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THE KELEMEN-WAY FINANCIAL PERSPECTIVE

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Planning For Health Care Expenses In Retirement

Until retirement, health insurance is often taken for granted. Employers know just how sharply premiums have increased in recent years, but at least they are a tax-deductible business expense and a necessity for attracting and keeping good employees. Premiums paid on of employees are not considered taxable income to the employee. And for the most part, working people are healthier than retired people, so "out of sight, out of mind."

All of this changes when you retire. The difference between a financially secure retirement and a disastrous one could depend upon the three largest unknowns in retirement planning: your life expectancy, health, and the costs of health care insurance.

We've talked about life expectancy many times before in this newsletter. The longer you are retired due to early retirement and/or longevity, the more money you will need. In the retirement planning projections we do for our clients, we model various investment return scenarios to help you predict how long your capital will last at various withdrawal rates and life expectancies.

Probability of Living to Certain Ages

	50% Probability	25% Probability
Male, Age 65	85	92
Female, Age 65	88	94
Couple, Both Age 65	92 (One survivor)	97 (One survivor)

Source: Society of Actuaries, 2000 Annuity Mortality Table. Assumes a person is in good health at age 65.

The chart is based on a wide pool of individuals and couples. For a more custom-designed estimate of your own life expectancy, try www.livingto100.com. (You may also find it a good educational tool about staying healthy.)

So how much will you need for health care?

Two significant studies have attempted to quantify these risks and suggest how much capital is needed at the start of retirement to pay for health care (but not long-term care).

A 2002 study by Fidelity Workplace Services calculated the amount of capital to fund Medicare supplement insurance and out of pocket costs for a retired couple. The costs ranged from $160,000 for a couple retired today at age 65 up to $260,000 for one that retired at age 55 today.

The Employees Benefit Research Institute (EBRI) conducted a more sophisticated analysis this year. It calculated three different premium inflation rates, with three different benefit options and out-of-pocket costs. The conclusions are sobering for early retirees, especially those that don't have a continuation of their group coverage. To get to age 65, a 55-year old could potentially need $47,000 to $256,000 of extra retirement capital earning a 4% after-tax return.

Then, at age 65 Medicare—and life expectancy—kick in. Again with a variety of inflation and benefit option scenarios plus five different life expectancy scenarios, the EBRI study estimates the retirement capital needed at age 65 to be $47,000 to $359,000—per person!

So a couple retiring at age 55, living to age 95, and covering all of their heath insurance and out-of-pocket expenses could require well over $350,000 to $600,000 of additional retirement capital at the start of retirement. And this does not include long-term care costs.

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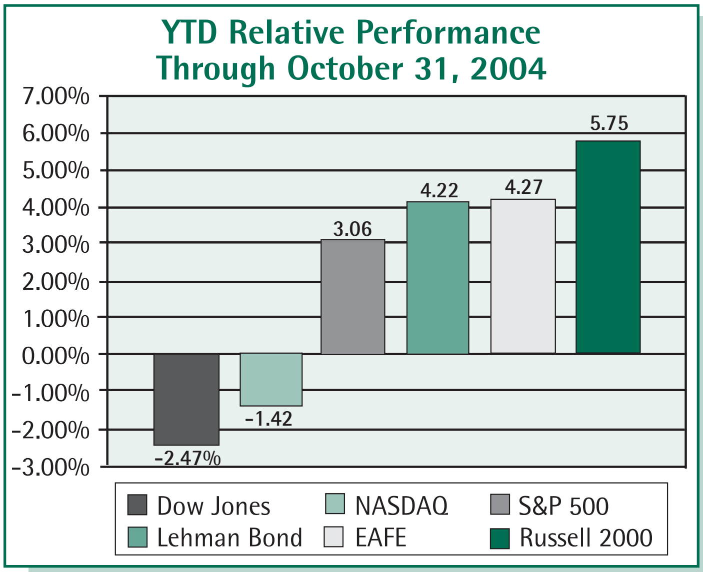
Don't Be Mislead By "The" Market

We are always amused when an acquaintance, client, or even our spouses say something like "Wow, the stock market has really gone up today." Or, "Darn, this is a lousy year for the market," or "What did the market do today?"

