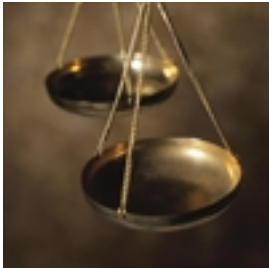


August 16, 2011

Market Volatility: Looking for Opportunity



In Chinese, the word "crisis" is composed of two parts. One symbolizes "danger"; the other represents "opportunity." If you can keep your head while all around you are losing theirs, you may be able to take advantage of remarkable opportunities. Though all investing involves risk, including the possible loss of principal, and there can be no guarantee that any strategy will be successful, we may be able to help you decide if any of the following may be appropriate for you.

Rebalancing at a discount

If you rebalance your portfolio periodically to try to maintain a certain percentage of your assets in a variety of investment types, market volatility might offer a good opportunity to consider your level of diversification. Rather than abandoning a single asset class entirely, you might look at adjusting your portfolio in a way that spreads your bets across a wider range of asset classes. Though diversification can't guarantee a profit or insure against a loss, of course, it might help better position your portfolio for the future. And the silver lining to indiscriminate broad-based market turmoil is that depending on the types of investments you want to add to your portfolio, you may be able to acquire them at a discount.

Being willing to use tough times

Anyone can look good during bull markets; being able to learn from a volatile market can better prepare you for the future. Sometimes the best strategy is to take a tax loss if that's a possibility, learn from the experience, and apply the lesson to future decisions. There are other ways to wring some benefit from a down market. If you've been considering whether to convert a tax-deferred plan whose value has dropped dramatically to a Roth IRA, a lower account balance might make a conversion more attractive. Though the conversion would trigger federal income taxes, that tax would be based on the reduced value of your account. A financial professional can suggest whether and when a conversion might be advantageous. Also, some sound research might turn up buying opportunities on investments whose prices are down for reasons that have nothing to do with the fundamentals.

Playing defense

During volatile periods in the stock market, many investors reexamine their allocation to such defensive sectors as consumer staples or utilities, which tend to experience relatively stable demand for their goods and services whether the economy is doing well or poorly (though like all stocks, those sectors involve their own risks). Businesses in defensive sectors aren't immune from economic hard times, overall market movements, or problems within individual companies. However, the ups and downs of stocks considered "defensive" have generally been a bit less dramatic than in sectors where revenues are heavily affected by the economic climate (past performance is no guarantee of future results, of course). Dividends also can help cushion the impact of price swings. Dividend income has represented roughly one-third of the average monthly total return on the Standard & Poor's 500 stocks since 1926.

Using cash to help manage your mindset

Holding cash and cash alternatives can be the financial equivalent of taking deep breaths to relax. It can enhance your ability to make thoughtful investment decisions instead of impulsive ones. A cash position coupled with a disciplined investing strategy can change your perspective on market volatility. Knowing that

you're positioned to take advantage of a downturn by picking up bargains may increase your ability to be patient.

That doesn't necessarily mean you should convert your entire portfolio into cash. A period of extreme market volatility can make it even more difficult than usual to pick the right time to make any large-scale move. Watching the market move up after you've abandoned it can be almost as painful as watching it go down. And are you sure you'll be able to pick the right time to move back into the market? Finally, an all-cash portfolio may not keep up with inflation over time; if you have long-term goals; consider the impact of a major change on your ability to achieve them. An appropriate asset allocation that takes into account your time horizon and risk tolerance should provide you with enough resources on hand to prevent having to sell stocks to meet ordinary expenses or, if you've used leverage, a margin call.

Checking your withdrawal rate

If you're retired and relying on your investments to produce an income, market volatility can be especially challenging. If your nest egg has shrunk as a result of market turmoil, you may need to rethink the rate at which money is taken out. If you currently increase the amount you withdraw from your portfolio each year by enough to account for inflation, you may be able to do away with those increases for a year or two, especially if inflation is relatively benign.

If you're withdrawing, say, 4% of your portfolio per year but you're concerned about losses, you might consider not automatically withdrawing the same dollar amount in upcoming months. Instead, you could base your 4% withdrawals on your portfolio's current value and withdraw that amount. For example, if you've been withdrawing 4% of a \$1.2 million portfolio that is now worth \$900,000, you could withdraw \$36,000 next year--4% of \$900,000--instead of the previous \$48,000. You also may want some expert help in determining whether your withdrawal rate itself--the percentage of your portfolio you withdraw each year--needs to be adjusted. Trimming your budget or finding additional income sources might help you avoid having to sell at an inopportune time.

Staying on track by continuing to save

Regularly adding to an account that's designed for a long-term goal may cushion the emotional impact of market swings. If losses are offset even in part by new savings, the bottom-line number on your statement might not be quite so discouraging. If you're using dollar-cost averaging--investing a specific amount regularly regardless of fluctuating price levels--you may be getting a bargain by continuing to buy when prices are down. However, you'll also need to consider your financial and psychological ability to continue purchases through periods of low price levels or economic distress; dollar-cost averaging loses much of its benefit if you stop just when prices are reduced. And it can't guarantee a profit or protect against a loss.

If you just can't bring yourself to invest during a period of uncertainty, you could continue to save, but direct new savings into a cash equivalent investment until your comfort level rises. Though you might not be buying at a discount, you'd at least be creating a pool of money to invest when you're ready. The key is not to let short-term anxiety make you forget your long-term plan.

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