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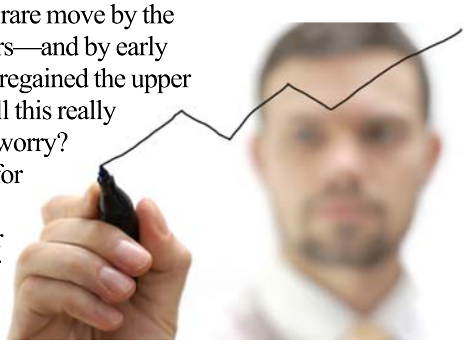
Volatility Is Back, But That's Not Necessarily Bad

Wall Street traders who were looking forward to another boring summer got a rude awakening this year. After a few jolts in the spring, financial markets around the world got downright stormy in July and August as investors worried about the subprime mortgage collapse and a credit crunch. Make no mistake about it, volatility was back with a vengeance. The ride got so intense that the Federal Reserve Board felt compelled to ease credit by reducing the bank discount rate—a rare move by the nation's central bankers—and by early October, the bulls had regained the upper hand. But what does all this really mean and should you worry?



One explanation for the summer's market turbulence is that, after repeatedly shaking off bad news during the past few years, stocks were simply overdue for a correction. Despite soaring oil prices and military setbacks in Iraq, share prices had pushed steadily higher, and in mid-July the Dow and Standard & Poor's 500 stock indexes hit record highs. And it had been a very smooth ride. From May 2003 through January 2007, the Dow never dropped more than 2% in a day. That was a period of stock market stability unmatched in more than a century, but it couldn't last forever. Finally, "the past few years' speculative excesses were pulled from the market," says Doug Roberts, chief investment strategist at Channel Capital Research.

But the summer stock market was also buffeted by a sudden credit crunch. When the economy is on the upswing, things often get a little out of hand, and this time that took the form of easy credit being offered to poorly qualified homebuyers in the form of subprime mortgages. When those homeowners couldn't keep up with their payments, foreclosures began to rise. And because those mortgages had been repackaged into complex, illiquid securities bought by hedge funds and other institutional investors, it was those sophisticated professional investors who suffered the worst losses. With these rarely traded securities still buried in some portfolios, the full extent of the damage may not yet be known.

But much of the devastation has been on public view. For example, in June 2007, Merrill Lynch seized $800 million in assets from two hedge funds managed by a venerable Wall Street firm, Bear Stearns & Company. The hedge funds suffered huge losses and became insolvent because of the plunge in value of the mortgage-backed securities they owned.

Although it was debt and not equities that triggered the summer stock sell-off, stocks couldn't avoid the fallout. Hedge funds tend to be highly leveraged—they borrow money hoping to increase the impact of their strategies—and many of those holding subprime mortgage-based bonds had to sell stock to meet demands by lenders that they come up with more cash. That onslaught of selling helped push down prices. Lenders, meanwhile, fearing widespread defaults, stopped lending.

(Continued on page 4)

Longevity: The Impact Of Stress And Financial Peace Of Mind

When you consider the best ways to extend your life, you probably think of good physical health habits—diet, exercise, medical screening. But moves that keep you financially healthy also help, by relieving stress that can lead to disease and a premature death. And good financial planning puts you in position to enjoy all those extra years.

Getting older is inherently stressful. Major lifestyle changes such as retiring, watching kids leave the nest, and downsizing to a smaller residence inevitably generate anxiety. If you're also taking financial responsibility for aging parents or for adult children who need help getting started, it only adds to the psychological toll.

Getting your financial house in order can help lighten the load. Knowing your retirement account is well funded, say, or that you have established a trust to take care of children from your first marriage, can help ease your mind. But if others around you are concerned about the future, their anxiety will inevitably affect you, too. So sit down now with your spouse, your children, and your parents to discuss what's ahead.

And talk with us. It's our job to help you achieve financial peace of mind, and the more we know about your goals and your stress, the better we can work with you to relieve your anxiety. Getting comfortable with your financial future just might give you more of it to enjoy.

Bob Keats
President

Should You Delay Taking Social Security Benefits?

When should you start collecting your hard-earned Social Security? Conventional wisdom says the longer you delay, the better off you are. Yet maximizing your payment through waiting is just one way to get the most out of this key retirement income source.

In essence, the government pays you to wait for Social Security, and docks you for taking benefits early. You're allowed to begin collecting at age 62, but your monthly payment will be lower than your "full benefit," and it will stay that way (see "The Cost Of Starting Early"). To get more, you must wait until you reach the Social Security Administration's "full retirement age," which used to be 65—and still is, if you were born in 1937 or earlier—but is now inching upward, depending on your birth year. If you delay taking benefits beyond your specified retirement age, your payment will increase an extra 8% for each year you postpone benefits until age 70.

