

## **Rocky Balboa vs the Bear: How to Invest (Or at least not make mistakes) in a Bear Market or Recession?**

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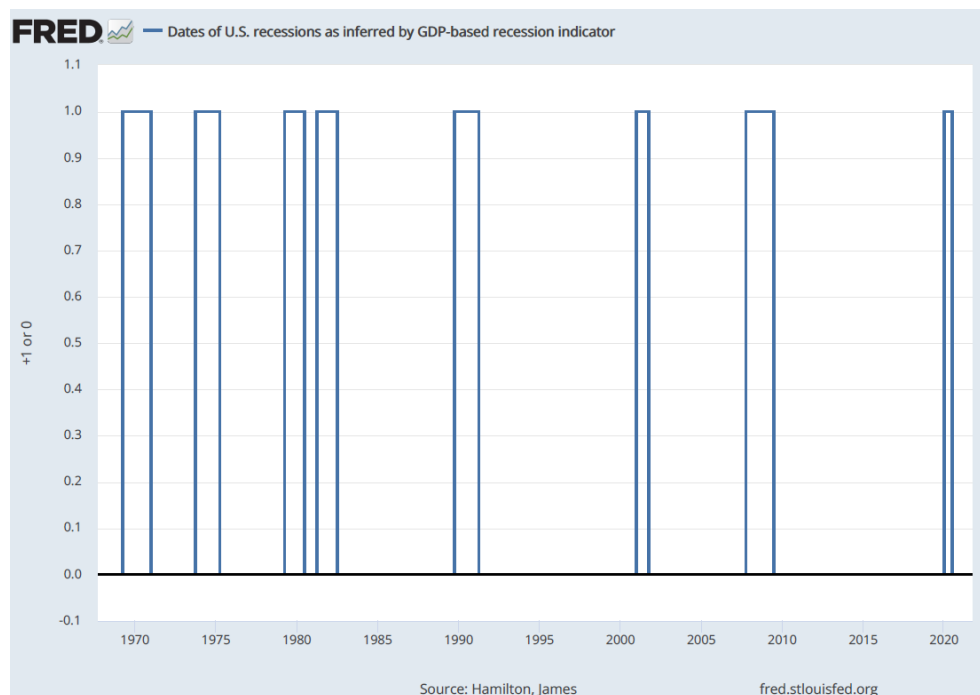
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It is the fifth round and Rocky Balboa looks pretty beat up with no hope of winning the bout, let alone stopping the bleeding and continued beatdown from his opponent. Then right when he is down and out for the count, he finds a little energy and fights back and manages to pull out the win against an unbeatable opponent.

That is how many investors feel right now. We are in what seems to be a never-ending fifth round and the stock market continues to beat on our 401k's and IRAs. What do we do? It challenges long held beliefs of even the surest investment professionals.

There are two potential problems headed our – a recession and a bear market.

Recessions are common. Recession occurs when the U.S.'s Gross Domestic Product (GDP) shrinks for two quarters in a row, and these often do coincide with economic crises. As you can see in the graph, there have been eight since 1970 including the one starting with COVID-19.



<sup>1</sup> Hamilton, James, Dates of U.S. recessions as inferred by GDP-based recession indicator [JHDUSRGDPBR], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/JHDUSRGDPBR>, May 23, 2022.

Many investors will refer to the 'stock market' averaging 9 or 10% since 1929 which is true<sup>2</sup>, but keep in mind that is an average. The S&P 500 has averaged 10.5% from 1937 to 2020. During that time, there were twenty negative years and sixty-four positive years. Even in those positive years, there are frequent drops during the year.<sup>3</sup>

So, what is a bear market? What is a correction? A 'correction' is when the stock market (S&P 500 or Dow Jones usually) loses 10% or more from its recent high. These occur about once a year and last an average of 3.5 months.<sup>4</sup> Bear Markets are common too; we hit one this year. A bear market is a 20% drop from the market's recent high. When a bear market does occur, stocks lose 36% on average and there have been twenty-six of them since 1928. The average length is 9.6 months (average bull market is 2.7 years). A bear market is not always coincident with recession either.<sup>5</sup> In comparison, a bull market is when the market reaches a 20% increase from its recent low.

