

# Timely Tips and Sturdy Strategies

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Seems like the only good news these days is when the bad news is slightly less bad. House prices still plummeting—but not quite as fast. A global slowdown—making the stagnant U.S. economy look a touch better by comparison. It's no wonder investors may feel like they've been through the wringer.

But it's no time to throw in the towel—this is when successful investors stick with their plans. (Don't have an investment plan? [Create one.](#)) Remember, some of the best bull markets in recent history have started when things looked gloomiest.

To help you stay disciplined and on track to achieve your long-term goals, we've gathered timely ideas from Schwab experts and put them together with smart strategies based on [Schwab's investing principles](#).

Whether you're new to investing, a seasoned veteran or somewhere in between, you'll find ideas below to help you take advantage of market conditions, strengthen your investment plan and boost your financial fitness.

## How to use this article

- **Click an idea below to go directly to that section.**
- **Click the links in each section to learn more about Schwab's tools and resources.**
- **Check back for the latest tips and strategies.** We update this article on a regular basis.
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## Timely Tips to Consider Now

## Beware the hidden costs of cash

The way the market's been going, you may be tempted to sell your investments, put the cash in a savings account or CD, and wait on the sidelines for better days. Perhaps you already have. Below we give one big reason why this is likely a mistake.

But consider also that cash is no panacea. Given the present combination of low interest rates and high inflation, staying in cash comes with hidden costs. For a simplified example (using all-too-common numbers for interest rates and inflation), assume you sold stocks in your taxable account and put the money in a CD instead:

- Your CD earns a 2% return.
- If you're in the 25% tax bracket, allocate one-quarter of that return to the tax man, and you're down to 1.5%.
- With inflation running at roughly 5% per year, the actual return on your CD drops to **negative 3.5%**.

So in real terms, your cash investment is losing money.

If the market has you leaning toward the exits, or you already cashed out, now is a perfect time to reevaluate your tolerance for risk and choose an asset allocation (mix of stocks, bonds and cash) that you can live with in all kinds of markets.

## What you can do now

- Read When to Go Against Your Gut.
- Learn how a Complimentary Consultation from Schwab can help you find the investment mix and level of risk that's right for you.
- Call a Schwab investment professional at **800-435-4000**.

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## Rethink your approach to dividend-paying stocks

Recently, big-name companies from Citigroup to Sprint have cut their dividends. It's a clear reminder for investors seeking income and potential capital gains: When you buy a dividend-paying stock, there's no guarantee the dividends will continue. So what should dividend investors look for? We suggest the following approach:

- **Consider dividend-yielding stocks as a bear market cushion.** Schwab research finds that, although dividend-paying stocks as a whole have underperformed the market in recent years, they tend to be less volatile—and stronger in down markets—than non-dividend-payers.
- **A dividend-focused portfolio isn't necessarily "safe."** Most dividend-paying stocks are in the financials sector, with health care and information technology underrepresented. If you're primarily a dividend investor, you could end up with an improperly diversified portfolio if you're not mindful. Make sure your dividend-focused portfolio reflects the market's overall sector weighting—failing to diversify across sectors can potentially offset the lower risk you're hoping for with dividend-paying stocks.
- **Consider growth stocks as well.** Companies with stronger growth prospects tend to reinvest earnings rather than pay dividends. If you invest only in dividend-yielding stocks, your portfolio may take on an anti-growth bias. Investing a portion of your portfolio in high-quality growth stocks may help reduce that bias.
- **Beware of stocks that are raising their dividends.** Remarkably, Schwab research has found that stocks that have raised their dividends in each of the past five years have *underperformed*

all other dividend-paying stocks by almost 3% annually since 1990! What's more, stocks that cut dividends in the prior year have outperformed all other dividend-yielding stocks by about 2.5% per year over the same time—possibly because investors view dividend cuts as a signal that management is serious about addressing financial difficulties facing the firm.

- **Focus on high-quality dividend-yielders.** Whether you plan to build an entire dividend-focused portfolio, or simply buy a few dividend-payers to supplement your existing holdings, quality is key. Consider using Schwab Equity Ratings to look for A- and B-rated dividend-paying stocks from each of the market's 10 sectors, following the guidance in our article series [How to Use Schwab Equity Ratings](#).

## What you can do now

- Read [Dividends: Myths and Realities](#).
- Learn more about [Schwab Equity Ratings](#).

