

FINANCIAL PERSPECTIVE



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CREATING CLARITY & CONFIDENCE IN A COMPLEX WORLD

Take Steps to Financially Survive an Earthquake

The “Big One” hit Japan and now we are being reminded that it can happen in Oregon. We’re long over due, if not for a 9.0, then at least for a smaller magnitude. Like most Japanese, we will be surprised when it actually happens, but unlike them, we won’t be nearly as prepared.

So with this disaster in the news, this is a good time to consider the financial risk of an earthquake. There are three ways of dealing with most financial risks: accept it, self insure, or transfer it.

1. Accept it.

This can either be a head-in-the-sand approach, or a rational decision. If your home or office is built to high earthquake standards, generally constructed of wood, is geologically located away from a red zone, or of small value, then perhaps accepting the risk is appropriate.

2. Self Insure.

This approach can work if you have enough financial assets to cover the loss without affecting your long-term financial security. Can you write a check to cover the damage or even replace your home and its contents? Can you afford to pay for extended alternative living arrangements while repairs are being made?

3. Transfer the Risk.

When you write a check to an insurance company you are transferring the catastrophic cost of a possible risk to a third party. You can afford the premium but not the devastating costs should a major risk event happen to you.

Earthquake Insurance 101

Most homeowner policies do not cover earthquakes. You must purchase this separately. According to the Oregon Department Consumer and Business Services, only 20% of Oregon homeowners or renters have this coverage. Earthquake insurance covers direct physical loss to property. An earthquake is normally defined in your policy as “shaking or trembling of the earth, caused by volcanic activity, tectonic processes, or any other cause.” Most policies state that any shocks that occur within a 72-hour period constitute a single earthquake.

Earthquake insurance does *not* cover a loss caused by landslides, erosion, tsunami, or volcanic eruption, even if an earthquake causes them to happen.

Costs

The premiums range for 0.1% to 0.2% of the home’s value per year. But this is a broad generalization. **Unlike a fire, an earthquake affects many buildings in an area. This drives up the replacement costs because there is a typically high demand for contractors and materials.** Insurance companies use earthquake modeling criteria for their underwriting. The models include the age, foundation, building materials, foundation, location, etc. Older homes cost more than newer ones built to higher standards. All homes must have the hot water heater secured before coverage will be issued.

Deductibles

Most policies have a high deductible, ranging from 10% to 25% of the insured amount, but 10% is more typical. Thus, with a \$400,000 home and a 10% deductible, you could still face a \$40,000 out-of-pocket expense.

Exclusions

Chimneys, brick facades, or other items can be excluded. Thus, in the example above, you might have your \$40,000 deductible plus the cost of the excluded items. Vehicles are not covered by earthquake insurance, but they are typically covered by your vehicle’s regular policy.

Some companies have a “Special Limit of Liability” schedule, which might place a limit on the coverage for chimneys, art work, swimming pools, hot tubs, etc.

Living Expenses

If earthquake damage to your home is so severe that you must move out, coverage for additional living expense is only available if you have earthquake coverage. Normally, this coverage is provided with no dollar limit and no deductible.

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Lessons from Current Events

The events of the past few months have provided a valuable lesson for investors. Between the Japanese earthquake, events in the Middle East, budget debates in Congress, and the S&P threat of a downgrade of the US Treasury obligations, there has been no shortage of bad news.

