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SUMMER 2014

Financial Conferences

(Boston, MA: June 9 – 10, 2014)

(Los Angeles, CA: June 19, 2014)

In June of this year, I was able to leave the office and attend two financial conferences. One was with American Funds, and one was with Putnam Investments. Both conferences were very well done. We touched on fund manager compensation, performance versus results, healthcare legislation, health and pharmaceutical trends, global investing, baby boomer trends, and FED Reserve news, just to name a few. The following is some information that I learned at the conferences, as well as information I have received or read about over the past 20 years being in the business.

Manager Compensation: It appears that the mutual fund industry finally gets it when it comes to rewarding the fund managers. As a Financial Advisor, I'm forced to review and see how investments are doing over the last quarter and year to date. When these short-term numbers do well, of course the 3–5–10 year's numbers improve. When these short-term numbers do poorly, the 3–5–10 year numbers get lower. Managers across the industry are now basing compensation on longer term. One firm bases the pay on a three-year rolling average, while another firm bases pay and bonuses on four- and eight-year averages. This is what it is all about (long-term success)!

Performance versus Results: This was interesting. We (the financial industry) are drilled about current performance and "What have you done for me lately?" There is a change, and it is shifting to Results. Results have to do with action and goals. A result would be drawing income from your portfolio in retirement. Maybe this is subsidizing your pension, or maybe the income from an investment ***is*** your "pension." Another result is paying for all or part of a college education. The scope of what is being done is now focused over what is being or has been accomplished or what will be accomplished (goals).

Healthcare Legislation: It is simply too early to tell about what is working and what is not working with respect to the new Affordable Care Act. There are several trends brewing. First, the massive Medicaid expansion across many states has flooded the system with new members. Second, the number of doctors who accept this subsidized insurance is being reduced. When you tie a benefit to an income level, that can become another problem. Example: if the limit is $40,000 and you receive $41,000, you are no longer eligible. These numbers vary by state; and of course, people start and stop employment. This moving target has been a disaster for most people in the industry; and most importantly, it is hurting the very people it was intended to help. Example: In the beginning of a fiscal year, a person may be eligible; by the end of the year, they may not be eligible and lose coverage. Navigating between eligibility and coverages is not easy, especially if you are in the middle of treatment.

Health and Pharmaceutical Trends: This area has probably been the most fascinating. There has been and continues to be some serious progress on cancer-fighting procedures. One speaker had evidence that in the not-too-distant future, the medical community will look back on chemotherapy, radiation, and surgery and say, "what were we thinking?" There have been some strong trials at John Hopkins in Baltimore that have reversed cancer in children with leukemia without the formative methods. There are also some promising trials underway with respect to treating memory issues. One manager who attended a medical conference believes there will be new drugs available within 10 years or sooner to combat

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memory loss. Keep in mind, some fund managers are medical doctors.

I listened to several speakers about the ins and outs of working with the Food and Drug Administration (FDA). Some felt the FDA is still too bureaucratic and slow to process new treatments. Others have felt the opposite — that the FDA is now quicker to approve a treatment as they now have the ability to recall a drug or treatment if it later gets deemed unsafe or too many awful side effects. Overall, it appears there are some exciting and perhaps life-changing treatments coming down the road.

Global Investing: This is something I hear often. There appears to be better valuations in Europe, Asia, and the developing world than here in the U.S. It is hard to think about when you see the barrage of daily bad news coming out of global headlines. However, it is the foreign countries, especially Europe, that are now headed toward monetary easing as the U.S. moves away from it.

Baby Boomers Retiring: Some people seem surprised to hear that the unemployment rate continues to decline. I am not. Baby boomers are retiring at a rate of 10,000 per day. Some of these boomers are doing the job of two or three or more already. It is often hard to replace them immediately. Usually, a firm will retire a person and decide to spread out the employees work among the remaining working peers. This only goes so far; at some point, more hiring has to take place. I feel we could be on the verge of an employee vacuum with not enough of a workforce. Companies and small businesses will be forced to pay a higher wage to get new/qualified employees. As Congress and past and future administrations battle the Immigration issue, this has to be part of the overall concern. With a lack of employees and the end of quantitative easing, we could see inflation in the coming years, as it may cost more to produce the same goods and services that we are accustomed to.

FED News: It is widely expected that the Fed will conclude its bond buying program within the next two months, with a last and final reduction of $15bn. They anticipate reducing the size of the Federal Reserve's balance sheet markedly going forward. In general, officials agree that the balance sheet should be reduced gradually to the "smallest level consistent with efficient implementation of monetary policy." Both the program itself and the sheer size of the program were unprecedented in nature, likely presenting unintended consequences during the eventual normalization process. However, many economists and fund managers I have heard do not believe the unwinding process will be unmanageably negative. In other words, stay tuned!