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## Don't get overexposed to international stocks

Schwab clients often ask us whether they should allocate, say, 50% of their stock portfolio to foreign equities. The case for a big allocation is simple:

1. These are big markets. Non-U.S. countries make up 58% of the world equity market and 78% of global GDP.
2. The dollar is weak.
3. Foreign economies are growing faster.

We suggest holding your international allocation to 25% of your equity portfolio. Many developed and emerging stock markets have outperformed U.S. markets in recent years, and U.S. investors have voted with their wallets. Successful investing, though, is about the future, not the past. We believe global inflation—led by still-high oil and food prices—could potentially lift U.S. markets (on a relative basis) back to the top spot in the standings, and boost industries closely tied to the U.S. economy over those with a global tilt.

Commodities and the dollar are the key factors. We believe commodity-based inflation will likely unleash wage inflation around the globe (it already has in some emerging markets) resulting in slower growth worldwide. However, we think the United States is better equipped to keep wage inflation contained. That could help the dollar, as investors' previously optimistic outlook for global growth withers and converges with the dour U.S. outlook.

So what to do? Make sure you're not overexposed to international equities.

In addition, if you agree that U.S. stocks are poised to outperform international stocks and the dollar might stabilize—and you're willing and able to tweak your equity portfolio—consider this tactical suggestion.

- **Consumer discretionary:** Consumer discretionary stocks have suffered lately, and are among the most domestically focused, with only about 18% of revenue derived from foreign sources. Stocks in the consumer discretionary sector tend to underperform when the dollar weakens, so it would be no surprise if the sector starts to recover should the dollar stabilize. We don't recommend overweighting the sector, but if you've avoided it, consider adding to your positions to get back to a market weight.

## What you can do now

- Read [Global Inflection Point?](#)
- Read [Too Much of a Good Thing](#).
- Learn more about Schwab's [Portfolio Checkup Tool](#).
- Explore [Schwab Equity Ratings](#).
- Learn how Schwab's [Complimentary Consultation](#) can help you see if your portfolio is on track to weather market volatility.
- Call a Schwab investment professional at **800-435-4000**.

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### Waiting for the economic clouds to clear? You may miss a market rally

With the economy down, you may be tempted to stay out of the stock market until the economic clouds clear. We think that's most likely a mistake. History shows that the market typically bounces back months before the economy does—and if you're not in the market, you may miss out on some potential gains.

The picture below highlights the market's tendency to anticipate when recessions begin and end. We looked at the 10 recessions since World War II and found that the market, on average, starts falling roughly seven months before a recession begins and starts rising around six months into the recession. Seen another way, the market has typically rallied a good four months before the average recession ends.

### The market's anticipatory behavior



Indexed price-only data from 1947 through March 31, 2002. Source: Ned Davis Research, Inc.

Looking closer, the market has fallen 25% on average from its peak prior to recessions (point 1 in the chart above) to its trough during recessions (point 2). However, the subsequent rally from the trough (2) to the recession's end (3) has been an average gain of 24%! In fact, some of the best rallies and new bull markets in history have begun during economic recessions.

Yes, it's tempting to believe a profitable investment strategy would be to move to the sidelines once you know a recession's begun and get back in when it's officially over. But here's the rub: The average lag between when recessions have begun and when the National Bureau of Economic Research—the official arbiter of recessions—has declared their start date is seven months. So typically, by the time the NBER says a recession has begun, the market has already started recovering.

But that's not all. The average lag between when recessions have ended and when

the NBER has declared their end date is a whopping 15 months! Given that the stock market has historically bottomed during recessions (not after them; and certainly not 15 months after), trying to time the market using "official" economic declarations is a late and most likely losing strategy.

Although this is not an exact science (and past performance is no guarantee of future results), we recommend having—and sticking with—a long-term, strategic asset allocation plan that you can live with in all types of markets.

### What you can do now

- Read [What's the \*Right Time\* to Invest?](#)
- Read [Panic Is Not a Strategy—Nor Is Greed.](#)
- Learn more about [automatic investing](#) at Schwab.
- Get details on how our [Complimentary Consultation](#) can help you make necessary adjustments to your portfolio.
- Call a Schwab investment professional at **800-435-4000**.

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## Sturdy Strategies for the Long Term

### Take some risk out of your portfolio by rebalancing

Picture your portfolio as a mix of asset classes—large-cap stocks, small-cap stocks, international stocks, bonds and cash. When a certain asset class outperforms the others, it will naturally make up a higher percentage of your portfolio's overall value than it did before. Likewise, when an asset class performs poorly, its percentage will shrink. Over time, as the various asset classes rise and fall, your portfolio can stray ever further from your [target asset allocation](#)—and get a lot [riskier](#) to boot.