If you opt to start Social Security payments at 62, you'll lose up to 30% of the benefit you'd get by waiting until retirement age. Still, delaying payments may not always be possible or even desirable. You could need the money—if, say, you've been downsized at work, or your health has forced you to retire early. In such cases, starting Social Security at age 62 may be better than draining your savings while you wait several years.

If you have plenty of other income, starting benefits early could pay off if you invest the money. But there's no guarantee you'd come out ahead with this strategy. Your success depends not only on your return, but also on how long you live. Receiving several extra years of payments undeniably puts money in your pocket, and if you start benefits at age 70 rather than at 62, for example, you'll need to live a number of years before the higher monthly payments make up for the cash you gave up by waiting. On the other hand, investing your early benefits in anything but the most conservative assets could put some of your otherwise guaranteed retirement income at risk.

The lower your portfolio's returns, the better off you may be spending down your savings while you wait for benefits to kick in at age 70, suggests John Marotta of MoneyNews.com. If your savings only keep pace with inflation—and if you live past the age of 83.4—waiting for the age 70 payout will be a better deal. But if you earn 2.5% a year above inflation, the "break-even" age is 87.25 years, according to Marotta.

These days, of course, achieving those milestones isn't unusual. According to the American Society of Actuaries, a 65-year-old male now has a 50% chance of surviving until age 85, while the average 65-year-old woman has 50-50 odds of being alive at 88. For a couple in which both spouses are 65, there's a 50% chance one will make it to age 92.

Ultimately, your decision about when to begin Social Security benefits may hinge on how that income affects your financial plan. If you're nearing 62 and would like to discuss your options, please give us a call. ●

The Cost of Starting Early

Year of birth	Age When You Can Begin Full Benefit	Percent Of Full Benefit Lost By Retiring At 62
1937	65	20.00
1938	65 and 2 months	20.83
1939	65 and 4 months	21.67
1940	65 and 6 months	22.50
1941	65 and 8 months	23.33
1942	65 and 10 months	24.17
1943 - 1954	66	25.00
1955	66 and 2 months	25.84
1956	66 and 4 months	26.66
1957	66 and 6 months	27.50
1958	66 and 8 months	28.33
1959	66 and 10 months	29.17
1960 & later	67	30.00

Source: Social Security Administration

Hackers Monitor Passwords To Break Into Online Accounts—

Let's give you the bad news first: Hackers have already broken into financial accounts at seven major brokerage firms—and the Securities and Exchange Commission says the problem could get worse. The good news: you can protect yourself from online attacks.

Merrill Lynch, E*Trade, Fidelity Investments, Charles Schwab, TD Ameritrade, Scottrade, and Vanguard Brokerage Services in March 2007 were victims of a massive attack. Hackers broke into investors' accounts, sold the holdings, and, in a "pump-and-dump" scam, used the proceeds to buy the stock of 15 companies. This is a variation on older online schemes that use mass e-mails containing false news alerts to spur buying and drive up prices. In the new version, the wave of buy orders using money from the hacked accounts artificially inflates the value of low-priced, volatile "penny stocks." The hacker owns the target stocks and sells at a big profit— sending the price plummeting—then wires the money to an untraceable account.

In the new pump-and-dump scams, the hacker steals your account user name and password using something known as keystroke monitoring software. This records all keystrokes entered on a computer, then emails the information to the hacker. It's easy for someone to install this software on public computers, such as those in libraries, airports and Internet cafes, but it can also end up on your home computer. A hacker might send you an e-mail message or a pop-up window saying you've won something; when you click to find out more, keystroke monitoring software may install itself on your computer. Then, the hacker just waits for you to enter the address of your brokerage firm's web site and watches the next several keystrokes—likely to be your user name and password.

What Else Should Be In Your Will?

When writing a will, most people focus on big assets—real estate, securities, and bank accounts. Often overlooked are smaller items, such as jewelry, paintings, and family heirlooms, as well as other instructions that have nothing to do with assets—whether you want to be buried or cremated, for example, or who should clean out your house after you're gone. This begs the question: Exactly what, beyond the obvious, should be in your will?

According to Mary Randolph, author of *The Executor's Guide: Settling a Loved One's Estate or Trust* (Nolo, 2006), "you can do pretty much whatever you want in your will." The question is, will what you want benefit your descendants—or only add to the confusion?

