Keats, Connelly and Associates, Inc.

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Is the 4% Solution Right For Your Retirement Plan?

Most financial planning is about accumulation. You work, you save, you invest, and if you do everything right, you win. But what will you do with that retirement account full of assets? And what will you truly be able to afford? When you start spending your nest egg, you'll need to decide on a withdrawal plan that will fund your big plans without jeopardizing your future. Perhaps the most common approach is to pull out 4% of your savings each year. In most situations, that will keep you solvent no matter how long you live. But it may not always be the best approach.

Earlier generations didn't have to deal with this question. People often spent an entire career working for one company and received a generous pension in return. Add Social Security and they had enough guaranteed retirement income to see them through their decade or so of life after work. But now company pensions are disappearing, and today's near-retirees have to worry not only about whether they've saved enough in their 401(k)s and IRAs, but also whether their savings will support them through as many as 30 years or more of active retirement. "We have this huge wave of baby boomers about to retire, and their overriding concern is whether their portfolios are adequate," says R. Gene Stout, a finance professor at Central Michigan University.

Calculating what is adequate is complicated by the fact that spending during retirement inevitably varies from year to year and decade to decade. In a recent survey of 2,000 pre-retirees by Sun Life Financial, most said they expected the income they needed to fund their lifestyles would fluctuate, particularly during the early years of retirement. But taking too much too soon could do outsized harm to a portfolio, draining assets that otherwise could have grown to help finance later years. Ill-timed market downturns and inflation can also be crippling.

What is a safe withdrawal rate or strategy? "There's always that investor who says, 'I've accumulated all of my life and now I'm going to retire and switch everything to bonds and take 5% for life,'" says Dru Donatelli, a professor at the State University of New York and Assistant Vice President of Special Markets at John Hancock Financial Services. But that approach may fail to keep pace with inflation in general and with rising health-care costs in particular. The latter is a big expense for most retirees, and health costs are increasing three times as fast as other prices.

Simply withdrawing 4% to 5% of a portfolio's assets each year has its own potential benefits and drawbacks. It has been thoroughly studied, and it seems to work. For example, consider the potential payout from model portfolios keeping 50% to 75% of assets in large-cap stocks and the rest in intermediate- and long-term bonds. If you withdraw 4% the first year from such a portfolio and continue pulling out the same amount, adjusted for inflation, you'll stay solvent for at least 30 years, according to one study. But unless you have a huge nest egg, that approach won't give you much to live on—just $40,000 a year for every $1 million you've saved.

Another simple solution, popular

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World's Millionaires Are Good To Others And To Themselves

For many of the world's wealthiest individuals, doing good and having fun apparently go hand in hand. According to the *World Wealth Report for 2007*, published by Merrill Lynch and Capgemini, 11% of the world's high-net worth individuals (HNWIs)—those with more than $1 million of net worth—donated more than 7% of their 2006 income to charitable causes. Meanwhile, 17% of those ultra-high net worth individuals (Ultra-HNWIs)—those with a net worth more than $30 million—contributed more than 10% of earnings, a total that exceeded $285 billion, to nonprofit organizations. In contrast, non-millionaires gave away only about 1.5% of annual earnings.

Millionaires in the Middle East were most generous, giving 11.8% of their income to charitable causes in 2006, followed by individuals in the Asia-Pacific and North America regions, who contributed 7.7% and 7.6% of earnings, respectively. European millionaires, however, donated only 4.6% of income, and Latin Americans gave just 3%.

Investment of Passion	HNWIs	UHNWIs
Luxury Collectibles	26%	25%
Art	20%	25%
Jewelry	18%	16%
Other Collectibles	14%	13%
Sports Collectibles	6%	8%
Miscellaneous	16%	13%

But earmarking money for good works didn't cause the wealthy to shortchange their own "investments of passion." They proved particularly partial in 2006 to high-end cars, private jets and yachts, while also investing liberally in art, jewelry, and "other collectibles," according to the *World Wealth Report*.

How To "Spin" A Reverse Mortgage To Relatives

Are your parents or in-laws struggling to make ends meet? A "reverse mortgage" could let them use their home as a source of tax-free revenue. Though there are risks and substantial expenses, a reverse mortgage could be a viable option in a pinch. But you'll have to put the proper spin on the deal to convince your elderly relatives.

