



NAPFA

Planning Perspectives



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Facing 2009 With a Long-Term Perspective

This issue of *NAPFA Planning Perspectives* is larger than any of our issues in the past, and it has a more personal tone than we have used to date. These features reflect the unique times facing the U.S. economy and the challenges facing all of us as investors and financial advisors.

NAPFA-Registered Financial Advisors communicated with their clients constantly during the abrupt downturn in the stock markets last fall. Through e-mails, phone calls, letters, and newsletters, NAPFA advisors supplied a calm perspective that was often missing in minute-by-minute media coverage of Wall Street. But the messages also contained honest assessments of the challenges; they were not glib promises of better times coming right around the corner.

This issue of *Planning Perspectives* reprints messages that were sent by eight advisors to their clients last fall. These advisors are located across the U.S., and they serve clients with different financial situations, unique goals, and wide disparities in incomes and wealth. Regardless of the differences in the audiences, the messages have broad relevance about the current economy and how it will affect individuals and families. We hope that these commentaries resonate with you.

Your Money Bus To Visit 40 Cities

Fresh from its featured appearance on "The Today Show" in November, the Your Money Bus will be visiting more than 40 cities in 2009. This unique outreach program is bringing consumer-friendly information and financial advice to tens of thousands of people across the U.S. At every Bus Tour location, NAPFA-Registered Financial Advisors will make presentations and provide free in-person consultations to walk-up visitors. The Your Money Bus is sponsored by the NAPFA Foundation for Consumer Education, with support from TD Ameritrade and *Kiplinger's* magazine. Go to www.yourmoneybus.com to find out when the bus will be in your area.

Finding an Advisor Is Easier Than Ever

With enhancements to its website, NAPFA has made it easier than ever to find a trusted financial advisor who meets your needs. Just go to www.napfa.org and click on "Find an Advisor" to begin your search. You can then select advisors by location (zip code, city, state) and also by fields of expertise. You can contact whom you want, or ask advisors to contact you, at the time you want—while being assured of getting a professional who is dedicated to objective, comprehensive, Fee-Only financial advice.

Historic Occasion?

By Holly P. Thomas, CFP®, AAMS www.indinsightllc.com

On September 15, 2008, I called some of my clients and used the word “historic.” That was the day the federal government let Lehman Brothers fail. I had no idea what would happen next but it seemed to me we would be living in different times from that day on.

On the one hand, I was right, but I also was wrong. On the one hand, I think I was right that U.S. consumers and businesses will not have the opportunity for a long time, perhaps never, to borrow from the rest of the world as cheaply as we have the last 50 years.

How was I wrong? I was afraid this turnabout in borrowing availability would mean an end to economic cycles as we know them. A permanent contraction of the money supply, combined with quasi-nationalization of our financial system (and now our auto industry?) would spell certain doom for our capitalist way of life. Visions of Soviet and Chinese five-year production plans drummed in my head.

Is the End Near?

Since the Lehman bankruptcy, I’ve been engaged in intensive reading about the economy, discussion (and soul-searching) with fellow financial professionals, and even watching Princeton economists on YouTube. I believe this economic cycle will indeed end, as all cycles do.

A column by a University of Chicago finance professor, John H. Cochrane (no relation to O.J. Simpson’s deceased former lawyer), in the *Wall St. Journal* on Nov. 12, 2008, postulates (my paraphrasing)—Whenever someone is selling, someone else is buying. I remember back in 1991, in the midst of the last massive wave of bank and S&L failures, and six months before the bank I worked for failed and overnight was sold to the highest bidder bank, our bank president told me at a lunch, “The people with the cash are going to be the big winners now.”

There are plenty of people and companies with cash today. Some of you can count yourselves in this group. When people with cash get tired of watching the cash lose ground to inflation, or when the time just “seems right,” they will invest in some sort of other assets. Asset prices will start to go up again.

Many people would like to know when that will happen. They would like to know how quickly the rebound will occur, and which assets will benefit the most. Only those pundits who win the prognostication lottery will answer those questions correctly.

