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Some optimism is the basis for better financial decision-making, says a new study. 2

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Grandchildren get billions, the boomers won't kill the markets, and more. 3

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Points of interest:

- Selling your stock investments in a bear market turns a temporary decline into a permanent loss.
- The U.S. stock market goes up by an average of 24% in the six months following a recession.
- Competing investments such as Treasury securities and bank deposits are offering uncompetitive yields.

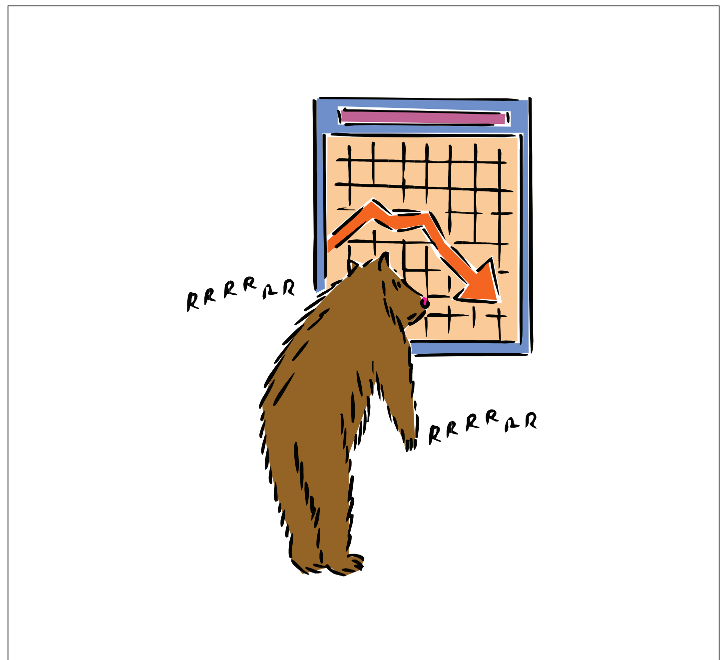
Have the bear market jitters? Here is how to survive and thrive

Recession fears, rising unemployment, and stock markets plunging worldwide: What's a poor investor to do?

Not only are the headlines scary and unsettling but so are the monthly statements from your brokerage firm showing a drop in your portfolio value.

It can be very hard to maintain your focus and long-term commitment to the stock market when investors all about you are losing their heads. Seasoned investors know that times like these demand calm and patience, rather than panic and action. In fact, it is usually better to sit it out and do nothing until the dust settles.

Here is a guide to help you avoid mistakes, maintain focus, and eventually prosper.



Bear markets are meant to scare investors away and cause losses. Patience and persistence can help you chase the bear away.

Avoiding mistakes

The worst mistake panicked investors make is turning a temporary portfolio decline into a permanent loss by selling out in an effort to avoid further declines.

An investor's portfolio that is diversified throughout U.S. and international stock markets will eventually recover as the markets begin rising at the end of a bear market.

In 10 of the last 11 recessions, the U.S. stock market rallied by an average of 24% during the six months after a recession ended. The sole exception was 2001, when stocks were still overvalued at the recession's end and had further to fall.

How to stay calm

The astute investor carries around a mental checklist of reminders that help him counter the daily drumbeat of bad news that accompanies a bear market.

First on the list: the horse is already out of the gate. By the time you think a bear market is in progress, there have already been sharp declines and the market is closer to the bottom. It is simply too late to take cover.

Second: are competing investments the best place for money in the long term?

During market panics investors flee to U.S. Treasuries. The heavy buying interest pushes down yields, meaning that new investors will get lower returns over time.

Last month yields on Treasuries fell sharply and new investors had the choice of locking in 10-year notes with yields as low as 3.5%. After taxes the chance of keeping up with inflation over the next 10 years is very low.

