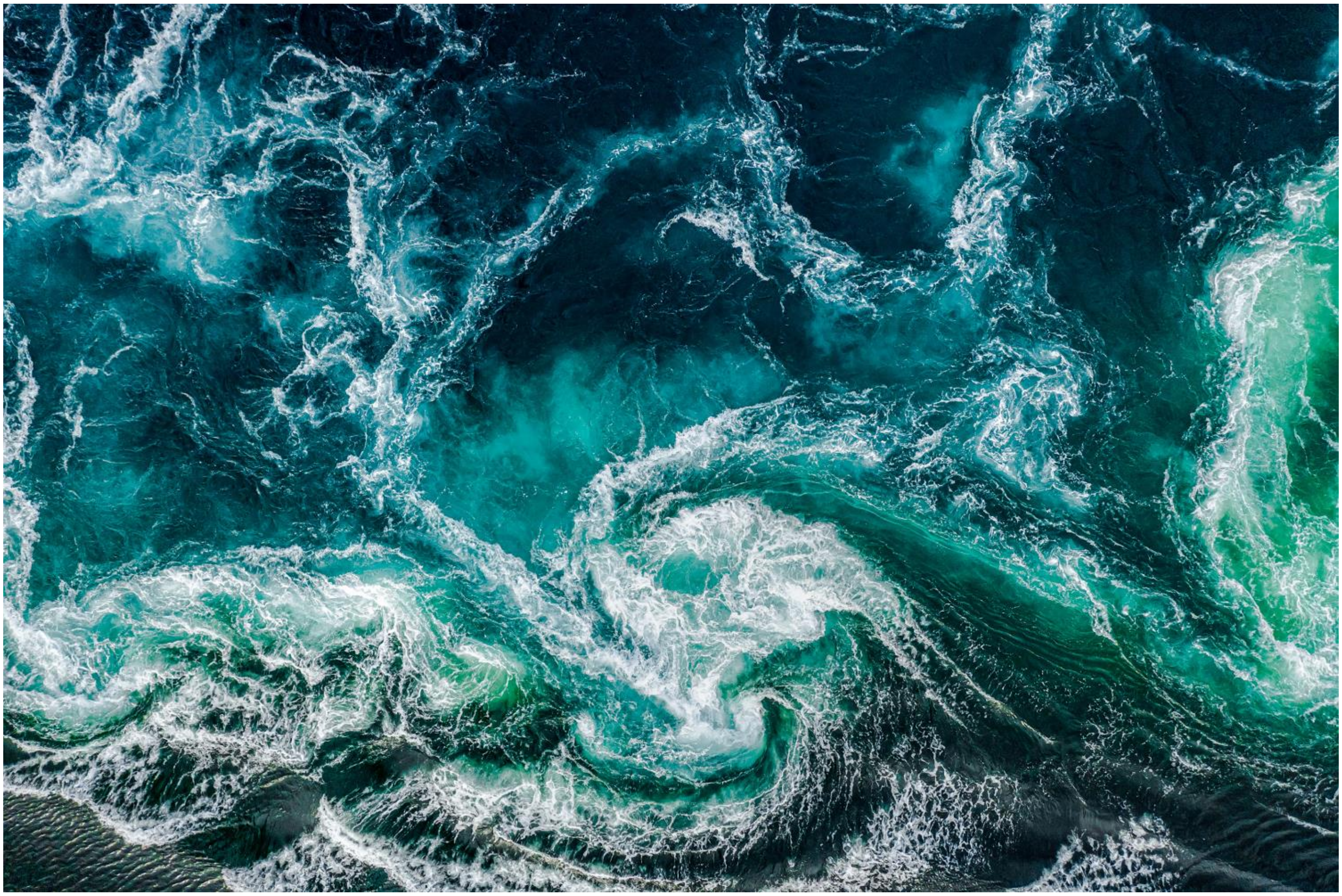
INVESTMENT CONSULTING GROUP

*of Wells Fargo Advisors*



# Playbook for a Down Market

Over time, markets move up and down. This, of course, is not something that investors can control. While down markets can be difficult, they may present opportunities for those that are ready with a proactive plan.

Direction of the market cannot be controlled, but actions taken during certain market environments are within our power. Control what you can control. These strategies are not suitable for everyone. Talk with your tax advisor before taking action.

Our team feels that it is important for clients and their families to understand the strategies that we may employ in their portfolios during downward markets. While we may not recommend sweeping portfolio changes, there are planning strategies that become attractive for the opportunistic.

Brandon Hays - First Vice President - Investment Officer

## Harvest Losses

In taxable accounts (non-retirement accounts), selling a security that has gone down in value creates a REALIZED LOSS. This loss can be used to offset REALIZED GAINS incurred.

Typically, capital gains are taxed at a rate of up to 20% so reducing or completely offsetting gains with losses may reduce your tax bill.

Importantly, selling a position at a loss isn't a great way to grow your portfolio over time, right? So, in order to sell at a loss, but still capitalize on potential future growth, immediate reinvestment is necessary. Just be mindful of the wash sale rule, which prohibits selling an investment for a loss and replacing it with a 'substantially identical' investment 30 days before or after the sale.

