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financial UCCESS

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Saving and Life Planning

Everyone is unique, so there's no such thing as one financial plan that will suit everybody. But that doesn't mean that there aren't some broad guidelines to fit common situations. So, when it comes to your savings, here are some benchmarks to indicate whether you're following the right priorities and are on track for meeting your financial goals:

In your twenties. Typically, this is the age when you're likely to have the lowest income in your working life, but also the fewest dependent-related expenses. At this stage, you should have two top priorities: First, you should concentrate on building an emergency fund equal to three to six months of living expenses held in short-term savings vehicles.

Second, you should begin putting money into an individual retirement account (IRA) or 401(k) retirement plan. The advantage of beginning to save for retirement at this age is time: in a tax-deferred account, even relatively small amounts can grow into significant assets when you have 35 to 40 years to harness the power of compounding. For example, if you contribute just $2,000 a year to an IRA and it grows 8% a year, after 30 years it could be nearly $227,000, and more than $518,000 after 40 years. *This example is provided for illustrative purposes only and is not meant to project the performance of an actual investment.*

If you're married, you may have a third priority: saving for a down payment on a house. It's best if you can accumulate 20% of the price of the house to avoid having to pay mortgage insurance, but whatever you can accumulate will help keep your mortgage payments lower.

In your thirties and forties. If you have children, it's a good idea

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Why Do Interest Rates Fluctuate?

✔ **Economic conditions** — In periods of economic growth, businesses require large amounts of debt to finance increases in working capital and fixed assets. This increase in demand coupled with increased consumer borrowing puts pressure on interest rates to rise.

✔ **Monetary policy** — The Federal Reserve attempts to assist the economy in growing at a stable rate with low inflation. Their actions, including buying or selling Treasury securities in the open market, raising or lowering the discount rate, and changing reserve requirements, impact the level of interest rates.

✔ **Expected inflation** — The market interest rate on a risk-free security has two components — the real rate of return plus an inflation premium. Investors' expectations about the future rate of inflation impact the level of interest rates.

✔ **Federal deficit** — Since the federal government is such a large borrower in our economy, significant changes in the amount that is being borrowed can impact overall interest rates. ❍❍❍

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Saving

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to be saving for their education. Consider a tax-advantaged 529 college savings plans that you can invest in the stock market. The principle here is that if you have more than five years before college bills start coming due, you can afford to take some risk to potentially achieve a higher rate of return than you might from bonds or other "safer" investments.

Now you should begin to ramp up your contributions to your retirement accounts. The more you can put aside now the better, as you still have 25 to 30 years of compounding to enjoy. Your emphasis should still be on the stock market; although by your late forties, you might consider increasing your bond investments to guard against losses due to market shocks.

In your fifties. This is normally the time when people make their largest contributions to their retirement accounts, because their incomes are close to the highest of their careers; and if they have any children, they're typically out of college and on their own.

Federal limits on annual contributions to retirement plans are more generous at this age, too. For example, as of 2012, below age 50, there's a ceiling of $5,000 for contributions to IRAs and $17,000 to 401(k) plans; but at age 50, those limits increase to $6,000 and $22,500, respectively.

It takes in-depth calculations to determine how much your retirement portfolio should be and whether you're on track to meet the accumulated value of the nest egg you'll need to retire. That said, it's not unusual for people who are in their 50s to have accumulated only about half of what they'll need by age 65, yet still be on track for a well-funded retirement. (If your account balances are considerably less than half of what you'll need, you might have some catching up to do, or it might be necessary to consider retiring at an older age.)

In your sixties. This is the home stretch of the period during which you acquire assets for retirement. As you enter this decade of your life, you should still be contributing more than you ever have to your retirement accounts.

With less than five years before you retire, you should consider reshaping your portfolio to include greater percentages of lower risk investments.

It's never too early to create or update your financial plan, so please feel free to call. ❍❍❍

Is the U.S. Past Its Savings Crisis?

From the 1990s until just a few years ago, the U.S. was experiencing a savings crisis. People were spending nearly all the money they earned and more, by borrowing on credit cards and the equity in their homes. In late 2005, the U.S. saving rate officially went negative.

