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With bear market upon us, here's how to use the stock market downturn to your advantage

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The first half of 2022 has been miserable for just about everyone's retirement investments. Not only have US stocks dropped into bear market territory, but the bond market has experienced its worst start to a year since they started keeping modern records in the mid-70s. My advice, think long-term and use this market decline to your advantage.

First, let's do a reality check. We're currently experiencing our fourth bear market since 2000, with the S&P 500 Index down just over 20% from its peak in early January. The previous 11 bear markets since World War II saw the S&P 500 Index fall on average 33%, with the worst, a decline of 58%, coming during the Great Recession of 2008-2009. The average recovery period, defined as the period of time from the market low to a new high, for the last 11 bear markets was 27 months.

Because stock and bond market prices are constantly discounting expected future events, they started moving down in January anticipating that growing inflationary pressures would force the Federal Reserve to raise rates and economic growth would slow. Russia's unexpected invasion of Ukraine in late February exacerbated these pressures.

With three rate hikes now in the books for 2022 and more expected, higher short-term interest rates are priced into the current market. Predicting when the next bull market will begin is tricky because it requires you correctly anticipate how high rates will go, when inflation pressures abate, and the impact inflation will have on future corporate earnings.

As for investment strategy, the first question you need to answer is about your time frame for needing the money you have invested. If you need any of it in the next twelve months, I recommend selling that amount immediately. If your time frame is longer, there's a good chance you'll be better off hanging on. If you're investing via a 401(k) or 403(b) plan, your regular bi-monthly contributions are "dollar-cost-averaging" your cost basis lower which will help boost returns once the rebound occurs.

If you've read this column before, you know I'm a big proponent of building and maintaining a diversified portfolio for the long-term. If you came into the year with a portfolio diversified between stocks, bonds, and hard assets, you're definitely feeling pain, but not as much as most. Now, rebalancing your portfolio is the smart play. That means selling some of the assets in your portfolio that have done well, or less bad, and buying more of the assets that have been hardest hit. If the stock market falls another ten percent, look at this an opportunity to rebalance again.

In addition, this sell-off presents an opportunity to implement a Roth conversion. Whether you hold your retirement assets in your employer's qualified plan or in your own IRA, consider paying some ordinary income taxes now in exchange for a life-time of tax free appreciation from these discounted values. Depending on your time frame for withdrawing this money, this move can save you thousands, if not millions, in future taxes.

Warren Buffett once famously described compounding as the "8th wonder of the world" yet in a traditional retirement account, one of the things you are compounding is your future tax liability. The best way to rectify this is to get as much of your retirement assets into a Roth account as possible.

A market sell-off presents a window of opportunity for such a maneuver. This assumes, of course, you're able to invest these Roth assets in a manner that allows for significant capital appreciation over time. It also assumes you have other assets you can liquidate to cover the tax bill which will come due next April to the pay the ordinary income tax you'll owe on the amount you converted into Roth.

Don't worry wondering what your tax bracket might be a decade or three from now, what matters is the avoidance of all taxation on the gains that will compound in this account from this point on.

For many, converting taxable retirement accounts to Roth is best done with partial conversions over a number of years. This allows you to minimize the tax bill in any one year and avoid pushing yourself into a higher tax bracket. Generally speaking, if you have more than five years before needing the money, a Roth conversion makes sense to consider.

Between making sure you are protecting your near-term spending needs, rebalancing your long-term investments, and converting taxable retirement savings into Roth, now is not the time to sit idly by fretting about how much lower the stock market might go. Take action and use this market decline to your advantage.

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