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Retire Now, Wait, or Fuhgeddaboudit?

The economy and financial markets are on everyone's mind these days and rightfully so. The financial news isn't good, and some of it borders on hysteria. Now that the euphoria of our recent boom days has faded, people are beginning to wonder about retirement. Should you retire now, later, or never?

It all depends upon your situation. But in the spirit of a popular financial magazine, here are **"The 10 Things You Must Consider** *(before the next issue hits the newsstands and we go off on a completely new 'must-do' track.)"*

1. **Avoid "circling the wagons" at retirement.** You can't spend your whole nest egg the first year of retirement. Keep your long-term money at work for your later years. Retirement is for the rest of your life. It could last 20-40 years. There will inevitably be several market corrections during the rest of your life. Never let short term events dictate your long term planning. Nothing stays the same.
2. Starting your retirement at the start of a bull market is better than starting at a market top, especially if your portfolio isn't large enough at the start of retirement. For example, retirees in the early 1990s or in the last five years have fared much better than those who retired in 1999-2001. But if you have sufficient assets and a reasonable withdrawal rate, it doesn't matter when you start.
3. If you are at or near retirement, insulate your retirement portfolio with cash reserves of at least 6-12 months. When the markets are going down, take your withdraws from cash. That takes the pressure off your portfolio when you must sell investments at lower prices. For those within a year or two of retirement, it might be a good idea to allocate less in your tax deductible retirement plan and place more into a bank account. Of course, this takes some tax planning, and perhaps your retirement plan has a cash reserves or guaranteed option. But don't over do it—see # 1 above.
4. Before retirement you can control how much you save and spend. You have some degree of control in the amount of assets you have at the start of retirement by saving more or postponing retirement.
5. Down markets are an especially good time to invest for retirement. Buy your investments on sale.
6. Keep your options open. Could you work part-time, consult, or try a different job?
7. If you are already retired, take charge of what you can control. That may mean postponing a trip, kitchen remodel, and gifts, or even slightly cutting back on your monthly retirement plan withdrawals. But seek advice before making unnecessary cutbacks. Consider tapping other resources temporarily, such as a savings account or CDs.
8. Consider all of your retirement income sources, not just the stock and bond market portion. Chances are a pension, real estate, part-time job, spouse income, bank accounts, etc. can take up the slack during a difficult market. And of course, a well-constructed diversified portfolio may also help minimize the effects of a down stock market.
9. **It's hard to face the future with confidence with all the economic uncertainty these days. But amidst all this uncertainty, the one certainty is that we're mortal and we won't have good health forever. Your life must go on regardless of events you cannot control.**
10. **Retirement is a confidence game.** You need to be confident that your assets will last longer than you do. You need the confidence that you will find meaning and fulfillment in retirement. You need to have the confidence to relax and enjoy it.

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Putting the Mortgage Crisis into Perspective—Back to the Future?

Since late 2006, over 250 major US lending institutions have gone out of business. How did we get into this mess? And just how messy is it?

In the "old days," one needed to have an income that was at least 33% of the amount borrowed. And 80% was the maximum loan. Loan applications were fully documented. If you were more than 30 days late on any loan payment on two or more loans, you could forget about getting a FNMA, VA or FHA loan.

But the mortgage lending industry started changing in 1977 with the passage of the Community Reinvestment Act. The goal was to increase home ownership by low and moderate income families. Gradually loan requirements started relaxing. Banks started selling more of their home loans to government loan agencies and to Wall Street brokerage firms who "securitized" them and sold them to investors. The investment houses started getting very creative, packaging different pieces of the loans—each with different returns and risk levels—to different investors. The world-wide appetite for US debt paper grew, especially those collateralized by mortgages.

After the tech and dot.com bubble burst in 2000, people started to look for something more tangible in which to invest. **In essence, we went from one speculative bubble to another. Blame for this situation can be spread almost equally five ways:**

1. Borrowers bought more than they could afford, didn't read the fine print or do the math.
2. Lenders put people into unsuitable loans, often without full disclosure.
3. Investment banks became careless and fee crazy with the loans they were repackaging.
4. Rating agencies did not do enough due diligence on the investment firms that paid them to rate the quality of their debt securities.
5. Investors did not pay enough attention to what they were purchasing.