Although we don't always say so, our first reaction is "To which market were you referring?" Quite often people are referring to the Dow Jones Industrial Average. Just like the other indexes mentioned in this newsletter, the Dow is not an investment, and it is not possible to invest directly in it. It is merely a collection of unmanaged stocks. In the case of the Dow, it is only 30 large companies.

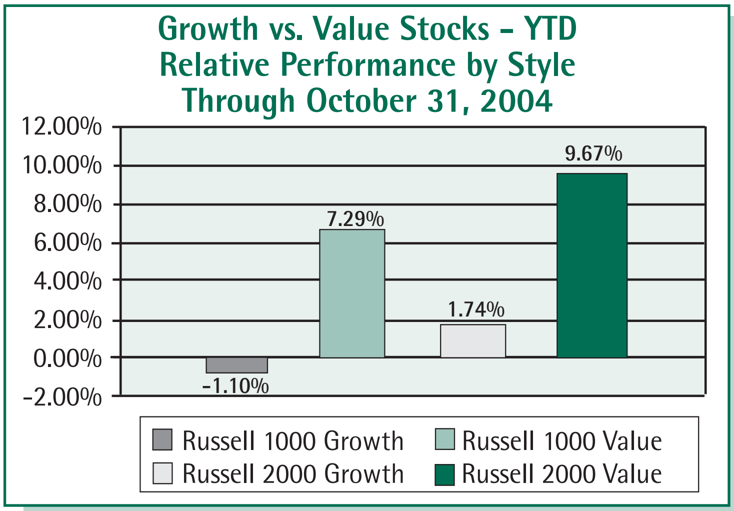
The Dow is currently calculated by dividing the combined share prices of each component by 0.13561241. The divisor changes periodically for stock splits. Thus, higher-priced shares affect the Dow's movement more. The S&P 500 is calculated by company size, where the largest companies, such as Microsoft, Intel, and GE have a much greater influence on the movement of the index.

We like to refer to indexes as a shorthand method of communicating for the media, often generating financial noise but not much information or wisdom. In fact, an index can actually distort what is really going on. Take the Dow, for example. On September 30, pharmaceutical giant Merck, one of the Dow's 30 companies, announced the recall of Vioxx. Its shares dropped 27% that day, sending the Dow down 60 points. One could conclude that "the" stock market went down that day. In reality, the other stocks in the Dow had a pretty decent day, and according to the October 1st Wall Street Journal, the Dow would have increased 33 points without Merck.



Source: The H Group, Inc. November 2004

The five-year history of the S&P 500 Index through August 31 provides us with another example of how relying on an index can give you a misleading impression about what is happening with stocks in general. According to a September 2004 Lipper Analytical Services report, the S&P 500 lost 12.3%, compared to a gain of 9.9% for the average actively managed stock mutual fund. This is because the S&P 500 had a heavy weighting in technology stocks, which have not done as well as other sectors.



Source: The H Group, Inc. November 2004

Looking at the three major stock indexes through October 31, 2004, one could also assume that "the" market was down or very lackluster for the year. The Dow and the NASDAQ were down, and the S&P 500 was up modestly. But the Russell 2000 index of small companies, the Morgan Stanley EAFE international index, and the Lehman Aggregate Bond index were up at least 4%. Thus, investors with diversified, properly balanced portfolios are having a pretty decent year.

But it goes farther than that. Those that were over-weighted in smaller value companies, as opposed to growth companies did even better. So there is no substitute for a properly constructed and reviewed portfolio. If done properly, you will usually—but not always—have asset classes in it doing well, some doing okay, and perhaps one or two not doing as well. If everything is doing well, you aren't properly diversified for sudden changes in the economy or financial markets.

Yes, it is easier to generalize about "the" market. And on good days with the Dow or the S&P 500 doing well, it's actually fun. **But when it comes to really knowing what's going on, the bottom line of your total portfolio matters more than an index.**

Planning For Health Care Expenses In Retirement . . . continued from page 1

Granted, as you age, you may be traveling less and not going out for dinners and evening entertainment as much. So, some of the extra lifestyle expenses in the early years of retirement can be offset by health care expenses later. But these, along with your current health and family history are some of the many elements that need to be carefully calculated into a financial plan for retirement. Health care in retirement is an expense that you may not have now. As you age, the expense can grow. The bottom line, retirement is your most expensive purchase. Plan for it accordingly.

