Navigating the New Reality

COVID-19, market turmoil and your financial well-being

Financial planning is a helping profession, and one of the greatest things about the financial planning community is the willingness and enthusiasm of financial planners across the country to pitch in to help in crisis situations. Dozens of Financial Planning Association® (FPA®) members are raising their hands to volunteer to provide pro bono financial planning advice to underserved communities at this time of uncertainty and others are eager to share their knowledge and experience, which you will see in **Navigating the New Reality**.

We asked FPA members for their most valuable tips for investors and savers when it comes to maintaining financial well-being in times of crisis, and they came through with information on managing market fear, contingency planning, budgeting for cash flow, and more. We are grateful to have members like the contributors to this e-book who are passionate about financial planning and eager to share their wisdom.

Keeping the 'Corona Crash' in Perspective

Market crashes are often described as times of great uncertainty. This is both right and wrong. It is right in that it is almost impossible to predict what will happen the next day. However, all market crashes follow the same universal pattern. That makes the long-term outcomes predictable.

Every market crash starts with a triggering event (e.g., coronavirus) and stretched valuations (e.g., S&P 500 after a decade of gains). The trigger event causes traders to become fearful. They start selling their risky positions. This selling causes the indices to decline which makes traders more fearful, so they sell more, and so on until we get a series of steep declines punctuated by a few strong gains.

Eventually the fear abates, and traders start picking through the wreckage to find bargains. This causes prices to rise. Eventually valuations again become stretched, and the cycle begins anew when a triggering event occurs.

Why investors become nervous varies from crash to crash. In the last few decades we had the dot com crash when valuations for internet companies without profits collapsed, the mortgage crisis in 2008, and now the Corona Crash. Market crashes are a normal part of financial markets. They feel chaotic because they shatter the status quo and replace it with wild price swings. But once we take a step back from the daily fluctuations and the extensive news coverage, we see that they all evolve according to the same template. Wild price swings will continue while fear runs high. When fear recedes, the swings will get smaller and the market direction will turn up.

We encourage you to let the predictable market crash pattern, rather than the latest sensational headline, guide your financial decisions.

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It’s Time to Outsmart Your Brain

Our brains evolved to survive, not to prepare for future retirement. Unfortunately, this means that our emotions affect us long before our logic kicks in. It also means that we are hardwired to mess up our investing. This is even more true during uncertain times—when we’re afraid. Here are three tips you can use to outsmart your brain.

Practice Financial Distancing

Bad ideas, spoken with confidence, can sound pretty good these days. We listen and believe confident people, regardless of the quality of their ideas. If these confident people spout complicated ideas, our brains shut down instead of analyzing their ideas. If you are persuaded by them, you will only hear ideas that validate these opinions. These noise peddlers don’t have the answers. If you have to listen to them, question their assumptions and don’t just assume they are right.

Don’t Panic

We hate to lose twice as much as we enjoy winning. When you hear that the market has dropped or see the value of your investments shrink, it makes you want to do something. Action feels like it will help. These two instincts combine to battle your logical brain. When markets are dropping like they are these days, we want to stop losing. The challenge is that selling now is terrible for your money’s long-term health. Do not sell just to do something.

Think Long Term

If you sell now, you will lose money and miss the benefit of future market rallies. If you have a long-term plan, follow it. If you don’t, make one. Your plan might go against the advice given by friends and experts. There is pain in going against the crowd that makes it difficult to ignore what everyone else is doing. If the markets are dropping and it seems like everyone is selling, it takes a strength of will to do what’s best for you. It is essential that you focus on your plan and your goals.

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Hindsight is 20/20, but Being Proactive is the Next Best Thing

Amidst the current crisis, one of the most popular themes in the financial media can be summarized as, "What do we do now?" Do we sell our equity holdings (stocks)? Is fixed income (bonds) the place to be? Should we bolster our cash reserves now that furloughs and layoffs are a strong possibility?

