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Setting a Steady Course in Turbulent Times

"It was the best of times, it was the worst of times." The opening line from Dickens' A Tale of Two Cities *could just as easily describe the last few years in the financial markets. Since the last bull market reached its peak in March 2000, the stock market has bounced around in response to world events, recession, Enron and other financial scandals. On the positive side, the 2001 tax law changes have made it easier for most people to save more for college and retirement and to pass along their wealth to their heirs.*

With all the ups and downs lately, many people are asking how they can safeguard their financial well-being through good times and bad. There are four basic steps you can take.

1. Plan. To secure your financial future, you have to know first where you're going. For example, if you're investing for retirement, you need to determine when you want to retire, how much you will need to live on in retirement, how much time your investments have to grow, and how much you can afford to save each year. Once you've answered these questions, you or your financial advisor can develop the investment strategy that will help take you where you want to go. For each element of your financial future, you will need to plan. Your financial plan incorporates many elements, including investments, savings, insurance and estate planning.

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2. Prepare. Make sure that all your emergency needs are covered—including insuring the security of your family's future and saving enough in a rainy day fund to tide you over during an unexpected run of bad luck. Once your emergency needs are covered, look at your investment portfolio and ask yourself, "What's the worst that can happen?" If you don't like the answer, you may want to rethink your investment strategy.

3. Diversify. When the stock market was climbing to dizzying heights, there were people who thought it could never go down. They invested only in stocks, usually the most speculative kind. Or, as some Enron shareholders discovered too late, some people were overloaded on one company's stock.

Even if you're an aggressive investor, it's never a good idea to put all your eggs in one basket. Those who most successfully weathered the high-tech bust were those who had a variety of investments—some fixed-income securities along with a diversified stock portfolio that included small- and large-cap, growth and value sectors. Asset allocation—the process of deciding which stock and bond sectors you want in your portfolio and what percentage of each—is important for two reasons. First, by spreading your bets among different types of stocks and bonds, you are more likely to protect your assets on

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the downside—that is, when the market is falling. Second, since no one can predict what next year's winners will be, having a piece of many types of securities makes it more likely that you will pick some winners. Your own asset allocation will depend on your age, your investment goals, your tolerance for risk and other variables.

4. Reevaluate. The most appropriate financial plans and asset allocations will only serve you for so long. Life circumstances change: children and grandchildren are born and grow up; your earning power increases; you get closer to retirement; you inherit money, and so forth. As your life changes, you'll need to reevaluate your financial plan to make sure it still meets your changing situation and goals.

You also need to periodically rebalance your portfolio. As the market goes up and down, your portfolio's allocation will change—a run-up in small-cap value stocks, for example, will increase the percentage you own in that sector, putting your portfolio out of balance. When you rebalance, you sell some of your winning sectors and buy more of the sectors that have not yet performed as well—thus conforming to the classic investment advice of "buy low, sell high." Rebalancing can help prevent your portfolio from taking on more risk than you had originally intended—and help you avoid possible losses when a formerly hot sector starts declining.

It may sound like a lot of work, but safeguarding your portfolio should be no different than safeguarding your car. Scheduling an annual meeting with your financial advisor should be as routine as taking in your car for an inspection. And by taking precautions beforehand, you will be in a better position to weather the good times and the bad times.

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