Planning Strategies

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Financial Planning during Volatile Markets

The first quarter of 2020 has presented investors with significant market volatility and temporarily diminished portfolio values from a combination of efforts to contain COVID-19, a shock to oil prices, and unprecedented rate cuts by the US Federal Reserve. While this is a time of much uncertainty for all of us, we also know that crises and disruptions can create opportunities. There are a number of planning techniques that you can avail yourself of that could improve your financial position in the long run. These techniques are highly situation-specific and need to be considered in the context of your overall financial plan. None of them should be embarked upon without thorough analysis. In addition, we want to remind you of some basic estate planning documents that you should have in place.

We are available to discuss any of the planning ideas we cover below.

1. **Revisit your asset allocation.** The temptation can be strong to sell out of stocks when they reduce dramatically in value, and increase cash holdings far beyond the long-term asset allocation that has been established between you and your investment team. Proper asset allocation planning should ensure that you have enough in cash to ride out the next few months of uncertainty, with more allocated to stable assets with more liquidity. There is no hard and fast rule as to how much of a cushion to keep in more stable-value investments, but a minimum of 1 to 2 years, with the possibly for longer if there are other factors to consider. For example, if you are in an industry with less stable income or if you are embarking on a riskier entrepreneurial venture, you should consider keeping 3 years in quality fixed income or cash equivalent investments.

   The rest can be viewed as a long-term investment and thus able to accept short-term declines, even when the short-term outlook is uncertain. However, this does not mean we should do nothing – there are assumptions to reevaluate during this time that impact your financial plan, including reevaluating time horizons to retirement or the amount you can reasonably save. Ensure that the asset allocation still makes sense for your time horizon, and the specific objectives you want to accomplish.

2. **Continue to invest.** In the context of a long-term plan, it is critical to stay the course and continue contributing to your investment accounts, whether through automated retirement savings, or manually in a taxable investment account. This strategy, often referred to as "dollar cost averaging," is helpful in keeping investors on track, and preventing emotions from ruling the day. While the cause of the current market and economic disruption is new, we believe that the economy is resilient in the long run. Staying invested and ensuring that you do not get caught in the day-to-day volatility by jumping in and out of the market is critical for long-term success.

3. **Consider Roth Conversions.** If a Roth conversion is under consideration, a market downturn – especially one as steep and unprecedented as this one – presents a unique opportunity. The cost of Roth conversions is the income tax owed on the conversion amount. With IRAs at lower values given the recent market downturn, the tax bill on Roth conversions is now significantly lower than what it would have been when the stock market was

at its high only a few months ago. If you are concerned about timing on this, you can divide the total amount to be converted across several months, converting in “chunks” instead of all at once.

It is also important that you pay the tax on the Roth conversion from funds outside the IRA so you don’t deplete the IRA. Keep in mind that a portion of your Traditional IRA could be made of after-tax contributions, which impacts proportionally the percentage of the Roth conversion that is taxable.

4. **Consider front-loading 529 college savings plans**. With the market pullback, this is a potential opportunity to accelerate college savings using the 5-year front loading strategy. Typically, an individual can give up to the annual gifting exclusion ($15,000 in 2020) to any other individual without gift tax consequences. However, for 529 college savings plans, the IRS allows for a 5-year front-loaded contribution, or $75,000 per child, per donor. Up to five years’ worth of gifting can be given in a single year, with the annual gift tax exclusion spread out over the following five years. For a married couple, that amount can be doubled. If this amount seems too aggressive to invest all at once, you can spread the contributions up to the 5-year frontload max over the course of the year. Keep in mind that any other gifts given to the same recipient outside of a 529 plan counts towards the gifting maximum.

   Moreover, 529 plan rules were changed under recent tax laws to allow tax-free withdrawals for private K-12 tuition up to $10,000 per year and to repay student loans. However, the use of 529 funds as a qualified expense varies on a state-by-state basis.

   Finally, for those who have or expect to receive a refund on tuition from an institution that was originally paid from 529 funds, the refunded tuition money should be rolled back into the student’s 529 plan within 60 days. Any amount rolled back from a tuition refund would not count towards the 529 plan’s contribution limit.

5. **Mortgage refinancing.** With extremely low interest rates here to stay for longer, there is an opportunity to consider refinancing existing loans. It is important to note, however, that the decision to refinance will depend on an analysis of upfront costs, the interest rate savings and the amount of time you believe you will retain the asset. There tends to be a break-even point where refinancing makes sense. In general, the longer you intend to stay in your property or keep the asset, the more sense it makes to refinance.

