

COMMENTARY BY:



Ron Kelemen, CFP®



Mary Way, CPA, CFP®



Alex Sheppard, MBA, CFP®

## Take Stock, Take Action

Okay, so your retirement accounts appear to be going down the drain. Your home value (which you thought could only go up) has declined. You or your loved ones seem to be working harder and earning less, or their employer is facing financial difficulties. The global economy is in terrible shape. And you're reminded of these constantly by the media.

So what are you going to do about it? In this environment, doing nothing is so much easier, but perhaps more stressful. Here is our prescription for financial stress reduction: **take stock and take action.**

### Take Stock

Knowing where you stand will give you a better sense of what you need to do. Here are some very basic questions to help you organize your thinking.

1. **What are my dangers?** Lay them out on the table and put them into perspective. Some may be realistic, others just a nagging energy drain. Usually health, lack of family time, bills, job security, running out of money, etc. come to mind for many people. But how realistic are they?
2. **What are my opportunities?** These may be the flip side of your dangers. Certainly there are some good investment opportunities at this time. This may be an opportunity to reassess your goals, values, and to focus more upon family and relationships.
3. **What are my financial weaknesses?** All progress begins by telling the truth.
4. **What are my financial strengths?** You may be better than you think. Certainly, your ability to earn an income is one of them. So are having a portfolio, a pension, Social Security, and a home.
5. **What is the current value of my investment portfolio?**
6. **How much do I owe on my residence, business, student loans, credit cards or other loans?**

7. **What is a reasonable estimate of my annualized living expenses?** Try to break this down between needs and structural obligations vs. desirable—but changeable—lifestyle expenditures.
8. **What major expenses do I see on the horizon?** These can be college, new roof, vacation, gifts, new vehicle, etc. Which of these are needs vs. wants, and can any of them be postponed?
9. **How many years do you have until your desired retirement date?** If it is quite a few years off, relax. If it is fairly soon, how set in stone is it? Are you willing and able to work longer?
10. **And how many years do you think you will live after you retire? Why are we asking this?** Add your years to retirement to your projected years in retirement and you will quickly see that you have a long time horizon. You may be retired longer than you worked. Longevity and inflation risks are the two stealth retirement planning risks.

### Take Action

With answers to the above questions in mind, you are now in a better position to think clearly, put things into perspective, and take action. **You cannot control what is happening in the world, but you can control your responses to it.** So the second part of our prescription is to take action. Here are just a few things you should consider between now and year end.

1. **Rebalance.** If you have a portfolio of stocks and bonds, by default it has become more conservative. That is because stocks have gone down and bonds have held their value. Rebalance back to your original asset allocation. This is the way to sell high and buy low. And rebalance even within the bond category. Government bonds are way over-valued; corporate bonds are a bargain.

Continued on page 4

# A Framework for Making Portfolio-Changing Decisions

To say that the economic crisis has changed many things would be the understatement of the year. One of the many changes we have noted is that many clients are not as risk tolerant as they once had thought. The crisis has caused some people to shift their focus from their long-term goals to their current stress level. So last month we prepared a decision-making diagram to help our clients think through any changes to their portfolios they were contemplating. Even if you have seen this before, we hope that it will help you in the future or that it will reinforce any decisions you have already made.

## Context

*A word of caution: this framework is only helpful if you put your overall situation into context.* We go into this in detail within the article on Page 1 entitled “Take Stock, Take Action.” If you are retired, that’s a much different situation than being 10 years away from retirement with a secure job. If you have a secure pension, that’s a much better situation than being mostly dependent upon your portfolio for income. If your child is a high school freshman that is different than if she is a college sophomore. If you are drawing upon your portfolio, carefully consider your income needs, as well as large-ticket expenditures that could be postponed. How many are truly fixed needs versus discretionary wants? Consider your age and life expectancy. Do you have other assets that you could temporarily tap? *And most importantly, what is your time horizon for each portfolio?*

## Criteria

*But before you make any decisions you must ask “What are my goals and my criteria?”* Do you want to reduce volatility and the stress it causes? Do you want current income in today’s dollars, or future income adjusted for inflation? Is taking care of yourself a higher priority than leaving an inheritance? Is avoiding further declines more important than all other goals? Do your criteria apply to all of your accounts or just to one or two of them?

