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Asset Management • Retirement, Tax and Estate Planning • Fee Only • No Commissions • Independent Advisor

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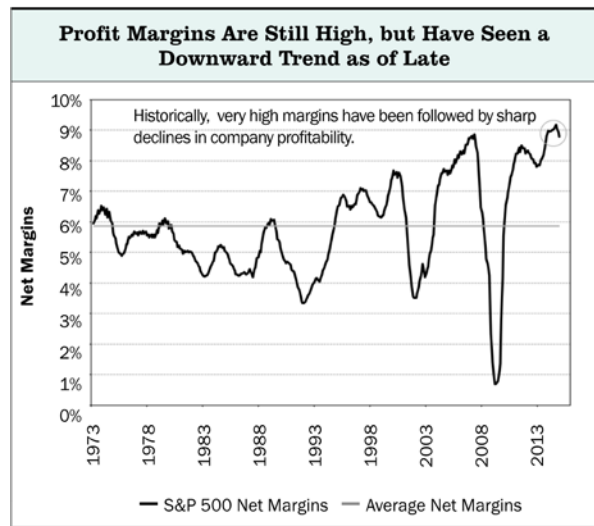
Here is our newsletter for the 3rd Quarter of 2015.

The Markets

Despite the higher volatility in the markets during the last few months, returns for the quarter were almost flat. U.S. large-cap stocks were up 0.3%, developed foreign stocks were flat and emerging market stocks were up 1.0%. The bond markets were down with the U.S. total bond market was dropping 1.8% and world bonds were down 1.5%. The only big moves were in REITs which lost 10.5% and the volatile commodity market which was up 7.6%. Our portfolios were little changed in the quarter.

We have been and will continue to hear lots of news about Greece and their debt problems. Greece will continue to be a problem and probably will default on their debt. However, it will not be the end of the world as Greece makes up about 2% of the Eurozone economy. We are also hearing a lot about the Chinese stock markets and this is a concern to watch as they have the world's 2nd largest economy. There is more economic growth from China currently than that from the U.S., Europe and Japan combined. One thing to keep in mind is China has many stock markets and the one getting all the headlines is their domestic market. We are investors in many companies in China but mostly large, global companies listed here in the U.S. and in Hong Kong.



Source: Robert J. Shiller and Standard & Poor's. Data as of 3/31/2015

The chart at right gives an update on where profit margins are for the S&P 500 companies. We have talked about this before but it is important. When margins and earnings drop back to the average or lower, stock prices will follow.

NAPFA Conference in San Diego

Every year the fee-only financial planning organization I belong to gathers along with fund managers, vendors and other financial professionals to network and attend numerous study sessions concerning the many issues facing our clients. Here are three of note.

Healthcare Planning

Carolyn McClanahan is a M.D., CFP and specializes in planning for health care. We hear from Fidelity and others that the average 65 year old will face future costs for health care of

$250,000 (out of pocket). This is probably close but the main problem is few of us are close to average: many spend less and many spend a lot more.

While healthcare costs may seem out of our control the facts say otherwise. Healthy lifestyle choices also play a big role. Go to www.livingto100.com to determine what you can do. There is a questionnaire that asks about your living habits, medical and family history which is used to estimate your longevity and to provide you with information to improve your health. One of the biggest factors is your body mass index, or BMI. Go to bmicalc.htm to calculate yours. Carolyn presented lots of information on how to estimate costs and make sure your insurance and estate documents are right for you.

Taking a Fresh Look at Reverse Mortgages

I mentioned these last year but Michael Kitces had a great presentation which discusses the details. These are not just as a last resort for those who need the cash now. They can be used as an effective planning tool to enrich your retirement.

In the past these loans have been used for your current residence to refinance the current loan or taken on a home with no debt to generate cash flow for retirees. What many do not know is you can buy a replacement home with a reverse mortgage. If there is still some debt on your existing home but want to move into a home which is a better fit for your lifestyle you could take a reverse on the new home. Depending on your situation you could eliminate your existing debt and perhaps receive payments from the bank while you live in your new home.

Another option is to take out a line-of-credit and only use it if and when you need some cash. After you put the line in place your maximum credit balance grows over time, so it may be a good idea to go ahead and start one now even if you don't need the cash now. The youngest borrower named on the loan has to be 62. If you fit the bill give me a call to discuss.

Reducing Taxes on your Portfolio

A fellow planner presented ways to minimize the taxes on your investment portfolio. I have talked about this in previous newsletters but want to make a couple of points. How taxes are taken on mutual funds and EFTs vary considerably from fund to fund. Two different funds might increase in value by 10% in a year yet the first fund might generate 5% or more in capital gains yet the second fund might not generate any capital gains. While we do have some tax-inefficient funds in our lineup we try to locate them in the right account (IRAs and other tax-deferred accounts) to minimize the hit. We also use many index funds which generate very little in capital gains annually.

We use a system on the TD Ameritrade platform called Gainskeeper to keep track of the gains in your portfolio to make sure we keep on top of our goal to minimize your taxes.

When Lower is Better

Recently we went thru the planning process with a new client which resulted in an interesting recommendation which seems counterintuitive to many. Turns out their portfolio is nowhere near where it should be.

A married couple (both boomers) wanted to plan out their fast approaching retirement and to determine if they should modify their investment portfolio. They have pension income and income from rental real estate. As part of the plan we recommended delaying taking their Social Security benefit to maximize their lifetime benefits. We then looked at how much income their investment portfolio would have to generate to supplement their other income and fund their retirement goals. Their current portfolio allocation was 83% equity with the remaining in bonds and cash. The clients used our new Riskalyze system to explore their risk tolerance. They took just a few minutes to answer a series of questions to determine what combination of return and risk they would be comfortable with. Their risk score suggested a portfolio that would consist of about 30% equities and 70% bonds and cash, a far cry from their current allocation.

We then used our financial planning software system to explore their need for returns. Do they really need to take the volatility associated with a mostly equity portfolio to fund their lifestyle? To explore the possibility I ran a scenario in their plan "Lower Returns/Risk" where the average annual returns for their portfolio were reduced from 5% to 3% and the standard deviation of those returns (how volatile) was reduced from 12% to 6%. We then use a technique called Monte Carol to determine the range of possibilities for their portfolio. The comparison of their Present Portfolio and the Lower Return/Risk Scenario is shown below. Chance of success below is the probability your nest egg outlives you.

	Present Portfolio	**Lower Returns/Risk**
Returns (annual average)	5%	3%
Standard Deviation of Returns	12	6
Chance of Success		
At age 95	65%	87%
At age 90	82%	98%
At age 85	93%	100%

Even though the returns are lower the probability of success is higher. In other words, accepting lower, less volatile returns increases the chances for success. Yes, the returns and volatility are all assumed and different numbers will change the outcome significantly. However, it does illustrate the concept that a portfolio with higher long-term returns may not be the best portfolio for you.

Thanks for reading and call me to discuss any issues you may have.

Sincerely,

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