At the risk of stating the obvious, the average person will spend a good amount of time planning their vacation—when and where to go, how to get there, how much cash to take along, and how to deal with contingencies that may arise (flight delays, health emergencies, etc.). Just like travel planning, financial planning is a proactive process that endeavors to anticipate the known and unknown.

Reactive is the opposite of proactive, and as the saying about closing the barn door after the horse has bolted teaches us, a lot less effective. For instance, accumulating a sufficient cash reserve to cope with a period of potential job loss can only be accomplished before employment earnings are gone as a result of a layoff, not after.

Just as loss of earnings due to unemployment or a health emergency is in reality an ever-present risk, so are the risks now playing out in the stock market. In other words, the possibility that equities could suddenly drop due to a pandemic, terrorism, war, civil unrest and a myriad of other reasons is nothing new and should be proactively factored into your financial plan and the portfolio construction process.

Whether it concerns travel or finances, planning ahead requires time and effort, but the rewards are clear when things take an unexpected turn!

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Whether You're Flight or Fight, Here's What You Need to Do

During periods of stress, our flight or fight instincts kick in. We either want to bury our heads in the sand and not think about it, or we want to do something about it. We either let the anxiety eat away at us, or we make poor decisions and suffer the unintended consequences.

If you are a flight person, face the fear. Call your financial planner and update your financial plan. Refresh your worst-case scenario, but factor in a subsequent recovery. You may be in a better position than you think. If you're not, your planner can walk you through your options. Your planner's job is to be objective and provide you with guidance, and you may have options available to you that weren't available before your circumstances changed. Either way, you'll rid yourself of what keeps you up at night.

If you are a fighter, focus on what you can control. Prepare for a layoff with a 'Plan B' for your career, even if you think it's unlikely to occur. Focusing on your future will help you feel in control. Seek out professionals who can help update your resume and use LinkedIn to build your network. Look at the certification programs offered by your local community college. Is there one that interests you or your non-working spouse? Is it possible to pay for the program with a tax-qualified distribution from one of your 529 plans? Talk to your financial planner about the logistics of beneficiary changes and the opportunity cost of making withdrawals from your child's 529. If you don't get laid off, at least you've pushed your career forward and when the economy turns around, you'll be better for it.

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You Can't Control Much Now, but You Can Control Your Cash Flow

When the stock markets are volatile, people become scared and want to do something to ease that fear. Many financial planners will recommend not making changes to your investment portfolio allocation during market volatility and may even recommend not checking your account balances for a while since that could cause more fear and panic.

But that doesn't help with satisfying your brain's desire to do something to ease the fear. So, what can you do?

You can take this time to find ways to free up cash flow. With COVID-19 having a ripple effect throughout society, what we do on a daily basis has been changed dramatically. There's a good chance that our economy will end up in a recession and that jobs will be lost. Now is a good time to check your bank and/or credit card statement and identify the things that you can cut out such as monthly subscriptions, convenience items, dining out, and other discretionary expenses. Make it a game to see how much monthly cash flow you can free up.

Some other areas where you may be able to save money are by shopping your homeowner's and auto insurance through an independent insurance broker and refinancing your mortgage, if your circumstances warrant it.

In the worst possible case, you could lose your job and this exercise will be necessary. In the best case, your personal financial situation won't be affected, and you've freed up some cash flow that you can use to help others, boost your emergency fund, or even add back in some of those things that you cut out.

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An Emergency Reserve Will Be Critical in the Worst-Case Scenario

While things have been tumultuous in the markets and economy largely due to the coronavirus outbreak, most Americans are still gainfully employed. However, if things continue like they are, we could see many people out of work. To prepare for the worst-case scenario, move as much money as possible into an emergency reserve. This reserve is where you'll access money for expenses if you were to lose your job. Here are ideas to build your emergency reserve.

