The Kelemen, Way & Hanslits

FINANCIAL PERSPECTIVE

Creators of The Planning Vision Process®



Ron Kelemen, CFP® Mary Way, CPA, CFP® Larry Hanslits, CFP®

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CREATING CLARITY & CONFIDENCE IN A COMPLEX WORLD

Nowhere to Hide

Investing For Financial Security in Difficult Times

The most common question we receive these days is "Where can I safely get a decent return on my money?" We answer with three basic questions:

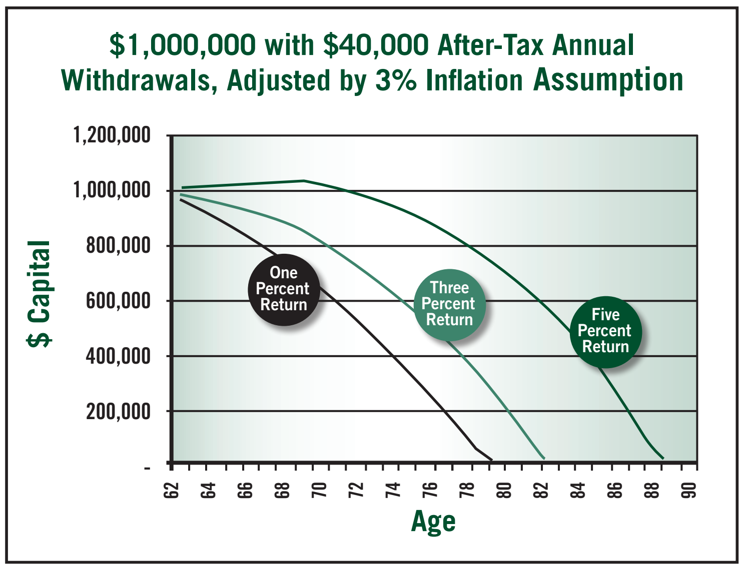
1. "When do you need it?"
2. "What is the purpose of this particular account?"
3. "How do you define 'safety'?"

For short term savers, it's an easy—but unsatisfying— answer: there is nowhere to hide <u>and</u> get a reasonable return. If your time horizon is six months to three years, a Treasury bill, bank CD, savings account, or money market fund are your choices. And it's going to stay that way at least until 2013 because of the Federal Reserve's policy to suppress short-term interest rates in the hopes that it would stimulate bank lending and the economy.

But what if this money is destined for retirement income, either soon or over the longer term? ***Then you cross the fine line between sleeping well now and eating well in retirement; where you need to think less about portfolio volatility and more about inflation risk.*** The Social Security Administration just announced a 3.6% cost-of-living adjustment (COLA) to reflect the inflation we have experienced over the past 12 months. This is slightly higher than the long term average CPI of 3.26% since 1919, and the 2.7% average annual COLA adjustment since 1990. *(Source: inflationdata.com and SocialSecurity.gov).* Many retirees complain that these COLAs don't truly reflect their increases in the cost of living. ***The point is that none of the "safe" alternatives/hiding places keep up with inflation. And when taxes are included, they are negative returns. This is going broke safely.***

This may be too abstract to grasp when the daily (excuse us, hourly) headlines scream at us to be fearful because it's a dangerous volatile world out there. So let's illustrate it with a simple model of three hypothetical 62-year old retirees. Let's say they each have $1 million, with 70% of it in an IRA, and 30% outside. Each wants $40,000 per year after tax from the portfolio (a reasonable 4% withdrawal rate at the start), adjusted by 3% per year for inflation.

Retiree A hides it at 1%; Retiree B puts it away at 3%; Retiree C tries to strike a balance at 5%. How do they do?



(Source: Money Tree Software)

As you can see by the graph, Retirees A and B don't do very well. If this was their only nest egg, they will have to fall back exclusively to Social Security or go back to work. Retiree C does much better, and can stay retired to age 89, assuming he/she earns 5% each and every year. But there will be ups and downs, and worrisome times like we are experiencing now. And what if Retiree C lives to age 95? When we run a simulation 10,000 times, and vary the returns and inflation rates, Retiree C runs out of money 12% of the time before age 80.

Now we're talking about serious risk, which makes all these worries about monthly portfolio fluctuations seem rather small. So, in this longer term concept, risk should be defined as running out of money before you run out of life.

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500 Liberty Street SE, Suite #310
Salem, OR 97301
(503) 371-3333

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So, let us introduce Retiree D. He/she invests in a well-constructed portfolio that includes cash and government bonds, but also a mix of dividend paying stocks, small, medium, and international stocks, commodities, real estate investment trusts, and higher-yielding corporate bonds. The assumed straight-line return is 7% every single year (a huge assumption), making the capital last to age 100, and with a very healthy buffer of over $1.4 million at age 90. When we vary the returns 10,000 times, he/she runs out of money only 3% of the time before age 85.