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RISK FALLS AS A BEAR PROGRESSES, AND NEW BUYING OPPORTUNITIES ABOUND

(Continued from page 1)

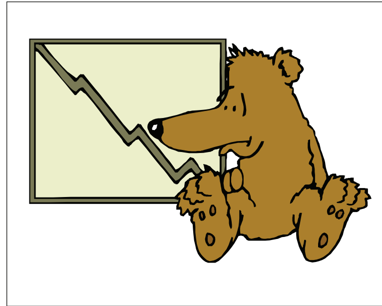
Meanwhile, rates on bank deposits and money market funds were falling due to rate cuts by the Federal Reserve.

Third, as scary as the market seems right now, it is actually less risky than it was last year. Yes, a recession will slow corporate profits, but stock prices fall so precipitously in a bear market that they become more of a bargain in relation to future corporate earnings.

Fourth, a diversified portfolio will offer decent returns over the long term. Although losses come at the beginning of the bear market, eventual recoveries boost your long term return so that, looking back a few years after a bear, returns look much better.

Your next move

You can help your portfolio recover faster by keeping it in balance. If you've set a target percentage of stocks to bonds, stick with it. When your stock investments fall by some predetermined amount (say, five percentage points below target), it is time to take some money out of fixed income investments and buy stocks. This forces you to buy bargains.



Bears present buying opportunities.

OPTIMISM IMPROVES YOUR FINANCIAL HEALTH

A novel study of optimistic feeling suggests that moderate optimism is key to making reasonable financial decisions.

However, too much optimism leads to imprudence, said the study by Duke University professors David T. Robinson and Manju Puri.

"This paper suggests that optimism is a bit like red wine: too much is clearly bad, but a little each day can be good for one's health," they wrote.

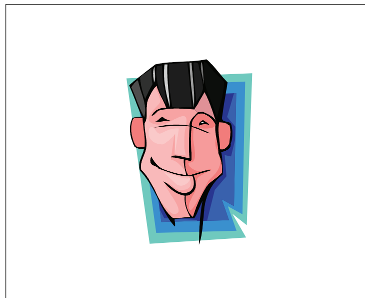
The researchers used an unlikely source to compile an index of optimism among American households—the Federal Reserve's triennial survey of consumer finance.

Big expectations

They identified optimists and extreme optimists by comparing each person's estimate of his or her own life expectancy to actuarial average life expectancies.

Those who thought they would live longer than the ages indicated on actuarial tables were pegged as optimists. The 5% most optimistic—some of whom expected to live 20 years past the expected average—were labeled as super optimists.

In general, it appears that some optimism leads to better work and life choices. Optimists are generally harder workers, expect to retire later, are more likely to remarry after divorce, invest more in individual stocks, paid credit card bills more promptly, and saved more, the study found.



A dose of optimism can lead to better and more prudent financial choices, but too much optimism may not be so good, a new study says.

Prudent or not?

The most interesting finding related to levels of optimism: a little optimism is definitely a financial asset, while excessive optimism can work against financial success, the researchers said.

"Moderate optimists seem to have prudent financial habits, while extreme optimists do not," they wrote.

Moderate optimists are more likely to pay off their credit card balances and have long planning horizons. Extreme optimists have shorter horizons and are less likely to save money. They also found that moderate optimists are more likely to work harder and less likely to be day traders in stocks. However, extreme optimists are more likely to work fewer hours, and hold a larger proportion of individual stocks in their portfolios.

Moderate optimists may have better self control: they have more liquid assets, and are less likely to smoke, than are extreme optimists.

"Moderate optimists are more likely to pay off their credit card balances and have longer planning horizons."

Are money market mutual funds headed for trouble?

Jitters in the credit markets due to fallout from the sub-prime mortgage mess have spread to that bastion of perceived safety, the money market mutual fund industry.

Should investors be concerned?

Probably not, especially if they deal with a large fund backed by a reputable investment company.

Although some money funds have inched close to subjecting investors' money to small declines over the years, no retail money fund has ever done so because their sponsors have always backed them up.

Stable since birth

The modern money market fund was born in 1970 and the industry now accounts for $3 trillion in assets.

The idea was to offer a safe, very short-term investment fund that always held its share prices at $1. That way an investor's principal does not fluctuate and the investor is paid the highest current short-term interest rate on top of that principal.

Money funds are closely regulated by the Securities and Exchange Commission. They are allowed to hold only top-tier investments with an average maturity under 90 days.