One could say that these are all so-called “Black Swan,” or “out-of-the-blue” events. Perhaps they are, but for a sense of perspective, here is a partial list of other natural and human-caused “black swans” over the past decade:

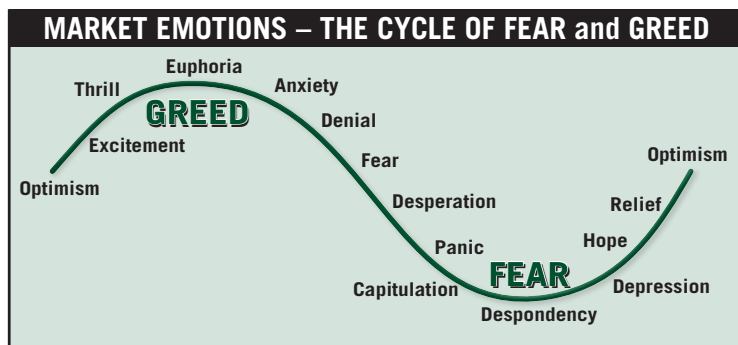
- 2001 attacks on the World Trade Center and Pentagon;
- 2001 Enron Scandal;
- 2003 European heat wave (40,000 deaths);
- 2004 Tsunami in Sumatra, Indonesia (230,000 deaths);
- 2005 Hurricane Katrina
- 2005 Kashmir, Pakistan, earthquake (80,000 deaths);
- 2008 Myanmar cyclone (140,000 deaths);
- 2008 Sichuan, China, earthquake (68,000 deaths);
- 2008 Derivatives roil the world’s banking system and financial markets;
- 2008 Failure of Lehman Brothers and the sale/liquidation of Bear Stearns;
- 2008-09 Bernie Madoff Scandal;
- 2008-11 30% drop in U.S. home prices;
- 2009 Dow hits 12-year low at 6,547
- 2010 Haiti, earthquake (315,000 deaths);
- 2010 Iceland Volcano shutting down 100,000 transatlantic flights;
- 2010 Russian heat wave (56,000 deaths);
- 2010 BP’s Gulf of Mexico oil spill;
- 2010 Greece Debt Crisis;
- 2010 market flash crash (a one-day 1,000-point drop in the DJIA);
- 2010-11 Surge of unrest in the Middle East;
- 2011 Earthquake and tsunami in Japan (at least 20,000 deaths so far)
- 2011 Unfavorable US credit outlook by Standard and Poors; and
- 2011 Devastating tornadoes in the US South and Midwest

Beside their unexpectedness and world-wide impacts, what do most of these events have in common? In nearly every instance “investors” overreacted by selling off. And in many cases, the financial markets recovered, some as quickly as a day or two later.

Are We Near A Market Top?

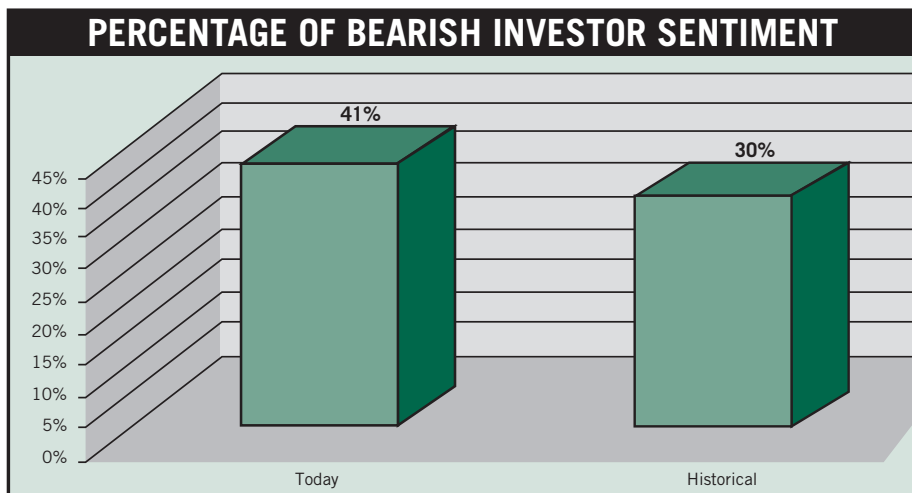
We’ve been getting this question a lot lately in social situations and from clients. In fact, negative investor sentiment hasn’t been this low since last August. In retrospect, that turned out to be a good time to invest.

