

TAB Magazine, Journal of the American Chamber of Commerce in Thailand, Volume 1/2009

Financial Planning – Fighting Back in a Down Market

By: Chad Creveling and Peggy Creveling

Making smart moves with your finances during times of major change like 2009 can really pay off. Events during 2008 slammed global credit, capital, and housing markets, with the chaotic effects negatively impacting virtually everyone.

No matter how you fared last year, 2009 is your chance to get your financial plan back on track. Here are eight areas where you can take solid action, and be positioned to benefit over the long run.

1) Make sure you're financially covered for emergencies

The economic fallout from last year will continue through this year, and therefore many face an increased chance of losing a job or having to relocate. Unfortunately, when times are tough, bad things can happen in multiples – you lose your job, you lose your health benefits, your tenant loses his job, you can't sell your house, etc. The stress of emergencies is bad enough – the last thing you want is to also be forced to borrow at prohibitive interest rates or to sell at today's distressed prices investments that were intended for the long term.

To mitigate this risk, make sure you have adequate amounts of liquid assets such as cash, short-term CDs, or money market funds in the correct currency. Don't go chasing yield with this money. Remember that holding Australian dollars "for the interest rate" when you'll need the cash in Thai Baht or U.S. dollars doesn't make sense. Small movements in exchange rates in the short term can wipe out any interest rate benefit.

If you're not sure how much you need, here are some ideas: if your situation is simple, you have health insurance and you have no dependents, consider holding a minimum of six months living expenses in liquid assets in the appropriate currency(ies). Go to 12 months or more if you have dependents or can think of real possibilities of needing cash.

2) Get your long-term portfolio back on track

Continuing extreme volatility in capital markets may have resulted in your long-term investment portfolio significantly deviating from your strategic targets. Compounding this, many investors have panicked, stopped contributing to their long-term portfolios, or, in some cases, bailed out entirely and gone to cash. While cash is great for funding short-term goals, there are few people who have enough of it to fund long-term goals such as retirement. Luckily, now is the time to get your portfolio back on track.

If you're waiting for the market bottom, remember that market movements are unpredictable and that market recoveries happen unexpectedly and usually begin ahead of economic recoveries (see Figure 1).

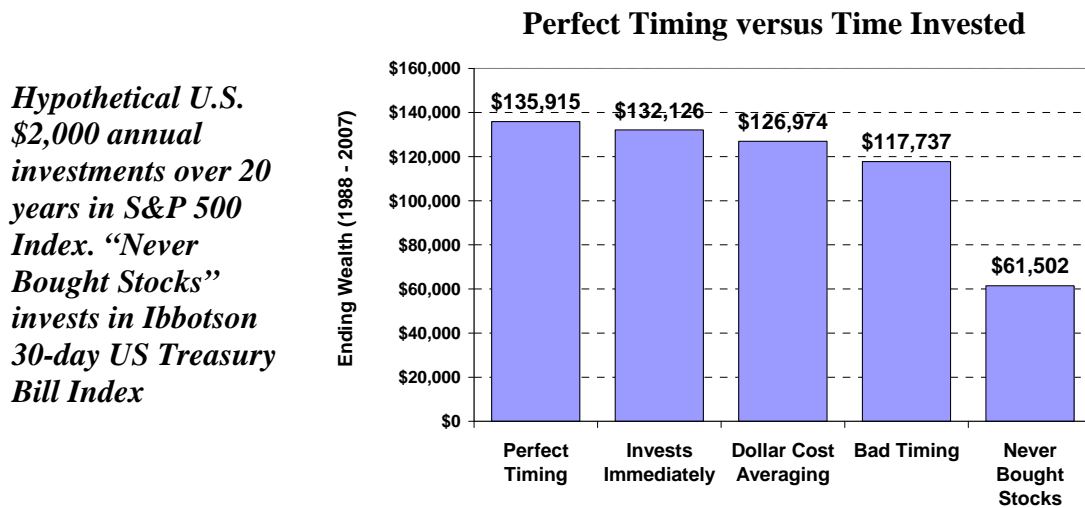
Figure 1

S&P 500 Performance Pattern Around Recessions				
S&P 500 Low Date in Recession	3-Months Later	6-Months Later	9-Months Later	1-Year Later
06/13/49	15%	19%	27%	34%
09/14/53	10%	18%	28%	39%
10/22/57	6%	10%	19%	32%
10/25/60	16%	25%	28%	31%
05/26/70	17%	21%	39%	45%
10-03-74	14%	30%	52%	35%
03/27/80	18%	31%	39%	37%
08-12-82	38%	42%	61%	58%
10-11-90	7%	29%	29%	29%
09/21/01	18%	17%	3%	-14%
Mean	16%	24%	32%	32%
Median	15%	23%	28%	34%

Source: Ned Davis Research, Inc.

Furthermore, unless your timing is consistently perfect, studies show that trying to time the market doesn't pay off as a long-term strategy (see Figure 2).