What to Do

My advice is to turn off CNBC, Fox, and other “news” outlets whose interest is in keeping your eyeballs permanently glued to “URGENT NEWSFLASH: COCOA FUTURES DIVE. BUFFETT ORDERS STRAWBERRY SHAKE INSTEAD OF CHOCOLATE.”

Instead, listen to people like Dr. Cochrane: “If you’re less leveraged, less affected by recessions, and have a longer horizon than average, it makes sense to buy. If you’re more leveraged, more affected by recession, or have a shorter horizon, it might be the time to sell, even though you might be cashing out at the bottom. If you’re about the same as everyone else, do nothing and relax. If you’re wrong, at least you will have excellent company.”

If you or someone you know can’t find clarity in the confusion, maybe your advisor can help. I’m sure that he or she would be glad to listen.



Nine Points of Advice for 2009

By B. Scott Logan, CFP® www.assetplanningsolutions.net

1. Take a deep breath. Let's face it, 2008 was horrible, and there was really no place for an investor to hide. No one can say for sure, but there could very well be some days and weeks during 2009 that feel similar to the last quarter of 2008. But, ultimately, I believe the market will be 10-15 percent higher by the end of 2009.

2. Pay attention. Many friends and clients have told me that they haven't even looked at their statements since October. As a planner who relies on giving advice based on all the data, hearing such comments makes me cringe. Take a look under the hood to see if anything needs to be repaired, or if any parts need to be replaced.

3. Diversify. I have heard pundits say that diversification failed investors in 2008. While I understand the gist of the comment, I don't agree with it. Had one invested mostly in financials or in energy producers, rather than diversifying, the damage could have been much worse. While the system failure made diversification much less attractive than owning cash, diversification still worked with regard to benchmark comparisons. It is important to note that because of the many asset class dislocations in the fourth quarter of 2008 and ensuing economic slowdown, a diversified portfolio looks much different today than it did just a few months ago. But diversification does work, assuming you prefer to avoid train wrecks and can enjoy life without hitting home runs.

4. Use the right measuring stick. It could be especially difficult after 2008 to make investment decisions with a 2- to 5-year time frame, but it is very important nonetheless. Otherwise, the fatigue from a rough 2008 could encourage investors to assume that 2009 will be similar to 2008, when the probability is that most of the long-term damage has been done.

5. Be nimble. While volatility was basically absent during December 2008, it could return during parts of 2009. Use big swings to either increase or decrease exposure to asset classes that become oversold or overbought.

6. Think outside the box. The old rules of diversification simply amongst stocks and bonds don't work as well as they used to. When the time and circumstances are right, include other asset classes.

7. Delay retirement or go back to work. There is no candy coating here. These have been tough times, and there will surely be more tough times. Obviously, not everyone needs to return to the workforce (nor are jobs available for everyone). But if your retirement security is hinging on a "goldilocks" economy and stock market in which everything is "just right," you are taking a big risk. If going back to work is not an option, then cut back on expenses to avoid draining your portfolio too early.

8. Plan before making big decisions. Undergo a thorough retirement needs analysis before turning in your retirement paperwork, or talk with your financial advisor before making large purchases.

9. Did I mention take a deep breath? Refer back to No. 1.



Rational and Irrational Markets

By David Hultstrom, MBA, CFP®, CFA, ChFC www.financialarchitectsllc.com

Based on monthly data since World War II, there have been six severe stock market downturns (declines over 20 percent in nominal terms). In these periods, the average decline has been about 33 percent, and the decline has lasted an average of slightly over three years (the time from a peak through a 20 percent or more decline, and then on to a new high). In the worst of these periods (1973-74 and 2000-02), the market declines have been on the order of 45 percent, and it's taken four to six years until portfolios were back to their previous values.

Currently, the U.S. stock market is down approximately 35 percent from its high over a year ago. *There is no way to know if it will go higher or lower from here.* This is a subtle, but important, point.