Periodically, I will continue to share my views along with those in the industry as we strive to give you, our customers, the results you deserve from your invested assets.

Sincerely,

Andrew Wade
President

Good News Out of Detroit!

Last summer, I mentioned in the newsletter about how we (the investing public) need to watch how Detroit would emerge out of bankruptcy and how various parties would be affected. The retirees' pensions were at stake as well as investments of bondholders. The case could have had an impact on not just the city of Detroit, but other municipalities throughout the United States as they watch this unfold.

It appears, based on the *New York Times* (7/22/2014), *CNBC* (8/12/2014), and *The Bond Buyer* (04/09/2014) that the massive bankruptcy plan is benefiting all parties. Retirees have agreed to take a 4.5% cut to some of their pensions, and COLAs have been reduced or stopped. This is better than a pension being cut in half or some other extreme measure. Some income is also better than no income (from a pension). The other party that has benefited is bondholders. Bondholders will recover 74% on the dollars from the city of Detroit. Municipal bond insurers' (such as Ambac) primary job is to insure these bonds in the case of a default. Municipal bond insurers can make up the difference so bondholders would be made whole in situations like this.

Detroit is certainly not the model for how to run the finances of a city. However, in the event that a city needs to restructure, I like the example this set for other cities and states. If bondholders were getting 20% on the dollar (original Detroit bankruptcy plan), the insurance on the bonds would mostly likely not have made up for the 80% difference. If this were the case, it may have had a negative long-term impact for other cities and pensioners, as the incentive to invest in municipal bonds would have been greatly reduced. This is why this bankruptcy was positive in many ways.

In general, municipal bonds make sense as the dividends can range 3% to 5% tax-free vs. the paltry 1% to 1.5% taxable as current one- to five-year CDs at your local bank or credit union. Yes, there is a little more volatility in principal; but over time, this sector has proven to be a good conservative and tax-friendly investment. These are not just a good investment to own, but they can also provide a nice stream of income. The default rate in municipal bonds in year 2013 was .107% (miniscule) and down from .144% in year 2014. Keep in mind, the very low default on these is backed up by insurance companies.

Sincerely,

Andrew Wade
President

How Much Life Insurance Do You Need?

There are rules of thumb to determine how much life insurance to buy — like seven to 10 times your annual earnings. You don't hear this advice much anymore, but if you do, ignore it. How much life insurance you need is a question that can only be answered after a thorough analysis, which means there's no one answer that's right for everyone.

Let's start with an understanding of the primary purpose of life insurance: It's supposed to provide support for the people who depend on your income, like a spouse and/or children. No spouse or children? Then you may not need any life insurance at all — unless you have special estate planning needs.

Replacing Your Income

Another way of describing the basic purpose of life insurance is income replacement. Simply put, it means leaving your beneficiaries a lump sum of money that can generate an income equal to the amount of money you were making.

Let's say you earn $100,000 a year. And let's assume that the decision-maker you leave behind could invest a lump sum that would generate income of 4% a year. To determine how much that lump sum needs to be is simple math: divide $100,000 by 4%. The answer is $2.5 million, which is 25 times your annual income.

Easy? Sure, if you ignore inflation — which is a very serious challenge — and the fact that these days it's not easy to find safe investments that can be counted upon to generate 4% income every year.

As for inflation, the problem is that every year a dollar buys less. So if you want your heirs to keep up with inflation — to maintain the same level of real income each year — then the investment return on the proceeds of your insurance policy has to equal the total of the rate at which your heirs withdraw from them *plus* an amount equal to the rate of inflation.

Alternatively, your beneficiaries could withdraw whatever they need to keep up with inflation. So, when inflation proceeds at a steady rate of 3% per year, they withdraw $100,000 in the first year, $103,000 in the second year, $106,090 in the third, and so on to keep the same level of real income each year. But this means they're drawing down principal, and that means it will eventually disappear.

In the example above, with the invested life insurance proceeds earning 4% a year and the heirs withdrawing $100,000 in the first year and more in each subsequent year to cover 3% inflation, the entire principal would be gone after 29 years. Now, that may be fine if your surviving spouse is 60 years old when you die, since it would cover him/her for most if not all of his/her lifetime; but it wouldn't be so good if your spouse was considerably younger when policy benefits are paid, or if you're hoping to support children or grandchildren.

In addition, the simple income replacement method overlooks other kinds of contingencies, like providing a college education for your children. This brings us to the second method of determining how much life insurance you need: needs analysis.