These losses can be carried forward year to year in order to offset future gains AND can be used to offset up to $3,000 in earned income each year.

All said, tax-loss harvesting can be a valuable strategy if tax-efficiency is a portfolio goal.

## Roth Conversion

This is the process of converting Traditional (pre-tax) retirement assets from IRAs or 401ks to Roth (after-tax) assets.

When a conversion is made, tax must be paid on the amount converted.  Since you initially put the funds in before you paid tax, the IRS now wants their tax revenue! After converting, you now have funds in a Roth IRA that can be distributed in the future tax-free.  Additionally, Roth IRAs are not subject to the Required Minimum Distribution at age 72, which may lower your tax bill down the road.

So why would a Roth Conversion make particular sense while the market is down?  Well, at market highs, if one share of XYZ stock was worth $1,000 and you wanted to complete a $10,000 Roth conversion, you would have converted 10 shares.  In a down market, XYZ stock may be worth $500 which would allow you to convert 20 shares and stay within the $10,000 conversion amount.  20 shares of XYZ will, undoubtedly, be worth more than 10 shares in the future and you will have the benefit of taking the funds out tax-free.

This move may be suitable for you if you feel that your tax rate may be higher in the future when you decide to access your retirement funds.  Upon conversion, be sure to pay taxes due with funds that are not part of your retirement account as the IRS may consider that a distribution as well.

"While we may not recommend sweeping portfolio changes in a down market, there are planning strategies that become attractive for the opportunistic."

## Increase Retirement Plan Contributions

For investors actively participating in a workplace retirement plan, a down market presents a unique opportunity.

As share prices move down, a fixed contribution amount buys more shares. The concept of dollar-cost-averaging* illustrates that, with a fixed dollar amount, more units (shares) are bought when prices are down and fewer are bought when prices are high. This holds true with regular contributions to retirement plans like 401ks. To leverage this concept of dollar-cost-averaging in a down market, an investor could increase the regular contribution to their retirement plan. Thus, buying even more units at a lower price.

As an added benefit, pre-tax contributions to retirement plans are often excluded from taxable income. So, this increase in retirement plan contributions may also reduce income tax owed in a particular year. Consult your tax advisor to be sure.

*A periodic investment plan such as dollar cost averaging does not assure a profit or protect against a loss in declining markets

## Rebalance

Over time, some portfolio holdings may go up, some down, and some nowhere. These movements can dramatically change the original allocation if left unattended.

If a portfolio holds 60% stocks and 40% bonds, after a handful of years where stocks outpace bonds, that allocation may now be 75% stocks and 25% bonds, a significant shift higher in potential risk.

To avoid this drift in allocation, consider selling securities that have recently outperformed and buying the underperformers. In effect, selling high and buying low in order to shift allocation back to the original stock/bond allocation. Periods of high volatility demand close attention to overall allocation.

## Harness the Volatility

In periods of heightened volatility, rather than anticipating the direction of markets, investors may use tools that potentially become more valuable during market tumult.

Options can potentially hedge existing positions or speculate on the future direction of a stock. The cost to buy these options has tended to rise in volatile times. To capitalize on this, selling options and collecting the premium can be used as a strategy to increase portfolio income.

These tools can be very complex and are not suitable for all investors. Transaction costs are significant and should be considered before entering into any strategy.

## Avoid Future Tax Burdens

Mutual funds that incur a gain in a given year must distribute that gain to shareholders. If you are the recipient of this capital gain distribution in a taxable account, it is taxable to you even if you haven't sold the fund.

Investors can potentially sell their mutual fund holding before the gain is distributed to avoid the tax impact. Down markets may reduce unrealized gains in a particular fund, making it more attractive to sell and reinvest.

Be sure to discuss with your tax advisor before taking action.

## Make Cash More Productive

Since 2022, interest rates for short-term instruments have broadly risen to the benefit of those with temporary cash positions.

This may include money market funds, CDs, or Treasury bonds. Rather than holding cash in a checking account, shifting 'parking spot' funds to alternative short-term, conservative instruments may make sense.

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## Know What You Own, Why

Down markets test resolve and may make investors question their portfolio holdings. Even high-quality positions can be unjustly punished in negative market environments.

Investors that have conviction in their holdings may be less likely to make emotional decisions during difficult market environments.

## Know What You WANT to Own

Negative markets tend to punish all securities alike. Having set criteria around security selection can help investors develop a 'shopping list' of positions that they want to own at certain levels. If you have uttered the phrase, 'If ABC stock drops to X price, I'd buy it' this may be of interest.

Investors can automate these 'shopping list' buys through the use of options or limit orders.

## Measure Twice, Cut Once

A good woodworker knows, an incorrect cut cannot be undone. Similarly, bad trades or ill-timed portfolio changes cannot be either.

Before making a move, think about your rationale and discuss it with someone.  Whether your financial advisory team, tax advisor, a friend, etc., vocalizing your thought process and getting additional perspective is a sound strategy.

Wells Fargo Advisors and The Investment Consulting Group of Wells Fargo Advisors are not legal or tax advisors.  However, we would be happy to collaborate them in order to employ the strategies most suitable to our clients.