### Option #1—Convert to cash investments

#### Pros

- Prevents further loss
- Creates some certainty and peace of mind
- Creates tax losses in non-retirement plan accounts

#### Cons

- Selling near the bottom; permanently locks in losses
- It may take many years at today’s low interest rates to recoup losses
- No inflation protection

### Option #2: convert to all bond portfolio

#### Pros

- Reduces risk and volatility
- Could increase income
- Creates tax losses in non-retirement plan accounts
- Some potential for account growth in certain classes of bonds

#### Cons

- Permanently locks in the loss in equities
- May be selling stocks low and buying bonds high
- Could lose value when interest rates and inflation increase

### Option #2.5: A more conservative investment mix

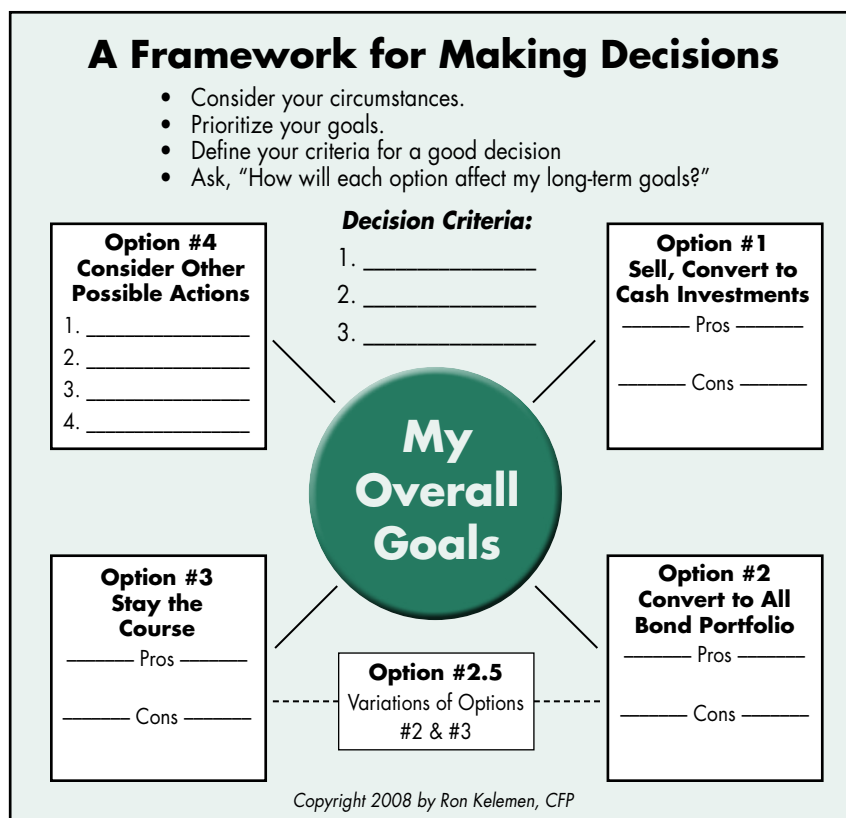
#### Pros & Cons

- Similar to those of Options #2 and #3, but to different degrees depending upon what you do

### Option #3: Stay the Course

#### Pros

- Market turnarounds are sudden and steep, especially in the early phases of a recovery
- Current good valuations, ratios, dividend yields, etc. in many equities
- Potential to recoup losses the fastest



#### Cons

- Things could go lower
- It’s nerve wracking!
- Equities could stay low for undetermined time

### Option #4: Consider other possible actions

- Spend less
- Work longer
- Postpone expenditures
- Invest now
- Take withdrawals from fixed accounts
- Liquidate other assets

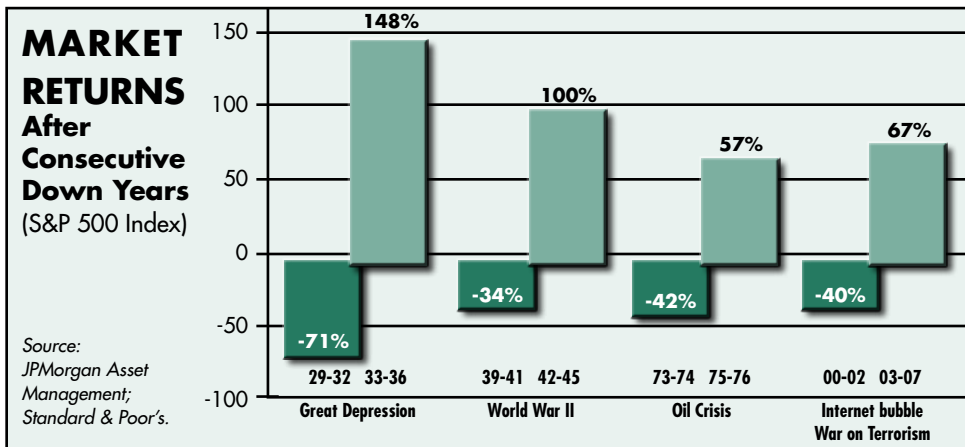
We’ll be the first to admit that this is a simplistic analysis and that there are many nuances to each option, advantage, and disadvantage. You may well think of additional bullet points for each option. But in this complex environment in which we find ourselves, sometimes simplicity can bring clarity and remind us of the key factors of each choice.