So where are we now?

We are having a correction in the housing market, especially in specific locations. Prices will likely go down even further. Call us Darwinian if you wish, but just as the stock market needs a correction now and then to rid the system of excesses, so do other types of investment bubbles. As Secretary of the Treasury William Paulson said on April 10, "We need to have this correction. It's not pleasant, but we need to have it." Unfortunately, the housing correction is rippling through the rest of the economy.

We're basically back to what lending standards were in about 1991. Gone are the lower credit loans, "no doc" (undocumented) loans, "stated income" loans (as opposed to verified income), and most 100% loans. There is virtually no trading in so-called jumbo loans. But qualified borrowers with good credit can still get loans.

A sense of perspective

Nobody likes to see the value of his or her home (or stocks) decrease. But, just like a stock, if you don't have to sell it, don't. If you're living in it, you derive value from it as a home and shelter. **The doomsayers, fueled by the media would like us to believe that this current crisis will make us all homeless. But take a deep breath and digest these facts.**

According to 2005 US Census data with recent updates:

- 67.8% of all Americans own their own home, either outright or with a mortgage.
- **33% of all homes in the US are owned free and clear.**
- 49% have a fixed rate loan.
- 91% have loans at less than 8% interest—a vast improvement over the past two decades!
- 52.7% is the median home equity.

According to Equifax and Moody's Economy.com, 4.46% of mortgages are at least 30 days past due in the first quarter of this year. That means that 95.52% are not. The national foreclosure rate for the quarter is 1.39%. That means that 98.61% are not. The default numbers include vacation homes and those who were speculating as house "flippers." Keep in mind that with a 0% down and no equity to begin with, some of these so-called "homeowners" with no equity never truly owned their homes. They are back to paying rent instead of mortgage payments.

Every correction has its losers. In 1998 it was the currency traders and certain hedge funds. In 2000 it was the dot.com speculators and day traders. In 2001 it was the Enron people who thought their company stock could only go up. Now it is those in the major investment houses, mortgage brokers, construction workers, real estate speculators, and those who got in over their heads with their home purchase, lines of credit, and type of mortgage. We're the first to admit that this correction affects far more people and "innocent bystanders" than the previous ones.

In this election year we have an abundance of rhetoric from both parties and all three presidential candidates about the mortgage crisis and its ripple effects through the economy and financial markets. All have their view of the situation and what they think should be the solution. While we don't offer a solution here, we caution against over-reaction. We'll get through this. But unlike stocks, our homes are our homes. And we all tend to take home ownership very emotionally. This time it's personal.

Are You Going Broke Safely?

Inflation is back in the news. Many people tend to confuse volatility with safety. They seem more concerned that their accounts may have dropped by 4%. The temptation is to park or permanently put the money somewhere "safe." But those kinds of drops are temporary. A four percent increase in inflation is permanent. At 4%, prices double every 18 years. Thus, $1,000 of cash in the mattress right now would be worth only $500. That is going broke safely.

But wait—it gets worse. If your money is not in a tax sheltered account, such as an IRA, 401-k, etc. you also need to factor in taxes. So here is a handy formula to calculate your break even rate of return, just to stay up with inflation and taxes.

$$\frac{\text{Inflation Rate}}{\text{100-Tax Bracket}} = \text{Break-even Required Rate of Return}$$

So, let's say we have a 4% inflation rate and you are in the combined federal and state tax bracket of 35% $\Big\}$ $\dfrac{4}{100-35} = 6.15\%$

That's just to stay even, let alone get ahead. That's not always possible in years like this, but you need to keep your money at work year in, year out to achieve your longer term goals.

Protect Yourself from a Retirement Plan Lawsuit

If you are a business owner, as a number of our clients are, it's bad enough managing your liability against potential lawsuits. But on February 20 of this year, the US Supreme Court just gave employers another headache—liability for fiduciary responsibilities of their retirement plans.

In *LaRue v. DeWolff*, the Supreme Court unanimously ruled that a retirement plan participant (i.e., employee) can recover the value of his or her assets lost due to fiduciary breaches that impaired the value of the participant's account. **What is significant in this case is that previously only the retirement <u>plan</u> could sue the plan sponsor. Now the individual participants can.** In this particular case, the employer did not implement the employee's investment direction for the employee's 401-k account. In short, the employer did not act as a fiduciary.