If there was a consensus that the market was going down further, *it would already be down to reflect that consensus.*

Conversely, if there was a consensus view that the market was headed higher, it would already *be* higher to reflect that expectation.

There are only two ways to “win” as an investor: 1) Be smarter than the collective wisdom of everyone participating in the market; or 2) Ignore short-term fluctuations and remain with your target investment portfolio, knowing that in the long run you will be better off than the vast majority of folks who tried to time the market by getting in and out. In investing, as with many things, slow and steady wins the race.

Occasionally, the market seems to get irrational, and it might be possible to profit from being less subject to the hysteria (either positive or negative). But this does not appear to me to be one of those times. I think the possible outcomes from this point are much more uncertain than we typically see, and there is a significant chance of further deterioration—just as there is a significant chance that the market could recover from this point.

I don't know, and I *know* that I don't know (which might possibly make me smarter than the TV talking heads). Uncertainty and risk is why advisors should not put clients into a 100-percent stock portfolio, nor should they allow clients to have 100 percent of the stocks they do own be solely in companies that are only in the U.S.



Patience and Fortitude

By Tony Farella, CFP®, AIF www.rjassociates.net

This fall, I spoke to many of our firm's clients about the nightmare on Wall Street. Obviously, they were concerned about the economy and their portfolios.

Through those discussions, advisors truly earn their fees. I've come to conclude that the greatest value an advisor can offer is to prevent clients from making critical investment mistakes at exactly the wrong time. Academic evidence suggests that on average, individual investors earn significantly lower returns than "institutional investors" such as pension plans, endowments, and foundations over the long term. Poor market-timing and panic selling in bear markets are the primary causes of this performance disparity.

When we are anxious, we naturally feel a need to do something, when in fact the right thing to do is nothing.

Here are some tips to help you weather these troubling times:

- **Know your risk tolerance.** Risk tolerance is not static. It tends to rise when things are good and markets are going up, and it tends to fall when markets are down and economic forecasts are bleak. Knowing your ability, need, and willingness to take investment risk is fundamental to maintaining your portfolio allocations during tough economic times.

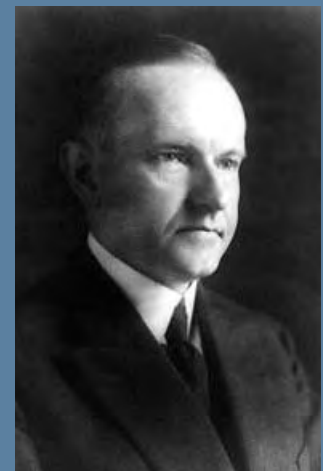
- **Embrace bear markets.** We know that markets rise and markets decline. Those of us with 20 or more years to work before retirement will live through a few down markets. Dollar-cost averaging our investments over our working lifetime allows us acquire stocks "on sale" in down markets. Bear markets must be endured to achieve expected returns above inflation—which is, fundamentally, why we invest in the stock market.

- **Revisit your goals.** The portfolio that you own should be designed specifically for you, in order to give you the best chance of meeting your investment goals. However, now is a good time to validate the goals you envisioned when your portfolio was designed. Validation will give you the confidence to stay the course. Alternatively, your goals may have changed. This may or may not require a change in your investment allocations. Let your advisor know if there are changes to your goals that require a re-examination of your investments.

- **Have faith.** Capital markets work. They've worked during many prior periods of uncertainty. I believe in the capitalist system that drives our economy and our success as investors. Rewards will come to those who maintain their faith in this system.



*"Patience and fortitude
conquer all things."*
-Ralph Waldo
Emerson



*"If you see ten troubles
coming down the road,
you can be sure that
nine will run into the
ditch before they reach
you."* -Calvin Coolidge

Higher Yields Reduce Your “Number”

By Frank Moore, MS, CFP® www.vintagefs.com

A couple years ago, a bestselling book was published called *The Number*. The theme was that there is a sum of money you could accumulate that would be enough to generate your retirement income for the rest of your life. That’s your “number.”