And while the valuation model we use still sees room for growth in some asset classes, we think a better tool is available—the Market Emotions diagram. *Based on what our colleagues and we hear, we think we are somewhere around between the “Hope” and “relief” points on the curve. There is simply too much pessimism out there for this to be a market top. (And there is a lot of cash on the sidelines, earning negative returns after taxes and inflation.)*



As we write this the last week of May, we realize that things could change dramatically by the time you read this and that we may be wrong. The outlook can change either way as interest rates, the economy, and company fundamentals change. If Congress does not raise the debt ceiling, the United States may need to default on the payments of some of its previously issued debt. US Bonds would likely suffer a world-wide credit downgrade and a large drop in value. We are hopeful that cooler heads on both sides of the aisle will prevail.

But back to the lesson from the first sentence of this article: We’ve managed to survive catastrophic events and financial crisis time and time again. Life goes on. We still need medical services, groceries, gasoline, toothpaste, internet service, cell phones, paper, pharmaceuticals, cars, detergent, college educations, and much more regardless of what’s happening in the world. These are mostly provided by businesses represented in the stock market. **The key is to expect the unexpected, build a portfolio stool with many legs to withstand these events, and don’t panic.**



Source: American Association of Individual Investors, May 20, 2010.

Take Steps to Financially Survive an Earthquake...Continued from page 1

Consult With Your Property and Casualty Agent

The above are just the basics. We are certainly no expert in this area, so it just makes good sense to talk with your agent to review your existing coverage and see how earthquake insurance might make sense in your situation. This is especially true, given the very specific building and location statistics that would be used to give you a quote.

Make Your Own Financial Emergency “Kit”

Much has been said lately about being physically prepared with emergency supplies. No argument here. **But in the event of a major quake—or even a fire for that matter—how do you go about putting your financial life back together?** If you own your own professional practice or business, you need a contingency plan and a way to secure and retrieve your business records. That’s beyond the scope of this article. For your home, your financial kit should include:

- ❑ A daily back-up system of your home computer, such as Mosey or IBackUp.Com. This is backed up to “the cloud” in secure servers in other regions of the country. You can access it anywhere in the world with an internet connection.
- ❑ An auxiliary hard drive back up system, such as Passport.
- ❑ Consider a service like Doc U Bank. Many attorneys recommend something like this for your estate planning documents, especially for powers of attorney and your Oregon Advance Directive. But you can also use it for other things, such as tax returns, birth certificates, etc.
- ❑ An on-line list of contacts. This is pretty easy to do now in an era of social media and free web-based email sites, such as those with Gmail or Yahoo.
- ❑ A portable waterproof and fireproof safe. These are about one cubic foot and weigh about 30-50 pounds empty, but it should be one of the things you grab if you must evacuate. Use this for whatever you think you might need to start your life over. It could include:

✓ spare keys	✓ Social Security card
✓ passports	✓ cash
✓ copies of your driver’s license	✓ password code book
✓ auto titles, deeds	✓ estate planning documents
✓ insurance certificate and policies	✓ important contact information, and
✓ birth certificates	✓ any other document or small thing
✓ health insurance card	such as special jewelry.

In this era we tend to think that we can handle everything electronically. But even if you have a computer, you still need electricity. As we saw in Japan, that ran out.

We are constantly being reminded that it’s not a matter of “if,” but “when!” So, hope for the best, but plan for the worst.

HAVE IT YOUR WAY!

Thanks to all of you who responded to our recent communications survey. We had an amazing 40% response rate, which is highly unusual for surveys. While we are pleased with the very high overall ratings for this newsletter, our quarterly update letters, and our overall communications, we won’t be satisfied until 100% of you rate us excellent in all categories.

One of our objectives was to learn how you wanted to receive your copy of the *Kelemen-Way-Hanslits Financial Perspective*. Unfortunately, there is no clear-cut consensus. About half wanted it electronically, and half wanted it as you are receiving it now. And since the survey was anonymous, we don’t know who wanted what.