A reverse mortgage is essentially the opposite of a conventional mortgage. Instead of taking a loan and making monthly payments of interest and principal, homeowners receive regular payouts, a lump sum, or a line of credit—or, sometimes, all three. It's a little like a home equity loan that lets you take advantage of the value built up in a home without selling it. Most reverse mortgages enable owners to continue to occupy the residence for as long as they live.

The payout amount depends on several factors, including:

- The homeowners' ages and life expectancies
- The current and projected value of the home
- The term of the loan
- The lender's annual interest rate
- The amount of equity in the home

The more equity, the bigger the payments are likely to be. And though life expectancies are used to calculate the payout, living longer than expected won't mean borrowers have to leave the home.

To qualify for a reverse mortgage, all owners of the home must be at least 62 years old. But the borrowers' earning capacity doesn't matter, and

for tax purposes, payments to the homeowners are treated as a tax-free return on investment. These loans may be available from three sources: the Federal Housing Administration (FHA), the Federal National Mortgage Corporation (commonly known as Fannie Mae), and a handful of proprietary mortgage lenders.

Given its advantages, a reverse mortgage might seem an easy sell to older homeowners who need extra income. If they're living in their biggest financial asset, and if they can draw out money without having to move, why not? But any pitch to elderly relatives must also acknowledge that reverse mortgages are confusing and potentially expensive, two factors behind the requirement that all potential borrowers must receive counseling before applying for a loan.

One potential drawback is that the mortgage must be paid off—with interest—if the owners sell the place, stop using it as their principal residence, or die. This could put a crimp in any plans to leave you the home. If you inherit the house along with a large loan, you'll likely have to sell.

In addition, closing costs for reverse mortgages are generally higher than for conventional mortgages. Typically, there's an application fee, an appraisal fee, a credit report fee, and possibly monthly service fees. Moreover, borrowers must buy insurance to cover the possibility that loan payouts may eventually exceed the value of the home.

However the pros and cons stack up for your relatives, whether to opt for a reverse mortgage is bound to be an emotional decision. But if it helps them maintain their lifestyle and independence, it may be worth considering. You can help by laying out the facts and being sensitive to their concerns. ●

Ease The Bite If You Owe Money On Your Federal Taxes By

If your tax bill is substantial, you probably wish you could pay it with a credit card that earns airline miles or other rewards —and you can, for a whopping 2.49% commission. That sounds like a lot, and may outweigh any rewards your card provides. Still, you may not want to dismiss the idea out of hand.

For several years, the Internal Revenue Service has allowed Official Payments Corporation and Link2Gov to collect tax payments via credit card. They tack on that extra 2.49% to cover fees charged by the card issuers and to make a profit.

If your credit card earns one mile for every $1 you spend, and it takes 25,000 miles to obtain a domestic airline ticket to fly coach, you'd have to spend $622.50 in fees to get one ticket. In most cases, you could probably just buy the ticket and save money.

So why would you ever use a credit card to pay your federal taxes? One reason is that many credit card companies offer benefits allowing you to more than recoup the lost fee. For example, if you're heavily indebted to Uncle Sam, you might pay a $45,000 tax bill with a card that earns double airline miles. That would cost you a $1,020.90 fee, but would earn you 90,000 miles—enough for a business- class seat on a Delta plane from Chicago to London. That's probably less than you'd pay for the same business class fare on the open market.

Meanwhile, you may be able to offset the 2.49% Official Payments and Link2Gov fee by using credit card points you've accumulated for other purchases. When paying taxes with an American Express® Card enrolled in the American Express® Membership Rewards program, for example, you can redeem membership rewards points to pay for the cost of the 2.49%

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. ●

Paying Uncle Sam With A Credit Card

convenience fee. According to Official Payments, 40,000 points will cut $200 off your fees. Of course, you still might do better using some of those points for an airline ticket.

If you own a business, charging tax payments could have greater benefits. Starting in 2007, small businesses can use a credit card to make payments related to federal business tax Forms 940, 941 and 944 for an expanded number of filing years: 1997 through the present. You might use a credit card to solve a cash flow problem, in effect postponing the due date for a federal payment by putting it on your card and then paying off the balance before interest charges accrue. (That's essential whenever you use plastic to pay taxes; interest costs will quickly kill any advantage of using the card.) And while you'll still pay the 2.49% fee, you can write off the cost as a business expense.

It's also possible to pay other types of taxes, such as local real estate taxes, with a credit card. See www.officialpayments.com or www.link2gov.com for details. ●

Too Much Sleep Also Not Good For You

According to longstanding conventional wisdom, eight hours of sleep is ideal. But a new British study is the latest to show that over the long term, seven hours of sleep a night may not only add an extra hour of productivity to your day, but perhaps years to your life.