*The most important thing you need to do when making a decision is to establish criteria for what constitutes a good decision for your circumstances and long term goals. We would welcome the opportunity to help you do this. And it may turn out that your best decision is to not make any emotional short-term decisions with long-term consequences.*

# Think Beyond the Moment

One of the most dangerous thinking patterns of behavioral finance is the tendency to think that the current trend will continue indefinitely. We saw it with real estate and oil, and now we're seeing it in the stock market. At the height of historic bubbles—whether it is in tulips, railroad stocks, dot.com stocks, real estate, mortgage-backed securities, oil, gold, or any other investment, people tend to believe that the sky is the limit. They think they can't lose, and they often back up that belief by borrowing to invest more. Then the prices become unsustainable and burst.

But the same irrational thinking happens in bear markets and bad economic times like we are in today. Some clients question whether things will ever turn around or whether they will ever recoup their losses in their lifetimes. Even relatively young clients are thinking that way!



If we could offer you a piece of wisdom it would be this: Everything—whether it be electrical currents, the weather, the seasons, the economy, political and social trends, fashion, real estate, stocks, bonds or interest rates—has a cycle. **Nothing goes up forever or stays down forever.**

It's hard to see the big picture even on a yearly basis. In the last 28 years through 2007, the market (as represented by the S&P 500) ended the calendar year positive 22 times. But every one of those positive 22 years had negative periods during the year, ranging from -3% to -34%.

**We don't know when the market will stabilize and come back. But with history on our side we do know that it will.** We also know that the quickest way to recoup losses is through the stock market, where most of the recovery occurs in the very early stages. The 21% gain in the S&P 500 late November and early December proves that, as does the chart of other major down periods.

## What Do a Chicken and a Mortgage Derivative Have in Common?

Derivatives are unbelievably complex financial instruments. They are one of the reasons for the economic mess in which we find ourselves. In a nutshell, a derivative is a separately-sold piece of an investment security, such as a package of mortgages.

Think of your local butcher as a dealer in chicken derivatives. The whole chicken in the refrigerated case is already a derivative because the feathers and feet have been removed. They were sold to someone else who has more use for them than you do. You can buy even more "exotic" chicken derivatives. The wings are packaged for those who want to cook buffalo wings. You might prefer the boneless, skinless breasts, but the bones and skin are used by a food processor to make chicken broth. Someone else wants chicken livers. So, the sum of the parts becomes more valuable than the whole.

Mortgage-backed derivatives are packages of mortgages. Some investors want income and principal payments, others want interest only. Still others are willing to receive nothing

Continued on page 4.

## 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 \$400 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* continues to list him as one of the 150 best financial advisors for doctors. He is President of the Rotary Club of Salem, chair of the Willamette Academy Advisory Board, and immediate past president of the Medical Foundation of Marion and Polk Counties. Ron is frequently quoted in the national press and professional journals.

### About Mary Way, CPA, CFP®

**Mary Way, CPA, CFP®** joined the practice in 1995. 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., is Vice President of the Willamette Valley Estate Planning Council, and a board member of the Salem Rotary Foundation. She is also active in the Financial Planning Section of the Oregon Society of CPAs.

### About Alex Sheppard, MBA, CFP®

**Alex Sheppard, MBA, CFP®** 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.

*The opinions expressed in this newsletter are those of Ron Kelemen, CFP®, Mary Way, CPA, CFP®, and Alex Sheppard, MBA, CFP®. They do not necessarily reflect those of The H Group, Inc. 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 wrote our last newsletter long ago in a different and almost carefree era—August! The weather was hot, the days were long, and the leaves were on the trees. But what has changed the most since then is the investment climate. Instead of our normal Financial Perspective newsletter to a broad audience, we opted instead to write several timely white papers and market update letters to our clients. A small portion of that content found its way into this issue. *Thanks for your business, referrals and support. We wish you security, prosperity, and happiness in 2009!*

Lani had another granddaughter in September and a grandson in November. Lani has also been unusually busy with her Church's Relief Society, supporting members in need.