So, for longer-term money, where can you invest it?

1. Defer Social Security

The best investment one can make right now is to postpone taking Social Security benefits to age 66 or beyond—even if you need to consume idle cash to do so. Why? Without factoring in the COLA, your monthly benefit actuarially increases an average of 6.2% per year between ages 62 and 66, and it increases 8% each year from age 66 to 70. All future COLAs will be based on those higher amounts. So let's assume your age 62 starting benefit is $1,793, and we adjust it for the 3.6% COLA just announced, and assume a 2.8% COLA in future years. By age 66 you would have a benefit of $2,691, and if you waited to age 70, your benefit would be $3,966. It's pretty hard to beat that return!

2. Debt repayments

Paying off high interest consumer loans with idle cash makes sense, as long as you don't run out and incur more debt or deplete your cash reserves. Paying off a low interest rate mortgage isn't always smart. ***There is a fine line between paying off debts and building a resource for retirement income.*** In this era of depressed real estate prices, tight lending standards, and illiquidity, you can't trade in a sliding glass door from your paid off home for a bag of groceries.

Thank You!

As the year draws to a close we wish to thank all of you for your loyalty, referrals, kind words, business, and patience. We are so grateful. We look forward to serving you even better in the year ahead.

3. Income-producing real estate

If you have the time, temperament, and tools, this might be a good time to purchase income-producing real estate. While real property doesn't appear to fluctuate in price every day, it presents its own set of risks and rewards. Make sure you can deal with the lack of liquidity, have the cash to deal with repairs and vacancies, and have the time or resources to manage it.

4. Stocks

Hypothetical Retirees C and D may have included some dividend-paying stocks. The average dividend yield of the 500 stocks in the S&P 500 index is 2.06% as of November 30, 2011. This is the same as the 10-year Treasury note yields, but without the potential for increases as companies raise prices and/or become more profitable. And while there is the possibility for share price depreciation, there is also the potential of share price increases over time. Quite a few name-brand companies in this list have payouts over 5%. Some are as little as 0.7%. But if we subtract the 104 companies that don't pay dividends (some of which are good growth companies), the average dividend yield is 2.6%--just 0.4% less than a 30-year US Treasury bond.

5. Bonds

Retirees C and D may have also purchased corporate bonds of varying maturities, or funds that invest in them. The Barclay's Capital Corporate Long-Term Bond Index had an average yield of 4.26% on November 30, 2011, while the index of higher yielding, higher risk bonds yielded 8.87%.

Short-Term Anxiety vs. Long Term Security

Assets traded on an exchange, such as stocks, bonds, or commodities, enjoy excellent liquidity. The published value is what a willing buyer pays a willing seller. (Real estate probably would fluctuate just as much if it were traded in a similar manner.) But the price we pay for this liquidity is often nerve-wracking volatility. We see the toll this anxiety takes on some of our clients and friends. But the really depressing cases are the newer ones in the door where people are near the end of their money too soon, due to circumstances, life style choices, or short-term thinking.

So when you feel the urge to put your portfolio under the mattress, try putting your concept of risk into the perspective of your lifetime. Best wishes for the holidays, and may you and your money have a long happy life.

2011 Small Business of the Year

We were very pleasantly surprised in late September to be named by the Salem Area Chamber of Commerce as the 2011 Small Business of the Year. In fact, it was such a surprise that Ron heard about it after the fact in a text message while he was in Chicago.

The award is based on: 1) business excellence, 2) customer/client relations, 3) community service, 4) achievement recognized by other organizations, and 5) innovation. We are truly humbled by the honor, because there are so many other businesses in the Salem area that are also worthy of this recognition. We'd like to express our thanks to everyone who has helped get us to the point where such an award is possible.

Volatility—Friend or Foe?

The financial markets have been very volatile lately, and most people can't stand it—especially when it is the bad kind of volatility when things go down. The VIX Index is the best measure of this volatility and it is often referred to as the "Fear Index." Using complex mathematics and S&P 500 future contracts, it is a measure of anticipated stock market volatility (up and down) over the next 30 days. It recently reached a high not seen since those scary days of January and February of 2009, but still half of what it was at the height of the financial crisis in the fall of 2008.

