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Bear Markets Are Good For Long-Term Investors

This is a great time to be young—particularly if you have the means and the foresight to invest in the stock market and the patience to let your investments work over time. Though the bear market has scared off many would-be investors, putting money into stocks during and after a downturn has historically been a winning strategy, according to a study by investment company T. Rowe Price. Long-term investors who systematically invest in equities during a bear market are actually better off than those who start investing during bull markets.

The T. Rowe Price study focused on four hypothetical investors. One began investing in 1929, another in 1950, the third in 1970, and the last in 1979. Each "investor" put $500 a month into a portfolio that replicated the performance of the Standard & Poor's 500 stock index for 30 years. The study assumed a $10 share price at the beginning of each period, and all dividends were invested in additional shares.

Two of the hypothetical investors—the one who started investing in 1929 and the other who began in 1970—entered the stock market just before two of the worst bear markets in history. During the decade of the Great Depression, from 1929 through 1938, the S&P 500 had a negative annualized total return, losing almost 1% per year, and the 1970s were only slightly better to stock investors, with the S&P averaging a 5.9% annual total return during years of exceptionally high inflation that reduced the value of market gains. Yet the investors could take solace from three positive factors during those dark days.

1) Investing during a bear market, they were able to buy shares of stock at depressed prices, and that let them accumulate more shares than they could have if prices had been higher. This positioned their portfolios for outsized gains when stocks recovered.

2) By dollar-cost-averaging—making regular, equal investments regardless of whether the market was up or down—and reinvesting dividends, the two investors who started during the bear markets would have posted small gains after the first decade. They would have done better than investors who had narrower portfolios or who had invested their money as a lump sum rather than as a series of periodic investments.

3) Compared with the two other investors, who accumulated fewer shares at a higher average cost during the rampaging bull markets that began in 1950 and 1979, the bear market investors fared much better after 30 years. The advantage of the investor who began in 1970 was particularly pronounced, thanks to stocks' exceptionally strong performance during the 1980s and 1990s.

For the 30 years beginning in 1929, the S&P 500 provided a decent 8.5% annualized return, rewarding that

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Early Bull Markets Must Overcome Walls Of Worry

After a dizzying downfall in 2008, the stock market recovered some of its value in 2009. The Standard & Poor's 500 index rose a heartening 63% between the March lows and the end of the year.

However, by December, that index's value remained nearly 30% below its October 2007 peak. Those numbers illustrate the recurring dilemma for investors trying to decide whether to jump in when it looks as if a bull market rally may be under way. Though the recession may have ended, economic conditions remain weak, and it's difficult to feel bullish.

How do you know whether a long-term advance has begun or whether markets have simply gained back some lost ground before resuming their retreat? There is no surefire way to know. The progress markets make after a significant downfall could be the beginning of the next bull market—or simply what is known as a dead cat bounce, a false rally.

But there is one thing you can know. Sooner or later, the nation has climbed out of every recession and resumed its long-term growth, even if the exact pattern of growth and recovery varies in every instance.

In America, the entrepreneurial spirit has always reasserted itself, fueling the economic progress that has been a hallmark of this country since its founding. That's why bull markets always climb walls of worry. It's when everyone is worried that stocks are usually beckoning with new opportunity.

Splitting Up Your Roth IRA Conversions

What may be an optimal time to convert a traditional IRA to a Roth IRA has arrived. Beginning in 2010, high-income taxpayers qualify to make the switch, and for some, the basic trade-off of a conversion—paying income tax now in return for tax-free income during retirement—could be worthwhile. As an added incentive, taxes on conversions made in 2010 can be paid during the following two years. Yet with markets unsettled, a conversion could backfire, leaving you to pay income taxes on assets that have lost value after the transfer to a Roth. Establishing multiple Roth IRAs, rather than just one, could give you the flexibility to minimize the damage.

By splitting up a converted Roth, you avoid having to make an all-or-nothing choice about whether to "recharacterize" the account back into a traditional IRA. The IRS gives you that option, allowing you to undo a conversion and avoid the associated taxes. But you can't do a partial recharacterization, returning only selected assets to the traditional account.

