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Charting a New Course

By Randy Myers

For years you did everything right — funneled money into your retirement account, diversified into all the "must have" investments, paid your bills on time, even tucked away some cash for that emergency you never really thought would come. And look where it got you. The mortgage-market meltdown poked a hole in your retirement portfolio that turned into a blowout, and your cash cushion is deflating faster than a cheap birthday balloon.

Now What?

For starters, don't panic. For all that's gone wrong, the basic rules of finance still apply. Save for the short-term. Invest for the long-term. Don't put all of your eggs in one basket. "This the eleventh time we've been through this — a recession — since World War II," says certified financial planner Greg Burie of Burie, D'Augelli and Associates, a private wealth advisory branch of Ameriprise Financial in Boca Raton, Florida. "While this one is much deeper and more pervasive than most people expected, all is not lost."

That said, it makes sense at this pivotal moment to do a broad reassessment of your financial plan. Are your goals still the right goals, or even realistic? Do you need to change how much you're saving, or how you're investing? Does your estate plan still make sense? What about cash flow? If the recession has impacted your ability to earn, what can you do to bring in more money, or stop sending so much out? Finally, is there any way this story can possibly have a happy ending?

To the last question, the answer, surprisingly, is yes. If you've got a decade or more till you retire, you've got a fair amount of time to make up lost ground. Even if you've got a shorter time frame, you can take steps to regain your financial footing provided you're willing to rethink the way you define retirement. "If you are willing to let go of what's been lost and look forward, you might be surprised at your own creativity and your ability, still, to construct a good life," says Bonnie Hughes, a certified financial planner with The Enrichment Group in Miami, Florida. "But first, you need to come to grips with what has happened and focus on the things you can control."

Take the Blinders Off

Start by figuring out exactly where you stand. Haul out your 401(k), bank and brokerage statements and take a hard look at what you've got. Then, in concert with your financial planner, recalculate the odds of meeting your retirement goals based on how much you're putting away each year and what you expect to earn on your investments. This is no time for rose-colored glasses. While the financial markets typically rebound nicely after a sustained sell-off, don't count on the double-digit returns stocks have generated in prior boom years. Planning on average annual returns of 7 percent for a diversified stock-and-bond portfolio over the next 10 years would be reasonable, says certified financial planner Mike Busch, president of Vogel

Financial Advisors in Dallas, Texas. Plug in your numbers, and if they don't add up, accept that you'll need to recast your plan using one, or both, of the two major levers at your disposal: spending less now so that you can save more, or working longer than you planned. Neither has to be as painful as it might sound.

"Scaling back can be extremely difficult, but with the right mindset it doesn't have to be devastating," says UCLA psychiatrist Judith Orloff, author of "Emotional Freedom: Liberate Yourself from Negative Emotions and Transform Your Life." "Once you stop defining yourself by the type of car you drive or the size of your house, you open yourself up to being grateful for what you do have in your life, especially friends and family. If you do have to move to a smaller house, make it a beautiful and wonderful haven for yourself."

Even the prospect of working a few more years can have its pluses. "Many of the retirees I counsel aren't happy with their situation; they're bored, they don't have enough money, they have no friends to play with," says Hughes. "I think people should find a job or career they enjoy and then plan to work at least through their 60s and hopefully into their 70s. Maybe not full-time, but at least doing something."

By spending less today and working longer tomorrow, you can save more and dramatically increase your monthly income once you do retire. While your financial planner can help you determine exactly how to save, get ready for a big number. "We tell young people they need to save a minimum 15 percent of their gross income for retirement and another 2 percent for future healthcare costs," notes Hughes.

That's a lot of money, and it doesn't even take into account what you should put aside to tide you through the next economic downturn. While you may need to focus all of your attention today on simply getting through this one, you'll want to begin rebuilding your cash cushion once you get back on your feet financially. How much you'll need depends on your circumstances. "If I had to pick an average number, I'd probably say six months living expenses," says Busch, who, like Hughes, is a member of the board of directors of the Financial Planning Association, an industry trade group. "If you're the sole breadwinner or in an industry where layoffs are not uncommon, I'd beef that up a little more."

