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Making The Best Of A Bad Time For The Economy

During the first few weeks of 2008, the stock market continued on the downward path of the previous quarter, and financial news seemed to worsen almost daily. By mid-January, most experts seemed to believe the U.S. economy was headed for either a recession or growth so weak that the gross domestic product (GDP) might as well be declining. With unemployment rising and billions more in worthless mortgage-backed investments being written off by Wall Street firms, Federal Reserve chair Ben Bernanke practically promised aggressive interest rate reductions and Washington began debating economic stimulus. Yet while portfolio pressures seemed certain to increase in 2008, this year's troubles need not set back your long-term plans.

Keep in mind that a recession, if it happens, may not spell doom for stocks. Sometimes the fallout is severe. During the brutal recession of 1973-75, for example, the Standard & Poor's 500 stock index dropped almost 25%—and a total of 48% in the accompanying bear market. Similarly, the S&P retreated 8.1% during the brief 2001 recession and 49% all told in a stock swoon that didn't end until 2002. Yet the stock market is considered a leading economic indicator, and while it almost invariably drops in anticipation of an economic downturn, it may also move up before GDP rebounds. During the recession of 1990-91, the S&P gained about 3% and tacked on another 8% in the six months that followed.

Based on these divergent history lessons, anything could happen this time around. Moreover, if a recession develops, we won't know until months after the fact, and by then stocks may or may not have begun to recover. So rather than try to time the market or forecast when it might start its next surge, consider these strategies:

Be prepared for personal setbacks. Sometimes, tough economic times come home to roost. And if, for example, yours is one of the raft of jobs cut during a recession, the performance of the stock market will be the least of your worries. So be sure to set aside a rainy day cash fund that can cover at least six months of living expenses. That may help you avoid selling investment assets when markets are down.

Keep investing, and look for bargains. If you're investing for the long haul, buying stocks when markets are down could pay off down the road. Dollar-cost averaging, the practice of periodically investing a fixed dollar amount regardless of what's going on in the markets, lets fund investors buy comparatively more when values are depressed. Purchasing solid companies caught in a general market downdraft also may give you more for your money. Relatively recession-proof sectors such as health care and consumer staples could hold up better than most.

Don't ignore dividends. Historically, much of the total return of the stock market has come in the form of dividends rather than share appreciation, and steady investment income can stabilize a portfolio when markets are volatile. But companies may cut dividends when times get tough, and financial stocks, in particular, whose sunken share prices translate into high

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WMN Refurbishes Website; Launches New Initiatives

Spring has sprung at WMN! Feedback on our refurbished website has been overwhelmingly positive. For those of you who have not visited it yet, please do so...and tell us what you think. Special thanks to Cheri Billiet for all of her hard work on www.theWMN.com.

Q1 also saw the launch of WMN's e-LETTER version of Wealth Manager. Some of you have told us that monthly e-LETTERs are too frequent, so we're going to send our tech-savvy clients quarterly updates. Please give Cheri or Terry your email address whenever convenient. Simply email them at cherib@theWMN.com or terryz@theWMN.com.

WMN was again a corporate sponsor in March for the CHOC Follies and the Hoag/Toshiba Champions Golf Tournament. Each event is a major annual fundraiser for these two favorite charities of WMN.

Speaking of philanthropy, we are delighted to announce the formation of the WMN Charitable Foundation, under the auspices of the Orange County Community Foundation. As you know, corporate philanthropy is the cornerstone of WMN's work ethic. Please direct all requests for contributions to your favorite charity to Lyn Clute at lync@theWMN.com or (949) 720-9980, extension 208.

Hope your Spring has been productive, and your Summer is full of family fun and relaxation.

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Annuities Offer Stability, But At A Price

Many retirees, worried that they'll outlive their savings, are turning to fixed and variable immediate annuities, both of which can guarantee a lifetime of income. But high fees and a susceptibility to inflation mean they're no panacea.

With a fixed annuity, you trade a lump sum to an insurance company in return for guaranteed, regular payments for a defined period or life, depending on the contract. Your payments are based on such factors as your life expectancy and what the insurance company believes it can earn on your money. Because the insurer calculates payments according to the longevity of its entire pool of annuity customers, some of whom will die early, monthly payments tend to be larger than you could earn from similar interest-bearing investments.