**Rebalancing your portfolio** means getting back to your target asset allocation. And at times it can seem downright counterintuitive. After all, it requires you to sell investments that have done well and buy those that haven't. But rebalancing is key to managing risk. And it's especially important after major market swings have dramatically shifted your asset allocation.

Today, many investors' portfolios are top-heavy with commodities and international stocks. They may be repeating the mistakes of the late '90s, when a booming market inflated the percentage of stocks in the portfolios of tech investors. When the market free fall began in 2000, these investors were hit much harder than if they'd rebalanced.

Let's back this up with some numbers:

- Rebalancing a moderately conservative portfolio each year from 1993 to 2002 would have earned you a bit more than doing nothing—7.8% versus 7.4% per year. But with the unbalanced portfolio, you would have taken on 26% more risk (as measured by standard deviation, a common measure of volatility).
- What's more, from August 2000 to September 2002, your portfolio would have dropped 17%, compared to just 8% if you'd rebalanced annually.

How often should you rebalance? We suggest comparing your current asset

allocation to your target asset allocation at least once a year—Schwab's [Portfolio Checkup Tool](#) makes it easy. Then, consider pruning any asset class that's overgrown its target by more than 5% and adding to those in which you're underweight.

## What you can do now

- Read [When to Go Against Your Gut](#).
- Read [Why You Should Rebalance Your Portfolio](#).
- Learn more about Schwab's [Portfolio Checkup Tool](#).
- Explore Schwab's [Mutual Fund Select List](#).

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## 3 steps for smart stock picks

Picking winning stocks and avoiding losers calls for a proven, consistent investment process—especially in choppy markets. That's where [Schwab Equity Ratings](#) can help, and we believe pairing it with our newly upgraded Schwab Industry Ratings can be even more effective.

Our research has shown that A-rated stocks in A-rated industries have outperformed all other Schwab Equity Ratings/Schwab Industry Ratings combinations, and soundly [beat the average 52-week return of the average stock covered by Schwab Equity Ratings](#). The performance of F-rated stocks in F-rated industries was just the opposite. Of course, it's possible that these results could vary going forward.

This doesn't mean you should simply be loading up on double-A stocks. You'd almost certainly end up with portfolio that's undiversified across sectors. Instead, we suggest you consider these three steps:

**Step 1: Build your portfolio.** [Create](#) and stick to a long-term asset allocation plan that meets your goals and [tolerance for risk](#). Keep your portfolio [well diversified](#), particularly across sectors.

**Step 2: Select your stocks.** Use Schwab Equity Ratings as your primary tool, supplemented by Schwab Industry Ratings. Buy A- or B-rated stocks in industries rated A or B. If there are no A- or B-rated industries in a given sector—say, financials and telecom currently—find the best-rated stocks in the best-rated industries in that sector. Remember, the key point is diversification.

**Step 3: Maintain your portfolio.** Sell any D- or F-rated stocks, regardless of their industry rating. Consider selling C-rated stocks in F-rated industries. And finally, replace stocks you sell with double-A-rated stocks whenever possible, staying diversified across sectors.

## What you can do now

- Read [Updated Schwab Industry Ratings](#).
- Learn more about [Schwab Equity Ratings](#).

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## Don't raid your IRA or 401(k)

When times are tough and money is tight, you may be tempted to dip into your retirement savings to help make ends meet. It is possible to withdraw from your IRA or qualify for a loan or "hardship withdrawal" from your 401(k)—or simply take it in cash if you leave a job. However, we believe this is a big mistake in nearly every circumstance.

- You give up the power of tax-deferred compounding—a huge factor in the overall return on your retirement savings—on any amount you withdraw.
- If you're younger than 59½, you'll pay the feds a 10% early withdrawal penalty, and possibly get hit with a state penalty as well (2.5% in California, for instance).
- Withdrawals count as income, so you'll owe federal and state income tax on the money. No low capital gains tax here, you'll pay according to your tax bracket—which could be higher than usual counting the withdrawal, potentially shrinking certain tax credits and deductions.
- If you take your 401(k) in cash when you change jobs, the government will help itself to a 20% withholding up front as an advance on the taxes and penalties mentioned above.
- If you take a 401(k) loan, you have to use after-tax dollars to pay back the money, which defeats the original benefit of making pre-tax contributions.
- Failure to repay a 401(k) loan on time will net you further taxes and penalties.
- It could take you years to catch up on your retirement savings, given the annual contribution limits on IRAs and 401(k)s—if you can catch up at all.