The answer as to how to navigate these issues lies in financial planning, your risk tolerance and understanding where you are relative to your goals. In other words, keep the long term in mind; long term investors get rewarded. If you thoughtfully create your plan, you can be ready for and weather a recession or a bear market. This is one of the reasons having a personalized financial plan is so important. If you create an investment portfolio based solely on stock suggestions or an online algorithm, you may end up with a diversified portfolio but it will not be connected to your bigger picture financial plan. That is the key to making sure your portfolio matches your goals and timelines and therefore the key to making sure you are ready for a recession or bear market.

One key item you should understand is your risk tolerance. Whether you are 25 or 85, really understanding your objective and subjective risk tolerance is important. If you are twenty-five, you can probably objectively take a hit to your investments and be fine in the long term but how do you emotionally respond to market ups and downs? Understanding this before something bad (or even good) happens is a great starting point to design your investments and financial plan.

Let's review a few different scenarios and possible responses to recession or a bear market.

### **Retirees**

#### *Recession:*

If you are truly retired, a recession should not create worry about job loss. Your income is likely coming from a combination of social security, pensions, investments, or annuities. If you are working in retirement, hopefully that job does not create the income you are using to pay the bills. Retirement income planning should have been part of your financial plan and this would line up your incomes with your spending plan. If you have not done that planning yet, it is never too late.

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<sup>2</sup> 'The Cost of Timing the Market,' Franklin Templeton Investor Education 2021.

<sup>3</sup> 'The Cost of Timing the Market,' Franklin Templeton Investor Education 2021.

<sup>4</sup> 'Keys to Prevailing through stock market declines,' American Funds from Investor Resource series.2022.

<sup>5</sup> '10 Things You Should Know About Bear Markets,' Hartford Funds. <https://www.hartfordfunds.com/practice-management/client-conversations/bear-markets.html>

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A recession could lead to stock market losses or even a bear market and you should also be prepared for that scenario (see Bear Market note below).

#### *Bear Market:*

As a retiree, income is the name of the game. It is nice to watch investments grow, but you need your money to create income. If you do have guaranteed incomes like pensions and social security that completely fill your income need, then you can take more risk in your investments. In this case, a bear market might be a bit scary when you look at your investment balances, but it will not affect your lifestyle as you can just wait for the bear to pass. You may only have to cut some luxuries for a little while if you are using your investments for that purpose.

If you are relying on your investments for income, it is a great idea to have 12-18 months of expenses saved up in cash. This way, if you do experience a drop in your investments, you can pause your withdrawals and use the cash. This will allow time for the market to recover.

Required Minimum Distributions (RMDs): In some cases, you will be required to take money out each year even if you do not want to take it, such as with IRAs and 401ks when you are over 72 years old. There's a formula the IRS publishes that helps you figure out what your RMD is each year.<sup>6</sup> If you don't need it right now, you can attempt to wait out the market downturn in hopes that it'll recover and you can sell less shares of your investment to raise the cash to cover the RMD. Keep in mind you still must take out the money during the calendar year. You can take the RMD from a more conservative account? Sometimes, you just need to take the money out and the market is down and there is no way around it. If that is your situation, then try to take just the RMD and no more. You can also save a little on taxes by utilizing the Qualified Charitable Distribution (QCD) – at least you are not liquidating shares then just to pay taxes – you can benefit your favorite charity instead.

### **Working Years**

#### *Recession:*

If you are younger and working, a recession is likely a bigger risk for you than a bear market. Your career is just starting out so if a company is struggling, they may choose to fire employees who are newer or sometimes, if you are lucky, they will keep the newer employees because they earn less. There is no way to know so be prepared. It is always a good idea to have an emergency fund - enough money saved in an accessible place like a Savings or Money Market account to cover 6-12 months of expenses. The more certain your employment is (think government employee or military), the closer to six months you can be and the more entrepreneurial you are, the closer to twelve months. So, if your expenses such as rent, food, important bills are \$3000 each month, you would need \$18,000 - \$36,000 dollars saved up and ready to go. You also need to consider your family situation – are you single, the sole earner, a dual income family, no kids, multiple kids, etc.? Again, a personalized financial plan can help you determine the right amount for you.

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<sup>6</sup> <https://www.irs.gov/retirement-plans/plan-participant-employee/required-minimum-distribution-worksheets>  
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### *Bear Market:*

If you are young, a bear market is an opportunity. If you are investing for retirement anyway, a bear market is a chance for your monthly investment dollars to be buying shares at a bargain. Then you can acquire more shares!

