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Identifying Investment Risk And Coping With It

Are you a risk-taker? To realize rewards, you usually have to take some risks, especially when it comes to finances. But beyond understanding that investment risk and reward go hand in hand, it's important to know how they relate. What is the nature of risk, and how can you handle the different kinds of risk that could affect the performance of your investments?

What is the nature of risk? For many investors, risk is associated with the inherent volatility of the equities markets. You run the risk that your investments will perform worse this year than last year or worse than you anticipated or worse than the markets as a whole.

Risk means you have something to lose—the money you've put into a particular investment or the money you might have made if you had made different choices. You also could run the risk of throwing good money after bad, of buying more of something when the price is low only to see the value fall further.

Although risk and reward are related, there's no direct, predictable connection between the two. You could decide to take fewer risks and still lose money, or you might ratchet up your investment risk without cashing in on higher returns. Nevertheless, it's important to try to keep risk and reward in a balance that fits your situation.

What are the main types of risks? Financial experts often debate

this question, but the pros generally agree that two significant risks facing investors are inflation and emotion.

1. Inflation risk. Essentially, this is the risk that money you earn will lose some of its purchasing power over time. For example, if you buy a five-year certificate of deposit (CD) from a reputable bank, there's relatively little risk that the bank won't live up to the terms of the CD. But there's a much bigger risk that the dollars you receive in five years won't buy as much as they would now.

If you're old enough to have experienced the 1980s, you might recall the days when money market funds paid interest at double-digit percentage rates. However, with double-digit inflation occurring at the same time, most savers barely stayed even.

Inflation risk can present problems to all investors, and especially to retirees. Someone who left work in 1978 might have felt pretty comfortable with a pension paying \$40,000 a year. But that \$40,000 was worth only about \$12,200 in 2013, according to the Bureau of Labor Statistics. This represents a loss of almost three-quarters of the money's buying power.

One way to protect against inflation risk is to include an appropriate ratio of stocks and stock funds in your portfolio. Or, if you're more conservative, you might consider



Look Out America, Here Come Millions Of Baby Boomers!

The first wave of the massive baby boom generation has reached retirement age at a time of great financial uncertainty. There were an estimated 79 million people born in the United States from 1946 through 1964, and in 2008, the oldest in that group turned 62, the earliest age of eligibility for Social Security retirement benefits. But 2008 also marked the height of the global economic crisis, and though conditions have improved since then, the economy has been growing fitfully, unemployment remains high, and home prices, which plunged during the crisis, have just begun to recover.

Against that backdrop, the question of when to begin receiving Social Security income has become more complicated—and more crucial. As recently as a decade ago, half of those who were eligible started at 62. But these days, more people are opting to delay their benefits. Waiting until full retirement age—66 for those born from 1943 through '54—means higher monthly payments, which can be increased further by waiting until as late as age 70 to claim benefits. Getting a bigger check can be particularly helpful for today's retirees, whose longer life expectancies increase the odds that they will outlive their assets.

Making the right decisions about Social Security and other retirement issues has never been more important. We can help you take stock of your situation.

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Markets May Not Be Certain, But Experience Is

Have you ever wished you could do it all over again? Experience can be a great teacher, and it's natural to imagine that with the benefit of hindsight you would have made better decisions about everything from raising your children to managing your financial affairs. And while that may or may not be true, what is certain is that you can offer younger family members some of the insight you've acquired along the way.

Here are some thoughts you might pass along:

1. When you get a pay raise or a new higher-paying job, consider earmarking at least part of the additional money for retirement savings. You'll be amazed by what tax-deferred compounding can do to even relatively small sums over the course of several decades. And using raises to increase your contribution to a 401(k) can be relatively painless. Ratchet up your saving rate by a percentage point or two each year and you'll soon reach the maximum for annual pre-tax contributions to 401(k)s and similar employer-sponsored plans—\$17,500 in 2014 if you're younger than age 50.

Beginning at 50, you'll be eligible to save an extra \$5,500 a year.



2. Try to resist the siren song of early retirement. Leaving your job in your 50s may be tempting, but it runs counter to several financial realities. Most people have not saved enough to retire comfortably even at the traditional age of 65, and quitting early can mortgage your future in two ways—reducing the amount you can save while extending the time that your savings must support you. By the same token, however, every year you keep working improves your situation. Moreover, as life expectancies

increase, more and more people find they want to stay on the job at least part time, and not only for financial reasons. Working can help keep you engaged and healthy, particularly if you find something you really like to do.

3. Consider postponing Social Security. You can begin receiving benefits as early as age 62, but each year you delay will increase the amount of your monthly payment, and if you wait until age 70, you'll get 76% more than if you had started drawing benefits at 62. And most people will live long enough to get a larger total payout if they begin later.

