Ep101: What Issues Should I Consider During A Recession or a Market Correction?

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PATTI BRENNAN: Hi, everybody. Welcome to "The Patti Brennan Show." Whether you have $20 or $20 million, this show is for those of you who want to protect, grow, and use your assets to live your very best lives.

Today's episode is part of an ongoing series called AskPattiBrennan. It seems to me that, given what we're experiencing this year, a few tips on what to do during a market correction and potentially a recession might come in handy. That's what we're going to talk about today.

Now, first and foremost, at the risk of sounding like Debbie Downer, I'm going to say to you, always be ready for it. Expect that these things are going to happen. When they do, you won't perhaps feel as uncomfortable when they do because you knew it was going to happen, and then you're going to have a strategy for dealing with it.

Number one, expect that these things are going to happen. I'm going to take that one step further and tell you that not only do they happen, but a lot of times, market corrections turn into a bear market. Let's define that. A correction is defined as a loss of 10 percent or more.

It's basically a market adjustment. It doesn't mean that you actually lost the money because you only lose the money when you sell. A bear market is when the market goes down 20 percent or more, which frankly does happen.

Call it every three to five years, I would expect, and you should expect that the market is going to lose 20 to 30 to maybe 50 percent in a really bad situation and in a completely unexpected event that the market could go down by a lot.

Now, along with that, for those of you who are working, we should also understand that it can lead to a recession. Recessions also happen. It's all part of the natural business cycle.

Along with recessions come layoffs. For those of you who are working, as these things occur, you really want to be prepared that if your name comes up and you're getting that pink slip, that you're ready for that as well.

Number one question is, if this did happen, will cash flow be tight? By that, I mean if you are working and you lose your job, you're going to get unemployment insurance, assuming that you don't get a severance. After that, if it takes a little bit longer for you to find your next position, what are you going to do?

How's that emergency fund looking these days? There's a rule of thumb, three to six months of expenses. That rule of thumb came about because most companies do not provide disability income coverage for the first six months.

People like Patti Brennan would say, "Keep six months of expenses in an emergency fund in the event that you're unable to work." Now, most companies do provide short-term disability insurance, but they don't provide insurance in the event that you are part of a layoff.

It lasts longer than unemployment provides coverage for. Are you ready for that? That's number one. When you think about your cash flow, again, is cash flow going to be tight?

For those of you who are watching, you may be retired. What are you going to do then? You don't want to necessarily sell investments. In that situation, why don't you turn on the tap?

Instead of reinvesting your dividends and your capital gains, have them paid in cash. You're building up your cash accounts that way. You're paying taxes on that money anyway, so you might as well just put that on the side for a rainy day fund.

In addition, you want to prioritize where you're going to go. For example, when markets are going down a lot, your fixed-income funds tend to remain fairly stable, maybe even going up a little bit. Instead of going here, let's go here instead.

That's why making sure that you're looking at this within the framework of your non-retirement accounts versus your retirement accounts because most people don't want to start tapping their retirement accounts too early.

You're losing that incredibly powerful tax-deferred compounding. Really focus on your non-retirement accounts and do the triage with those.

In addition to that, think about your payments, maybe renegotiate, extend your payment dates, maybe looking at your mortgage. You may have a 15-year mortgage, maybe a 30-year mortgage may be better for you. That's really important.

A lot of people don't take into consideration those unfortunate times when people are laid off and the impact of their cash flow if they've got these fixed expenses that have to be paid every single month.

In addition, the most important thing I would say during this time period is, watch your credit rating. Please, make sure that you're still making those payments to any credit card balances. I hope none of you have credit card balances. But just in case you do, don't miss those payments.

This is the last thing that you need, especially if you are looking for a new position. New employers are going to be checking your FICO score. If you don't have a halfway decent FICO score, they're going to question your ability to deal with responsibilities, like making payments on time.

If you're hoping to retire soon, for those of you who have planned and who have prepared, this could be the best news in the world, because a lot of times during recessions, companies are asking for voluntary layoffs. You could raise your hand.

You were planning on retiring in the next year anyway. You were fully prepared, and guess what? You're going to get some extra perks as a result of this unfortunate situation called the recession and these layoffs. If you are not prepared, it's bad news.

If you are watching this today, just do everything you can to shore up your finances so that you don't become a victim of circumstance, something that nobody can predict and nobody knows whether or not you're actually going to be impacted. Assume the worst, hope for the best, and you'll do fine.