Last year, a major financial firm picked up the idea with a cute advertising campaign that shows people walking around carrying their “number.”

The concept is valuable, but getting your number is actually very complicated. Your actual number comes from your financial goals and your desired standard of living in retirement, as well as your expected longevity. It’s also affected by interest rates, inflation, and many other factors.

The good news is that your number is much lower today than it was a year ago. You might be focused on the fact that your investment losses have left you further from your financial goals. But that’s only half of the story.

Couple No. 1. Consider an example of a married couple that retired a year ago and wanted a \$70,000 annual retirement income. Social Security provided them \$30,000, so they needed an additional \$40,000 per year from their portfolio. They had saved well over the years and had accumulated a \$1-million portfolio, which they invested half in high-quality bonds and half in stocks. Their plan was to use the bond interest and stock dividends to live on, while hoping that the dividends would grow enough to offset most of the rising cost of living. If necessary, they could sell stock shares in their later years if their income didn’t keep up or they had high medical expenses.

In November 2007, high-quality bond yields were about 5.9 percent, according to Barron’s Best Grade index, and the dividend yield on the Dow Jones Industrials Average was 2.3 percent. This produced a little over 4 percent in income from their 50-50 stock-and-bond portfolio, or \$41,000:

2007 Bonds: \$500,000 @ 5.9% =	\$29,500
2007 Stocks: \$500,000 @2.3% =	\$11,500
Annual Retirement Income	\$41,000

Then we suffered through 2008. Yet, despite the drop in stock and bond prices over the past year, this couple’s bonds still pay the same interest. Even better, their stock dividends have increased. They now have an annualized \$41,600 in investment income. Although their portfolio balance has dropped sharply, they haven’t sold their assets, and they continue to receive income according to their plan.

Couple No. 2. Now let’s look at another couple that is retiring today. Their portfolio was nearing their target “number” of \$1 million last spring, but it has since fallen to just \$700,000. That’s the bad news.

The good news is that yields on both stocks and bonds today are much higher than a year ago due to the global credit crisis. The same high-quality bonds that paid 5.9 percent a year ago now pay 7.4 percent, and the dividend yield on the Dow has increased to 4.8 percent. By splitting their \$700,000 between stocks and bonds, this couple could receive about \$42,700 in income:

2008 Bonds: \$350,000 @7.4% =	\$25,900
2008 Stocks: \$350,000 @4.8% =	\$16,800
Annual Retirement Income	\$42,700

So today’s higher yields—brought to you by the global credit crisis—are actually offsetting the sickening plunge in your portfolio balance.

Many people today are fixated on the decline in their portfolio balance and are extrapolating it to zero in the coming months. They are panicking and selling out their portfolios and going to cash. That would be a mistake.

If we assume the first couple’s portfolio had fallen from \$1 million to \$700,000 and they cash out and invest in CDs, then their income would drop from \$41,600 to \$24,100 (one-year CDs currently average 3.44 percent, according to bankrate.com).

The lesson: Don’t worry too much about your portfolio balance. Your retirement savings is designed to buy a retirement income, and there’s a great sale going on today.

Fed Policy and Credit Bubbles

By David Bourn, MBA and Martin Gremm, PhD www.pivotpointadvisors.com



Federal Reserve Building, Washington DC

The U.S. relies heavily on consumer spending. In times of economic contraction, The Federal Reserve Board spurs consumption by adjusting short-term interest rates, which encourages Americans to buy consumer goods on credit.

Historically, consumer debt levels have risen faster in lower-interest-rate environments. Each time the Fed lowers interest rates to smooth the economic cycle, the amount of outstanding consumer debt increases. The problem is that consumer debt shows no signs of decreasing when the economy is strong.

Consumer debt has been increasing since the Great Depression. This trend cannot continue indefinitely. At some point, it will become impossible for consumers to make their interest payments, let alone repay their debts. We may be dangerously close to that point today.

