COLLEGE

For 529 Plans in a Bear Market, Timing Is Everything

If your child is close to college age and their college fund has taken a hit in the market, there's one thing you should think about doing.

(Image credit: Getty Images)

Nobody likes a down market, though most investors probably should. Down markets are where most of the big future gains come from when you are contributing to your investments on a regular basis. Dollar-cost averaging your investments when markets are low is no different than buying anything else when it's on sale. This is a great way to build wealth for retirement.

But what about when you're investing to save for college? How do down markets affect those with 529 college savings plans? One way could involve changing the timing of when you decide to tap into the funds you've saved.

Saving for College Like You Save for Retirement

Many college savers, like many retirement savers, use the age-based portfolio models for their investments. Age-based 529 investment funds are similar to target date retirement funds. The theory is that as your child ages, the 529 college savings investment portfolio becomes less aggressive, with the goal of reducing the risk the closer you get to needing the money.

That isn't to say that once your child is ready for college that all the risk is gone from the portfolio. Depending on which investment provider's plan you are using for your 529 plan, the amount of risk still in the portfolio can vary widely. So, this means that even when your child is ready to go to school, a down market can still have a substantial effect on your account values.

Advice: Consider Holding Off on Tapping Your 529 Plan

It's important to remember that you do not have to take money out of a 529 college savings account just because your child is about to start college. If the market is down at the time your child enters college, then you could consider waiting until future years to use the funds inside of the 529 college savings accounts. Doing this would give the accounts time to recover from the market declines, especially if you are still contributing to them via dollar-cost averaging. This could give your investments up to three additional years to grow.

So how do I pay for college if I'm waiting to use my 529s?

Tap into your home: Home equity could be an option, especially with the inflated home prices we've seen over the past few years. We often suggest clients have a home equity line of credit (HELOC) for a variety of reasons. Paying for college is a potential use of that HELOC. Just be mindful of interest rates, especially if we continue to see rates climb.

Tap into your savings: Some clients are using savings or current earnings to fund the first year or two. While we don't suggest tapping into your emergency fund, many investors have additional savings that are earning low rates of interest, so redirecting those low performing savings to help pay for college, particularly in your student's early years, can help allow the 529 balances time to recover.

Take out a loan: Lastly, loans for early years may be an option. Both subsidized and unsubsidized federal loans are a great place to start because they can later be consolidated after graduation with favorable repayment options. Parents and students can explore both Parent PLUS and private loans as well. Some states have their own loan programs, which may have favorable interest rates. Thanks to the SECURE Act of 2019, you can now use 529 funds to repay student loans up to $10,000 per student. (Note that the $10,000 limit is a lifetime limit, not per year.) We have even had clients use a loan against their portfolio, known as a securities-backed line of credit, to pay for a year or two of college before tapping into the 529s.

Colleges may even be willing to work with you given the current state of the market. It doesn't hurt to ask for additional financial aid, although don't expect all schools to be receptive to your request.

The Bottom Line When Markets Fall

As we have seen so far in 2022, markets go down and sometimes by a lot. While this certainly isn't ideal, just remember that markets are up far more often than they are down, typically by a margin of more than 3-1.

Most times it makes sense to stay the course. If your children are still in grade school or just entering their freshman year of high school, then there is no need yet to start making their 529 college savings portfolio more conservative. You should have ample time to recover any market declines.

Dollar-cost averaging does not assure a profit and does not protect against a loss in declining markets. This strategy involves continuous investing; you should consider your financial ability to continue purchases no matter how prices fluctuate. Securities offered through Kestra

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