Do you want to receive your copy via email? If you haven’t already done so, please email us at Salem@TheHGroup.com. If we don’t hear from you, we will continue to send you this paper version in the mail. Thanks for your interest!

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 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* continues to list 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 Immediate Past President of the Willamette Valley Estate Planning Council, and a board member of the Salem Rotary Foundation.

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.

The opinions expressed in this newsletter are those of Ron Kelemen, CFP® Mary Way, CPA, CFP® and Larry Hanslits, 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're busy and we're having fun. Tax season went smoothly this year, and all of Larry's clients are now seamlessly merged in to the practice. As you can see on page 3, we also conducted our communications survey. Unfortunately we cannot offer our quarterly reports and billing statements electronically at this time. We've been updating our website, and hopefully the IT people will make those changes shortly.

Lani and husband Jim drove to Monterey, California Easter weekend to visit their Navy son, Adam and his family, then stopped over in Yreka on their way home to see daughter Holly's family. A week later, they went with friends on their first-ever cruise, the Inside Passage to Alaska, to celebrate their 35th anniversary. (Now they can get back to focusing on their jobs, church work and gardening.)

Debbie was kept busy preparing the transfer paperwork for the clients of a very small practice we purchased. She and husband Bob escaped the rain and May coolness with a trip to Cabo San Lucas, Mexico.

Mary, as Immediate Past-President of the Willamette Valley Estate Planning Council, organized and moderated a panel discussion on the topic of Advance Directives and end of life planning.

Larry judged the financial planning scholarship competition at Oregon State University. From some of the excellent work samples he showed us, we are excited about the future of our profession. He had a working "staycation" at his horse ranch in Florence, getting it ready to market.

Ron worked on our website update and the communications survey. He wrapped up a number of his duties with the Willamette Academy Advisory Council and as the Rotary District 5100 World Community Service Chair and Group Study Exchange Team leader to Bangalore.

We wish all of you a fun and pleasant summer!



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Making Your Summer Vacation—and Your Life—Count

Sometimes the relaxed pace of summer and time spent with your spouse on a vacation can create huge breakthroughs in goal setting and personal reflection. About 10 years ago, we created a thinking tool called *The Second Half Focuser*.™ It's helped many of our clients get out of the trap of living day to day, and of incremental thinking.

First, quickly write down the age you're going to die. (We're serious!) We all have some idea in our minds, based on family history and health. Whether it is 55 or 105, it doesn't matter. Just write it down.

Second—and most important—write down in each of the categories how you would like life to be in your final years:

- Relationships (spouse, family, friends)
- Physical (health, vitality, physical activity)
- Financial (net worth, income, security, legacy)
- Mental
- Spiritual
- Self-Assessment
- Accomplishments (travel, cultural, artistic, career, volunteer, etc.).

Don't censor your ideas at this point—just list as many as possible. This is what Stephen Covey calls "starting with the end in mind."

These ends won't just happen the year you die. It may be too late to get started on some of them even at retirement. You need to get started on them now. Sounds daunting, but it is really easy if you break in down in to small pieces. So, for each goal, write down benchmarks of your progress for each of them for the following time periods:

- 10 years 5 years 3 years 1 year
- 3 months 1 month 1 week.

You may not be able to list your dream vacation for this year, but perhaps you could start planning it. In terms of relationships you can say or do something meaningful for your spouse or children as soon as today. For health and other categories, you could get some exercise, read a book, or do something with friends. The point is to get started, then review your progress at least quarterly.

What's this got to do with wealth planning and money management? Plenty! Many of life's great goals often involve money, goal setting and prioritization. The most difficult cases we deal with are those clients without a sense of direction and purpose.

So, try this on a day off or on vacation. In fact, we challenge you to do so. If you'd like some simple forms to make it easy, please call our office. Good luck with it, and make it a great summer!