Figure 2



Source: *When is the Right Time to Invest?* by Mark W. Riepe, CFA, Charles Schwab Research.

So, to get your portfolio positioned to benefit most over the long run: review your asset allocation to make sure it's appropriate for you and adequately reflects your ability to take risk; and review specific investments to make sure they best represent the asset classes you've chosen. Make sure your portfolio is as tax efficient as possible. Chances are that some of your investments have fallen much further than others last year, so it

may be time to rebalance, which forces you to maintain the discipline of buying at a relative low and selling relative high.

3) Lower your current and long-term U.S. tax bill by harvesting portfolio losses now

U.S. tax rates are likely going up and we may see the current low rates expire in 2010 with top U.S. federal marginal rates potentially reverting to 39.6% and capital gains rates to 20%.

One way you can mitigate your future tax bill is by locking in short-term losses now. This ensures that these losses can be used in the future to offset income that is taxed at your highest U.S. marginal tax rate, either by using against short-term gains, or ordinary income up to U.S. \$3,000 per year.

You can do this without straying from your long-term allocations by employing a strategy called Tax Loss Harvesting. If done properly, tax loss harvesting should result over time in significantly improved after-tax portfolio performance.

For example, if you invested U.S. \$100,000 in the market last year you may have U.S. \$20,000 or more in unrealized losses today. Depending on your U.S. tax bracket and individual situation, harvesting them now could result in a tax savings of up to U.S. \$3,920 – or roughly 20% of the total loss. If the losses are unused in any given year, you can carry them forward indefinitely. And even if you already harvested losses last year, the market's ongoing volatility means you may have additional chances to harvest more losses in the current year.

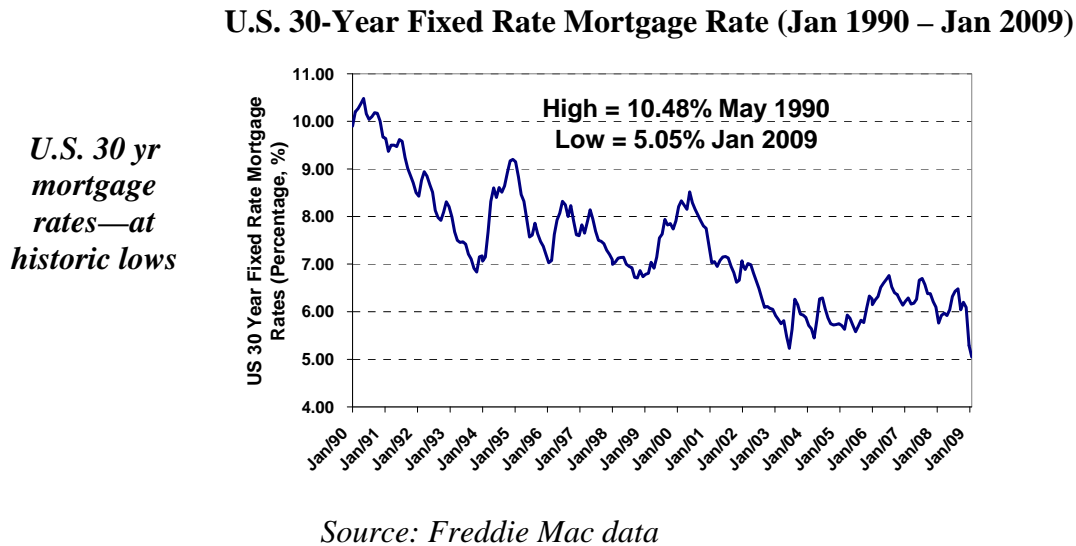
Tax Loss Harvesting strategies should be followed with some care. Check with a tax advisor to make sure that you avoid the Internal Revenue Service's "Wash Sale" rules, and ensure as part of your strategy that you are reinvesting appropriately to keep your target allocation in tact.

4) Refinance existing U.S. mortgages

If you qualify for refinancing, now is an excellent time to do it: U.S. mortgage rates are at historic lows and likely to go even lower this year, especially for 30-year fixed mortgages (see Figure 3). If you're in the top U.S. tax bracket and your home qualifies as a principal residence, you may be able to lock in a 30-year loan with an effective after-tax shield rate of 3.25% or even lower if tax rates increase or you're later subject to state tax.

You'll want to shop around because lenders are offering a variety of deals for qualified borrowers. Depending on your situation, the next couple of years may also turn out to be a great time to purchase a retirement home.