The term "fiduciary" is more of a financial term, meaning one who serves in a special relation of trust, confidence, or responsibility in certain obligations to others. If you as an employer act as an administrator or trustee of a retirement plan that includes employee assets, you must act as a fiduciary on at least three levels.

1. Administrative Level

The liability created in The LaRue case mentioned above was not directly about an investment that went south. Rather it was about the employer not taking prompt action and/or dropping the ball before the investment went south. **If you have a retirement plan in which employees can self-direct their investments, you must have systems and procedures in place to promptly process their contributions and your employer match and to follow through on their investment direction.** You must also efficiently administer beneficiary designations, loans, transfers, and payouts. These days many employers reduce their liability and paperwork by using a web-based plan administrator. The employees go on line to view their account balances and make investment changes. The administrator communicates with the investment advisor to make it happen seamlessly. The costs are very reasonable, especially when you consider the liabilities and it frees up the time it takes you or your bookkeeper to do it.

2. Investment Choice Level

Many employers erroneously think they have eliminated their fiduciary liabilities by providing their employees with a wide choice of investments. This is the so-called "safe-harbor" rule under the Employee Retirement Income Security Act of 1974 (ERISA Section 404(c). For this to work, you need to perform initial <u>and</u> on-going due diligence on the available choices, keeping in mind diversification, fees, risk, etc. At a minimum you should have three diversified portfolio choices ranging from conservative to growth oriented. If you are offering individual mutual funds, more than three should be offered. But don't go overboard; as new research shows that the more choices employers offer their employees, the less likely they are to voluntarily participate in salary reduction contributions.

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CFP Board Awards Alex His Due

We are pleased to announce that Alex Sheppard has earned the rights from the CFP Board of Standards to use the CFP® and Certified Financial Planner™ marks after his name. Alex took additional training from Boston University. He passed his 1.5 day comprehensive exam with flying colors 18 months ago. The exam covered general financial planning concepts, risk management, investments, retirement planning, and estate planning. Less than 52% of all candidates pass the exam on the first attempt.

And even though he has an MBA in finance and worked four years as an analyst at a major mutual fund company, the CFP Board requires three years of actual experience working with clients in the field of financial planning. Given the tasks he handled and the complex client situations he helped us with, we would like to think that those three years with us were the equivalent of 10 years elsewhere.

Congratulations, Alex. We're proud of you.

The Team Advantage™

Ron Kelemen, Mary Way and Alex Sheppard are independent Certified Financial Planner™ certificants. They jointly serve their clients as a team with over 41 years of combined experience. They are all members of The National Association of Financial Advisors (NAPFA), and as such work on a fee only basis and do not accept any third party compensation or finders fees. Their practice focuses on wealth planning and management for professionals, business owners, and retirees. They are advisory associates of The H Group, Inc., one of the largest independent fee-only registered investment advisory firms in the Northwest with 18 professionals and over $500 million under active management.

About Ron Kelemen, CFP®

In practice since 1981, **Ron Kelemen, CFP®** is a contributing author of three financial planning reference books. *Medical Economics* listed him as one of the 150 best financial advisors for doctors. He is President-Elect of Salem Rotary, active in mentoring and in several local charities, and is frequently quoted in the national press and professional journals.

About Mary Way, CPA, CFP®

Mary Way, CPA, CFP® celebrated her 14th anniversary as a member of the practice. She is also a non-practicing CPA with 16 years experience in banking, business, and finance. She sits on the Investment Policy Committee of The H Group, Inc. and is Secretary of the board of the Willamette Valley Estate Planning Council. She is active in Salem Rotary and the Financial Planning Section of the Oregon Society of CPAs.

About Alex Sheppard, MBA, CFP®

Alex Sheppard, MBA, CPF® joined the practice in March 2005. He has a variety of experience in financial services, including four years as an analyst with a major mutual fund company. He is active in the Salem Area Chamber of Commerce and serves on the board of South Salem Rotary and the Willamette Chapter of The American Red Cross.