That's the benefit of establishing multiple Roths. You might use one account for stocks, for example, and a second for non-stock investments such as bonds. Then, when it's time to file your tax return for the year of the conversion, you can look at the investment performance of each account. If stocks have fallen while bonds were positive, you might decide to recharacterize the stock Roth IRA but leave the other alone. In fact, rather than just creating two Roth accounts, you can go even further with this technique, subdividing the "stock" account by industry sectors or capitalization.

The old rule for conversions, which required an adjusted gross income of $100,000 or less, is eliminated in 2010. But those who choose to convert a traditional IRA to a Roth IRA will still owe income tax on the converted amount that's attributable to tax-deductible contributions and earnings. (Non-deductible contributions are exempt.) That tax is particularly painful if the value of account investments has fallen sharply, and many account owners who converted early in 2008 undid the conversion after the stock market plummeted later in the year. You have until your tax return due date, plus extensions, to change things back to the way they were.

By splitting your assets into separate accounts, you can wait to see how each account performs. The earlier in the year you make the conversion, the longer you'll have to make a final decision. For example, if the conversion took place on January 1, 2010, you have until April 15, 2011, to decide about a recharacterization—or until October 15, 2011, if you elect an extension.

What if you determine that future investment performance will improve for that asset class you just recharacterized? You can "reconvert" your traditional IRA to a Roth, but not until the start of the following year or 30 days after the recharacterization, whichever comes later. ●

Financial Tips For Those Out Of Work

The numbers are scary. From December 2007 through October 2009, unemployment in the U.S. doubled from 7.6 million to 15.1 million. But the statistic that matters most is your own, and if you've been laid off or your company has gone under, you're competing with an army of others for the few available jobs. Still, manage your financial affairs carefully and you'll certainly survive the economic crisis. You might even emerge in better shape than you were before. These eight suggestions could help.

1. Don't panic. It's normal to be nervous if you've suddenly been sent packing after years of gainful employment. But now's the time to take stock of your situation as calmly as possible. Keeping your emotions under control will make it easier to find the way forward.

2. Reduce spending. Food and shelter are necessities, but other purchases are discretionary. Consider ways to trim your cable TV bill and think twice about dining out. Finding things you can do without may also help you overcome the feeling of powerlessness that often comes with unemployment.

3. Eliminate unnecessary debt. Cut up your credit cards? Maybe not, but charge only what you can afford to repay each month. Otherwise, a small debt could quickly spiral out of control.

4. Take advantage of benefits. These days, you can likely avoid those dispiriting visits to the unemployment office and apply for jobless benefits by mail or online. And if you need to continue your health insurance coverage under COBRA, a provision of the American Recovery and Reinvestment Act of 2009 will subsidize 65% of the cost for nine months.

5. Network, network, network. Applying for posted jobs pits you against a host of other applicants. You may do better reaching out to friends, family, and business associates. Be

Many Workers Leave Their 401(k) Behind

If you're leaving your company because of a downsizing or a switch in jobs, you wouldn't think of going without cleaning out your office. But what about the assets in your 401(k) plan? All too often, departing employees leave behind their retirement plans without giving much thought to the consequences.

According to a recent survey by Charles Schwab, almost half of the money held in 401(k) plans by employees who left their jobs during the first quarter of 2008 had not been moved a year later. Though there's no penalty for keeping your funds in an ex-employer's plan, you can't continue contributing to the account. Also, you may have concerns about how the account will be administered after you've gone, and you could face obstacles in recovering the money if the company goes under.

But you don't have to let your assets languish in a former employer's plan. You have three other principal options: take a cash distribution, move the funds to a new employer's plan, or roll over the assets to an IRA.

Take a cash distribution. Frequently, an employee will elect to take a lump-sum distribution from a 401(k) plan when leaving a job, especially if money is tight. But that could result in a hefty tax bill. The amount representing pre-tax contributions and earnings in the 401(k) is taxed at ordinary income rates reaching as high as 35% on the federal level. If you're under age 59½, the IRS will generally tack on a 10% "early withdrawal" penalty. And don't forget about state and local taxes and state penalties.

