

A Silver Lining: Five Planning Opportunities for Volatile Markets



Wealth Planning Insights

Managing emotions during volatile markets can be difficult. As long as an investor has an appropriate plan and asset allocation in place, it is important to stay the course, rebalance portfolios, and take advantage of circumstances as they present themselves. In finances, as in many things in life, difficult times present opportunities. History has shown us that market contractions are often followed by market growth. Five planning actions to consider now include:

1. Roth Conversions: Although voluntarily increasing your income tax liability during a down market may seem counterintuitive, converting assets to a Roth IRA when market values are depressed will allow future market appreciation to occur inside of the Roth IRA and thereby allowing for tax-free growth, and should actually decrease your long-term tax liability. Accordingly, Roth conversions remain attractive. By converting an IRA to a Roth IRA, you pay ordinary income tax on amounts converted in the year of conversion, with tax-free growth after conversion. This strategy is particularly attractive in an environment where tax rates are assumed to increase in the future. In order to fully maximize this strategy, taxes generated by the conversion should be paid from non-IRA assets.



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- 2. Retirement Plan Contributions:** If you are not already maximizing your contributions to a 401(k) or other defined contribution retirement plan, a volatile market is a good time to start. In addition to benefiting from an employer match of a portion of your contribution, dollar-cost averaging into an unsettled market is beneficial. Dollar-cost averaging allows investors to systematically invest funds over time, thereby reducing the risk of market timing. In addition, there are many benefits to maximizing retirement contributions. In addition to a disciplined approach to savings that helps participants meet their retirement savings goal, retirement plan contributions can grow either tax-free or tax-deferred. If available, you should consider contributing to the Roth portion of your 401(k) to enjoy the future benefit of tax-free growth even though current contributions generate a current tax liability. Also, do not forget to review your asset allocation within your retirement plan assets to ensure it is appropriate for your long-term goals.
- 3. Gifting:** An opportune time to make gifts is when you believe an asset's value will appreciate after the gift. Lifetime wealth transfer is a common goal and there is no better time to make gifts than when asset values are temporarily reduced. Although it can be psychologically difficult to make gifts in a down market, if doing so fits into your wealth plan, making gifts in such a market allows the recipient to benefit from future appreciation of the assets while utilizing less of your gift tax exemption. Since the gifted assets are out of your estate, any future appreciation associated with the assets will not be subject to transfer taxes. While gifting cash is preferable, if you are transferring assets in-kind it is important not to transfer assets with an embedded loss. It is always recommended to determine if an outright gift is most appropriate or if funding a trust for the benefit of the recipient is a better choice. There are many considerations when it comes to gifting, so it is important to work with a wealth advisor and estate planning attorney to determine the best strategy for your family and situation.
- 4. Intrafamily Loans:** Mortgage and other interest rates have risen significantly in the last few months. Although minimum interest rates for loans to family members have also risen, intrafamily loans continue to remain attractive in comparison to third-party loan terms. The current long-term Applicable Federal Rates (AFR), or minimum interest rate, is just over one-half the rate of a 30-year, fixed-rate mortgage. If you have the capacity, lending money to family members at these more advantageous rates may be appropriate, as long as you are willing to accept what may be a below-market financial return for yourself in the spirit of wealth transfer. When considering an intrafamily loan, it is also important to clearly communicate intentions and understand the impact it can have on family harmony. While you may be delighted to help a family member by financing a loan, it can create tension in the family if payments are missed or the loan is not paid back.

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5. Review your Wealth Plan: One of the best ways to get comfortable with your finances in a volatile market is to review your wealth plan. It is important to periodically revisit the assumptions utilized in your wealth plan and refresh the plan. Most financial planning projections utilize Monte Carlo simulations that show a range of possibilities that varying market conditions can have on financial success. Reviewing your plan can be helpful to remember the impact that both strong and weak market returns can have on your overall financial health. It also enables you to reassess the aspects of your financial life you can control (spending choices, income generation, asset allocation, etc.) versus the aspects over which you have less control (market conditions, taxes, etc.). Understanding the different levers in your control can be empowering, especially during the stressful times of down markets, and reviewing your wealth plan can help you realize that although the markets may be unsettling, your overall long-term plan is intact. If you do not already have a wealth plan, a volatile market is a good time to work with your wealth advisor to develop one.

Managing emotion during volatile markets can be difficult and it is important not to make decisions without understanding your entire dynamic. Ensuring you have a solid foundation in place can help manage your reaction to the turbulence and evaluate opportunities as they present themselves. Before implementing any of the strategies discussed, it is important to reach out to your Fiduciary Trust Investment Officer and Wealth Planning team to review your individual situation. ■

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