Bernstein
Global Wealth Management

Lemons to Lemonade: The Planning Opportunities Created by Market Instability

Recent Events

The market turbulence of recent years has been hard on investors emotionally as well as financially. Many are "shell-shocked" and scared to make any decision; others are panicking and want to sell any risk-bearing investments. Unfortunately, emotional choices tend to lead to bad outcomes. Inaction can cause one to miss valuable opportunities, and panic can cause one to sell assets at the worst time—when their price is temporarily depressed.

Fortunately, there are a number of simple actions one can take that can have significant benefits and *higher* effectiveness when the market is *lower.* As the old saying goes, "If life deals you lemons, make lemonade."

Personal Finance Strategies

Rebalance accounts. Rebalancing helps you avoid the emotion-driven trap of buying into a bull market and selling in a bear market—in other words, buying high and selling low. If your stock allocation has fallen more than 5% relative to its target, start rebuilding the position. Over time, rebalancing trades add to return while reducing risk. Bernstein systematically reviews every client account every day and rebalances automatically.

Refinance your mortgage. The current market volatility has pushed mortgage rates to near their all-time lows. If you haven't refinanced already, it's hard to imagine a better time. While most people opt for a traditional 30-year fixed-rate mortgage, it may be worth considering a 15-year mortgage or even a variable-rate mortgage to take advantage of the most attractive rates available.

Gift to your 529 plan. Make the $13,000 annual gift when values are depressed, so that the recovery takes place in a tax-deferred account. If you haven't started a 529 yet, it's a great time to open one, and potentially fund five years of gifts up front. These plans aren't restricted to your own children, either: You can create them for anyone—including grandchildren or relatives.

Income Tax Strategies

Harvest losses. Use this opportunity to sell stocks that are at a loss in order to offset realized capital gains. A net loss of up to $3,000 can also be used to offset ordinary income. If you want to maintain exposure to the stocks in case a recovery occurs, keep in mind the "wash sale" rule, which disqualifies the loss if you repurchase those stocks in the next 30 days. Bernstein will automatically make these trades for you, taking into account your tax loss carryforwards and any outside gains or losses that you have reported to us. If you haven't done so already, please contact your Bernstein Advisor to update your tax information with us.

Sell concentrated stock positions. Large holdings of a single stock are more risky than most people think, and our research indicates it generally pays to reduce concentrated positions and reinvest in a diversified stock portfolio. The tax cost of diversification is lower following a stock market pullback. By reinvesting in a diversified portfolio, you can participate in a stock market recovery.

Exercise Incentive Stock Options (ISOs). ISOs are a type of option for which the gain can be treated as a long-term capital gain if you hold the stock for a year after exercise. So holders should consider exercising now while the *price is low*. And then, sell in one year while the *capital gains tax rate remains low*. If you may be subject to the Alternative Minimum Tax (AMT), you will need to be cautious, as the gain as of December 31 would be a taxable item for AMT purposes. Before exercising ISOs, one should always consult with a professional tax advisor.

Estate Planning Strategies

Roth conversion. If you expect to leave a legacy to your family, there is no better asset to leave than a Roth IRA. If you have considered converting a traditional IRA to a Roth, it's best to do it when market values are down, because this reduces the up-front tax hit. For those who have already done the conversion, the government allows you to have a "do-over." If the IRA has lost value since the conversion, you can recharacterize it back to a traditional IRA and then reconvert in 30 days.

Gift to an Intentionally Defective Grantor Trust (IDGT). It's better to make a gift of stock when values are depressed so that future gains take place outside of your estate. Under recent tax legislation, individuals can gift up to $5 million to a trust for the benefit of their descendants (including grandchildren) without incurring gift tax, estate tax, or generation skipping tax. Under current tax law, the maximum gift will revert to $1 million in 2013.

Immunize Grantor Retained Annuity Trusts (GRATs). If you executed GRATs funded with stocks earlier this year, take this opportunity to "immunize the GRAT." Substitute bonds and reroll the stocks at the lower prices into a new GRAT so that the appreciation from here is transferred to beneficiaries.

Initiate long-term wealth transfer strategies. Low interest rates make many wealth transfer strategies unusually effective. IRS hurdle rates will be at or near all-time lows in September 2011. For long-term GRATs, charitable lead trusts, intra-family loans, and installment sales, there is a significant cost to waiting.

For a more detailed explanation of these strategies, see our white paper *Making Two Years Last a Lifetime*.

In Summary

Unusual times can create unusual opportunities—and make thoughtful planning more important than ever. Please don't hesitate to contact your Bernstein Advisor to discuss whether any of these strategies make sense for you. ■

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