Figure 3



5) Convert deflated IRAs to Roths now, and maximize your after-tax upside

Roth IRAs can be a great deal for many U.S. taxpayers, especially if you expect your overall marginal tax rate to be higher in the future (including federal and/or state rates). And now may be an ideal time to convert—with asset prices depressed, your total tax burden on conversion will be low. While that may sound like simply putting a positive spin on the unfortunate fact that your IRA collapsed last year, remember that when equity markets rebound, you'll get to keep the entire amount gained in the Roth tax free. Before doing the conversion, be sure you qualify and remember that foreign earned income exclusions do not apply in calculating either your Modified Adjusted Gross Income or the tax owed. Even if you don't qualify for conversion this year, everyone should qualify beginning in 2010 unless current rules change.

6) Diversify out of Company Stock

Many company executives find that a significant amount of their net worth is dependent on their company's well being. Vested stock options, restricted stock units (RSUs), stock held in 401(k)s all add up – and that's in addition to being dependent on future cash flows from the company, such as salary and defined-benefit pensions.

While you may work for a company with a bright future, from a risk-reward perspective, there's still no rational benefit to holding more than 5% of a diversified portfolio in any one company. The likely long-term upside potential of a given company (especially a large one) is not likely to be more than the portfolio as a whole, but the risk in holding an individual stock is considerably greater.

If you're in this situation, now may be the most opportune time to trim your holdings back and diversify: overall prices and long-term capital gains rates are low, so the tax burden should be relatively minimal. (You'll want to have a specific strategy for vested stock options as these have special considerations.)

If you're leaving your job this year and have company stock in your 401(k) that has appreciated significantly from the time you acquired it—depending on your situation—you may find that not rolling the stock to an IRA using the Net Unrealized Appreciation (NUA) tax break will result in lower after tax returns for you overall. Choosing the NUA treatment for company stock isn't for everyone: depending on the amount of gain, the timing of likely future distributions and your expected future ordinary tax rate, it may still make sense to roll the stock to an IRA. You'll want to analyze your own situation to see which is likely to be best for you.

7) Be aware: Popular U.S. property tax breaks are no longer available

In your financial planning, don't count on all tax breaks lasting forever. For example, from 1997 until the end of last year, married couples who lived in their home for two out of the last five years could make a profit up to U.S. \$500,000 on the sale of the home without paying capital gains tax, and single tax filers had an exemption of U.S. \$250,000.

Unfortunately, that deal is no longer available. As January 1, 2009, people who sell a home that they did not live in for a period of time will have to pay tax on the portion of the gain proportionate to the period that they lived elsewhere (there may be exceptions to this rule for military and foreign service members).

Other property tax issues: If you're renting out your U.S. home, be sure that you depreciate it appropriately. Be aware that depreciation will be recaptured upon sale – even if you later convert it to a principal residence to escape the rest of the gain.

On a positive note, for 2008 only, taxpayers who don't itemize can deduct up to U.S. \$500 (U.S. \$1000 for married couples) of property taxes in addition to their standard deduction.

8) Contribute to a Thai RMF or LTF

Depending on your situation, you may be able to cut your current year Thai tax bill considerably by contributing funds to Retirement Mutual Fund (RMF) or Long Term Equity Fund (LTF), or both. For example, Thai taxpayers can contribute up to 15% or Bt500,000 of their annual salary to either a RMF or their company's provident fund, and another 15% or Baht 500,000 to an LTF. Although this won't change your U.S. tax bill, it may serve to reduce your overall tax burden – and you may be able to save the equivalent of 37% of your total contribution if you're in the top Thai tax bracket.

One caveat: Understand the rules first and then choose which RMF or LTF you will contribute to carefully. You'll be locked into the investment for a period of time (between three and five years for the LTF depending on when you contribute, and until age 55 for the RMF, with special allowances for early withdrawal if you leave Thailand permanently).

Act now: The dismal 2008 is over. But 2009 will be another pivotal year in many ways. Don't wait until the end of the year to get your finances in order. It's time to take back control now. Take care of the big planning areas first:

- Make sure you have enough liquid assets to cover your short-term needs, and raise your emergency reserves as needed.

- If you bailed on your long-term portfolio, revise your strategy to something that suits your risk profile and long-term goals, and keep contributing.
- And get back in the market if you cashed out.

And all the other standard planning axioms still apply:

- Contribute to your tax deferred plans (if you qualify).
- Review your insurance coverage and listed beneficiaries.
- Update wills.
- Review your charitable giving.
- Organize your tax records and file where required.
- Consolidate unneeded accounts.
- Report offshore accounts.
- Review your exercise strategies for stock options.
- Pay-off debt and get rid of unneeded credit cards.

Remember, there are no financial planning emergencies – *only lack of planning emergencies* – and these are preventable.

About the authors: Chad Creveling, CFA and Peggy Creveling, CFA are co-owners of Creveling & Creveling Financial Planning Limited, a fee-only cross-border advisory firm that is US SEC regulated and Thai licensed, and may be reached at chad@crevelingandcreveling.com and peggy@crevelingandcreveling.com.

Disclaimer: The information in this article is subject to legislative changes and is not intended to be legal or tax advice. Consult a qualified advisor regarding your specific circumstances.