The short lifespan of a money fund's investments means there is less chance of default while held by the fund.

Money market funds are regularly rescued by their investment managers.

Breaking the buck

The big fear for investors is that a money fund's holdings will decline to the point that the fund has to price its shares at less than $1, a phenomenon known as "breaking the buck."

In practice, this has happened only once, when a small institutional money fund in 1994 was liquidated and institutional investors got 96 cents on the dollar.

Retail funds offered to the public have avoided breaking the buck by having their sponsors buy troubled assets from the funds.

This has happened during periodic financial crises over the years. Recently, it is estimated some 30 money fund sponsors have bailed out their funds by purchasing declining investments at face value.

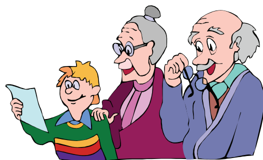
Big brokers and other money fund sponsors don't want their funds to break the buck because a loss of consumer confidence would affect their reputations and future business.

"The big fear for investors is that a money fund's holdings will decline to the point that the fund has to price its shares at less than $1."

Lucky kids, the Boomer effect, & more

Grandchildren in the United States have it made: their grandparents are spending $50 billion per year on them, according to a study done for Grandparents.com.

About half of that amount is being contributed to investments for grandchildren.



The study found that the average grandparent spends $1,691 during the child's first year , while a first-time grandparent spends $3,150.

Some 71% of grandparents in the study said they wanted to contribute to their grandchild's education.

No baby boom effect

Fears that baby boomers will depress the financial markets by dumping their stocks and homes at retirement are overblown, found a study by Capitol Analysts Network Inc., a Washington, DC research firm.

Baby boomer retirements will be tempered by the 21 million younger immigrants who came here between 1980 and 2000.

"There will be many more Americans than ever who will want to buy your stocks and your bonds and your houses," said firm president Stuart Sweet.

An adage for investors

Investors shocked by the big declines in stocks in January may feel that getting out of the market now and getting back in later will help.

They would do well to remember a time-tested Wall Street saying about investment patience: It is time in the market, not market timing, that counts.

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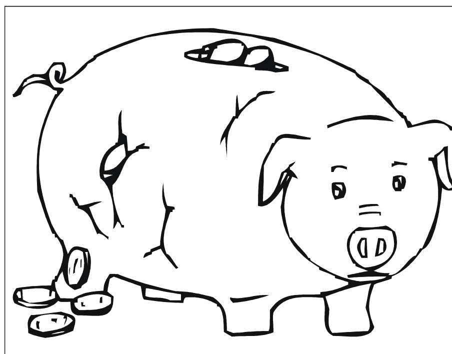
The expanded kiddie tax leaves fewer alternatives for saving

Remember the days when kids were encouraged to plunk away money for the future, especially for a college education?

It seems the federal government has lost the urge to encourage thrift. Starting this year, an expansion of the notorious "kiddie tax" discourages children from having large savings or investment accounts in their own names.



The federal kiddie tax is taking a bite out of some children's savings accounts.

The kiddie tax began in 1986 in order to catch high income parents who were shifting large amounts of money or investments to their children in order to take advantage of the children's lower income tax rates.

Starting that year children under age 14 who had more than a modest amount of interest or investment income had to pay income tax at either their own tax rates or at their parent's tax rates, whichever was higher.

But two years ago Congress expanded the tax to children under age 18. Now it has expanded it to a maximum of age 24, if a child is a full-time student and not providing more than one-half of his or her own support.

The limit for a child's unearned income was $1,700 in 2007 (it's inflation-adjusted each year but not by much).

So a child with a custodial account earning interest or dividends over $1,700 may be taxed at the parent's highest marginal rate.

Where does this leave families who want to save big money for college and teach their children about investments?

It is still OK to put some money in a child's name, but the bulk of the savings should be done in a 529 college savings plan account for those who want the maximum tax advantage.

These accounts defer taxes on earnings and allow them to be used tax-free if withdrawn for college expenses. Plus, they give a parent control over the money after age 21, unlike a traditional child's custodial account.