Figure 1 shows the Debt Service Ratio (estimate of debt payments divided by disposable income) over the past several decades. Currently, consumers spend over 14 percent of their disposable income to service \$2.6 trillion of unsecured consumer debt. The Fed's reliance on consumer deficit spending to smooth out the economic cycle has long-term consequences that this country will eventually have to face.

In the best-case scenario, the Fed will lose its ability to boost short-term economic growth as lenders become unwilling to extend further credit to consumers, or high levels of debt payments pressure borrowers to stop taking on more debt.

In the worst-case scenario, a rise in interest rates or outstanding consumer debt, or a decrease in the median family income, could push the Debt Service Ratio into unmanageable territory. The result would be a marked increase in consumer debt defaults.

The impact of widespread defaults could be enormous. The total amount of unsecured

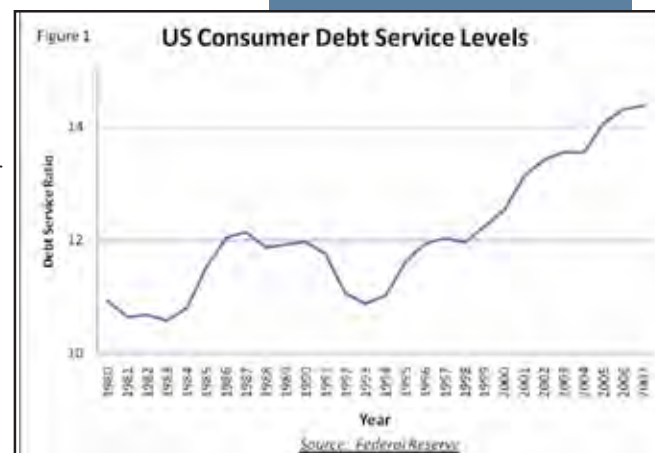
consumer debt is considerably larger than the total amount of subprime mortgage debt. Because there is no collateral, such as a house, that lenders can seize to recover some of their losses, lenders could collapse very quickly.

The government's economic policies are not primarily responsible for the increase in consumer debt. Consumers who are willing to live beyond their means by funding discretionary spending through the use of credit are a necessary ingredient.

What can we do now that our happy, overextended boat is sinking in the sea of consumer debt? For the individual, the answer is fundamentally easy: Live within your means! Do your part to decrease consumer indebtedness, even if the policies of the government encourage you to take on exorbitant levels of debt.

For policy makers, the answer is more complicated. They need to balance the short-term benefit of smoothing the economic cycle with the long-term consequences of increasing the level of consumer debt. For the last two decades, the emphasis has been on smoothing the cycle, but it needs to shift to gently deflating the credit bubble before it pops on its own. The tech bust and the mortgage crisis are recent examples when policymakers stepped in only after the crisis had started, and it was too late to do anything but pick up the pieces.

Unfortunately it is very unlikely that politicians or the Fed will take steps to defuse this looming credit crisis until events force their hands. At that point, the "solutions" will be more bailout packages, which mainly work by transferring unmanageable debt from individuals to the government. This is another short-term fix that amounts to refinancing the problem, instead of solving it.



Tax Tips: Poor Economy Helps Bump Investment Caps

By James L. Watt, CPA/PFS

As we begin 2009, all the bad economic and investment news of 2008 is still fresh in our minds. But amid all the bad news, some adjustments in tax rules are providing a small amount of good news for the upcoming year. Looking at these opportunities now will enable you to adjust your savings strategies so that you can take maximum advantage of the opportunities.

Retirement Plan Contribution Limits. If you participate in a 401(k), 403(b), or 457 retirement plan, your 2009 contribution cap is \$16,500, up \$1,000 from last year. You can make an additional \$5,500 catch-up contribution if you were born in 1959 or earlier.

Smaller employers often offer SIMPLE retirement plans. If your employer offers a SIMPLE plan, you can contribute up to \$11,500 in 2009. Taxpayers who are or who will be age 50 in 2009 can contribute an additional \$2,500.

