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## **When Recession Fears Surface, Check Your Plan – Or Make One**

It's been a wild ride on Wall Street so far but what about the months or quarters to come?

If this question fills you with worry, then it's pretty clear you're operating without a plan, or at least one you haven't recently checked. That's OK. When worldwide market worries surface, it's easy to get scared. It's particularly easy when we've had such major market calamities as the U.S. mortgage debacle and the lingering disarray in the banking and investment industries.

But sudden action is usually a mistake. In the late 1980s, Harvard psychologist Paul Andreassen made news with a research project that found that people who listened to market news actually made lower returns. Why? Because those who sold – or bought – during a market swing probably found a day later that the market was really running on hype, not fundamentals.

You pay an advisor or financial planner to devise a financial strategy that matches your risk tolerance and long-term financial goals. No, there is absolutely no way to guarantee that you'll never lose money. But if a plan truly matches you, the noise shouldn't make a difference, particularly if you don't need the money *today*.

So the next time world markets spike or slide, ask yourself:

**What's my plan?** If you've worked with a financial planner such as a (CFP) Certified Financial Planner™ professional, you should be able to articulate those goals all by yourself or with the assistance of an advisor. Much of the riskiest investing, overbuying and panic selling during the late 1990s and early 2000s could have been avoided if individual investors had sought advice for achieving *long-term* specific goals such as retirement or a college education.

**What's my risk tolerance?** At your first meeting with an advisor or financial planner, you should have discussed a number of questions about how you handle risk and what your expectations were about investment returns. You might have had to do this more than once if your risk tolerance was low but your investment expectations were high – low-risk investors can't expect the highest returns. That's part of the education process when you visit a planner.

**Am I prepared to stay invested – no matter what?** We all remember the "Tech Wreck" of 2000. At the worst of that downturn, investors bailed out of the stock market or drastically cut back, only to get back in after they were "convinced" that the market was rebounding. In reality, they missed out on stock market gains during the early stages of recovery, and that's costly in the long run. Of course, some investors looking for that late 20<sup>th</sup> century investment high also got into the real estate market, and they perhaps learned a similar lesson when that market started heading south two years ago.

In 2004, SEI Investments studied 12 bear markets since World War II. Investors who either stayed in the market through its bottom, or were fortunate to enter at the bottom, saw the S&P 500 gain an average of 32.5 percent (not counting dividends) during the first year of recovery. Investors who missed even just the first week of recovery saw their gains that first year slide to 24.3 percent. Those who waited three months before getting back in gained only 14.8 percent.

**Am I diversified?** The NASDAQ lost 39 percent of its value just in 2001, and another 21 percent in 2002. Meanwhile, real estate investment trusts, which performed poorly in 1998 and 1999 when stocks were booming, had banner years in 2000 and 2001, performed so-so in 2002, and had an excellent 2003. Bonds also returned well during the bear market. Your advisor or planner, based on your risk profile, should have you in diversified investments that fit your goals.

**Do I still feel the same way I used to about returns?** Having a long-term investment plan doesn't mean make the plan and leave it to gather dust. You and your advisor or planner are a team. Both of you should talk and decide when it's time for a detailed review of your investment goals and whether or not they should change. An annual conversation makes sense if nothing's going on, but life events like death, divorce, kids moving out, and illness are good reasons to do a head-to-toe review of a financial plan.

If you're worried, there is no reason why you should not call your advisor or planner to calm your nerves and confirm your investment plan. And if you've never consulted with an advisor or financial planner before, now might be a pretty good time to start.

Please call our office at (925) 299-1500 or toll free (888) 299-1500 if you are interested in scheduling a review of your investment strategy and/or financial plan. If you are not a client of Capital Advantage, Inc., we offer free no obligation consultations.

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## Early Social Security: What Will It Cost You?

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By **Emily Brandon**

The first baby boomers are turning 62 this year, the magical age at which you can begin to lay claim to all those payroll taxes you shelled out paycheck after paycheck your entire working life. The nation's symbolic first baby boomer, Kathleen Casey-Kirschling, a retired Maryland teacher, who was born one second after midnight on Jan. 1, 1946, has already filed online for her Social Security retirement benefits.

Nearly 80 million Americans of the baby boom generation (born from 1946 through 1964) will follow her in becoming eligible for Social Security benefits over the next two decades, a phenomenon Social Security Commissioner Michael Astrue is fond of calling America's "silver tsunami."

