

MANAGING YOUR FINANCES

Trim With Care When Selling Stocks

STOCK MARKET giving you cold sweats? We would never advise you to bail out of stocks completely. And selling when stocks are down is generally not a good strategy. But if trimming your holdings a bit will help you sleep better, you need to be smart about how you go about it.

Before you start selling, devise a long-term financial plan. Look at your noninvestment income, such as a pension, Social Security, an annuity or rental income. See how far this income goes to cover your basic expenses, including food, housing and health care. "Make sure you can take care of those nonnegotiable needs," says Dean Catino, managing director at Monument Wealth Management, in Alexandria, Va.

Then consider your desired lifestyle, says Catino. If you want to travel extensively, for example, you may need an aggressive allocation with more stocks to potentially provide a higher return. You may be able to take less risk if you have other income and your goals are somewhat modest.

Keep your emotions in check. Your plummeting portfolio may tempt you to chuck your equities, but keep an eye on the future. Most experts say retirees need some stock exposure for growth in the long term—20 years or more if you're 70, for example.

Lisa Kirchenbauer, president of Omega Wealth Management, in Arlington, Va., says that if you reduce your stock risk too much, you could create a different kind of risk. Your portfolio might not keep up with inflation, or it might run out of money.

Figure out what kind of target allocation will generate the money you need. Say your target has been 65% in stocks and 35% in bonds, and perhaps you want to change to 50% stocks and 50% bonds. If the analysis of your lifestyle, expenses and risk tolerance allows, you can start reallocating.

■ **Decide which stocks to sell.** Next, evaluate the stocks you hold. You want to be well diversified across asset classes and market sectors—large and small companies, U.S. firms and international com-

panies. If you're overly weighted in, say, energy stocks, that's a place to trim. "Start with the end in mind," says Susan Brown, a wealth manager at Back Bay Financial Group, in Boston.

Evaluate the fundamentals of the company. Compare a company to its peers in the same sector. One factor is the price/earnings ratio; a high ratio

means investors expect more earnings growth than companies with a low ratio. Look up information at www.morningstar.com or www.finance.yahoo.com.

Doug De Groote, managing director of United Wealth Management, in Westlake Village, Cal., says he's looking for companies with little or no debt that also have great cash flow. Some signs of trouble include falling profits, reduced profit margins, big changes in inventories and new competitors in the market.

If you own mutual funds, see if their holdings overlap by industry and by company. If you're invested

in three large-company stock mutual funds, you could drop one if your portfolio is not diversified.

■ **Strategies for selling.** The markets may have done much of the reallocation work for you. But if you want to reduce your stocks further, it's best to trim gradually, says Nicholas Yrizarry, chief executive officer of Nicholas Yrizarry & Associates, in Reston, Va.

An incremental reduction is essentially dollar-cost averaging in reverse. If you slash your stock allocation from 50% to 20% in one day, and the next day the market goes up 500 points, you've missed out on some gains. If instead you prune your allocation 5% a month for the next six months, you can smooth out the gains and losses.

If you're still working, you could reduce your stock allocation by adding new money to the non-stock portions of your portfolio, such as a cash reserve. Stocks will make up less of your total portfolio, and you won't lock in losses.

If your stocks already are well diversified, then trim across the board. If the categories are off kilter,



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then sell in the overweighted categories. If you're holding too much of one stock, sell some shares. A portfolio should hold no more than 5% in an individual company. If a stock has done well over time, take some profits and invest elsewhere.

Also weed out the big losers. The number of obituaries of once-great companies has been growing. If a stock is getting pummeled and the future of the company is bleak, get out while you still can. "You shouldn't just buy and hold until the stock goes into a death roll," says De Groote.

Corporations won't announce their imminent demise. Look at the trend of the stock's price. Listen to investor conference calls, and read quarterly reports. You can set a target price for selling, such as a 20% loss from the time you bought the stock or a 20% loss during the past year.

Prepare your remaining stock allocation for a future recovery. Because stocks are cheap, take the cash from the stock sale and snap up a bargain-priced stock that's better poised for a comeback.

■ **Remember Uncle Sam.** The tax tail should never wag the investment dog. But when you sell, try to reduce your tax hit. If you're going to reinvest, you're best off selling shares in a tax-advantaged retirement account, such as a 401(k) or IRA. You can sell stocks, and then perhaps shift to bonds or cash, within these accounts without causing an immediate taxable event. But if you sell and take a distribution, you'll get hit with a bill for ordinary-income taxes.

If you need to sell shares in a taxable account, be as tax-efficient as you can. Selling at a loss from a taxable account can be smart, because there is a tax benefit. You can use losses to offset any capital gains as well as up to \$3,000 of ordinary-income tax. Plus, you can carry forward the losses to future years.

As for stock that's gone up in value since you bought it, sell shares that you've held for more than a year so your tax bite will be smaller—you'll owe long-term capital-gains taxes of up to 15%. For stock held less than a year, you'd have to pay ordinary-income taxes of up to 35%. Taxpayers in the 10% and 15% brackets, though, get a break: a 0% tax rate on long-term capital gains for 2008, 2009 and 2010.

The capital-gains tax rate may rise in the future. President-elect Barack Obama said he would raise the rate to 20% for families making more than \$250,000 a year and \$200,000 for individuals. Says Yrizarry: "If there was ever a time to sell off highly appreciated stocks, it's now." ■ —RACHEL L. SHEEDY