For employer-sponsored plans that provide matching contributions, your savings will grow even faster. (Sadly, some of the nation's largest companies have eliminated their matching programs during the financial crisis.)

KEOGH Plans. Many professional businesses have profit-sharing, Keogh, and similar defined-contribution plans. The contribution limit for these plans has been increased in 2009 to \$49,000, which is an increase of \$3,000.

IRAs and Roth IRAs. There is no change in the contribution limit for traditional and Roth IRAs. The limit remains at \$5,000, plus an additional \$1,000 for individuals who are age 50 or older.

Gift Tax Exclusions. The annual gift tax exclusion has been raised to \$13,000 this year, an increase of \$1,000. This gift tax exclusion is appealing to parents and grandparents who are able to make gifts to their children and grandchildren. The lifetime gift tax exemption remains at \$1 million.

Health Savings Accounts. The annual cap on deductible contributions to health savings accounts has been increased to \$5,950 for family coverage and \$3,000 for singles. HSA owners age 55 and older

can contribute an additional \$1,000. Also, minimum policy deductibles have been increased to \$2,300 for family coverage and \$1,150 for individuals.

Long-Term Care Insurance. The deductible limit on long-term care insurance has been increased for 2009. The amount depends on the age of the taxpayer.

Estate Tax Exemption. For taxpayers who still have significant wealth, the federal estate tax exemption has increased this year to \$3.5 million from \$2 million last year. The tax rate on estates exceeding the exemption is 45 percent.

Social Security Taxes. The Social Security wage base is increased to \$106,800 in 2009. Workers and employers will pay 6.2 percent FICA tax. Workers and employers also will pay 1.45 percent on all wages for Medicare. The rates are doubled for the self-employed.

There is one other adjustment this year that doesn't represent a tax savings, but which can be very helpful to some people.

Required Minimum Distribution. If you are or will be 70½ or older in 2009, you are required to take a distribution annually from your traditional IRA or your 401(k)-type retirement plan. However, Congress enacted legislation late last year that suspended the Required Minimum Distribution for 2009. This was done to help individuals who were hurt by stock and bond market performance and who don't want to sell investments at the bottom of the market. If you automatically receive RMD income that you do not need in 2009, you can call your account custodian and ask to suspend (or reduce) the distributions. This is only a one-year exemption.

Here's another wrinkle in the system that might be helpful to you. Because income level affects the amount of a Social Security benefit that is subject to inclusion for taxation, not taking your RMD in 2009 might reduce your amount of Social Security income subject to taxation, too.

Investment Tip: Roth IRAs Provide Silver Lining to Market Downturn

By Kathleen Campbell www.campbellfp.com

The economic downturn has provided an excellent opportunity to convert traditional IRA assets to Roth accounts, since equity holdings in IRA accounts are lower in value. The account holder has to pay tax on the converted amount (assuming the contributions weren't taxed in the first place), so the lower values provide an opportunity for less tax to be paid. Once shares are converted to a Roth account, they will grow tax-free, as long as the Roth requirements are met (such as the 5-year holding period).

Here's an example: Suppose the account holder purchased shares for a traditional IRA at \$50 per share and those shares are now worth \$10 per share. Those shares can be sold, and the funds can be used to purchase shares for a Roth IRA. Alternatively, the shares can simply be transferred from the traditional IRA to the Roth IRA.

The account holder will have to pay taxes on the conversion to a Roth, but the taxes would be 80 percent less than they would have been when the shares were purchased originally. As the economy improves and those shares grow in value, that growth will be tax-free because it's in a Roth IRA.

For some people, the Roth conversion can be even cheaper than before, if retirement or a job loss has reduced earnings and put them into a lower tax bracket.

There are a few details to watch when doing a Roth conversion, especially if you have both tax-deferred and taxable investments in your IRA accounts. So it's best to work with an advisor to be sure that you're doing the conversion properly.

Fiduciary - fi·du·ci·ar·y adj.: An individual, company or institution that has a legal duty to put the interests of their clients above their own.