The World Series is over, the election is over, and the year is almost over. It's time to think about these things before the Rose Parade begins. So start the year off on the right foot with some serious thought about where you are going, when you are going, and how you will get there.

Are You Adequately Insured Against A Major Loss?

Last year's wildfires in California and Oregon, and this year's hurricane season in Florida have been a wake up call for many homeowners about their property and casualty insurance policies. Most realized too late that their homeowner's policies were inadequate. You could find yourself in a similar situation in Oregon with fire, water, storm damage, theft, or earthquake.

In 2003, Marshall and Swift/Boeckh, and company that provides building-cost information software to the insurance industry concluded that nearly two-thirds of U.S. homes were underinsured by an average of 27%. There are several reasons for this. People forget to update their policies after a major remodel, construction costs have soared, and new building codes increase reconstruction costs.

Another reason is that many insurance companies have started substituting a "guaranteed replacement policy" for an "extended replacement policy." The first one guarantees replacement of a destroyed home, while the extended one pays the amount stated on the policy plus an additional 20% to 25%.

It is basically your responsibility to read your annual notices and make sure your coverage is up to date. Solid financial planning starts with sound risk management by protecting what you already have. So here are some points to consider:

- Although it's not the most exciting reading you'll ever do, read your policy. Ask your agent to explain the clauses you don't understand.
- Make certain you understand what kind of living expenses you would receive after a disaster. Many insurers limit payments to 12 months, which is often not enough time to rebuild a home.
- Consider adding an "inflation" guard clause to your policy.
- Ask for a building-code upgrade endorsement on your policy, since codes usually change over time. Otherwise, your company may not pay the extra costs of rebuilding up to code.
- Be sure that your agent knows what's special about your home. This could include the type of counter tops, wallpaper, and light fixtures.
- Inventory your personal possessions. A good way to do this is to take a walking tour of your home with a video camera, making commentary as you go, and keep the cassette in your safe deposit box. Then be sure to insure your personal possessions for replacement costs (the new price) rather than cash value (the old price). For example, look inside your closet. What would it cost to replace just the shoes and clothing in there? What about all the special cookware and kitchen gadgets, tools in your garage, etc.?
- Your land cannot be insured, but what would it take to replace your expensive trees and shrubbery?
- Purchase an umbrella policy in addition to your homeowner and auto insurance to provide additional liability coverage against lawsuits. Most companies will give you a discount on it if you also have your homeowners and auto policies with them. They can cover the legal expense and the cost of claims from dog bites, libel, slander, wrongful death and other items usually not covered claims not covered under your home owner or auto policy.
- Ask about what kind of coverage you have for mold and/or water damage. Many companies are starting to limit their coverage for these losses.
- Don't forget to do all the above for any vacation property, which might be even more vulnerable to fire.
- This is Oregon, and we are on a major fault line. The time to get earthquake insurance is before the next Big One. The way Mt. St. Helens has been acting up these days, now is the time to do it. Earthquake insurance has a high deductible and doesn't cover brick facades, but it could really help in a catastrophic event that affects the foundation of your home.

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THE KELEMEN-WAY ADVANTAGE

Ron Kelemen and Mary Way are independent Certified Financial Planner™ certificants and jointly serve their clients as a team with over 31 years of combined experience. Their fee-based practice focuses on wealth planning and management for professionals, business owners, and retirees. Together, they have developed *The Planning Vision Process®* and several other unique processes. They are both advisory associates of The H Group, Inc., one of the largest independent fee-based registered investment advisory firms in the Northwest with 18 professionals and over $380 million under active management. They are also registered with Financial Network Investment Corporation, (unaffiliated with the H Group, Inc.) a national broker-dealer with offices throughout the United States, Member SIPC.

About Ron Kelemen, CFP®

In practice since 1981, **Ron Kelemen, CFP®** is a contributing author of the definitive book on retirement planning: *Ways and Means: Practical Answers from America's Foremost Financial Advisors and Retirement Planning Attorneys*. His other contributory book, *Strictly Business–Planning Strategies for Privately Owned Businesses*, is now available from Ron or Quantum Press. He is President of the Willamette Valley Estate Planning Council, active in mentoring and in several local charities, and is frequently quoted in the national press.