Besides incurring tax liability now, this approach means forfeiting the future benefit of tax-deferred savings and putting a hole in your retirement plan. After 60 days have passed, you'll have lost the opportunity to transfer the funds to another tax-advantaged plan. And don't think you'll receive the full balance of assets in your account. The employer's 401(k) administrator will automatically withhold 20% of the payout, regardless of your personal circumstances. Unless you have a dire need for funds, you would do better choosing one of the other options.

Transfer assets to a new employer's plan. If you find another job, you often can move your 401(k) balance to another 401(k) or other tax-qualified retirement plan available through your new company. That way, your assets will continue to grow tax-deferred without interruption. This direct transfer is also exempt from the early withdrawal penalty, and there's no tax withholding as long as you arrange a trustee-to-trustee transfer from one plan to another. If you take the funds yourself, you have 60 days to complete the transfer, but 20% will be withheld, and you won't be able to recover that money until you file your tax return for the year of the transfer.

The main potential drawback to this option is that you'll be limited to the investment choices in your new employer's plan. Those may be better or worse than you had before, but the third option—rolling over assets to an IRA—is likely to provide more investing flexibility and a wider menu of choices.

Move your account balance to a rollover IRA. Just as when you transfer assets to a new 401(k) plan, you may continue tax-deferred savings by rolling over your retirement savings to a traditional IRA. And here, too, you can avoid automatic tax withholding by using a trustee-to-trustee transfer. Otherwise, you have 60 days to complete the rollover without triggering income tax liability or an early withdrawal penalty.

This may be the most advantageous approach. Again, an IRA generally offers greater investment flexibility, letting you invest in a wide variety of stocks, bonds, and mutual funds, compared with 401(k) choices that tend to be more limited. And the IRA may give you greater control over distributions during retirement.

Beginning in 2010, all employees now also have a fourth option—rolling over employer plan funds to a Roth IRA that provides tax-free distributions during retirement. (Previously, Roth conversions were allowed only in a year in which your adjusted gross income didn't exceed $100,000.) But moving money to a Roth means paying income tax on the untaxed portion of your account, unless you have large tax deductions that you can claim to offset this extra income.

Almost all of these options are likely to be preferable to leaving your 401(k) account with your former employer. We can help you explore the possibilities and find the best approach for your situation. ●

casual—you don't want to seem desperate—but be sure they know you're job hunting.

6. Consider a career change. If your industry or profession seems unlikely to rebound, you might broaden your search to include related fields—from print media, say, to work on a website, in public relations, or in another job requiring writing and editing.

7. Start a new business. If you've always dreamed of turning a hobby or other passion into a profitable business, this might give you the push you need to go for it. If you can fill a niche with high-quality services or products while keeping startup costs low, you'll stand a good chance of success.

8. Stay positive. An extended job search may sap the energy you had when you were first laid off. But perseverance will pay off. And remember: If you're middle-aged or near retirement, your wealth of experience is an asset, not a liability.

Finally, in a pinch, you may need to tap your retirement plans. But money you pull out now will be difficult to recoup later on, so consider this option only for emergency purposes. ●

Bear Markets Are Good

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period's systematic investor with a total return of 960%. Even more impressive, the investor who began in 1970 would have earned a 1,753% total return during the next three decades. And the investors who started during bull markets? Each earned total returns of less than 400% during 30 years of investing, according to the T. Rowe Price study.

The bear market investors thrived because they began when times were tough, rather than despite that apparent misfortune. To prove that point, the study also examined what would have happened if the first two decades of each period had been reversed—so that, for example, the tough sledding of the 1970s had been preceded by the strong market performance of the 1980s, rather than followed by it. An investor beginning $500 monthly contributions in 1970 would have had $589,707 after two decades—but only $358,972 if the decades had been reversed. That was true even though, in both cases, the S&P 500's annualized return for the 20-year period would have been an identical 11.5%.

Investing in the stock market during a bear market—and during the hard economic times that led to the downturn—requires a leap of faith for new wage-earners as well as for older investors stung by recent losses. But down cycles for stocks and the economy have always been followed by rebounds, and equity markets tend to recover months in advance of a return to economic growth. As the T. Rowe Price study shows, it can pay to take advantage of those trends by beginning a program of long-term, systematic investing just when conditions seem worst. That's a lesson even middle-aged investors could take to heart as they look to regain their investment footing after the historic market plunge.

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