6 Actions to Take When You Think a Bull Market Is Ending

By Tim Clift, Chief Investment Strategist, Envestnet | PMC

We are in the ninth year of an aging equity bull market. Since the start of this bull market in March 2009, the S&P 500 Index has gained 426% through September 30, 2018—an annualized return of 19%. Meanwhile, the US economy is firing on all cylinders, with the unemployment rate falling to a multi-decade low and domestic growth at multi-year highs. However, recent market volatility is showing signs that we may be in the late stages of the current bull market and economic expansion.

Advisors are rushing to foretell the next downturn, and no matter when it occurs, the natural laws of our capital markets mean that at some point, you will be forced to endure it. The easy money has been made, so finding returns gets harder from here, and protecting gains becomes important. Below are a few ways to work with your financial advisors and prepare for tougher market conditions ahead.

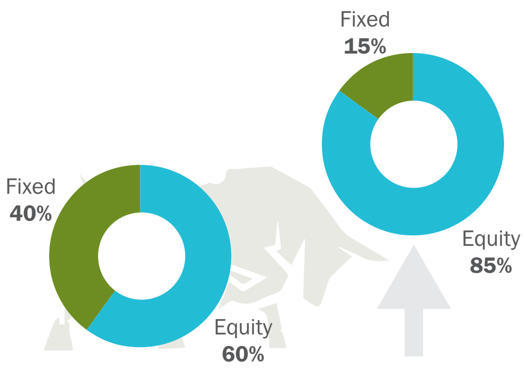
1 Diversify, Diversify, Diversify

After nine years of substantial equity market appreciation, you should revisit your portfolio allocations carefully with your advisor, as your original allocation may have deviated significantly from target, and your portfolio may no longer be as diversified as intended.

For example, a buy-and-hold 60/40 equity/fixed income portfolio at the start of the bull market would have become an 85/15 equity/fixed income portfolio*, as equity market gains have far exceeded fixed income market gains.

Moreover, the distribution of gains within the equity market has been very unbalanced, with certain pockets of the equity market doing exceptionally well at the expense of others.

60/40 Allocation at the Start of the Bull Market Becomes an **85/15 Allocation** With a Buy-and-Hold Strategy



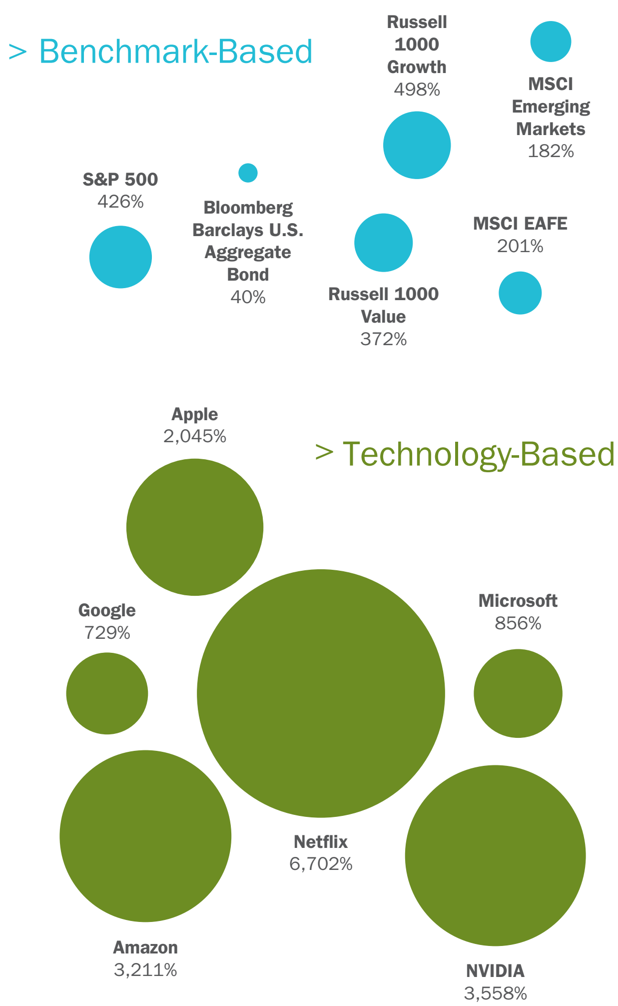
* Using the S&P 500 Index as proxy for equity allocation and the Barclays U.S. Aggregate Bond Index as proxy for fixed income allocation.

As an example, US equity markets have far outpaced other countries; growth stocks have significantly outperformed value stocks; and technology stocks have simply become a league of their own. Thus, even though your portfolio seemingly may be diversified, under the hood, it can be quite concentrated and exposed to certain pockets of the market.

