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Volatility Is Back, But That's Not Necessarily Bad

Wall Street traders who were looking forward to another boring summer got a rude awakening this year. After a few jolts in the spring, financial markets around the world got downright stormy in July and August as investors worried about the subprime mortgage collapse and a credit crunch. Make no mistake about it, volatility was back with a vengeance. The ride got so intense that the Federal Reserve Board felt compelled to ease credit by reducing the bank discount rate—a rare move by the nation's central bankers—and by early October, the bulls had regained the upper hand. But what does all this really mean and should you worry?

One explanation for the summer's market turbulence is that, after repeatedly shaking off bad news during the past few years, stocks were simply overdue for a correction. Despite soaring oil prices and military setbacks in Iraq, share prices had pushed steadily higher, and in mid-July the Dow and Standard & Poor's 500 stock indexes hit record highs. And it had been a very smooth ride. From May 2003 through January 2007, the Dow never dropped more than 2% in a day. That was a period of stock market stability unmatched in more than a century, but it couldn't last forever. Finally, "the past few years' speculative excesses were pulled from the market," says Doug Roberts, chief investment strategist at Channel Capital Research.

But the summer stock market was also buffeted by a sudden credit crunch. When the economy is on the upswing, things often get a little out of hand, and this time that took the form of easy credit being offered to poorly qualified homebuyers in the form of subprime mortgages. When those homeowners couldn't keep up with their payments, foreclosures began to rise. And because those mortgages had been repackaged into complex, illiquid securities bought by hedge funds and other institutional investors, it was those sophisticated professional investors who suffered the worst losses. With these rarely traded securities still buried in some portfolios, the full extent of the damage may not yet be known.

But much of the devastation has been on public view. For example, in June 2007, Merrill Lynch seized $800 million in assets from two hedge funds managed by a venerable Wall Street firm, Bear Stearns & Company. The hedge funds suffered huge losses and became insolvent because of the plunge in value of the mortgage-backed securities they owned.

Although it was debt and not equities that triggered the summer stock sell-off, stocks couldn't avoid the fallout. Hedge funds tend to be highly leveraged—they borrow money hoping to increase the impact of their strategies—and many of those holding subprime mortgage-based bonds had to sell stock to meet demands by lenders that they come up with more cash. That onslaught of selling helped push down prices. Lenders, meanwhile, fearing widespread defaults, stopped lending.

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WMN's Open House Is Well Attended; Big Plans for '08

WMN's November 28th Open House/20th Anniversary Forum was attended by close to 100 guests, all of whom were glad they came. Lucy Dunn (Orange County Business Council), Shelley Hoss (Orange County Community Foundation), Andy Policano (UCI's Merage Business School), Dr. Rick Afable (Hoag Memorial Hospital), and Supervisor John Moorlach all made informative presentations and answered questions from the audience.

After the presentations in the building's lobby level conference center, guests adjourned to the WMN suite on the second floor to partake in catered food and beverages. Live guitar music greeted folks as they exited the elevators, old acquaintances got reunited and new friendships were spawned. In short, a grand time was had by all!

On January 4, 2008, the entire WMN team participated in our Annual Advance, where we reviewed 2007 and made plans for 2008. Please mark your calendars for Thursday, February 28th, 4:00 to 6:00 p.m., which will be the first WMN Forum of the New Year. The topic will be estate planning, and will include presentations by attorneys, accountants, and insurance specialists. This complementary educational session promises to be most informative...plan now to attend!

Best wishes for continued prosperity in 2008! We appreciate the personal, and in many cases business, relationships we have with you.

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Should You Delay Taking Social Security Benefits?

When should you start collecting your hard-earned Social Security? Conventional wisdom says the longer you delay, the better off you are. Yet maximizing your payment through waiting is just one way to get the most out of this key retirement income source.

In essence, the government pays you to wait for Social Security, and docks you for taking benefits early. You're allowed to begin collecting at age 62, but your monthly payment will be lower than your "full benefit," and it will stay that way (see "The Cost Of Starting Early"). To get more, you must wait until you reach the Social Security Administration's "full retirement age," which used to be 65—and still is, if you were born in 1937 or earlier—but is now inching upward, depending on your birth year. If you delay taking benefits beyond your specified retirement age, your payment will increase an extra 8% for each year you postpone benefits until age 70.