Now, when you think about where we are today, we deal with your investment portfolio. Remember the three R's, reallocate, rebalance, replace. Reallocating is when you take a look at the balance, the percentages you might have in certain asset classes.

From time to time, it does make sense for you to revisit those allocations, maybe you want to overweight large-cap growth. Maybe you want to go and overweight dividend-paying stocks or small companies. That's reallocation.

Rebalancing is when you take that mix of assets and take a look at those percentages, the goals, and realize that because of the correction or the bear market, they're out of whack. What do you do? You just simply sell high, buy low to get you back into the original allocation that you had intended for your long-term financial goals.

Reallocating, rebalance, and then replacing.

Replacing is that idea of taking a look at the managers that you may have chosen in each of the investment classes that you have and keeping an eye and make sure that they are doing what you want them to do. Now, let's go back to the beginning. Let's go back to the purpose of this podcast.

We're in a correction. We're in a bear market. We're in a recession. What do you do with your investment portfolio? Of the three R's, I'm going to tell you right now, I only want you to do one of them. Now is not the time to be tinkering with your allocation.

It's human nature to want to sell the things that are losing money, reduce the amount that you have allocated in that, and move more money into safe areas. Don't do it. Please don't reallocate.

I would also say it may not be the time to replace your managers. Sometimes, managers are going to underperform for a period of time. Wait for the full cycle to go all the way around, and then do an evaluation, and determine whether or not you're doing what you would hope that they would do for you.

This is absolutely the time to rebalance though. Of the three R's, that second one, rebalance, absolutely do it. Now, do you have to wait until the end of the year to rebalance? Absolutely not. Do it now.

Can you only do it once? No, you can do it as often as you want. Just be aware of short-term versus long-term capital gains. I would encourage you to only rebalance those assets, especially in non-retirement accounts, where you're going to get the long-term capital gains treatment.

Rebalancing - it's a home run because you don't have to think about it. Sometimes when we talk about this stuff, we, as human beings, have these biases. We tend to overthink these things, "I think this is going to happen," and then adjust our portfolios accordingly. I'm going to tell you right now, stop thinking.

You want to have the discipline. You want to have those strategies laid out, hopefully well in advance, so that you can execute on them. Ignore that noise that's going on in the back of your head because nobody knows for sure what's really going to happen. We talked about the portfolio. What about cash?

Once you know that you've allocated, and you've got plenty in your emergency fund; hopefully you have a home equity line of credit as a backup.

If you have extra cash, research has shown time and time again that the people that have the courage and the discipline to go ahead and invest when everybody else is selling, those are the people that tend to do much better over time.

If you do have extra cash, go ahead, start to invest it. Do you invest it all at once, or do you do a little bit at a time? Human nature, you're going to want to do a little bit at a time. My suggestion is the markets are already down, plunk it. Again, for those of you who have a financial advisor, talk to your financial advisor about that.

With that in mind, for those of you who are doing IRA contributions, don't wait until April. Get that invested while the market is down. Whether it be Roth, or regular, or after-tax, get that money invested.

If you're considering doing a Roth conversion, that can be powerful, taking money out of pre-tax retirement accounts and converting them into Roth IRAs that will grow tax-free.

I got to tell you guys, there is no better time to do that than when markets are down. You get a much bigger bang for your buck. Again, nobody knows what's going to happen. It's even more powerful when you do it when valuations are low.

In addition to that, for those of you who are looking at doing some estate planning, again, a great time to begin to think about and execute on the strategies that really favor low valuations, low-interest rates.

A few examples of those would be charitable lead annuity trusts. It's a wonderful technique for those of you who might be charitably inclined. It sounds bizarre, but intentionally defective grantor trust, again, I know it's a lot of Greek for most of you out there.

In the right situation, home run, all the way. Walk off home run. They are especially powerful when valuations are low.

In addition, private annuities that deal with a family member or intrafamily loans when interest rates are low. There's a lot of things that can be done and a lot of different ways to turn this lemon, which is a bear market or a correction and a recession, into lemonade.

Thank you so much for joining me today. I hope this has been helpful. Remember, we do this hopefully to provide some value to all of you who take the time to listen to the AskPattiBrennan series. To me, we are much more than just a tagline. We really do provide wealth management with wisdom and care.

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