Stock Plan Services

Stomach volatility in your company's stock without losing your mind

By Joanna Glasner and Bruce Brumberg, myStockOptions.com

Key points

- *Remember that stock compensation is a long-term deal, and with restricted stock or RSUs, you receive at least some value at vesting, even if the company's stock price has fallen since grant.*
- *Seek help from good advisors. Focus on aspects of company performance that you can contribute toward, thus helping to lift the stock price.*

Stock options, restricted stock units (RSUs), and other types of equity compensation are valuable benefits that inspire employees to stay with their companies and feel motivated at work. Shares of companies in hot industries can skyrocket amid a strong economy and prosperous stock markets. However, markets sometimes falter. High-flying stocks can plummet. Shares that seemed headed for new heights can quickly tumble. The tumultuous market conditions triggered by the COVID-19 crisis have given many employees a front-row seat to the impact of market volatility on their stock awards.

When things don't go as well for your company or the stock markets as you had hoped, it is important to remember that stock compensation is a long-term deal. Obsessive scrutiny of the company ticker symbol is unhealthy. Ecstasy can swiftly turn to anxiety when the stock price swings up and down like a yo-yo.

Tips for staying sane in volatile markets

Intermittent volatility in the stock markets has not dampened enthusiasm for stock compensation, whether nonqualified stock options, restricted stock/RSUs, stock appreciation rights, or employee stock purchase plans (ESPPs). While certain companies and industries routinely experience more volatility than others do, the stock prices of all companies can fall amid concerns about the economy or other factors. Don't panic.

Following are 9 tips from experts in financial planning, human resources, and psychology about how to stomach the wild ups and downs that stock prices can experience.

1. Know what types of equity awards you have.

There are two types of stock options: incentive stock options (ISOs) and nonqualified stock options (NQSOs). Restricted stock and RSUs are essentially the same. Identifying which kind of grant you have is key for making sound investment decisions in a volatile market. If you have both types of options, in stable markets it may make sense for tax reasons to focus on which type to exercise and whether to hold the shares. However, in a volatile market it is safer not to let tax decisions drive your choices: instead, look at where your company's stock price sits in its trading range, what its prospects are, and what your time horizon for the money is. With these elements in mind, you are more likely to exercise the options and sell the shares at the same time, so the net gains with ISOs and NQSOs are essentially the same. This makes any concerns over the alternative minimum tax (AMT) and long-term capital gains somewhat irrelevant.

2. Sometimes volatility is the norm, not the exception.

Get used to turmoil in certain industries. Indeed, in those areas, fluctuations of share price may be around for a while. At the same time, it is also helpful to remember that after the historically unusual crisis which befell the stock markets during 2008 and 2009, a robust market recovery soon began.

3. It can be more fun—really!

Believe it or not, volatility can be exciting and profitable, according to Corey Rosen, a former executive director of the National Center for Employee Ownership. Mr. Rosen asks employees at companies with rollercoaster stock prices which type of company they would prefer to have stock options and/or RSUs in: one with a constant 10% annual gain or one with the same annualized gain over 10 years but with peaks and valleys that greatly exceed 10%.

While you don't want to fixate on your company's stock chart, these ups and downs actually present better opportunities for profiting on stock options over the 10 years you have to exercise them. For example, employees with ISOs who plan to exercise and hold will reap more net tax gains if they exercise at lows and sell at highs.

4. A watched pot never boils.

Remember that watching the company's ticker symbol on your computer screen for eight hours a day will not make the stock go up. You may be far more satisfied with the performance of options and other stock grants if you check their worth a little less frequently.

5. Stop expecting quick riches.

Think of equity compensation as a tortoise rather than a hare. "You've got to remember that most stock options have a 10-year life. It is a long-term incentive," says Mark Edwards, a compensation consultant on the west coast. "A whole lot of folks out here like to talk about internet time, not looking out beyond a year or 18 months." Though the stock price may be down or unpredictable now, your stock options will have great leverage if the stock price rises again later in their term. This potential upside can be very rewarding.

With restricted stock or RSUs, you receive at least some value at vesting, even if the company's stock price has fallen. This can balance out some of the volatility of stock options, but the potential upside with restricted stock and RSUs is less dramatic. You can therefore consider restricted stock/RSUs as the more conservative part of your stock compensation portfolio.

6. Use stock compensation for big things.

Don't depend on unexercised options or unvested restricted stock to cover regular expenses like car payments or mortgages, advises Richard Haas, president of Financial Catalyst Group in Sunnyvale, California. People who plan on using gains from stock grants to cover living expenses can wind up in deep trouble if the share prices tank. Anchor your spending on your cash salary and what you have in the bank so that your lifestyle is no worse off if your company's stock price shrinks.

Mr. Haas recommends paying for big purchases with cash from sales of shares acquired via stock compensation. He also cautions clients with ISOs and ESPPs to keep enough cash on hand to cover future tax bills, as there is no tax withholding at the time you exercise ISOs or sell the stock.

7. Seek help from good advisors.

Don't make all the decisions yourself. Stock options, restricted stock, and ESPPs are complicated financial instruments. Finding an accountant, a lawyer, or a financial planner who is familiar with the tax and investment ramifications of company stock sales is a good way to avoid making rash decisions, particularly when a substantial chunk of your net worth is tied up in your company's stock grants.

A good advisor can help your decision-making with questions that you should be pondering now if you have exercised ISOs at a market high and are holding the shares. According to Art Meyers, a lawyer with Choate, Hall & Stewart in Boston, "if employees hold ISO stock from exercises this year, and if the price of the shares has dropped substantially, they need to analyze whether it makes sense to sell the stock in the same year to cancel any potential AMT hit."

8. Greed or fear?

Now is the time to reassess your greed-to-fear ratio. Volatility in the stock market helps you rethink your attitude toward financial risk. Take a look at your asset allocation for all your investments. This review should include your company stock options, unvested restricted stock, ESPP shares, and stock holdings in taxable and 401(k) accounts. If you have stock compensation, you may find that you have too much in one basket, i.e. your company's stock. If so, you will be less nervous when your net worth is not riding on that single stock. Although diversification is a basic part of sound investing, it does not guarantee a profit or protect against loss.

Alternatively, you may find that your company's stock price is quite undervalued and that now is a great time for also buying it on the open market or through an ESPP.

9. More grants ahead?

While companies are reducing the number of employees who are eligible for stock grants, your first grant of options or restricted stock/RSUs is unlikely to be your last. Stock options have built-in tax-deferral advantages that make them more beneficial than mere cash bonuses. When share prices fall precipitously, companies sometimes issue new grants, but don't expect your company to reprice underwater stock options. Down markets can be a good time to get a new stock option grant, as your exercise price will be lower than your company's usual trading range.

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Also, many companies with very volatile stock prices are shying away from doling out their grants in one lump. Your company may prefer to grant batches every several months or readjust its grant guidelines for volatility. Some companies are even granting combinations of options, restricted stock, and performance shares.

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