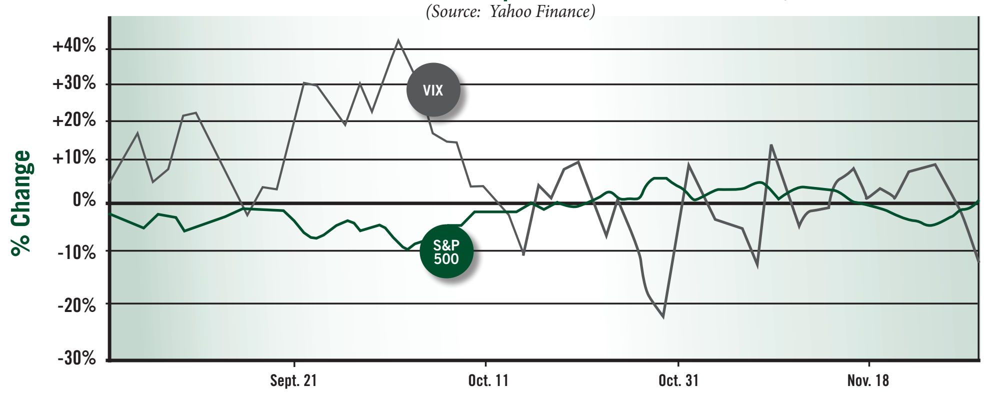
We have suspected that much of this market volatility in recent months has been news-driven, not driven by company or economic fundamentals. So we were happy to see research published in the November 22 issue of *Goldman Sachs US Daily.* It found that over the past six months policy announcements had an overwhelming impact on market volatility, while economic releases seemed to have very little.

Most people like the good kind of volatility, such as the huge 490-point Dow Jones surge on November 30. But we would argue that as a long-term investor, the "bad" volatility can also be your friend. Take a look at the two charts. The really jagged peaks and valleys show the VIX Index. A high point means the stock market is very volatile and investors are generally fearful. The more steady line is the S&P 500 Index, a general proxy for stocks.

In many cases, the S&P 500 line is low or decreasing when the VIX Index is high, and vice versa. **So, if you want to invest when things are relatively calm, you may probably end up buying in at higher prices. Likewise, if you're thinking of getting out of the market when economic conditions seem bad and volatility is peaking, you could be selling out near the bottom.**

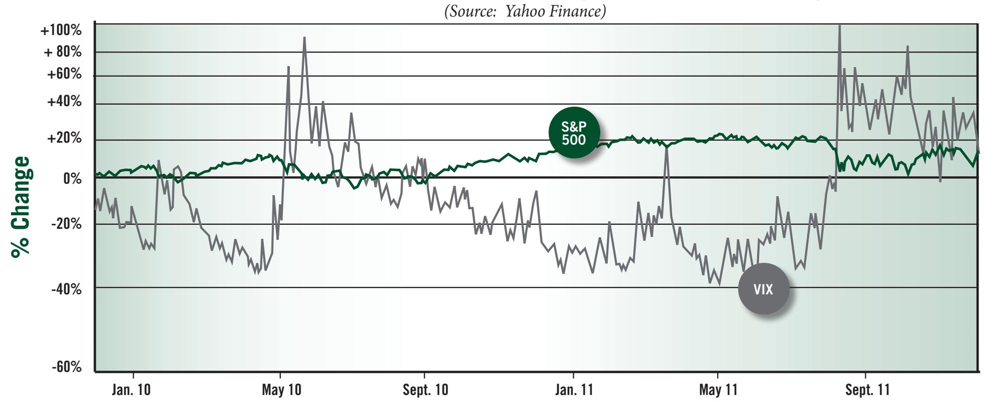
The VIX Index vs. The S&P 500 September 1 to November 30, 2011

(Source: Yahoo Finance)



The VIX Index vs. The S&P 500 December 1, 2009 to November 30, 2011

(Source: Yahoo Finance)



Check Out Our Updated Website!

Creating a website is like having a child. It's fun and easy to get started, but nobody tells you about the next 18+ years of maintenance! So you might want to check out what we've done recently in the maintenance department. Go to **www.TheHGroup.com** to check out our new look and feel. If you want to go straight to our section, go to **www.PlanningVisionProcess.com**. Our plans for 2012 are to post more current perspectives and to eventually make it a place where we can securely exchange documents with clients.

The Team Advantage™

Ron Kelemen, Mary Way, and Larry Hanslits are independent Certified Financial Planner™ certificants. They jointly serve their clients as a team with over 72 years of combined experience. They are members of The National Association of Personal 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 is a contributing author of three financial planning reference books and is frequently quoted in the national press and professional journals. *Medical Economics* lists him as one of the 150 best financial advisors for doctors. He is active in Rotary and several non-profit organizations.