If you opt to start Social Security payments at 62, you'll lose up to 30% of the benefit you'd get by waiting until retirement age. Still, delaying payments may not always be possible or even desirable. You could need the money—if, say, you've been downsized at work, or your health has forced you to retire early. In such cases, starting Social Security at age 62 may be better than draining your savings while you wait several years.

If you have plenty of other income, starting benefits early could pay off if you invest the money. But there's no guarantee you'd come out ahead with this strategy. Your success depends not only on your return, but also on how long you live. Receiving several extra years of payments undeniably puts money in your pocket, and if you start benefits at age 70 rather than at 62, for example, you'll need to live a number of years before the higher monthly payments make up for the cash you gave up by waiting. On the other hand, investing your early benefits in anything but the most conservative assets could put some of your otherwise guaranteed retirement income at risk.

The lower your portfolio's returns, the better off you may be spending down your savings while you wait for benefits to kick in at age 70, suggests John Marotta of MoneyNews.com. If your savings only keep pace with inflation—and if you live past the age of 83.4—waiting for the age 70 payout will be a better deal. But if you earn 2.5% a year above inflation, the "break-even" age is 87.25 years, according to Marotta.

These days, of course, achieving those milestones isn't unusual. According to the American Society of Actuaries, a 65-year-old male now has a 50% chance of surviving until age 85, while the average 65-year-old woman has 50-50 odds of being alive at 88. For a couple in which both spouses are 65, there's a 50% chance one will make it to age 92.

Ultimately, your decision about when to begin Social Security benefits may hinge on how that income affects your financial plan. If you're nearing 62 and would like to discuss your options, please give us a call. ●

The Cost of Starting Early

Year of birth	Age When You Can Begin Full Benefit	Percent Of Full Benefit Lost By Retiring At 62
1937	65	20.00
1938	65 and 2 months	20.83
1939	65 and 4 months	21.67
1940	65 and 6 months	22.50
1941	65 and 8 months	23.33
1942	65 and 10 months	24.17
1943 - 1954	66	25.00
1955	66 and 2 months	25.84
1956	66 and 4 months	26.66
1957	66 and 6 months	27.50
1958	66 and 8 months	28.33
1959	66 and 10 months	29.17
1960 & later	67	30.00

Source: Social Security Administration

Selecting A Corporate Trustee Certainly Has Its Drawbacks

Does the idea of putting control over trust assets in the hands of a virtual stranger give you the shivers? Or maybe you've heard that corporate trustees are pricey, take longer to make decisions, and—due to personnel changes—may mean your beneficiaries will have to deal with a series of point people rather than one individual.

All are potential drawbacks. But before you opt for a friend or family member as trustee, consider the pros of choosing a corporate trustee.

• **Staying power.** The role of trustee can be demanding, and may span a long period. An individual could find that responsibility overwhelming, and if that person dies or becomes mentally incapacitated, it could create problems for the trust and its beneficiaries. A corporate trustee, however, can administer the trust for as long as it endures.

• **Objectivity.** Friends and family members are likely to have emotional connections to beneficiaries, could cave in to unreasonable requests, and may not be able to balance the needs of current and future beneficiaries. A corporate trustee will follow the grantor's wishes to the letter.

• **Expertise and commitment.** The role of a trustee is complicated and time consuming. Trustees must not only collect, value, and safeguard assets, but also invest and distribute them, as well as keep accurate records and follow complex accounting, legal, and tax regulations. And flubbing a filing or omitting a tax payment can have serious ramifications, and could leave the trustee liable to charges of fiduciary malpractice.

• **Conflict resolution.** An independent corporate trustee can serve as a buffer when conflicts arise and may be better equipped to resolve disagreements or make unbiased decisions.

Of course, it's essential to choose corporate trustees with care. Plan to talk to several candidates. Consider factors such as how long the trust department has been in business, the number and the

Smart Moves Five Years From Retirement

The notion of outliving your retirement income is not a happy one, and now, with tens of millions of baby boomers about to embark on decades of life after work, anxiety is running high. But with some wise preparation, you can create a retirement strategy that keeps you comfortable and financially secure.

