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Are You Ready for a Rally?

A market rally can begin quickly, often before many investors even recognize it's under way. That's why it's critical for you to be ready when it happens. For example, in each of the past 10 recessions, the S&P 500 index had a total return of 32%, on average, within a year of the market's low point. That's quite a gain, and one you could easily miss if you've been skittishly stashing cash in the bank—or even less secure places—during the turmoil.

It's impossible to pinpoint the timing of a market turnaround, notes Jack Hough, author of *Your Next Great Stock*, but it is possible to get your finances in order to be prepared when the recovery eventually comes. "The stock market is forward-looking," he says. "By the time you see improvement in your own day-to-day living situation, stocks will have already responded."

In other words, you probably won't recognize the beginning of the turnaround till it's already well under way. Better, then, to be in the market than out of it. Here are some tips for preparing for the rebound while still keeping the economy's volatility in perspective.

KEEP A COOL HEAD AND CONSIDER DOLLAR-COST AVERAGING

Many investors tend to rush to sell during downturns, when prices are lower, and to buy into market rallies. This is driven largely by speculation, panic and euphoria—none of which should dictate your moves in the stock market. Rather, work with a financial advisor to gauge your underlying portfolio's fundamentals, regardless of the market's daily action.

Related to trading out of fear and euphoria is trying to time the market bottom by making a large lump sum investment right after a big dip in prices. That's been particularly dangerous in this bear market, which has featured a succession of new lows over the course of a few weeks.

A good way around this, while still participating in the market, is through dollar-cost averaging. Here, you invest equal portions of your investable money at regular intervals, regardless of how the market is doing. That can reduce risks and smooth volatility by taking the guesswork and emotion out of the equation. When prices dip, you are, in essence, buying more of the assets at a cheaper price. When prices get ahead of themselves and rise ahead of another fall, you are buying fewer of them.

ADD TO YOUR RESERVE

But regardless of the temptation to "get in before the rally begins," you need to ensure that you aren't tapping into your emergency cash to cover your living expenses for several months, should you lose a job or the market's slump is deeper and longer than you anticipate.

Likewise, try not to tap into your investments to fund an emergency reserve, if possible. Selling now simply locks in prices at the bottom, and would leave less room to participate in an ongoing rally.

For your cash reserves, you can still look to eke out a mild yield in savings accounts, money mar-

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ket funds or a certificate of deposit. But remember: Liquidity is key. If you're investing cash in CDs, a five-year certificate of deposit may not make sense—but laddering CDs with shorter maturities just might. The same applies to short-term bonds. Your financial advisor can discuss how laddering and other liquid investments such as money market mutual funds can be used as part of a rally-ready strategy.

MAINTAIN AN EVEN MIX

A significant rise or fall in markets can throw your asset allocation out of whack. The major equity indexes have recently shed more than a third of their value; some of that money went into U.S. Treasuries, which held up relatively well last year.

As a result, your portfolio may now be overweighted toward bonds at a time when stocks could be poised to outperform. Review your

current asset allocation with your financial advisor to identify possible adjustment opportunities. “Stocks are still the best way to grow wealth over long time periods,” says Hough.

CONSIDER DEBT AS WELL

Investors often make the mistake of managing their assets and their debts separately. The two are interrelated. You may get a better short-term real return by paying down a debt with a high interest rate than investing that money in the stock market. Stocks have returned an average 7% annually over the past 40 years; the average consumer credit card currently charges about 14% interest.

The calculations can get complicated, since each investor's financial profile, including tax implications, will vary. Your financial advisor can crunch the numbers after looking at the big picture.

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