6. **Securities or Asset-backed Loans.** During times of crisis, there can be unforeseen pressure from multiple issues including temporary loss of income and a spike in health care expenses that may deplete even a well-planned cash cushion. Consider setting up a line of credit that could enable you to access liquidity without selling holdings in your portfolio at depressed values, locking in the losses. The goal is to avoid a permanent impairment of capital that could result in having to shift assumptions and timelines such as retirement age. With securities-backed loans, your taxable investment account is used as collateral, and the loan value is usually a portion of the account value to ensure a buffer against market volatility. Because this is not a margin loan, meaning you cannot use the loan to buy more securities, the interest rates are generally significantly more attractive. This needs to be carefully considered with a pay-back plan in place before drawing on the loan. However, there is often no cost to setting one up in case of a future need.

   Another option is a Home Equity Line of Credit (HELOC), which provides access to cash based on the value of your home. Evaluate whether your income is likely to be stable to support the loan payment before taking one on. In general, if there are repairs or renovations that need to be done, these are optimal reasons to consider a HELOC. If funds from a HELOC are used towards substantially improving or building your home, then the interest on the HELOC would qualify for a tax-deduction.

   Any strategy that increases leverage against your assets – securities or real estate – must be undertaken with extreme care and consideration of the risks. If conservatively

implemented, it can serve as a helpful and temporary liquidity bridge. However, if imprudently applied, increasing leverage can accelerate financial distress – the very outcome we strive to avoid.

7. **Estate planning**. With health and medical care issues currently top-of-mind for everyone and their families, there is increased urgency to ensure estate planning documents are up to date and in order. We recommend contacting an attorney sooner rather than later, as increased demand for their services may delay your timeline further. Here are some basic estate planning ideas and documents you should have in place:

    a. ***Check your beneficiaries***. Now is the time to check all beneficiary designations across all of your accounts and insurance policies, including IRAs, 401(k), life insurance policies, transfer-on-death (TOD) accounts. Beneficiaries on record supersede instructions in a will, which makes it especially critical that they are accurate.

    b. ***Will.*** A will is a foundational estate planning document that everybody should have. A will directs what will happen to all property held in your name at death and appoints an executor to take charge of your assets and guide your estate through probate after you pass away. For anyone with minor children, a guardian would be named to raise the children in the event of the parents' death. A will is revocable and can be changed at any time.

    c. ***Revocable trust.*** A revocable trust is straightforward to set up and does not require any irrevocable gifting. Revocable trusts work in tandem with your will. They offer seamless, more private transfer of assets by avoiding probate. Also importantly, a funded revocable trust provides an efficient way for your assets to be managed under your direction, should you become incapacitated.

    d. ***Durable Powers of Attorney***. These documents allow you to designate an agent to make financial decisions on your behalf. You want to make sure you have a durable power of attorney (POA) instead of a general POA. A general POA ends when you become incapacitated, whereas the durable POA contains language to ensure the agent's authority continues beyond incapacity.

    e. ***Healthcare directives.*** These are written, legal instructions that specify your medical care wishes in the event you cannot communicate or make the decisions yourself.

        i. ***Medical or Healthcare Power of Attorney.*** Allows you to name an individual to make decisions for you if you are unable to do so. This can also be called a durable power of attorney for health care or health care proxy.

        ii. ***Living Will.*** A written, legal document that lays out the medical treatments you would and would not like to be used. It can also list your preferences for pain management, organ donation, and other medical decisions including end-of-life care.

    f. ***Trust planning during low-interest rate periods.*** There are several trust strategies that are particularly attractive in low interest-rate environments. We have written a more in-depth piece on estate planning considerations during low-interest rate periods, including the use of Grantor-Retained Annuity Trusts (GRATs). GRATs operate most effectively when interest rates are low and asset values are low. We certainly have low interest rates, and with the recent market pullback, it's very likely that many individuals are also facing lower asset values in their portfolios.

We believe there is much to be done from an investment and financial planning standpoint over the next few months. It is important to “do no harm”, which often means avoiding an automatic reaction. A major planning decision should be made with the long-term plan in mind, which makes this a good time to revisit your financial plan or to start the planning process. A strong financial plan incorporates both positive and negative scenarios, and is able to adapt to new circumstances quickly – key elements to thriving in this age of uncertainty.
We are always available to discuss any questions you may have over the upcoming days and weeks.

LU HAN, CFA, CFP®
Principal, Senior Client Advisor

Lu Han is a Principal and Senior Client Advisor at 1919 Investment Counsel. Her primary focus is financial planning for individuals and families. Lu takes a comprehensive approach to assessing all aspects of a client’s financial situation, including retirement planning, goal funding, cash flow analysis, insurance reviews, college savings, and estate planning. She partners with Portfolio Managers to identify and integrate meaningful solutions with investment management, and to interface with clients on a regular basis to provide ongoing financial planning services as a part of the firm’s wealth management services.

Lu joined the firm from UBS Financial Services Inc., where she was a Financial Planning Specialist working with financial advisors to deliver planning and advice to clients. Lu is a Certified Financial Planner®, a CFA Charterholder, and holds a B.A. in English and Psychology from Barnard College. She enjoys rock climbing, hiking, running, and traveling.

Email address: lhan@1919ic.com

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