Needs Analysis

While the income replacement calculation beats the old rules of thumb, it still represents only a very basic level of planning that can leave many important considerations unexamined. As an alternative, the needs analysis calculation looks at all of your survivors' relevant lifestyle needs to determine the appropriate amount of life insurance. This approach relies on many of the same considerations that a full-fledged financial plan addresses, such as:

✔ **Will your surviving spouse work?** The extent to which your spouse can earn income from employment will reduce the amount of insurance you need. If a paycheck is a possibility, though, to what extent will it be reduced by childcare expenses?

✔ **Should your spouse pay off debt?** If your spouse's income possibilities are limited, it might make sense to use some life insurance benefits to pay off a mortgage or other debts.

✔ **Funding a college education.** If you were planning on using a portion of your income to fund your children's educations, is the life insurance policy enough?

✔ **Financing your spouse's retirement.** If your contributions to an IRA or workplace retirement account are essential to meeting your retirement goals, you need to factor that into the calculation of your life insurance amount.

The bottom line: there's no one-size-fits-all approach to determining how much life insurance is right for you and your family. The best approach is to work from a plan that takes all aspects of your financial life and goals into account. If you're unsure whether you have the right coverage, please call.

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Investing in Your Golden Years

There are so many unknowns: Will Social Security be there when you retire? How long will you live? Will the stock market decline right as you need to make retirement withdrawals? How aggressive should you be with your retirement allocation as you near retirement?

As is often the case, the answer is, it depends. While we can't predict the future of Social Security or how long we'll live, we can take steps to allocate our investments so we have the right balance of stocks, bonds, and cash equivalents for our financial goals. Determining that mix as you near retirement involves both qualitative and quantitative factors. You'll need to consider:

- ✔ How much you've already accumulated for retirement
- ✔ How much you can save annually between now and when you retire
- ✔ How large a portfolio you're going to need, based on how much you want to withdraw annually during retirement

Each investor's needs are different, so the strategy that optimizes one person's allocation may not work for the next investor. However, there are some general guidelines to consider for your portfolio as you approach retirement:

- ✔ The younger you are, the higher your allocation to stocks can be. With time on your side, your portfolio will have time to recover from any market downturns.
- ✔ Even if you're young, you'll probably want to include some bonds in your portfolio, which will help reduce the overall volatility.

As a general rule, as you approach retirement age, you'll want to increase the percentage of your portfolio that's invested in bonds. If you have other stable retirement resources, such as pension benefits or Social Security, you may be able to allocate a larger percentage of your portfolio to stocks.

Likewise, if you have a large portfolio, more than you will deplete during your lifetime, you might be able to be more aggressive, since a short-term setback in the market won't seriously affect your ability to make withdrawals from your portfolio.

Whatever your unique situation, the optimal stock-bond-cash portfolio allocation is probably not 0% stocks and 100% bonds and cash. While you don't want to near retirement with a portfolio that's too aggressive, some stocks may help your portfolio continue to grow. ❍❍❍

Discussing Your Estate Plan

Talking about what will happen after a person dies can be a painful and scary discussion, but a necessary one. It's important to talk with your loved ones about what you want, what they want, and what is laid out in your will.

- ✔ **Keep it light —** Having this discussion can bring up a lot of emotions for your loved ones, so keep the conversation light but to the point.
- ✔ **Talk openly and honestly —** A decision you have made may hurt someone's feelings, or there may be things you don't want to tell people about; but it is crucial to be open and honest.
- ✔ **Discuss values, not just valuables —** When you die, how do you want people to remember you? What parts of you do you want to live on? This may include traditions, values, family names, rituals, religious beliefs, and so on.
- ✔ **Have a professional present —** In many cases, a professional has a better understanding of how estate planning works and can assist by answering any questions your loved ones may have. You might have a family-only conversation first and then a second conversation with the estate planning professional. ❍❍❍

Financial Thoughts

In a recent survey about whether individuals would have made different life choices, 46% of those between the ages of 50 and 64 said that they would have chosen different professions (compared to 29% of those age 65 and older), 25% said they would have delayed having children (compared to 17% of those age 65 and older), and 43% would have ended a bad relationship (compared to 25% of those age 65 and older). In the same survey, 11% of those between the ages of 50 and 64 said that their family was doing very well financially, compared to 22% of those age 65 and older (Source: *AARP Bulletin*, January–February 2014).

Approximately 28% of Americans would consider moving to another state or county to get better and/or cheaper health insurance. Of those between the ages of 18 and 29, 40% would be willing to move to another state (Source: Bankrate.com, 2014).

Almost 37% of investors believe that they can meet their financial goals without investing in stocks, while 22% believe that stocks are the best long-term investment (Source: *Money*, January 2014). ❍❍❍