An immediate annuity's fixed income stream means no more worries about securities markets or interest-rate fluctuations. You'll be locking in a long-term interest rate. A future brush with inflation could undermine the value of your fixed payments, just as it did to retirees in the early 1970s whose fixed pensions were ravaged by inflation in the late 1970s and 1980s.

With a variable immediate annuity, in contrast, you could put part of your money into a fixed-income option that generates a guaranteed payment and direct the rest into an equity-based portfolio. Your income would then go up or down based on the portfolio's performance. But early payments from a variable annuity are generally lower than from a fixed annuity. And fees are high. Total costs typically range from 1.5% to 2% annually.

Choosing between fixed and variable? You have to weight the risk of the stock market and its potential for higher payout versus the certainty of a fixed annuity that does not offer growth.

While annuities have a role in some diversified portfolios, there are situations in which they are a bad choice

The fixed annuity's ironclad guarantee and lower costs will appeal to some retirees. The fixed annuity helped new retirees avoid the past bear market losses that fractured so many nest eggs of retirees.

One drawback to immediate annuities: their performance depends on how long you live. If you beat the actuarial tables and live longer than expected, you'll make out well. But if you die before your time, the return could be paltry.

While some annuities promise to pay your heirs for unused benefits, your initial monthly payments will be smaller to pay for that promise to put in a rider. The array of riders and options and their associated fees makes shopping for an annuity a complex task.

"It's difficult to comparison shop," says Geoff Bobroff, a consultant to mutual fund companies. "Many fixed annuities, especially if they are backed by bonds, don't have the same prospectus requirements as variable annuities." With a fixed annuity, you rely on the credit rating of the insurance company to gauge the risk of the insurer not paying, but be mindful that the rating agencies have occasionally made mistakes.

Finally, while immediate annuities may have a role in some retirement plans, if you have a substantial portfolio you may also want to consider creating your own withdrawal program. It might deliver more flexibility and greater returns than you'd get with an immediate annuity. ●

You should consider a variable annuity's investment objectives, risks, and charges and expenses carefully before you invest. The annuity's prospectus contains this and other information about the annuity, and should be read carefully before investing.

With The Economy Sluggish, Junk Bonds Require Scrutiny

In a thriving economy, high-yield bonds (often called "junk" bonds) tend to be popular, paying high interest rates and generally outperforming the market. When the economy starts to slow, though, high-yield bonds may be among the first casualties. Now, with some economists predicting a major downturn, it's important to know how much of your portfolio is allocated to these relatively risky investments—and to consider shifting money into steadier holdings if you have too much junk.

During the past five years, the average high-yield bond mutual fund has been reliable, delivering approximately a 9% average annual return, according to fund tracker Morningstar. This run came after the last recession and a downturn for this risky class of bonds. This is not 2002, when fallout from the dot-com bust led to defaults by many companies that had issued high-yield debt. Today's high-yield companies have stronger financial positions than the vacuous internet companies that collapsed early in the decade. Still, a cautious approach seems wise.

Two factors are putting pressure on the high-yield bond market. Interest rates have moved higher over the last three years, increasing the cost of borrowing. Meanwhile, the use of high-yield bonds in the recent flurry of mergers and acquisitions has led to monstrous amounts of below-investment-grade debt. With interest rates rising, companies with high-yield debt must increase earnings to avoid defaulting on interest payments to bondholders.

This is all part of what could become a vicious cycle. Suppose a company has acquired a competitor, using the proceeds from junk bonds to finance the purchase. Now, a heavy debt load—and a promise to pay high rates to bondholders—leaves the merged company scrambling to meet its obligations. A big chunk of profits must go toward making bond payments, making it difficult for the company to

Nine Estate Planning Mistakes To Avoid

Thanks to increased home values, well-funded retirement accounts, and hefty life insurance policies, many retirees today not only have enough money to live comfortably but are also likely to have wealth to distribute at the end of their lives. But it can be tricky making sure your bequest gets where you want it to go. Here are nine common mistakes to avoid.