Debbie and husband Bob spent 10 days in South of France with friends. Fortunately this came at a time when the dollar was rising.

Alex spent three long—but exciting—days as a Medical Society intern, job shadowing six different doctors. Like Ron and Mary before him, this gave him better insight into the medical profession and the challenges our physician clients face. He and Mary attended a day-long software workshop.

Mary spends considerable time doing research and participating in conference calls for her role as a member of The H Group, Inc. and Focus Point Solutions investment policy committee. She went to Minnesota to see her step daughter perform as the lead soprano in an opera at St. Olaf College. She and husband Steve took weekend opportunities to go crabbing at Newport.

Ron is finding his role as Rotary President a pleasant distraction on evenings and weekends. He attended the Financial Planning Conference in Boston in early October, giving him insights from many prominent experts just as the rescue package was being debated in Congress. He later attended an advance planners retreat in Forest Grove, limited to those in practice for more than 20 years. They all looked so old, grey and bald!

We are pleased to announce that  
**Medical Economics Magazine**

ONCE AGAIN SELECTED

**Ron Kelemen, CFP**

AS ONE OF THE

**150 Best Financial  
Advisors for Doctors**

*Ron was the only advisor listed  
between Eugene and Olympia.*

For the full story go to [www.MeMag.com](http://www.MeMag.com)

## Chicken and a Mortgage Derivative... continued from page 3

now, in return for a higher return later. These have been around for more than two decades, and were commonly known as collateralized mortgage obligations or CMOs. So the brokerage houses and hedge funds took this concept and found even more ways to slice and dice the chicken. They did the same with different types of debt instruments such as commercial loans.

And then they borrowed heavily to leverage them many times over. But unlike the chicken parts at the poultry case, the parts were so heavily processed and leveraged that the buyers had no idea what they were getting. The hedge funds thought they were borrowing heavily to buy boneless, skinless thighs. Instead, brokerage houses and investment banks sold them ground up bones and feathers, leaving all of us with a (pardon the pun) very foul taste.



**THE H GROUP, INC.**  
Independent Wealth Management Solutions

**Ron Kelemen, CFP®**  
**Mary Way, CFP®, CPA**  
**Alex Sheppard, MBA, CFP®**

The Kelemen, Way & Sheppard Financial Perspective

960 Liberty Street SE, Suite #210 • Salem, OR 97302

ADDRESS SERVICE REQUESTED

PRSRT STD  
U.S. POSTAGE  
**PAID**  
SALEM, OR  
PERMIT NO. 106

## Take Stock, Take Action... continued from page 1

- 2. Net gains and losses for the year.** This is a tax opportunity too good to pass up. Believe it or not, some mutual funds will declare capital gains from earlier this year. So realize some losses to match them. What losses you cannot pair with gains can be carried over indefinitely. And up to \$3,000 per year can offset your ordinary income.
- 3. Consult with your tax professional.** This may be a good time to adjust your quarterly estimates.
- 4. Max out 401k or other retirement plan.** This is an historic time to buy low, for your overall retirement plan, IRA, or other investments. If you are under age 50, you can contribute \$15,500 to your 401-k. If over age 50, you can contribute \$20,500. The numbers increase in January to \$16,500 and \$22,000 respectively.
- 5. Make equipment purchases.** If this is going to be a high income year, and you need new equipment, this would be the time to take advantage of the Sec. 179 rules by putting new equipment into service and writing it all off this year. (See your tax professional for details.) Believe it or not, banks still loan money.
- 6. Re-think your goals.** There is nothing like a crisis to sharpen one's thinking and create an atmosphere for revising goals. Numbers eight and nine in the Taking Stock section are good areas to start. What has to happen in the next 3-5 years for you to feel good about your progress? How do you want to be remembered?
- 7. Update or revise your financial plan.** What will it take you to reach your goals now? We can help you integrate all of your "take stock" items with your "take action" items.
- 8. Focus on your co-workers, partner, family, and charities.** They need you more than ever.
- 9. Take care of yourself.** Maybe you can't do all of the above items, but this is one thing everyone can do. It's like the oxygen masks in airliners—your must put your own mask on before helping others. That means a healthy diet, exercise, sleep and healthy pursuits.

Time and again, our clients have told us that what we do best is help them pull together all of the above pieces for them. We would welcome the opportunity to update your plan or start fresh. Either way, thinking about these things is a good way to reduce stress and get your New Year off to a good start.