Coping with the "New Normal"

Seven Tips to Help You Adjust Your Investment Thinking and Stay Financially Afloat

By John Jenkins, AEP, EA, CFP®

Normalcy. The word coined by U.S. president Warren G. Harding conjures up a simpler time and sounds so attractive in today's economic unpredictability. During his 1920 presidential campaign, envisioning a return to the way of life before World War I, Harding stated, "America's present need is not heroics but healing; not nostrums but normalcy; not revolution but restoration. We must strive to normalcy to reach stability." Harding's statement provides terrific advice for managing your money as the market continues its wild ride from recession and toward recovery. In fact, this push "to normalcy to reach stability" is likely what Bill Gross and his colleague Mohamed El-Erian at PIMCO believe investors must do to succeed in what they refer to as the "new normal."

There's no sugar-coating it. Slow economic growth, diminished investment returns, higher unemployment, tighter credit, the threat of inflation, and higher taxes will make the journey to normalcy and stability difficult. To survive the "new normal," an investment world of limited upside with plenty of uncertainty, try these strategies:

1. **Don't get overly influenced by fad thinking.** Every decade or so, we're told by the talking heads on CNBC that the investment world has changed for good. Remember the "New Economy" in the late 1990s when technology stock valuations were no longer subject to the laws of gravity? It's just as dangerous to think that we are in a period of diminished returns and volatility that requires us to turn our back on equities. It's easier to live with market uncertainty if you trade your view that "It's different this time" in for "This is a normal secular bear market."

   Throughout history, economies have gone through major expansion and contraction cycles. These major cycles are referred to as Secular Bull or Bear markets and the expansion/contraction generally lasts from five to 25 years as the market soars up and careens back down in a series of boom and bust cycles. If the Secular Bear's grip continues, several years of significant expansion could be greeted with another recession. Accordingly, our planning lens must change to ensure we both protect existing wealth and position ourselves to take advantage of the bull rallies within the secular bear market.

2. **Increase diversification**. While most portfolios are split between stocks and bonds, the downturn has underscored that cash, too, is a valuable asset class. In addition, investors looking to mitigate risk by diversifying further might include commodities, gold, and real estate or other alternatives. It's worth noting, too, that the traditional relationships between asset classes have changed and therefore portfolio adjustments may be in order. For example, in our increasingly global economy, domestic equities and international equities are tracking closer together, decreasing the diversification benefit.

3. **Invest globally.** Some believe that as government debt soars the US dollar will lose its role as the world's reserve currency. At the same time, growth is occurring in the developing world, specifically in the emerging markets of India and China. While conventional wisdom has suggested investing a maximum of 25 percent of your stock portfolio abroad, it may be time to increase that allocation, especially given that approximately 60 percent of the world's total stock market value lies outside of the US. SOURCE:

http://publications.fidelity.com/investorsWeekly/application/loadArticle?pagename=VP0910international

4. **Take a more active approach to your portfolio.** Regardless of what asset classes you own, investment returns likely will be lower. That means being in the right place at the right time is more critical than ever. Seeking to capture a short-lived opportunity, take gains, or avoid a potential decline may require more frequently trading your portfolio. “Staying the course” never meant doing nothing.

5. **Spend less, save more.** You can only control what you save and spend. If what you sock away is going to grow more slowly, you need to save more. If you are already retired, you may need to withdraw less. As you cast your eagle eye on household expenses, don’t forget investment costs which can diminish your returns. Taxes, too, can take a heavy toll on your nest egg, so make sure you have a tax efficient investment plan. Finally, manage job transitions wisely. When switching jobs, if your 401(k) account balance is $5,000 or above, you can leave the money in your former employer’s plan. You also may be able to roll the funds into your new employer's plan, a traditional IRA, or convert them to a Roth IRA, which can offer tax-free growth potential and withdrawals. Any of these options is better than cashing out the account.

6. **Manage risk more tightly**. Although diversification can be an effective risk management strategy, dispersing your eggs among numerous baskets didn’t work in 2008 and 2009. Therefore, the approach of diversifying once and then adopting a buy and hold philosophy needs to be supplemented with much more responsive risk management. Consider constructing a portfolio where just part of it is held for the "long term." Carve out a percentage that you manage more actively to capitalize on emerging opportunities. Also, once you set your ideal asset allocation, you may need to rebalance more frequently to maintain it, say twice a year rather than just once.

7. **Remain an investor, not a trader.** Commenting on whether or not it was possible to time or call the market, Jack Bogle, founder of Vanguard, said, “After nearly fifty years in this business, I do not know of anybody who has done it successfully and consistently. I don't even know anybody who knows anybody who has done it successfully and consistently.” You can’t win trying to time the market. However, there are three reasonable ways to potentially profit from market volatility. First, stick with your investment plan and review it at regular intervals, so your portfolio isn’t as impacted by market highs and lows. Second, keep some cash for opportunistic bargains. Finally, if you decide to exit the market, first construct a plan that outlines how and under what conditions you will re-enter.

There’s no denying that the past few years have been challenging for investors and that more challenges are ahead. As you plot a careful course to rebuild your portfolio and protect sporadic gains in the “New Normal,” the long-run may turn into a very long and winding road where no one is sure what lurks around the corner. With uncertainty as a way of life, it’s wise to step up your portfolio’s defenses but, at the same time, don’t give up on the prospects for growth from a well-diversified, well-tended portfolio.

Next month I’ll be discussing goal setting – how to get motivated in the face of uncertainty and what to do if stuck in neutral.

About John Jenkins and Asset Preservation Strategies, Inc.
John Jenkins is president and founder of San Diego-based Asset Preservation Strategies, Inc., which provides a team of financial professionals collaborating to address all of the elements of successful wealth management. He has conducted numerous financial planning workshops during his career and has been a guest on the PBS show “The Money Makers” and its successor, “The Financial Advisors,” as well as the syndicated news magazine show “Heartbeat of the City.” Jenkins has also authored and co-authored several financial planning books and publications. He is frequently quoted in the financial press, including

Financial Planning News, The San Diego Union-Tribune, the La Jolla Light and the San Diego Business Journal. He has been named for three years in a row as a 5 Star, Best in Client Satisfaction Wealth Manager by San Diego Magazine based on surveys of more than 30,000 clients of wealth mangers and data from more than 4,000 financial service professionals. Learn more at www.asset-preservation.com

Investments in foreign markets entail special risks such as currency, political, economic and market risks. The risks of investing in emerging market countries are greater than the risks generally associated with foreign investments.

Asset allocation seeks to maximize the performance of your investment portfolio using diversification and disciplined investing. Diversification can be thought of as spreading your investment dollars into various asset classes to add balance to your portfolio. Although using an asset allocation methodology does not guarantee greater returns or against the risk of loss in a declining market, it may be able to reduce the volatility of your portfolio.

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