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A Financial Plan: Where Do We Go From Here?

Unfortunately 2008 was not simply a bad dream. Many of us woke up on January 1, 2009 in great moods, eager to embrace the new year, until we soon realized the financial disaster that was 2008 was very much a reality. Portfolio balances were far lower than they had been when the year began; secure employment situations suddenly looked quite uncertain; plans for retirement may have to be put on hold for another few years; those education savings accounts may not cover all of the necessary college expenses.

The stock market collapse was very much like a bad train wreck from which we simply cannot look away. We followed the "expert" insight of those financial pundits on cable TV, blogs, and websites (without even knowing about their credentials). We gathered around the water coolers at work, sharing horror stories, and casting doubt on that one officemate who claimed to have sold everything at Dow 14,000. We over-analyzed every global economic release as if we had earned PhDs in finance and international business. We logged into our online investment accounts multiple times throughout the day, hoping that the prior calculations had been made in error. We had trouble sleeping each night and found ourselves watching CNBC-Asia at 3:00 a.m. to predict how the U.S. markets would open in a few hours.

The Year in Review

Markets: For much of 2008 (at least, the last four months), investors had no idea how to react to the daily news and markets remained highly volatile. Four of the Dow Jones' worst percentage decline days in its 113-year history occurred during the past few months of the year. In October, the index enjoyed two of its biggest (percentage) daily gains, only to move to lower lows just days later. Each time Treasury Secretary Paulson or Fed Chair Bernanke spoke, investors seemed to throw in their towels without even digesting their messages. Stocks suffered their worst declines since the Great Depression, wiping out almost $7 trillion in market wealth as all 10 S&P sectors recorded sizable losses. Each of the major domestic indexes plunged over 30% (Dow -33.8%, Nasdaq -40.5%, S&P 500 -38.5%, Russell 2000 -34.8%) and the foreign markets fared no better (Brazil -55%, Japan -42%, China -65%, Germany -40%, Britain -31%).

Economy: While the average post-World War II recession lasted 11-months, the current one shows no signs of letting up any time soon. GDP fell in the 3rd quarter by 0.5% and many economists predict a far more substantial decline (about 5%) in the 4th quarter. The labor market contracted for 12 consecutive months as over 2.6 million jobs were lost from the economy in 2008. Many economists believe that housing, the sector that initiated the downtown, will ultimately be responsible for the rebound. Unfortunately, that rebound does not seem imminent as home sales, construction activity, and median prices continue to decline with each passing month. The auto sector has put a damper on manufacturing output as orders for durable goods continue to fall.

While economists have grown accustomed to retailers' crying "doom and gloom" each holiday season, this year's tears were more than justified and even discounter Wal-Mart was not immune to weaker activity. From an inflationary standpoint, a substantial decline in retail gasoline prices since the summer has helped provide a nice (non-governmental) stimulus package at the pumps. However, eternal pessimists fear that lower overall prices will lead to deflation and keep the economy in the doldrums as consumers hold off on major purchases for the foreseeable future. While the promise of a stimulus package (to the tune of $700 billion to $1 trillion) complete with significant tax cuts could go a long way toward generating some economic activity by late 2009 or early 2010, plenty of partisan bickering will be sure to emerge in the days ahead.

Implementing a Plan We Can Control

In reality, the daily gyrations of the markets and the duration of the recession are well beyond our immediate control. Therefore, we should try to pull ourselves away from watching the remnants of the “train wreck” and focus on some positive steps we can take in 2009 to ensure that our financial plans are structured in the most appropriate way for ourselves and our families.

Investment Planning: We have learned a lot about ourselves and our tolerances for risk in 2008. As the new year begins, we should assess just how comfortable we are with the objectives (and associated risk) we have set for our investments, and determine if we need to make some modifications to help us sleep better at night. For many long-term investors who will not need to access these funds for years, a Rip Van Winkle (or buy and hold) approach may work best. Rebalance portfolios based on overall goals and tolerances for risk and refrain from considering additional changes every time the markets rise and fall. While we never want “buy and hold” to become “buy and forget,” we need to get out of the habit of calling up those online accounts multiple times a day. By the way, don’t forgot to reallocate those retirement plans at work and education savings accounts, if needed. Often, these portfolios are structured at the time they are open, but rarely reviewed or rebalanced. In some cases, investors may choose to take a more conservative approach as college/retirement grows closer.

Retirement Planning: While many of us may be looking for ways to cut costs and save moneys for that rainy day, if at all possible, refrain from limiting those contributions to retirement accounts. These are dollars earmarked for our twilight years and most of us can ill afford to put off such forced savings/investing too far into the future. In 2009, the maximum contribution an individual (under 50) can make to a 401(k) increases to $16,500. Also, those investors above age 70.5 will not be forced to take previously required distributions from IRAs and 401(k)s in 2009 so these moneys can continue to grow, and additional taxes may be deferred.

Estate Planning: While no one ever likes to consider our own mortalities, periodically we must review our wills and incapacitation documents to make sure they still reflect our true wishes and all beneficiary designations are consistent with our overall plans (i.e. in line with designations within insurance policies and retirement accounts). In 2009, the federal estate tax exemption amount climbed from $2 million to $3.5 million so individuals with sizable estates need to make sure their documents are structured in the most appropriate manner to take advantage of this potential significant tax saving.

Budgeting and Cash Management: Be aware of the fine line between the need to save vs. the ability to spend. Unfortunately, for many of us, the prospects of a job loss or (forced) early retirement have grown significantly over the past few months. Make sure to maintain a minimum of three to six months of cash reserves available in case that dreaded day arrives. Analyze monthly expenses to see where cuts can be made and which “necessities” are really just “luxuries” in disguise that can be eliminated for the time being. On the other hand, individuals who are confident about their employment situations and comfortable with their financial positions could take advantage of the tremendous retail bargains that currently exist. The surest way to work our way out of this recession is for those individuals and businesses (who are able) to spend and pour money back into the economy.

A Call to Action

The new year represents a great time to get our financial affairs in order and make sure our plans are working the way we hoped. This year, in particular, we should take the time to review each aspect of our financial lives and make any adjustments needed to account for the "challenges" each of us faced in 2008. Your advisor can help you assess your current situations and modify your financial plans, while keeping your short- and long-term goals and objectives in mind.