4. Don't feel like you have to go it alone in making financial decisions. Working with an advisor could help you make sense of complex financial markets and chart a comfortable path toward your goals. The right advisor can assist you in deciding how much to save, how to allocate your investments, how to weigh the pros and cons of buying a home and other major financial choices, and, when the time comes, how to deploy your retirement nest egg. ●

Don't Chase After The Market News

Did you read the newspaper today or check the news online? Invariably, the stock market will be heading up or down, with the movement triggered by anything from company earnings announcements to a change in economic indicators or even a political event such as the recent U.S. government shutdown. And, more often than not, financial pundits may respond by urging investors to buy or sell something.

But you can drive yourself crazy, if you haven't already, by making stock market decisions based on what just has occurred or what you think will

happen next. In fact, chasing after the news is a common investment mistake. There are at least four good reasons to avoid this temptation like the plague:

1. The stock market usually moves ahead of the news.

There was no "all clear" signal that the severe stock market downturn of 2008-2009 had abated. But the market hit bottom on March 9, 2009, and embarked on a long, profitable climb even as other financial news remained dire. Typically, stocks move about six months ahead of economic developments, reflecting the collective knowledge, trends, and inclinations of investors. If you try to beat the market

by reacting to the latest news, you'll probably be much too late to benefit.

2. You don't have all the necessary information.

Markets tend to move based on the decisions of mutual fund managers or professional analysts who monitor and interpret financial data for a living. They have a lot more information than you do, and they get it much sooner than you—and millions of others like you—who will hear it on television or find it on the Internet. That puts you at a decided disadvantage.

3. You can't believe all the hype.

In this electronic age, media reports are often prone to hyperbole, as

Remarrying In Your 50s? 7 Key Aspects

Jack Webster had given up on romance after his marriage splintered five years ago. His two children were now both in college. Rhoda Seaver, divorced with three teen-aged children, also was skeptical about diving back into the dating pool. But Jack and Rhoda found each other through a dating service and now are engaged to be married.

It's not an uncommon story. According to the Census Bureau, more than 50% of the divorced males in this country over age 50 and more than 40% of the divorced females in the same age bracket end up remarrying. But there's more to creating a union late in life than just melding family units. Several important financial considerations may be difficult to resolve for soon-to-be retirees. Here are seven issues that could cause problems:

1. Social Security and pension benefits. If you're divorced, getting remarried generally will suspend your right to receive Social Security benefits based on your ex-spouse's earnings record. Similarly, if you're widowed and plan on collecting benefits based on your deceased spouse's record, you may have to wait until age 60 to remarry. (Getting married again also could affect the amount you're entitled to from a former spouse's pension plan. Contact the pension plan administrator

to determine the impact of remarriage on benefits.)

2. Marriage penalty. Because of the way federal income tax rates are structured, some couples are hit with a "marriage penalty" if both have substantial incomes. In other words, filing a joint return will produce greater tax liability than they would have to pay if they continued to be single filers. That problem has been exacerbated by the 2013 tax law and its new top income tax rate of 39.6%.

3. Estate planning. It's always crucial to have a valid will in place so that your heirs won't have to depend on state law to dictate where assets will go. That's even more important if you're remarrying. You'll certainly need to revise an existing will as well as being sure to update beneficiary designations for retirement plans, because those supersede your will. Moreover, even if your will says your home will go to children from a prior marriage, it will go to your new spouse if the two of you own it jointly with rights of survivorship.

4. College financial aid. Will a new marriage in your 50s affect the financial aid your children are entitled to when attending college? To determine financial aid awards, the government looks at the income and assets of the "custodial parent"—the

one with whom a child has lived for most of the preceding year—but such calculations also may reflect income and assets of a new spouse when the custodial parent remarries. Your intended's wealth indeed might reduce your child's college aid. (Some colleges also include the noncustodial parent's assets in the equation.)

5. Health-care expenses. Your state may impose special rules relating to payments of medical expenses, and the rules for nursing home care could be particularly significant. Typically, if someone requires nursing home care, it may be possible to transfer some of that person's assets in attempt to qualify for assistance under Medicaid (subject to certain imposing restrictions). However, in some states, you may still be responsible for the costs of a spouse, even if the spouse has transferred assets out of his or her name. Such rules could affect your financial arrangements with a new husband or wife.

6. Alimony. If you receive alimony from your ex-spouse, it likely will come to a halt when you remarry, though remarriage generally doesn't affect child support. Consider how this will affect your family's lifestyle. Figure out whether you still will be able to afford some of the luxuries you enjoy now or whether you'll have to scale back. Look at options for replacing the lost income.

7. Beneficiary designations. When you get remarried, it's common practice to change the designated beneficiary (or beneficiaries) on insurance, retirement plan accounts and annuity contracts (see #3). Don't forget to do this. If you fail to do this, an ex-spouse might be entitled to most or all of such benefits.