Here are five critical moves to consider five years in advance of your retirement deadline.

1. Visualize your retirement. Steven Covey, author of *The Seven Habits of Highly Effective People*, famously suggested: “Begin with the end in mind.” So before you crunch the first number, dig deep and imagine what you want from retirement. You might begin by making sure you want to retire at all. These days, more and more people are deciding to continue working, at least part time. And if you will leave work behind, how will you spend your time? Pursuing adventure travel? Kicking back at your lake cottage? Downsizing and moving to a new community?

If you’re married, talk to your spouse about what she or he envisions. It’s important that you get on the same page about your plans and goals. Once you’ve identified your objectives, determine what they’ll cost and consider where your income will come from—Social Security, a company pension, distributions from your 401(k), rental property income, interest and dividends on other savings, perhaps an inheritance.

2. Examine your footprint. Most people underestimate what retirement will cost, but a simple cash-flow planning exercise can help set the record straight. Start with your core living expenses, and project those out for the next five years, adding in other goals that will require funding: helping a child with wedding expenses, for example, or a house renovation.

Next, consider what your expenses will be in retirement. It’s likely the early years will be more active—and more expensive. A big cost that many pre-retirees don’t see coming is health insurance, which can easily run $16,000 a year for a married couple until age 65, when Medicare kicks in. Thanks to health care costs and other rapidly increasing expenses, many financial experts now suggest retirees have as much income during retirement as when they were working.

3. Address your liabilities. There’s good debt and bad debt. As you approach retirement, it’s critical to get rid of anything on which you’re paying double-digit interest rates. That likely includes credit cards and possibly even car loans. For longer-term obligations, if you’re paying between 5% and 7%, that’s probably all right, particularly if it’s on a mortgage or home equity loan for which some of the interest may be tax deductible.

4. Max out your savings. You’re in your peak earning years, and now is the time to push hard to save all that you can. Many experts recommend saving 20% of your income as a rule of thumb. At the very least, make the maximum allowable contributions to your retirement plan and, if eligible, to an IRA as well. This is your last, best chance to increase the size of your nest egg and your income during retirement.

5. Fine-tune your investment portfolio. One factor to consider during this crucial period is whether stock options, restricted stock, or company stock you own outright in taxable or tax-deferred accounts leaves you dangerously overexposed to the fortunes of your company. You may do well to diversify, to the extent you can, even if it generates taxable capital gains. But now is also the time to revisit your overall asset allocation. The risk of major losses on the eve of retirement argues for a more conservative approach, yet it’s important for your portfolio to continue growing, now and during retirement.

We would be happy to review with you your current retirement plan and asset allocation in view of your goals for your years after work. Please give us a call.●

But It Can Also Give You Peace Of Mind

average size of the trusts it manages, and the experience level of its employees. Because you’re looking for someone you’ll be comfortable talking to about your personal relationships, you’ll probably want to meet with your top choices in person.

Delve into the financials by comparing investment returns, fees—including when the last increase took place and how much of a bump it was—and services. Ask for samples of trust statements or reports to see whether they’re written in language a lay-person could understand. Find out what restrictions, if any, limit the corporate trustee’s investment options; some conservative firms provide only internal investment options, which significantly reduces a trust’s investment opportunities.

When you’ve settled on a corporate trustee, consider when to introduce the trust officer to your family. Often, trustees are designated to take charge after the grantor’s death—a time of great stress and instability for the family. A better bet may be to bring in a corporate trustee now and hold regular family meetings, giving the trustee and beneficiaries the chance to build a working relationship. And designate one or more persons to have the power to remove and appoint a corporate trustee if it becomes necessary. ●

Funding A Friend's Business Venture

Sandy thinks her friend Danny has a great business idea—an exciting, almost revolutionary new service. Now he wants her to make a significant investment in the corporation he's starting in exchange for a 10% ownership stake.

Sandy is tempted. Why not help a friend see his vision to fruition, claim partial credit for launching the wave of the future, and potentially earn extremely handsome returns?