Assuming you don't need an estate plan because you don't owe estate tax. With estate tax laws currently in flux, whether your estate is large enough to owe estate taxes may depend on when you die. But even if taxes aren't an issue, estate planning can ensure your assets are controlled according to your wishes if you're incapacitated and parceled out appropriately at your death. It can also help to avoid the cost and delay of probate and minimize emotional and financial burdens on your beneficiaries.

Not having a will. Without a will, state law will govern the disposition of your probate estate, with the government deciding who gets what. Depending on your state of residence, if you are survived by a spouse and children, your estate will typically be divided among them even if you had something else in mind. Moreover, assets could be poorly managed and your estate could end up paying more than it should in taxes and legal fees. A will lets you specify who gets what and could help minimize estate taxes.

Not having a letter of instruction. What happens if you change your mind about who gets your favorite jewelry or whether you want to be buried or cremated? You can note these wishes in an addendum to your will called a "letter of instruction." Though not legally binding in all states, this document will at least give your heirs an idea what you want and help them avoid needless conflicts.

Leaving your entire estate to your spouse. While many couples leave all assets to one another, that's not always the best strategy. You may want some property to pass directly to children from a previous marriage, or to go into a trust to make use of both spouses' estate tax exemptions. Trusts, which come in many varieties, may help you fine-tune your estate plan, are typically less vulnerable than wills to legal challenges, and can provide asset protection.

Owning all assets jointly. Most couples own property jointly, with rights of survivorship—meaning that upon the death of one spouse, the jointly owned property automatically passes to the surviving spouse, avoiding probate. But this may not be the best choice in all situations. For example, owning property separately could make it possible to fund a trust and take better advantage of the estate tax exemption.

Not considering annual gifts. Using yearly gifts to distribute your estate while you're living can be immensely satisfying, and it takes advantage of an annual gift tax exclusion that allows you to make tax-free gifts each year of up to $12,000 each to an unlimited number of recipients. (If you give with your spouse, the limit is $24,000.) You can use your $1 million lifetime gift tax exclusion to make even larger gifts. And any gift now avoids potential estate taxes later.

Failing to consider the benefits of charitable contributions. Fulfilling your philanthropic goals can also have many tax benefits. Your estate can take a deduction for gifts—including cash, personal property, real estate, and certain investments—made to charitable organizations upon your death. (Charitable gifts during your lifetime are also deductible, and reduce the size of your taxable estate.) Other options to consider are a charitable remainder trust that pays a lifetime income to you and distributes remaining assets to a charity at your death, or a charitable lead trust, which reverses the equation, paying the charity now and your heirs when you die. And you might use life insurance to "compensate" family members for the part of their inheritance that goes to charity, if you are insurable and inclined to do so.

Keeping life insurance in your taxable estate. Life insurance benefits aren't taxed as income but they do go into your estate and could increase your heirs' estate taxes. A better option may be to have your policy owned by an irrevocable life insurance trust that can pass along proceeds without tax liability.

Failing to update estate strategies periodically. Everyone's circumstances change. Your wealth may increase or decrease, new children may be born while others reach adulthood, and you could be widowed or divorced and remarry, adding the complications of a second family. Regular reviews can make sure your estate plan keeps up. ●

And History Suggests Caution

grow. What does increase is the risk of default—and the more often this scenario is repeated, the more likely the junk bond market as a whole will suffer.

The heavy debt some companies are taking on now is reminiscent of the leveraged buyout craze of the mid-1980s. In the late 1980s, high interest rates and unsupportable debt levels led to a crash in the high-yield market, as companies that never should have been extended credit received sizeable loans they simply could not repay. Rates are lower today than in 1987 and 1988, but some companies are piling on debt. If interest rates edge upward, there could be danger ahead.

A bond fund can hold up to approximately a third of its assets in bonds not suggested by the fund's name. So a "Government" bond fund could hold a significant position in junk bonds. Our firm tracks such issues to ensure that your exposure to potential high-yield problems is appropriate and that funds live up to their names. If you are concerned about this issue, please do not hesitate to give us a call. ●

This article is for informational purposes and is not a recommendation to buy or sell a security. Whether bonds of any type mentioned in this article should be part of your portfolio is an individual decision to be made after considering your investment needs, time horizon and tolerance for risk.