Dollar Cost Averaging is a fantastic way to take advantage of a volatile stock market. Let us assume you are maxing out your IRA for 2022 (\$6000 or \$500 per month). Each month, the share price of your theoretical investment goes up and down – in this example, it starts at \$6 and ends at \$6, but goes up and down in between.

Month	Investment	Share Price	Number of shares purchased each month
1	\$500.00	\$6.00	83.33
2	\$500.00	\$7.00	71.43
3	\$500.00	\$8.00	62.50
4	\$500.00	\$9.00	55.56
5	\$500.00	\$10.00	50.00
6	\$500.00	\$8.00	62.50
7	\$500.00	\$6.00	83.33
8	\$500.00	\$5.00	100.00
9	\$500.00	\$3.00	166.67
10	\$500.00	\$3.00	166.67
11	\$500.00	\$5.00	100.00
12	\$500.00	\$6.00	83.33
<b>Total</b>	<b>\$6000.00</b>	<b>Average = \$6.33</b>	<b>1085.32</b>

In that 12-month period, you manage to buy 1085.32 shares of your investment at an average price of \$6.33. Our goal is that our actual cost is less than our average price. We purchased 1085.32 shares for \$6000 or \$5.53 per share. At the end of month twelve, we now own 1085.32 shares at \$6 per share or a value of \$6,511.90, so we made \$511.90 over that year. That is the goal of dollar cost averaging. Obviously, not every 12-month period will turn out like this, but it demonstrates a concept that should work over an extended period of time. This is why it is a great idea to invest in your 401k monthly or each paycheck!

When you are young, concentrate on accumulating shares of quality investments. You can worry about the share price when you are getting closer to retirement.

### **Have extra cash in your budget or in your savings?**

Even better! Whether it is a recession or a bear market, if you have extra cash, you can take advantage of the situation by increasing your monthly investment or 'buying the dips' or using IRA conversions.

Buying the dips refers to putting in lump sums of cash when the market is at a low point. Now, no one knows when the low point of a bear market is. If that were possible to know when it is happening, that person would not have to work for the rest of their life! But you can know when things are relatively down. Let us say you had an extra \$10,000 in cash. You could put it into the market during a downturn a little bit at a time, say \$2000 at a time. You could do that once a week or once a month to try and catch the dips. You will likely miss the exact bottom of the market, but you will have bought shares on the way down, which last time I checked is the way to win – buy low and sell high!

Another great strategy that anyone can pursue is IRA conversions. If you have pre-tax dollars in your IRA, you can convert some or all of them to a Roth IRA. The amount converted is subject to income tax, so it is important to fully understand the tax consequences and to make sure the conversion is worth it relative to the tax bill. It is well advised to use a knowledgeable accountant and financial advisor to do conversions. Once the dollars are in the Roth IRA, they cannot be removed without penalty for five years, but all future growth is tax free!

IRA conversions are a valuable tool during a bear market or recession because it is likely your shares are worth less. So, if you own one hundred shares of a mutual fund that was worth \$10,000 and now it is down 20% and worth \$8,000, you can convert all one hundred shares and only pay taxes on the \$8000.

Keeping the long term in mind can help you avoid the big mistake. In investing, avoid a mistake can often mean more than hitting it big in an investment. Emotions can run high during economic crises so understanding your plan can help you keep those emotions in check. If you pull out of the market during a downturn, you will likely miss the recovery and create a permanent loss of capital by turning a loss on paper into a real loss. If you leave your money invested, you will be poised to take advantage of the recovery.

I am sure you have heard and read the phrase, "Past performance is no guarantee of future performance" or some iteration of that. We investment professionals, rightfully so, cannot promise anything about the stock market. One prediction that is likely, however, is that if you invest you will likely see the value of your account drop at some point, if not frequently, during your investing experience. If you can create a plan about how you will handle it ahead of time, you'll be much better prepared to weather the barrage of right hooks and uppercuts the markets like to deliver sometimes. I have always wanted to shout something like, "Yo Adrian, I did it." (Cue dramatic music in the background). Perhaps if enough investors can be better prepared for the eventualities of investing and understand success is more about your own behavior than stock picking and timing, we can all get to our goals and shout "I did it!"