As a result, the federal government, corporations, and homebuyers had to rely on foreign investors purchasing American debt to fuel their spending. There was a chorus of woes that the binge would catch up with us, and the U.S. economy was destined to a future of weaker growth. Then came the recent recession, plummeting stock and real estate prices and sending unemployment to nearly 10%.

If you define the health of U.S. savings in terms of the net worth of the American consumer, we're still a long way away from our peak just a few years ago. But if you define the health of U.S. savings in terms of the percentage of their earnings that Americans are socking away, the picture is much rosier. According to the U.S. Bureau of Economic Analysis, Americans are saving about 6% of what they earn, largely in an effort to replenish their accounts. That's close to the 7% we averaged throughout the 1960s, 1970s, and 1980s, and bodes well for the U.S. economy — if we can sustain it.

If you're among the unemployed, the good news about the U.S. saving rate is cold comfort. Still, it provides a glimmer of hope for the economy's future growth. Savings are a major contributor to growth, because they provide a capital base for business to invest in new equipment and productivity. In general, the greater the pool of available capital, the lower interest rates borrowers have to pay.

But you don't have to be an economist to understand why it is so important to you and your family to save money. It's the best way to provide financial security, now and in the future. A "rainy day" fund of 3–6 months of expenses saved in safe, highly liquid accounts will help you weather the storms that always come, from an unexpected vehicle repair to job loss or illness. And saving — in special tax-advantaged plans for education to 401(k)s and IRAs for retirement — leverages the power of compounding in the market to help you fund your future.

Are you doing all you can to save? Are your investments working as hard for you as you are for your paycheck? From finding ways for greater tax efficiency to potentially increasing your returns, please call for help. ❍❍❍

Your Plans for Retirement

How much will you need to live a comfortable retirement? It's a question that can't be answered without giving serious thought to how you really want to spend your retirement.

Retirement is no longer viewed as a time to slow down, but is now considered a new beginning in life. Thus, your current living expenses may have little to do with your retirement expenses. However, keep in mind that retirement often proceeds in stages:

✔ An active phase, when the retiree is in good health and actively pursues travel and hobbies. This is typically the most expensive retirement phase.

✔ A passive phase, when the retiree's energy starts to wane. Life starts to slow down, and living expenses typically decrease.

✔ A final phase, when medical conditions often result in subsistence living. This is typically a more expensive time than the passive phase due to increased medical expenses.

To help you visualize your retirement so you can estimate retirement expenses, consider these questions:

✔ When do you want to retire? Will you realistically have the resources to retire at that age?

✔ Do you plan to stay in your current home, trade down to a smaller one, or move to a different city? If you plan to move, is the cost of living more or less expensive than your present city?

✔ Will your mortgage be paid off by retirement? What about other debts?

✔ Will you continue to work after retirement? If so, will you work part-time or full-time?

✔ How will you spend your free time? What hobbies will you pursue? How often and where will you travel?

✔ How will you pay for medical costs?

✔ Do you have any medical conditions that are likely to impact your quality of life in retirement? What would you do if you became physically disabled? How will you provide for long-term-care costs?

✔ How much of your income will be provided by personal investments, including 401(k) investments? Are you confident you can invest so those investments will last your entire retirement? How much of an investment loss could you tolerate without changing your retirement lifestyle?

✔ What would happen financially if your spouse dies? If you die, would your spouse be able to support himself/herself financially? ❍❍❍

Estate Planning for Unmarried Couples

While estate planning can be complex for married couples, it is even more complex for unmarried couples. Basically, this is due to the fact that unmarried couples do not benefit from two provisions that apply to married couples:

✔ The unlimited marital deduction allows married couples to bequeath as much of their estate as they want to their spouse with no estate tax consequences. Unmarried couples can only shelter up to the estate tax exclusion amount from estate taxes. While that amount is currently very large, $5,120,000 in 2012, it is only valid this year. No one knows what the exclusion amount will be after that.

✔ Even if proper estate planning documents aren't in place, such as a will or trust, spouses still inherit at least a portion of each other's estate. Unmarried couples, on the other hand, must make special provisions to ensure they inherit any assets from each other.

