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DARE TO BE DULL

Year-end things to do on what's left of our portfolio

It's not exactly headline news, or news to anyone for that matter, that this has been a disastrous year in the stock market.

In fact, I have a chart that I share with clients showing how volatile the market can be during any one year, based on 200 years of history. Barring an 11th hour rally during December, 2008 could go down as the worst year in the history of the stock market, so this chart might be in need of updating.

I've written enough columns about thinking long-term, not panicking, staying the course, you get the idea. So, I thought I'd forego the dogma and offer some actionable advice.

1. Harvest your tax losses. I know it seems like the stock market will never go up again, but it will. Sell some of your losers and harvest those tax losses — especially the short-term losses. You can only deduct \$3,000 annually but you can carry those losses forward indefinitely and offset them against future gains, with certain restrictions.

My advice would be to replace these losers with broad, low-cost domestic and international index funds. Don't stay out of the market now that it's having sales better than Black Friday.

Hope will return and so will capital gains. If you recognize these losses now, you can benefit from them in the future. Mark Patterson, partner in the CPA firm Stockman Kast Ryan & Co., calls tax-loss harvesting making lemonade out of those nasty lemons the market has dumped on our doorstep.

2. Don't shoot for the stars. Behavioral finance shows that when we are facing certain losses, we suddenly become big risk takers. As advice for the last bear market,



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Jonathan Clements' book "You've Lost it, Now What?" recommends we resist the temptation to shoot for market-beating gains because it's a strategy for ending up as a big loser. Instead, capture as much of the market return as possible by buying market tracking index funds.

3. Be wary of strangers with solutions. Every time there is a traumatic market plunge, the insurance industry reacts by coming up with "solutions" for us battle-fatigued investors that promise the upside of the market without the downside risk.

Unfortunately, the only ones getting the upside/no downside are the people selling them. Buy your investments and insurance direct but never mix the two. These prophets are only interested in their profits.

4. Build your own insurance investment. Who needs that expensive insurance company to provide the guarantees when you can do it yourself? Let's take a \$10,000 investment, one could invest:

■ \$5,888 in a 10-year Discover Bank CD (earning 5.44 percent APY).

■ \$4,112 in a low-cost broad index fund of ETF.

At the end of 10 years, you'll get \$10,000 back from the bank (Your \$5,888 plus \$4,112 in interest). All insured by the Federal Deposit Insurance Corp. I admit I'm a little less confident in our government right now, but I'll still take a government guarantee over one from any insurance company any day.

And even if the market goes nowhere, we still get the market return of the \$4,112 we put in the index fund.

I call this stock investing on "training wheels," because knowing we'll get all of our money back in 10 years makes us less likely to panic and flee from the market at

just the wrong time.

5. Consider the alternatives. As much as I preach broad index funds, I'm also a believer in alternative investments.

In the book "The Only Guide to Alternative Investments You'll Ever Need," Larry Swedroe and Jared Kizer make the case for certain alternative investments that don't always follow the stock market. That provides some additional diversification.

Some of the alternatives they recommend are real estate, commodities, Treasury Inflation Protected Securities (TIPS) and fixed annuities. Just as important, the book talks about other alternatives to common stock that should be avoided like the plague.

While real estate and commodities worked well during the bear market earlier this decade, they have not provided the diversification we had hoped during this bear. Nonetheless, I recommend REITs and possibly some precious metals and mining stocks, if your stomach can handle the volatility.

Finally, TIPS are yielding the best real rates ever, paying inflation plus 3.5 percent. This is because we are having deflation during the short-run and their principal can actually decline.

But with our government printing money at record rates, buying a long-term TIP could be just the ticket to protect against hyperinflation while taking no default risk, as long as the U.S. government survives.

Here's hoping my 2009 year-end column will be more cheerful!

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