Almost a third of the 2.9 million boomers born in 1946 plan to apply for benefits this year, like Casey-Kirschling, according to a recent MetLife Mature Market Institute survey. But class of 1946 boomers who file this year will receive a reduced benefit for life, compared with those who hold out until what the Social Security Administration deems their full retirement age—in this case, 66. Holding out until age 70 will bring in an even bigger monthly check.

So, for example, a boomer with a final salary of \$75,000 might receive a \$1,320 monthly Social Security check if he collects at age 62, according to a University of Pennsylvania Pension Research Council Working Paper by James Mahaney and Peter Carlson. If the same boomer were to delay until age 70, he would get \$2,884 monthly, more than twice as much. Even after counting cost-of-living increases, the boomer who began to collect at age 62 would by age 70 probably receive only \$1,637 a month.

"Waiting is a good deal if you have other means of getting by," says Laurence Kotlikoff, an economics professor at Boston University, unless you are certain you won't live a long life because of a health problem. "If you have a terminal heart condition, you want to take benefits immediately. Otherwise, in general—if you can—you want to wait as long as you possibly can to get benefits." Kotlikoff found that delaying taking the Social Security benefit can raise your standard of living in retirement by up to 10 percent. "That's like working an extra year or two," he says.

Your Social Security benefit increases by approximately 7 percent each year you delay taking it from age 62 to 66 and by 8 percent a year until age 70, Kotlikoff found. That could be a better return than retirees are getting on their investments. "You have to compare that with what your pension is giving you," says Hugo Benitez-Silva, an associate professor of economics at SUNY–Stony Brook. So, if your 401(k) or IRA is not giving you a higher return than that, you might want to start delaying Social Security and drawing down your other assets first, Benitez-Silva says. Olivia Mitchell, a professor of insurance and risk management at the University of Pennsylvania's Wharton School, agrees. "Delaying is better if you can afford to wait," she says. "What you should do is save more of your money upfront and use that savings to finance your early retirement and then use the [Social Security] benefit later."

But most employees show little inclination to wait before collecting Social Security. The Employee Benefit Research Institute found that 65 percent of current workers plan to retire at age 65 or younger—before most will be eligible for full Social Security benefits. And only about 32 percent of boomers born in 1946 say they will wait until age 66 or beyond to receive full benefits, MetLife reports. Those who plan to collect as soon as possible cite feeling entitled to receive their benefit, preferring to have the cash in their pocket and not the government's, needing the money now, and having a pervasive fear that the Social Security system will collapse.

"There is a widespread belief among Americans that benefits in the future are going to be lower than they are today," Benitez-Silva says. "There are justifications that claiming early may be a very rational behavior." Other retirement experts say the fear is unfounded. "I think the government would sooner default on its debt than cut benefits for someone who is currently age 62," Kotlikoff says.

But it is not only your age that matters when deciding when to claim Social Security. Retirees should also consider whether or not they intend to work, which can temporarily reduce benefits and increase taxes if their earnings are too high, and review their spouse's plans before collecting their due.

## Reverse Mortgages: Why They're Not for Everyone

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By **Christine Dugas**

After her husband died, Ernestine Boach felt she needed financial guidance. It was 2003, and Boach had just turned 62. An adviser urged her to take out a reverse mortgage, available mainly to those 62 and older, and use the money to buy deferred annuities. "He told me that he had a wonderful deal for me," she says.

It turned out to be a huge mistake. Boach wasn't well-suited for a reverse mortgage, which is a loan against home equity that doesn't have to be repaid until the owner dies or sells the home. The estate repays the loan, plus interest and fees. The home is typically sold to make the payment.

But Boach had planned to leave her home to her daughter. "It's in a trust for her, and I was assured that the home was going to be saved," says Boach, who is now 66 and lives in San Diego.

Reverse mortgages represent a small fraction of the mortgage market. But they're growing fast because of a tantalizing advantage: They let seniors with small nest eggs tap equity in their homes for cash, without having to repay the loans as long as they stay in the homes. As the oldest baby boomers turn 62 this year, they're likely to face high-pressure pitches for reverse mortgages.

As Boach learned, it isn't always a wise idea, especially during the early retirement years. There are other ways to draw income out of a home, such as a home equity loan, that are cheaper and more flexible, experts say. The amount you can borrow in a reverse mortgage hinges on your age, the home value and interest rates. The older you are, the more you can borrow. Yet the average age of borrowers is falling.