About Mary Way, CPA, CFP®

Mary joined the practice in 1995. She is also a non-practicing CPA with 16 years experience in banking, business, and finance. She is a board member of the Salem Rotary Foundation, and like Ron, a past president of the Willamette Valley Estate Planning Council.

About Larry Hanslits, CFP®

In practice since 1985, Larry merged his practice with Ron's and Mary's in 2011. He sits on the investment policy committee of The H Group, Inc., provides advanced estate planning case writing services to attorneys nationwide, and is a teacher and a judge for the financial planning scholarship competition at Oregon State University.

TEAM UPDATE

Many of our clients view their New Year starting when school/college starts. Others want to review their goals at this time of year so that they can hit 2012 with a running start. So we've been busy with many plan updates, year-end planning, and keeping close tabs on the European situation. And we finally got our website updated!

Lani got our data bases and contact lists updated. It's a bigger project than one would think the way people change emails and cell phone numbers all the time. She's the one to thank for getting our wreaths sent. She spent a week in Utah for her mother's 85th birthday and reaped a bountiful harvest from her garden and new coup of chickens.

Debbie sent the last of the IRA minimum distributions, as well as capital gains estimates sent to clients and their tax professionals. She and husband Bob spent a week at Black Butte with friends. After 10 years as empty nesters, son Pete moved back in from Arizona—but he pays rent and earns his keep! If you hear some jubilant quacking around here, it's because she and Bob have been going to the Oregon Duck home games this season.

Larry was the featured speaker at the Willamette Valley Estate Planning Council on the topic of integrating estate planning with investment and retirement planning. His home, horse arena and 90-acres in Florence are starting to get some showings, so he and Laurie started house hunting in Salem.

Mary attended an AICPA retirement planning conference and came back with some useful materials to integrate into our ongoing planning for clients. She spent time with her stepson and daughter-in-law in Bend and in Newport. But the big news is that she celebrated the Big 6-0 with Steve in Cabo San Lucas for a week. She reports that life is good at this stage of life.

Ron worked on the website upgrades and spends much of his time on research and client communications, such as our regular quarterly letter and this newsletter. He and Kathy hosted Rotary visitors from India, moved Kathy's mom into an apartment in their condo building, and visited two of three daughters in New York and Boston for a week. They also squeezed in three weekend camping trips from Labor Day to Veterans Day with their fellow Airstream trailer cult members.

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Ron Kelemen, CFP®
Mary Way, CFP®, CPA
Larry Hanslits, CFP®

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500 Liberty Street SE, Suite #310 • Salem, OR 97301

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Looking Ahead to 2012

Every year at our team's year-end mini retreat, we ask ourselves ***"What are our dangers, opportunities, and strengths?"*** We thought it would be interesting to list some of them for the year ahead as it might affect all of us economically and socially.

Dangers

- No significant progress on resolving the European debt situation.
- The US election will generate negativity about our country and ill will among fellow citizens.
- The Washington gridlock will hinder our leaders' ability to cooperate and solve big problems.
- Our deficit and debt hinder our ability to maintain our military, invest in education, infrastructure, and in health care.
- The continued shrinking of the middle class.
- Persistently high unemployment rate.
- Unknown geo-political or natural disaster events.

Opportunities

- Continued economic growth, thus avoiding a recession.
- Continued stock market recovery to pre 2008 levels.
- More job growth.
- An honest debate about possible solutions to some of our dangers
- More breakthroughs in medical research and information technology

Strengths *(to help reduce dangers and maximize opportunities)*

- The most innovative and free country in the world
- Rich in natural resources and infrastructure
- The largest economy in the world[1]
- The largest manufacturer in the world[2]
- The rule of law
- Large increases in corporate profitability
- Vast improvement in corporate balance sheets
- Record amounts of cash on the sidelines that could be put to work
- A renewed ethos of financial self reliance and intolerance for debt
- A country where millions of people on the planet would trade places with us in a heartbeat.

It is tempting to focus only on the dangers, which are substantial. We think it is just as important to focus on our strengths and opportunities because they are the antidotes to the dangers.

We encourage you to apply this D.O.S question to your own situation—health, family, income, and finances. Make it a happy and prosperous 2012!

[1] Business Insider.com, March 2011. In 2010, it was $15.6 Trillion vs. #2 china at $6.4 Trillion. On a per capita basis, the US GDP is 10 times larger than China's.

[2] United Nations Statistical Division, 2011. In 2010, the US produced 21% of all global manufacturing; China was #2 at 15%. If the US manufacturing sector was a country, it would be the 8th largest economy in the world, according to manufacturing blog ShopFloor.org.