About Mary Way, CFP®, CPA

Mary Way, CFP®, CPA is a professional team member on Ron's team for over nine years. She is also a non-practicing CPA with 16 years experience in banking, business, and finance. She is active in Salem Rotary, the Financial Planning Section of the Oregon Society of CPAs, The Oregon Financial Planning Association, and The Willamette Valley Estate Planning Council.

The opinions expressed in this newsletter are those of Ron Kelemen, CFP® and Mary Way, CFP®, CPA. They do not necessarily reflect those of The H Group, Inc. or Financial Network. They are general comments that may not be appropriate for every individual. They should not be construed as legal or tax advice. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. All economic information is historical and not indicative of future results.

Team Update

We are busy wrapping up our best—and busiest—year ever. A number of new regulatory mandates have added to the workload, and will continue to do so. But we're on track to get things pretty much wrapped up so that we can take some extra time off around the holidays. We hope you can, too!

Lani Moore took one of those "get caught up on home projects" vacations. Her father passed away in early November, so she and husband Jim made an unexpected trip to Salt Lake City.

Debbie Renggli has had her nose to the grindstone processing new business, account conversions, and client requests, and required minimum IRA distributions. Daughter Gretchen transferred closer to home at the University of Portland. Son Pete will graduate from Emory Riddle in December and has a job as a helicopter pilot and instructor.

Mary spent a lot of time covering for Ron while he was gone. She attended the Oregon CPA Society's financial planning conference. Much of her free time has been consumed as editor of the Salem Rotary's widely acclaimed bi-weekly bulletin. She and Steve just celebrated their 10th wedding anniversary with a trip to Seattle. They also are proud owners of a new Toyota Hybrid Prius, and just about have the controls figured out.

Ron was elected President of the Willamette Valley Estate Planning Council. His comments about the election from the last issue of this newsletter were published in the *Oregonian*. He and **Kathy** launched their new empty nest era with a trip of their own after sending daughter Skyler off to Boston University, along with her older sister. They traveled from Normandy France to Nuremberg Germany for three weeks with Kathy's parents, retracing her father's WWII steps as a tank commander under General Patton. They also traveled together to New Mexico for Ron's advanced financial planning conference, and made a short trip for parents' weekend at Boston University. It's good to be home and to stay home for awhile!

Free Credit Reports

The Fair and Accurate Transactions Reporting Act of 2003 requires the major credit reporting agencies to offer all Americans a free annual review of their credit report. The law is being phased in, starting with the Oregon and other western United States on December 1. **This is a great opportunity to review your report for errors and spot potential signs of identity theft.** And you may be curious to know your FICO score, which measures your credit worthiness. The score ranges from 350 to 850. The current median score is a respectable 723. **To order your free reports from the three major agencies call:**

Equifax 800-685-1111
Experian 888-397-3742
Trans Union 800-888-4213.

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Year-End Tax Planning

This is an important time of year to meet with your tax professional. It is so much easier for them to save you taxes and penalties now, than after December 31. We will send estimates of portfolio gains, losses, interest, and dividends to the tax professionals of our fee-based retainer clients in plenty of time for them to help you with your year-end projections.

And speaking of tax planning, you have until December 31 to maximize your voluntary 401-k, 403-b, or 457 retirement plan contributions, and to establish a plan if you don't already have one. Those over 70 ½ must also have taken their IRA minimum distributions by then. Give us a call and we'll be happy to help.

Thank You!

As the year draws to a close, we would like to extend our thanks to all of you who helped make this our best year in the business! We sincerely appreciate your referrals, friendship, gratitude, and continued confidence. Best wishes for a safe and happy holiday season, and for a very good year in 2005!

Are You Adequately Insured . . . continued from page 3

Some of these changes may raise your premium, but you can offset that by taking a higher deductible. The purpose of insurance isn't to "get something back" from it for minor losses. Rather, it is to transfer the risk of a catastrophic loss that you cannot afford to take yourself.

Finally, the lowest premium from an out-of-state telephone-marketed insurance company may cost you dearly in the long run. Your property and casualty agent is your partner in helping you to manage risk. So select a local agent with a good reputation who knows you, your property, Oregon insurance rules, and the local market. Like us, their reputations are one of their most valuable assets.