In September of 2007 a team of researchers from the University of Warwick and University College of London presented their findings to the British Sleep Society. The team had examined sleep patterns of 10,308 civil servants aged 35-55 over a period of 17 years, and tracked the workers' mortality rates based on changes in sleeping times.

After taking into account age, smoking, and a number of health variables, the group's data confirmed that subjects who cut back to five hours of sleep or less a night faced a 1.7-fold increased risk of death from all causes—including twice the chance of a fatal cardiovascular problem. The study's author, Dr. Francesco Cappuccio, Professor of Cardiovascular Medicine at University of Warwick's medical school says that it's a trend that's increasing in industrialized nations as we attempt to fit in more time to work, play, socialize, and be entertained.

But what was even more surprising was that the data also showed those who increased their nightly sleep hours from seven to eight or more hours a night throughout the study were more than twice as likely to die—mostly from non-cardiovascular problems such as cancer.

These results support findings from a 2004 Japanese study conducted by Dr. Akiko Tamakoshi of the Nagoya University Graduate School of Medicine, which followed mortality and average hours of sleep among more than 100,000 people over a 10-year period. Those researchers also found that among their subjects, sleeping less—or more—than seven hours contributed to earlier mortality.

Daniel Kripke, a sleep researcher at the University of California-San Diego School of Medicine, noted that the Japanese study also showed a progressive factor. The longer the subjects slept per night, the more likely they were to die early. His own findings on the subject, which he presented in Seattle at the 2002 Annual Meeting of the Associated Professional Sleep Societies, showed that individuals who slept eight hours per night were 12% more likely to die within six years than were those who slept seven hours. The highest mortality rate—15%—occurred among subjects who slept more than eight and one-half hours.

Whereas medicine is able to connect sleep deprivation to a host of life-threatening problems, including diabetes, high blood pressure, and inflammation, the mechanisms by which oversleeping contributes to early mortality aren't clear. According to Dr. Cappuccio, "Potential mechanisms by which long sleep could be associated with increased mortality have yet been investigated... some candidate causes for this include depression, low socioeconomic status, and cancer-related fatigue."

Dr. Cappuccio said adults should try to get seven hours of sleep a night—not much more or less. He says, "In terms of prevention, our findings indicate that consistently sleeping around seven hours per night is optimal for health."

As far as the eight-hour ideal sleep in so-called conventional wisdom, sleep researcher Neil Stanley of Surrey University said of the Japanese study, "I've been in this game for 22 years, and I still don't know where that came from." ●

The 4% Solution Right?

(Continued from page 1)

during the mid-1990s, was developed by mutual fund legend Peter Lynch. His model portfolio, fully invested in equities and generating average annual returns of 10% to 11%—the long-term historical average—could support a 7% annual withdrawal rate, adjusted for inflation, without draining assets. But such a portfolio could be decimated during bear markets like the three-year decline that hit stocks in 2000-2003.

Today, many experts prefer a flexible approach that adjusts withdrawals according to changing income needs and market fluctuations. Increasingly powerful computer simulations make it easy to model different scenarios and to gauge the impact of changes in many variables. For example, a study by three Trinity University professors considered withdrawal rates ranging from 3% to 12%. The money came out of five model portfolios—one with all stocks, another all bonds, and three with various blends of stocks and bonds. The researchers plugged in historical data from withdrawal periods beginning at different starting points and lasting 15, 20, and 35 years.

According to the study, adding bonds to the portfolio mix increased the likelihood of success, particularly at lower withdrawal rates, but the authors also concluded that most retirees would benefit from having at least 50% of their holdings in stock. Meanwhile, withdrawing just 3% to 4% from a stock-heavy portfolio was likely to create wealthy heirs at the expense of a retiree's current income. And for payout periods of 15 years or less, withdrawing 8% to 9% each year from a stock-dominated portfolio appeared to be sustainable. However, don't underestimate the importance of long-term care insurance in protecting yourself; a major long-term care situation early in retirement could devastate your life savings, since Medicare won't cover expenses until a great portion of your assets have been exhausted.

"Taking 4% a year gives you a starting point," says Peng Chen, president of Ibbotson Associates, an institutional research and consulting firm. "It gives you a rule of thumb in terms of how much you can take out versus how much you have. But there are many different strategies for managing your money and spending it during retirement, and these days, it's possible to create very sophisticated plans. No one size fits all." ●