It's only prudent for Jack and Rhoda to consider these financial issues before saying "I do." Other considerations, such as whether to use joint checking accounts or a prenuptial agreement, also may come into play. Having an open discussion before you remarry may avoid problems that could fester later. ●

the pressure to generate interest from a fickle public continues to increase. That could lead producers to overreact to news tidbits or sensationalize minor events. One small incident usually doesn't portend a complete economic collapse, so take reports of impending doom with a grain of salt. It isn't likely that the sky is falling!

4. Market timing is difficult, if not impossible.

To be successful at market timing, you have to be extremely skilled or lucky, or both.



Over the long term, buying or selling based on what you hear or read almost never beats a consistent, methodical long-term approach. It's better to make investment decisions based on financial particulars rather than on instincts and hunches.

Building a diversified portfolio combining stocks, bonds, and other investments can help you progress toward your financial goals—and it can help you stop worrying about what you hear on the news. ●

Reminders On Your Beneficiary Choices

Quick: Who are the beneficiaries of your retirement plan, life insurance policies, and investment accounts? Many people don't remember whom they named as a beneficiary or are uncertain. But it's important to know, especially if your circumstances have changed since you completed the original paperwork.

You probably carefully considered whom to designate as beneficiaries of your financial accounts and life policies when you initially established them. But you may have shoved the documents into a drawer and forgotten all about them.

Suppose your family situation has changed. Maybe you have remarried and you have children from an earlier union. Do you still want your former spouse to inherit anything? Should your new spouse be named as a beneficiary? Aging, death, divorce, and other life-events, including the birth of a child or a job-switch, make it wise to periodically review beneficiary choices and ensure your assets go to the people you want to benefit most.

One reason it's so important to get

beneficiary designations right is that when you name a beneficiary on your retirement accounts and life insurance policies, those assets will be transferred without going through probate or facing other complications.

Moreover, the designations for financial accounts and insurance policies trump whatever it may say in your will. So, even if you change your will to cut out an estranged relative, that person still could benefit unless the beneficiary designations also are changed. And if there are discrepancies, the matter could end up in court—probably the last thing you would want.

Furthermore, getting the beneficiaries right may affect estate taxes. For instance, if you name your spouse as the beneficiary of your 401(k) and IRAs, those accounts won't be included in your taxable estate (although the assets eventually could be subject to estate tax when your spouse dies).

Another money-saving idea that

might surface from reviewing your beneficiaries: If you have more than one child and intend to divide your

IRA proceeds evenly, you may be able to reduce taxes owed by splitting your account. For example, if you have three children, you can split an IRA into three individual IRAs, naming one child as beneficiary of each new IRA. As a result, your children can take distributions from their inherited IRAs based on their longer individual life expectancies, not yours.

Finally, if you name a charity as an account beneficiary, the asset will pass to the charity tax-free. In addition, your estate will be entitled to a charitable deduction, which may reduce or eliminate tax liability.

For these and other reasons, it's crucial to get beneficiary designations right, and to revise them when necessary as your circumstances change. Going to the trouble of regularly reviewing your designations could be time well spent. ●



Identifying Investment Risk

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inflation-protection bonds. History has shown, however, that holding even a modest equity stake may increase returns without undue risk when compared to a pure fixed-income portfolio.

2. Emotional risk. It's easy to let emotions rule decision-making. Almost everyone is subject to bouts of fear and greed, and investors have an innate tendency to be overconfident about their ability to choose winning positions. But simply doing what feels right—or avoiding what feels wrong—can lead to adverse results.

Consider an investor who sits on the sidelines during a bull market, nervous about following the crowd—a

tendency that indeed can be counterproductive. But finally the investor gets tired of losing out and jumps in, buying at the top of the market and without carefully considering the fundamentals of particular investments. Others get into trouble when the market is falling and they sell solid holdings in a panic, losing out on the chance to benefit when they rebound.

The best protection against emotion is to have a carefully considered investment plan and to try to stick with it even when markets are highly volatile. Having a balance of bond funds for stability and income and stocks for growth can help smooth out inevitable market bumps.

How do you manage risk?

Everybody has a different risk

tolerance. A good approach for managing yours is to stick to investment fundamentals. That may be as simple as refocusing on the key principles of diversification and asset allocation.

Diversification spreads your investments over a broad mix of asset classes, an approach that has the potential to reduce risk. Asset allocation is the process of assigning percentages to those asset classes based on your particular needs and risk tolerance, and then rebalancing your holdings regularly to keep them close to their assigned allotments.

There's no way to avoid risk completely, but you still can generate earnings while staying within your comfort zone. We're here to provide guidance. ●