Eight Ways To Save On Life Insurance

The price you pay for life insurance largely depends on things you can't or don't want to change: your age, health, habits, and other lifestyle choices, such as smoking and skydiving. Still, there are ways to save when buying a policy.

Buy the type of insurance you need. Though there are dozens of variations, life insurance basically comes in two flavors: term or permanent. With a term policy, you pay an annual premium and, assuming you die during the term of the policy, the insurer guarantees it will pay your beneficiaries the face amount of the policy upon your death. A permanent policy does the same thing, but premiums are higher, because you build up cash value that you can borrow against or withdraw if you cancel the policy. The right type of insurance for you depends on several factors, including your age, family situation, and financial goals. Often a term policy can save you money.

Don't be loyal to one company. You may receive free or discounted life insurance through a current or former employer. But you'll probably need to supplement that coverage, and buying additional insurance from that insurer may not get you the best deal. Keep in mind, though, that you'll likely have to qualify medically for a policy you buy on the open market, which may not be required if you buy through an employer.

Negotiate. Smoke one cigar a month? You'll probably be lumped into the same category as someone who smokes two packs of cigarettes a day. And a dangerous activity, such as skydiving, that you tried just once could also ratchet up your premium, even if you have no intention of doing it again. Your premium may be negotiable, if you write to the insurer explaining why you think you should qualify for a better rate.

Find a specialist if you have health problems. Some insurers specialize in covering people with heart disease, cancer, or diabetes. These companies employ underwriters trained to differentiate, for example, between people with high blood pressure who take their medication regularly and those whose hypertension is uncontrolled.

Buy in bulk. If you're planning to buy $950,000 of coverage, a $1,000,000 policy may actually cost less. Insurance is priced in multiples of $250,000, and an insurer may charge disproportionately more for an in-between amount.

Avoid hidden fees. Before you sign up for any convenience, find out how much it costs. For example, some insurers charge for deducting monthly payments automatically from your checking account.

Choose riders carefully. An insurer may pad your policy with extras called riders. For example, the accidental-death rider, more commonly known as double indemnity, pays twice the normal death benefit if you perish in an accident. But the chance of that happening is quite small and may not be worth the extra cost. Be sure you understand what riders you are buying.

Review. It's wise to review your policies every two or three years, especially permanent policies, to see if they can be leveraged or exchanged into a new lower-cost policy. ●

Making The Best Of Bad

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percentage yields (calculated by dividing a stock's annual dividend by its current share price), seem likely to reduce payments to shareholders. So look for companies with solid balance sheets and a history of raising dividends.

Choose bonds carefully. On the fixed-income side, yields on Treasuries are likely to decline as the Fed continues to cut interest rates, and investors may get better returns from highly rated corporate bonds. Meanwhile, yields on many municipal bonds are nearly as high as those on Treasuries, and that's before factoring in the municipal bonds' federal tax-free status. But many local governments and agencies that issue municipal bonds face rising financial pressures, increasing the risk of default. High-yield (junk) corporate bonds may also suffer. Treasury inflation-protected bonds (TIPs) could help insulate your portfolio if rate cuts boost inflationary pressures.

Look overseas, but don't overdo it. Most well diversified portfolios need an international component, and at a time when the U.S. economy and markets are under pressure, foreign stocks could provide some relief. But much of international stocks' recent outperformance has been attributable to the declining U.S. dollar, which inflates foreign profits when they're converted back into greenbacks. And while the dollar's woes could well continue, that's hardly guaranteed. Moreover, although the economic outlook for much of Europe and Asia may be brighter than for the U.S.—and while emerging markets could continue to lead developed markets—loading up on foreign stocks could add risk to your portfolio just when it makes sense to try to minimize volatility. Some of your international exposure can come via U.S. multinationals that get significant income from overseas operations. Indeed, those blue chip companies may also provide relatively high, dependable dividends.

Your response to the U.S. economic downturn could range from standing pat to making judicious adjustments. We can discuss the current economic and market environments with you, review your portfolio, and help you decide what needs to be done to keep you moving toward your long-term financial goals. ●

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