It may surprise you to see the concentration of returns during this bull market run:

Concentration of Returns During the Bull Market Run

from 3/9/2009 to 9/30/2018



2 Make Rational Decisions Based On Your Circumstances

Rebalancing is vital to ensure you are comfortable with the level of risk your portfolio now reflects—in essence, you must be able to sleep at night. For example, bond yields may appear scant when compared with more robust equity returns, but when the market enters correction territory (as it inevitably does), bonds, depending on their investment grade, can provide a source of stability. When reallocating your assets, keep in mind the following:

- Trim your equity allocation if you have been intentionally overweight in equities or are above your target allocation, especially if you are currently distributing from your portfolio (or will be within a few years), and even more so if you are distributing at a rate of 4% or higher. Four percent is generally viewed as the maximum annual withdrawal rate that can be taken without impacting your principal.
- Dollar-cost-average over a period of time into the scenario you and your advisor agree on.
- Once you have a plan, stick with it. Resist the urge to overreact when volatility rears its head.

If you decide to trim your equity allocation, remember, no one can time it just right, and you may miss out on some of the remaining bull market returns. Be both realistic and willing to adhere to a “winning-by-not-losing” philosophy.

3 Think Alternatives—Literally

Most alternative investments, especially liquid alternatives that are available to most investors, have lower risk-and-return profiles than equity investments, and their major attraction is their low correlation to traditional investments, making them great portfolio diversifiers. The current market environment, in the late innings of the equity bull market and late-cycle phase of the economic expansion, is the ideal environment for alternative investments. In addition to providing portfolio diversification benefits, alternative investments can help protect—or even thrive—in volatile or down markets. Work with your financial advisor to determine what types of alternative investments are right for your portfolio.

4 Be Mindful Of Taxes

When the market drops, losing investments can have a silver lining: you may be able to use them to lower your tax liability and better position your portfolio going forward. This strategy is called tax-loss harvesting, and it’s one of the many tax-smart strategies you should consider.

Tax-loss harvesting generally works like this:

- You sell an investment that’s underperforming and losing money.
- Then, you use that loss to reduce your taxable capital gains and potentially offset up to $3,000 of your ordinary income.

- Finally, you reinvest that money into a different security that meets your investment needs and asset allocation strategy.

The general principle behind tax-loss harvesting is fairly straightforward, but it's best to do some planning with your financial advisor before implementing the strategy to make sure you avoid some common pitfalls.

5 Evaluate Your Family Spending Policy

Your budget is another area over which you have some control. If you are nearing retirement or simply drawing from your portfolio, it may be time for a granular look into your spending habits.

If you are distributing from your portfolio, think in advance about the expense areas you could trim if you need to reduce your distributions during a recession. If your budget is tight and does not allow you to trim, think about other potential sources of income during this time period. Can you defer retirement or work part time for extra income? Do you have a line of credit available on your home that could provide some relief from your portfolio distributions and allow you to reduce your distribution rate? Do you have outstanding debt on your line of credit now? If so, consider increasing your monthly payments now to reduce your outstanding balance so that you have borrowing capacity if necessary. (Note this should be a last resort, as a rising-rate environment means higher adjustable rates, which can put additional pressure on cash flow.)

6 Keep Your Emotions In Check

Keep in mind recessions are typically much shorter than expansion periods. If you are still working and have several years until retirement, history has shown you can ride out a bear market and return to prior levels during the next expansion cycle IF you remain invested.

Assess your own risk tolerance BEFORE the end of the expansion period. We have had very little volatility in the last few years, but 5–10% corrections are normal one to three times a year. How have you reacted during such corrections? Were you invested during 2008–2009? If so, did you overreact and make any changes? Understanding your risk tolerance is critical. If you do not think you can stay put in your current equity allocation, consider trimming your equity exposure to something you can stick with through all market conditions.

Do not let the media dictate emotions; base your analysis on hard data and objective criteria. This may be your first bear market, or you may have lived through the painful meltdown of 2008. Either way, seeking the advice of a professional who can help you implement some of these strategies can make you better prepared for inevitable market disruptions.

Tim Clift
Chief Investment Strategist

Mr. Clift serves as Chief Investment Strategist at Envestnet | PMC and is responsible for research, portfolio management and consulting services for the organization. He leads a team of analysts who are responsible for the selection and monitoring of investment managers and a team of portfolio managers who manage a suite of investment products for the Firm. He also manages a team of consultants who support institutional and advisory clients. Clift co-chairs PMC's Investment Committee and is instrumental in setting investment policy for the Company.

Prior to joining Envestnet | PMC, Clift was the Chief Investment Officer and Chairman of the Investment Committee at FundQuest. He joined FundQuest in 1994 and maintained overall responsibility for the firm's investment management programs for separately managed accounts, mutual funds, alternative investments, exchange traded funds and annuities.

Mr. Clift is a frequent speaker at industry conferences and is a regular contributor to such publications as The Wall Street Journal, Financial Advisor, Investment News, Citywire and FundFire. He was named one of the 10 most important people in ETFs in 2015.

Clift possesses over 28 years of industry and investment management experience. He received a Master's in Business Administration in Finance from Boston University and a Bachelor of Arts in Economics from Allegheny College.