"It's a generational shift," says John Rother, policy director at AARP. "Our parents' generation saw the home as a bedrock of security, and it was a good deal to pay off the mortgage and own it free and clear. Many boomers, on the other hand, are treating the home as a financial asset and are using it to borrow against its value."

Meg Burns, director of the Federal Housing Administration's Single Family Program Development, notes that "as the boomers come of age, they'll be thinking about their home as an asset in their portfolio" that can help ensure a comfortable retirement.

The FHA's reverse-mortgage program, called the Home Equity Conversion Mortgage (HECM), is federally insured and is the most popular type. Those considering a loan that isn't federally insured should be sure they're working with a strong financial institution with a solid track record, says Peter Bell, president of National Reverse Mortgage Lenders Association.

Some reverse mortgages are now available for second homes. World Alliance Financial has introduced Simple60, for those as young as 60. The FHA's federally insured reverse mortgages aren't available for anyone under 62.

The reasons younger retirees might need a reverse mortgage vary. John Dull, now 66, retired in 1995 when his company was downsizing and he'd had some health problems. Since then, Dull and his wife have been relying on his pension and Social Security benefits. But their bills have been rising while their income hasn't.

"We had some debt to clear up and some improvements to make on the house," Dull says.

Still, reverse mortgages tend to be costlier than other home loans. The FHA's loan typically charges an original fee of 2% of the home value and a mortgage insurance premium of 2%. There are title searches, appraisals and other costs, too.

Say, for example, a 62-year-old Michigan woman with a home value of \$250,000 applies for an FHA "HECM 100" loan. The total fees and costs would be \$11,410. So the loan amount that the borrower is qualified for, \$127,556,

would be reduced to \$116,147, according to World Alliance Financial, a provider of the HECM and other reverse mortgages.

“The fees are kind of high,” John Dull says. But the couple went ahead with the loan because they felt they had no better option for tapping money. “The advantage of the loan outweighs the disadvantages,” he says.

Two years ago, William Mansfield considered a reverse mortgage when he needed to fix a summer house on Block Island, R.I. “We had to do extensive renovation,” he says. “We were trying to figure out how we might pay for it.”

Mansfield waited until his wife, Kit, turned 62. (The FHA requires that both spouses be at least 62.) Before consumers can apply for the FHA’s reverse-mortgage program, they must consult an independent counselor. Based on the advice they received, the Mansfields decided against a reverse mortgage. In part, the high cost deterred them. They also realized that if they took the loan, the 200-year-old home wouldn’t stay in the family after they died.

Others start looking toward a reverse mortgage even before they turn 62. Joe Higginbotham, 56, says he’s considering one even though he won’t qualify for six years. Higginbotham, who retired from International Paper in 1997 after being hurt in an auto accident, moved near Grand Junction, Colo. He’s drawn to the idea that a reverse mortgage could let him borrow money and stay at home.

“It’s a great thing,” he says. “There are no payments. You still own [your home], and you can still live in it until the day you die. And you can do whatever you want to with the money.”

Reverse mortgages traditionally have been used by older retirees to pay health care bills. But younger people tend to use the money to pay off credit card debt or pay down their mortgage, according to the AARP national survey.

Affluent borrowers, meantime, often consider a reverse mortgage to buy a second home, Bell says. And others take one out even if they don’t need money right away. Some of them, Burns says, worry that their car could break down or their house will need a new roof.

Those may be good reasons for taking out a reverse mortgage. But one thing has caused much concern: Too often, retirees are urged to use the loan to take out a deferred annuity, which typically provides high commissions to salespeople. And deferred annuities “are almost always inappropriate for seniors, as they can tie up retirement savings far beyond one’s life expectancy,” Sen. Herb Kohl, D-Wis., said during a recent congressional hearing on reverse mortgages.

Single women—who account for about 45% of reverse-mortgage borrowers, according to the AARP survey—may be particularly susceptible to such advice. Ernestine Boach says her adviser recommended a reverse mortgage and high-cost annuities. Though she underwent credit counseling before she applied for the reverse mortgage, she says her adviser told her it was just a formality.

“He told me not to listen to that, because they don’t know what my financial adviser is doing with the money,” she says. To keep her home, she took out a home loan for \$140,000 and used it to pay off the reverse mortgage. To do so, she had to cash in the deferred annuities, which caused her to be slammed with high surrender charges. On top of having home mortgage bills to pay, she says, her credit card debt has hit \$10,000.

Boach feels embarrassed by the whole situation. “I was naive,” she says. “I still am. I don’t understand all these policies. But I hope this story helps somebody else.”

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