TEAM UPDATE

Whew! We made it through another tax season. And with the turbulent markets, we took on several more new clients. So it's been busy around here!

Lani was born in Hawaii, but it has been decades since she's been back. As you read this she is probably sitting on a sunny beach with husband Jim. Lani spent several weeks conducting an effort on behalf of her church's Relief Society to collect clothing and household goods, which were then distributed to local families and community service organizations. She also received a special gift from daughter April the day before Easter with the birth of a new granddaughter.

Debbie has been busy processing new account paperwork and withdrawal requests for taxes. She and Bob have taken a couple of short trips in the Northwest.

Alex had his three year anniversary with us and is now officially a CFP. He started to feel his age at an ultimate Frisbee tournament in Bend, but the rest of us aren't giving him much sympathy. Alex also chaired the Chamber of Commerce's Leadership Salem Education Day and has been busy as a board member of the Red Cross.

Mary is enjoying her first spring in her new home in Silverton, and has prepared a small garden space to grow herbs and tomatoes. The daffodils she has transplanted four times over the years at three different homes are now blooming in the new yard. Without a dog since Lucy died in December, she regularly goes out of her way to ask dog owners if she can pet their dog. She continues her commitment to fitness and health with Jazzercise, weight training, and yoga.

Ron and Kathy almost didn't go to Indonesia for three weeks in January on a Rotary fact finding mission. But they did, and it turned out to be the trip of a lifetime. They made new friends, ate extremely well, and came home with lots of photos and projects for partner Rotary clubs in Oregon. He has been very busy getting ready to take over as president of the Rotary Club of Salem and helping Kathy complete the design of their new condo and get their home ready to sell. (It sold in less than a week at almost full price!) As you read this they are moving into an apartment until their condo is ready in December.

Retire Now, Wait, or Fuhgeddaboudit? . . . continued from page 1

Like articles in the consumer press, **"The 10 Things You Must Consider"** on page 1 are mere guidelines. They may not be applicable to your situation. **The only way you will truly know if you can confidently retire or stay retired is to get a thorough analysis, taking all the relevant factors into account. If you are within 2-5 years of retirement seek professional advice.** Your retirement is too important to leave to chance or to generalized articles where the author or newscaster doesn't even know your situation.

You can read an article about cardiovascular health in the paper. Yes, you may think you're doing okay for your age. But until you get a thorough checkup, you won't have the confidence to go wilderness backpacking, skip a workout, or enjoy that cheese omelet.

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Protect Yourself from a Retirement Plan Lawsuit . . . continued from page 3

But merely offering the proper number of portfolios and/or mutual funds will not relieve you of your liability. You are required to provide your employees with enough education to make an informed choice. If you are using a commission-based broker, that person cannot be compensated more on one product than on another. And they can't charge fees, yet still earn commissions or trail fees. That's why more and more employers elect to use either a professional employee education service, or a registered investment advisory firm working strictly on a fee-only basis to help them provide employee education.

3. Investment Management Level

Some business owners want to manage the retirement plan money themselves. But if they do, they must act as a fiduciary. In the old days—dating back to 1830—being a financial fiduciary meant acting "with the care, skill, prudence and diligence of a **prudent person**." But the bar was raised under ERISA. Now a "prudent person" must act in "a manner that someone in like capacity **and familiar with such matters** would use in similar circumstances." In short, you are held to the standard resembling that of a **"prudent expert."**

What does this mean? You will most likely be judged against investment professionals applying the Uniform Prudent Investor Rule, which Oregon and most other states have adopted. Most of these professionals apply modern portfolio theory and apply risk/return analysis to construct diversified portfolios. They develop a written investment policy and stick to it. They carefully research their choices and monitor them regularly. They avoid conflicts of interest and pay attention to costs. All of this is very time consuming and it takes expertise.

Of course, with careful selection and monitoring, you can delegate these activities to a registered investment advisor who agrees to become a fiduciary to your plan. It still doesn't completely absolve you of your fiduciary liability, but it reduces it and frees up your time to do what you do best. We would welcome this opportunity to help reduce your liability and find you more free time. **And if you aren't a business owner, why not act as a fiduciary to your own future? We can help.**