- **Reduce spending:** Start by cutting your spending in dining out, entertainment, and shopping. Make meals at home and find more productive ways to use your time (volunteer, read, exercise).
- **Cancel subscription services:** Monthly subscriptions are deceivingly inexpensive—$49.99 per month for one streaming service amounts to $600 per year!
- **Stop accumulating charges on your credit card:** If you carry a balance on your credit card, you're wasting money on finance charges. Only place new charges on your credit card if you know you can pay it off in full at the end of the month.
- **Sell unused items for extra cash:** Look in your closet for unused or gently used items. Use apps like decluttr, letgo, or even Facebook groups to sell these items.
- **File your tax return now if you anticipate a refund:** Be sure to pay attention to how the current reality impacts tax planning since filing and payment extensions could be adopted or extended further by the IRS.
- **Remove or reduce optional payroll deductions:** Your paycheck stub shows deductions, including optional benefits. Discuss with your HR department which benefits you could remove or reduce to increase the amount of your take-home pay.
- **Reduce your federal student loan payment:** It was recently announced that federal student loan borrowers can suspend payments for 60 days. Contact your servicer and discuss options for payment reduction.

As economic conditions improve, promise to keep your emergency reserve equal to at least six months of your income.

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Bring Your Investments Back Into Balance

With every financial plan and portfolio review meeting, we make a point of discussing the possibility of a recession and reviewing our clients' investment policy. Every one of our families has their own **investment policy**, but it generally follows a **rebalancing method**. For most, that means shifting the composition of their account once the portfolio diverges more than 5% from our target. For example, your target allocation is 65% stocks (equity) and 35% bonds (fixed income), and now it is 60% stocks and 40% bonds due to the drop in the stock market. Rebalancing your portfolio back to the initial 65/35 allocation means you will be "buying low (stock values) and selling high (bond values)" by liquidating some of the bonds that performed well and invest in stocks that are priced lower due to panic selling. As Warren Buffet said, *"Be fearful when others are greedy and greedy when others are fearful."*

In addition to rebalancing your portfolio, here are some suggestions that may fit those individuals who may be able to take advantage of the following financial planning basics:

- Increase the contribution to your retirement savings.
- Accelerate contributions to your profit sharing, defined benefit pension plan, 529 college plan, and HSA accounts (instead of waiting until end of the year).
- Refinance your mortgage and consider a Home Equity Line of Credit.
- Consolidate credit cards and other personal consumer debt.

While rebalancing and having the discipline to follow the client's investment policy is our job as trusted financial planners, we are all human beings and must be empathetic to our clients' emotions. Simply saying, "Stay the course" is not going to work, especially for those nearing a goal such as retirement or college. You want to know you are still on track. The key, in my opinion, is working with a financial planner and being committed to educating yourself when times are good or bad. Doing so will keep you calm and rational, and help you avoid making rash **decisions based on emotions**.

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It's a Good Time to Reevaluate Your Insurance Coverage

While stuck at home, now is a great time to re-evaluate your insurance coverage. I tell adult prospects and clients that most of us should maintain private insurance coverages: life insurance, disability (income) insurance, and long-term care coverage.

Consumers typically think that their insurance coverage via their employer is enough. What they fail to realize is that these coverages typically do NOT follow them when they leave their employer. Also, in many cases, the coverage offered via the employer while employed are not adequate.

Considering how much life insurance coverage you may need is analogous to a goal post. On the left side of the goal post is the minimum amount of coverage for your family—this typically includes your mortgage balance, as well as college savings for children. On the right side, or high end of the coverage scale, you would add to that a predicted income stream based on the life of the insured. For example, if you earn $100k/year, and expect to work for another 30 years, that means an additional $3 million in coverage. My clients tend to fall somewhere between the goal post amounts—based on their cash flow and priority to make that a line item in their budget.

Disability insurance has bands imposed by insurers which disallows for "over insurance." Long-term care insurance typically gets considered by clients in their 50s and beyond—although if my clients are believers and have the cash flow, I propose it in their 40s as well.

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