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The New York Times

Retirement

THURSDAY, OCTOBER 23, 2008

How to Cope With Plunging Portfolios

By JAN M. ROSEN

MILLIONS of retirees and people approaching retirement view the current market maelstrom as a financial version of Hurricane Ike battering the Texas coast, producing the same fearful questions: "What should I do now?" and "What's going to happen next?"

These are people who saved and invested diligently for retirement. They didn't take out subprime mortgages only to default, nor did they slice, repackage and trade debt obligations like the too-clever-by-half financial professionals who helped produce the events that have shaken the global financial system. Nevertheless, they are affected.

How should they respond? Should they bail out of mutual funds and equities? Or should they hunker down and hope the markets recover, restoring their portfolios' values? Is there a financial haven?

There are no general answers to these questions — individual financial circumstances can make a big difference. To help people devise a strategy or find the best financial adviser, several financial experts were interviewed. Unsurprisingly, their opinions varied about what lies ahead and how best to address it.

Many people have seen the value of their portfolios decline and feel they have lost a great deal of money. But there is nothing lost until an asset is sold for less than it cost. Hold the security, and it may recover.

What's more, a holding may be down from its value a month or two ago but still above its cost — a reduced profit is not a loss.

If the sale is made in a regular account, any gain on an asset held less than a year is taxed as ordinary income. Longer-term investments are taxed at the capital gains rate of 15 percent for taxpayers in regular-income brackets of 25 percent and higher.

Capital losses on sales can be used to offset capital gains; if the result of the two is a net capital loss, up to $3,000 can be taken against ordinary income. Losses above that are carried forward to future years.

The rules are different for tax-deferred accounts like most I.R.A.'s, 403(b)'s and 401(k)'s. Pretax money goes into the account, and withdrawals during retirement are taxed as regular income. Any sales or purchases within the account have no tax consequence. That means a nervous account holder could sell a winning stock and move the proceeds to the safety of Treasury notes with no tax liability. However, if he sells a loser, he cannot use the loss to offset other income.

A reassessment of investments? Good. Panic? Not so much.

Various financial advisers have different long-term outlooks, but they agree on the need for liquidity. Retirees should have enough cash or equivalents like Treasury bills or money-market funds in either regular or retirement accounts to meet basic living expenses for one to three years — views vary.

People age 70½ or older need enough liquidity in their retirement accounts to take required minimum distributions without having to sell securities at an unpropitious time, like the current bear market.

Whether a retiree has that liquidity and whether she is invested entirely in equities or stock mutual funds are key issues in deciding when to reallocate investments.

One of the more pessimistic voices in the investment landscape is that of David W. Tice, whose Dallas-based firm manages the Prudent Bear Fund and the Prudent Global Income Fund. He stands behind his forecast of a year and a half ago — when the Dow average was in the 12,000s — that the market would fall 50 to 60 percent over the next two years. He predicted "tough times, equal to the 1930s."

"What we have is gross credit excess" on both the personal and national levels, he continued, and credit excesses fuel speculative manias. "Individuals are using their homes as an A.T.M." by taking out home-equity loans, he said at the time, adding that when the credit bubble burst, both real estate and stock prices would go down, as would consumer spending, and jobs would be lost.

"We have way too much consumer infrastructure — movie theaters, gambling casinos, resorts," he said recently. "We have to cut back on lifestyle. We're going to have to take some pain. Our prior system is broken."

As for investments, his advice is to "reduce equity exposure, hold gold — it's a quasi-currency." Cash and Treasury securities "keep your principal intact," he added, though they lose some purchasing power to inflation. He also likes some Swiss and Canadian bonds.

A good many professional investment advisers are less bearish than Mr. Tice. Don't panic, they say. Clients with adequate liquid assets and a balanced, diversified portfolio of stocks, Treasury bonds and investment-grade corporate bonds should see values recover over time. But people whose I.R.A.'s or 403(b) or 401(k) plans are invested entirely in stocks or stock mutual funds may need to make some adjustments.

Steven B. Weinstein, president of Altair Advisers, an independent investment advisory firm in Chicago, said, "Clearly we're in a period of time that none of us have experienced in our lifetime, but basic principles still apply."

One is for retired people living on income from their portfolios to keep cash reserves of up to two years. "You don't want forced liquidations" of securities during a down market, he said. But in the long term people are likely to need securities to keep their portfolios' growth ahead of inflation.

Tim Kochis, chief executive of Aspiriant, an independent wealth management firm with offices in San Francisco and Los Angeles, compared the markets' recent plunge with past crashes and said, "the speed this time has caused people to think that it's worse." But he advised patience, saying markets should recover, just as

they have before. People who sell now are "locking in losses, depriving themselves of the opportunity to recover," he said.

Still, people should treat the markets' plunge as a wake-up call, he suggested. If their financial objectives for retirement can be met with lower-risk portfolios than they have, it may make sense to reallocate some money.

Barry Picker, a partner in Picker, Weinberg & Auerbach C.P.A.'s in Brooklyn, said he told worried clients, "If you don't need it currently, ride it out." He added: "I have long-term faith. Personally, I'm looking to pick up securities that I think are very cheap," like General Electric and AT&T.

People who have a percentage of their salaries withheld from each paycheck for their retirement plans are getting more shares in today's market than they were for the same money a few months ago, so they can expect sizable gains after a recovery, he said. He cautioned that portfolios should include fixed-income investments, as well as equity.

Mark Ruloff, director of asset allocation for Watson Wyatt Investment Consulting in Arlington, Va., said the proper risk level for a portfolio depended on whether other sources of retirement income were available. People with Social Security and a defined-benefit pension plan, as well as a 401(k), can be more aggressive in their 401(k) selections than people without them.

In structuring a portfolio, "don't gamble with your lunch money," he said. Choose conservative investments to pay for basic living expenses, and be a bit more aggressive when saving for discretionary expenditures, he said.

Some target-date mutual funds — you tell the fund manager when you want to retire, and the mix of investments is reallocated for you — are too aggressively invested for basic needs, he continued. A fixed life annuity, if available through an employer plan, could be an appropriate part of a retirement portfolio, as could a stable value fund.

Chris Blunt, senior vice president and chief operating officer of life and annuity arrangements for **New York Life Insurance**, said his company had seen a "real flight to quality," with fixed-income annuity sales up 65 percent over a year earlier. The fixed-income annuity within a retirement plan is for accumulation. Then when a person retires, she can convert it to a lifetime income annuity.

Mr. Blunt suggested that an annuity would be appropriate for 30 to 40 percent of a retirement portfolio, not the entire portfolio. The amount of income from a lifetime income annuity depends on the holder's sex, age and various options chosen, but the company offered this example: A 65-year-old man can begin a stream of income with a payout rate of more than 8.3 percent guaranteed for life. In other words, for every $100,000 paid as a premium, the annuitant would receive $8,334 a year, or $694.57 a month.

People interested in annuities need to check that the insurance company is sound and should be aware that an annuity is a relatively illiquid investment. But it does provide a degree of certainty that is otherwise lacking in today's markets.

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