Though such opportunities may feel like the chance of a lifetime, there's plenty that can go wrong. If there's any rule of thumb for investing in a private venture as a minority owner, it's that you should do it only with money you can live without.

Consider Danny's corporation. With no market for its stock, Sandy's capital is likely to be tied up for five to 10 years. That's how long it may take to build a company that can go public or attract an acquirer. During the incubation period, Sandy must be prepared to rely solely on other assets to meet her financial commitments.

Then there's the failure scenario. Unlike stock in a deteriorating public company that can usually be sold for something on the way down, private shares' lack of marketability means the investor is strapped in for the full ride to zero.

There's also the matter of taxes. Owners of S corporations as well as partnerships and most limited liability companies pay income tax on their share of the business's earnings, even when those profits aren't distributed. While she's waiting to get her investment back, Sandy might have to spend more money on taxes.

Still another concern is share of ownership. Assume things go swimmingly and the company seeks to expand. Can Sandy remain a 10% owner? Depending on the laws of her state and the articles of incorporation, she and other shareholders may, or may not, be entitled to first crack at any new shares the corporation issues, in the same proportion as current ownership. (Partnership and LLC operating agreements, when properly drafted, indicate whether owners have the right to maintain their original percentage of ownership.) Without that promise, Sandy's interest could be diluted and her share of the profits compromised.

Not just money but also relationships may be at risk. If the venture bombs, will Sandy blame Danny? Will their friendship suffer? If it does, will she mind? Even with a successful venture, resentment can arise if some of those involved feel others are prospering more than their contribution merits.

For all of these reasons, investing in a friend or relative's business can present problems from the get-go. Sandy should obviously research the investment before diving in. But her friendship with Danny could hinder her ability to objectively analyze his business plan and his ability to execute it, and could make it awkward to quiz him about the plan's marketing or financial assumptions.

Dream deals do sometimes come along. But what often separates successful capitalists from dreamers is finding the right reason to say "yes" or "no." Before you make an investment in a friend or relative's company, talk to us. We can help you analyze the numbers and evaluate the opportunity. ●

Volatility Is Back

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The sudden credit crunch spurred the Fed on August 17 to lower the discount rate—the rate at which the U.S. central bank lends to commercial banks—a full half percentage point. Little money is actually borrowed from the Fed at the discount rate, but this largely symbolic move demonstrated that the Fed, which had been thought more likely to raise interest rates than to lower them, had suddenly changed direction. The Fed followed up by reducing other key rates.

Even before this market correction, however, stocks were not wildly overpriced by historic standards. One key measure of stock value is the market's price-to-earnings multiple. Since 1935, investors have been willing to pay an average of $15.80 for every dollar of profit on stocks in the Standard & Poor's 500 stock index—in other words, the ratio of stock prices to corporate earnings was 15.8. When the stock market peaked on July 20, its price-to-earnings ratio was above average, at 18.3, but relatively low compared with other recent bull market highs. For instance, during the bull market that ended in 2000, the p-e ratio of the S&P 500 topped out at 34. Investors seven years ago were willing to pay almost twice as much for every dollar of corporate profit as they were this summer.

As worrisome as volatile markets may be, they're nothing new. Some research speculates that ancient Babylon suffered through a rough stretch between 1740 and 1700 BCE, when costs more than tripled, and a run on donkeys in Roman Egypt around 200 AD pushed up the price of the animals eightfold.

These days, the markets are still jumpier than they were a year ago, but the shifting balance has helped the Dow and S&P 500 climb back to their July highs and even beyond. There's less mystery about what the Federal Reserve and other central banks will do, p-e ratios have retreated a bit (making stocks seem cheaper on an earnings basis), and some of the most irrational exuberance has gotten a dose of reality as investors remember just what risk means.

Hopefully, dissecting the summer decline calms any fears you may have. As long as your investment portfolio remains aligned with your long-term financial goals and attitude toward risk, you're likely not too upset about the stock market correction. But if you are still concerned, please give us a call. ●

Wealth Management Network, LLC ● 610 Newport Center Drive, Suite 280 ● Newport Beach, CA 92660
Phone: (949) 720-9980 ● Fax: (949) 720-9998 ● www.theWMN.com
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