Revisit Your Portfolio

Once you've figured out how much you need to save and invest for retirement, revisit your investment portfolio to make sure it continues to reflect sound investment principles. Given the big hit it has likely taken since the stock market's peak, your gut may be telling you to stay out of stocks completely. At the same time, your head may be telling you to go all-in to make up lost ground. Neither extreme makes sense. Stay diversified. Even in the terrible markets we've endured over the past 16 months, investors who owned diversified stock funds lost less money than those who invested only in, say, bank stocks or automakers, and those who owned stocks and bonds lost less than those invested only in stocks.

If the idea of holding stocks simply won't let you sleep at night, you could consider investing in a variable annuity with a living benefit, though you'll have to reconcile yourself to paying higher fees than those charged by garden-variety mutual funds or ETFs. These tax-deferred investment vehicles are wrapped by an insurance contract that protects against market losses, while their living-benefit feature guarantees a minimum payout. "No one knows if we're at a market bottom yet, so these products can allow you to participate in the upside, for a fee, and put a floor on the downside," notes Eric Henderson, senior vice president of individual investments at financial services firm Nationwide Financial.

If you are invested only in stocks, start adding a bond component to your portfolio now. Certified financial planner Cathy Pareto, president and founder of Cathy Pareto and Associates in Coral Gables, Florida, confesses that prior to the market's meltdown, she wouldn't have thought twice about having a 35-year-old professional invested exclusively in equities. "Now," she says, "my base minimum bond exposure for any client, even a young client, is 20 percent."

Investors at or near retirement have greater liquidity needs than younger investors, and more to fear if the stock and bond markets don't bounce back soon. If you fit that profile, certified financial planner Ian

Weinberg, CEO of Family Wealth & Pension Management LLC in Woodbury, New York, suggests replacing a portion of your stock and bond portfolio with an immediate annuity — an insurance contract that guarantees a fixed payout for life or a specified period of time. Right now, he says, a 72-year-old investor can purchase an immediate annuity earning in the neighborhood of 8 percent a year for life, with a guaranteed payout to beneficiaries during the first 20 years of the contract. Tax-free municipal bonds are another good source of immediate income right now, he says, with high-grade, long-term issues recently yielding nearly 5 percent.

Estate and Tax Planning

Once you've got your investment portfolio in order, spend a little time on tax and estate planning, too. If you've been looking for a chance to convert a regular IRA to a Roth IRA for tax-diversification purposes, for example, this could be the time to act. Any time you make such a conversion, you owe income taxes immediately on the entire amount you convert, excluding any nondeductible contributions you may have made to the traditional IRA. At current depressed levels, your tax hit will be far smaller than it would have been a couple of years ago, and probably smaller than it would be a few years from now, too, especially if, as widely expected, income tax rates for higher earners go up.

By the same logic, let's suppose that despite the economic meltdown you still have substantial assets you were planning to pass on to your heirs beginning in a few years. With asset values depressed right now, you can give a bigger percentage of your estate to your children and grandchildren today, without triggering gift taxes, than you could when markets were stronger.

Righting your financial plan in the wake of an economic tsunami can be a big job, and figuring out all the right moves can be even more challenging when the economy and financial markets alike appear to be in a freefall. Don't be embarrassed to ask for help. "Having an advisor today is even more valuable than when times are good," Burie notes, "because the advisor can take an impartial look at your situation and help you make decisions that are not driven by emotion." By taking charge of your financial plan today, you may yet achieve much of what you once dreamed possible for tomorrow.

Randy Myers is a freelance writer in Dover, Pennsylvania, whose work has appeared in Barron's, CFO, Corporate Board Member, and other prominent business publications.