Let's look at an example: If you leave your job and cash out of a 401(k) worth \$56,000, you could end up paying a federal penalty of \$5,600 plus, say, 28% in federal income tax (20% of which is withheld from the distribution). Your \$56,000 has shrunk to \$34,720. And that doesn't even include any state taxes and penalties you may owe.

Only consider tapping your tax-advantaged retirement savings plans if you're facing a worst-case scenario—such as eviction or foreclosure due to **temporary** financial circumstances, or you can't put enough food on the table—and you've exhausted all other possibilities, including getting a second job, borrowing money, and asking your family or church for help.

Roth IRAs are a bit of a special case, but the same principles apply—only tap your Roth IRA as a last resort.

## What you can do now

- Read [What to Do With Your 401\(k\) When You Change Jobs](#).
- Learn how Schwab's [Complimentary Consultation](#) can provide an objective analysis of your overall financial situation.

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## Understand how FDIC insurance works and optimize your coverage

Although bank failures are relatively rare events, prudence suggests evaluating the steps you can take in order to protect the assets you have in the banking system.

Steering depositors away from panic and instilling public confidence in the

banking system were reasons why Congress created the Federal Deposit Insurance Corporation (FDIC) in 1933 as an independent agency of the United States. The FDIC insures deposits at 8,494 banks and savings associations and is backed by the full faith and credit of the U.S. government. When a bank fails (which has happened 127 times in the past 15 years), depositors can take some comfort in knowing federal law requires the FDIC to make payments as soon as possible.

Finding out your bank has failed is nerve-racking, and there's not much you can do after the fact. However, with a little bit of planning beforehand, depositors can greatly increase their insured amounts and significantly reduce their exposure to loss should their banks fail.

- Make deposits at FDIC-insured banks.
- Make sure you understand the rules of insurance coverage. The FDIC aggregates each customer's deposits, such as checking accounts, savings accounts and CDs, into several "ownership categories" that each receive separate FDIC insurance coverage. Understanding and taking advantage of these ownership categories is the primary way for depositors to maximize their FDIC-insured balances.
- When purchasing CDs through a brokerage account, make sure to stay under the \$100,000 insurable limit with any single issuing bank, and don't forget to consider any other deposits you may have with an issuing bank.
- Be aware of the implications of bank mergers and acquisitions. If you have deposits at both banks, you may inadvertently end up with uninsured balances.
- If, after exhausting all of your options, you still have uninsured balances remaining, then your final option is to open another account at a different bank.

## What you can do now

- Read [Protecting Your Banking Assets](#).
- Learn more about Schwab's [CD OneSource® marketplace](#).

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## Important Disclosures

**Investors should consider carefully information contained in the prospectus, including investment objectives, risks, charges and expenses. You can request a prospectus by calling 800-435-4000. Please read the prospectus carefully before investing.**

**Past performance is not guarantee of future results. Investment value will fluctuate, and shares, when redeemed, may be worth more or less than original cost.**

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Schwab Equity Ratings are assigned to approximately 3,000 of the largest (by market capitalization) U.S.-headquartered stocks using a scale of A, B, C, D and F. Schwab's outlook is that A-rated stocks, on average, will strongly outperform, and F-rated stocks, on average, will strongly underperform the equities market over the next 12 months. Schwab Equity Ratings are not personal recommendations for any particular investor. Before buying, investors should consider whether the investment is suitable for themselves and their portfolio.

Schwab Industry Ratings provide Schwab's outlook for industries based on Global Industry

Classification Standard (GICS) groupings, such as Beverages, Pharmaceuticals and Software. Ratings are assigned using an A, B, C, D and F rating scale and can be helpful in evaluating which industries investors may want to emphasize within a specific sector.

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Diversification strategies do not assure a profit and do not protect against losses in declining markets.

Investing in specific sectors may involve a greater degree of risk than an investment with greater diversification.

International investments are subject to additional risks such as currency fluctuation, political instability and the potential for illiquid markets. Investing in emerging markets may accentuate these risks.

Periodic and automatic investment plans do not assure a profit and do not protect against loss in declining markets.

Schwab does not provide tax advice. Clients should consult a professional tax advisor for their tax advice needs.

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