To protect each other's interests, unmarried couples should properly plan their estate. Consider these tips:

✔ **Prepare a will.** At a minimum, unmarried couples need wills to outline who should receive their estate. You may also want to consider a durable power of attorney to allow someone to take over your financial matters if you become disabled or incompetent, and a health care proxy to give someone the power to make health care decisions when you are unable to.

✔ **Review beneficiary designations.** Assets with named beneficiaries, such as life insurance policies, individual retirement accounts, and pension plans, will automatically go to the named beneficiary. Make sure your beneficiary designations reflect your wishes.

✔ **Make sure assets are properly titled.** Owning an asset as joint tenants with rights of survivorship means the asset will automatically go to the co-owner after your death.

✔ **Take a look at life insurance amounts.** If you are leaving a large estate to a significant other, that person may have to pay significant estate taxes, since the unlimited marital deduction does not apply. Thus, you may want to review life insurance amounts and adjust them upward to help deal with estate taxes. If properly structured, the proceeds will be received free of income and estate taxes. ❍❍❍

Consider Maturity Dates

All investments seem more volatile these days, including bonds. To help control volatility in your bond portfolio, carefully consider maturity dates before purchase. Bonds can be purchased with maturity dates ranging from several weeks to several decades. Before deciding on a maturity date, review how that date affects investment risk and your ability to pursue your investment goals.

Typically, yield increases as the maturity date lengthens, since you assume more risk by holding a bond for a longer time. Investors are often tempted to purchase bonds with long maturity dates to lock in higher yields, but that strategy should be used with care. If you purchase a long-term bond knowing you'll need to sell before the maturity date, interest rate changes can significantly affect the bond's market value. Two fundamental concepts about bond investing apply:

✔ **Interest rates and bond prices move in opposite directions.** A bond's price rises when interest rates fall and declines when interest rates rise. The existing bond's price must change to provide the same yield to maturity as an equivalent, newly issued bond with prevailing interest rates. You can eliminate the effects of interest rate changes by holding the bond to maturity, when you will receive the full principal amount.

✔ **Bonds with longer maturities are more significantly affected by interest rate changes.** Since long-term bonds have a longer stream of interest payments that don't match current interest rates, the bond's price must change more to compensate for the interest rate change.

Although you can't control interest rate changes, you can limit the effects of those changes by selecting bonds with maturity dates close to when you need your principal. In many cases, you may not know exactly when that will be, but you should at least know whether you are investing for the short, intermediate, or long term.

Please call if you'd like to discuss bond maturities in more detail. ❍❍❍

The Basics of Interest Rates

It can be difficult to understand why interest rates vary from bond issue to bond issue. Basically, there are three rules that govern the relationship between bonds and interest rates:

1. Interest rates are higher for bonds with longer maturities. Investors typically demand higher interest rates for bonds with longer maturities to compensate for giving up use of their money for longer periods. There is also more risk associated with longer-term bonds, since numerous factors can affect an issuer's ability to repay a bond over a long time period.

2. Interest rates are higher for bonds with more credit risk. Rating agencies rate bonds to give investors an indication of an issuer's ability to repay debt. Bonds with lower credit ratings typically pay higher interest rates to compensate investors for the increased credit risk.

3. Interest rates are higher when investors expect higher inflation. Investors are concerned with their real rate of return — how much they earn after the effects of inflation. Thus, when higher inflation is expected, interest rates rise. ❍❍❍

Financial Thoughts

In a recent poll, 81% of Americans age 55 and older said they have learned valuable lessons about saving and investing as a result of the recent recession. The majority of preretirees intend to delay retirement until age 69, compared with age 64 just 10 years ago. Approximately 70% believe they may need to provide financial support to adult children, while 62% may need to provide support to grandchildren (Source: SunAmerica, 2011).

To cover living expenses, 50% of unemployed or underemployed individuals tapped their savings, 32% used credit cards, and 22% took withdrawals from retirement accounts. Among those who were unemployed for one year or longer, 39% took a withdrawal from a retirement account, compared with 20% for those who had been unemployed or underemployed for less than one year (Source: Transamerica Center for Retirement Studies, 2011).

Due to increasing health care costs, 88% of employers surveyed increased employee cost sharing, copays, or deductibles; 21% reduced or eliminated employee raises or bonuses; and 38% reduced coverage levels during the past five years (Source: Corporate Synergies, 2011). ❍❍❍