you were planning to cash in your investments and spend all the money tomorrow the current market downturn should have no effect on your personally financial security.

Have questions call us for a phone update or schedule an in person meeting today.