Many people writing wills indicate exactly who should receive specific big-ticket items—a car, a boat, the summer house—then stipulate that the rest of the estate be divided equally among all heirs. That's nice and simple, says Randolph, but it could spark family disputes. "Even in families in which everyone gets along fine, in times of stress, disagreements can bubble up," Randolph says.

Your goal should be to leave specific instructions without getting too complicated. Attaching conditions to a gift, for example, can be problematic. Suppose you'd like to provide your daughter with a financial reward only if she attends college—but what does "going to college" really mean? Does she have to attend full time, or can she take night classes? Does she have to enroll in a four-year university, or is a community college or unaccredited online program acceptable? And is there a specific time frame? What if she attends college in 50 years—does the estate have to reserve enough money to pay her then?

Randolph recommends you think about what material goods are particularly important to your family—your grandmother's china, a favorite painting, an 18th century armoire—and make specific bequests of those items. But those instructions don't necessarily have to be in your will. About half of U.S. states accept a "property memorandum"—a list, outside your will, of personal items you want to leave to certain people. If you choose this route, your will can simply indicate that you wish your personal effects to be divided according to the attached memorandum. This approach saves you the hassle of rewriting and re-notarizing your will if you acquire additional items you want to give away or change your mind about who gets what.

For the remainder of your personal effects, try to come up with a way for heirs to divide things up among themselves. For example, you might let each descendant pick one item and then another, until everything is accounted for. Or, you might assign everyone a certain number of points, which can be used to bid on individual items. "That way, your children can decide what's important to them," Randolph says. "John may want to spend his 100 points on furniture, while Mary prefers to spend hers on a snow globe."

You can also make specific instructions in your will—for example, that your son gets the job of cleaning out your house, or that you want to be cremated, not buried. But here you may find yourself in tricky legal territory.

First, you need to make such a request in language suggesting it is legally binding. "Saying, 'I want my son to clean out my house,' is not binding," says Randolph. "But saying, 'I appoint my son as executor and direct that he shall sort and divide my personal belongings as he sees fit' " is.

Next, consider when your will is likely to be read. If you want to be cremated, it's better to make that request in a final arrangements document or a similar form, because your will probably won't be reviewed until after the funeral.

Finally, realize that whether you make such requests in your will or another document, they may not have the weight of law. Most state laws don't say anything about how to make final instructions legally binding. Those that do require a form that must be witnessed and notarized—and even then, the instructions have to be followed only if they're reasonable. "You probably can't say you want to be buried in a Cadillac," says Randolph. "Your best bet is to write down what you want according to the laws of your state, and hope for the best." ●

But You Can Avoid Becoming A Victim

Though investment companies aren't required to reimburse you for losses from fraud, in most cases, they will. But to avoid the hassle of trying to recover your money, it's relatively easy to protect yourself. It makes sense not to visit your online brokerage account from a public computer. At home, don't open email from senders you don't recognize, and don't click on links in pop-up windows. And consider installing anti-spyware software. These programs remove existing spyware—including stroke monitoring programs—and prevent the installation of new spyware.

Anti-spyware software is widely available. You can get Lavasoft's Ad-Aware, for example, both in a free version called Ad-Aware Personal and two retail verisons, Ad-Aware Plus and Ad-Aware Professional. Other well-known anti-spyware products include PC Tools' Spyware Doctor, Webroot Software's Spy Sweeper, Trend Micro's Anti-Spyware, and Sunbelt's CounterSpy.

But research these products carefully before you buy. Several anti-spyware companies have incorporated into their programs what may itself be a kind of spyware. This software doesn't steal your personal information, but it does record your online activity for advertising research. ●

Accumulating More Frequent Flier Miles

These days, you don't have to be a frequent flier to earn frequent flier miles. Most miles, in fact, are earned on credit card purchases rather than through airline flights. But there are many kinds of cards, from those issued by banks and credit card companies to those affiliated with airlines or hotels, and choosing the right one can be tricky. "If the choices were clear-cut, there wouldn't be as many cards as there are," says Tim Winship, co-author of *Mileage Pro: The Insider's Guide to Frequent Flyer Programs.*

Winship favors concentrating your miles in a single program, and he suggests choosing a card affiliated with the airline you use most often. If you decide to participate in several programs, you may be best served by an American Express or Diners Club card, Winship says, because both allow you to transfer earned points to a variety of airline programs. If you tend to rack up a lot of credit card purchases, a bank card could help you accrue points redeemable for free tickets, and bank card fees are among the lowest fees, Winship says.

Last year, the Freddie Awards, the frequent traveler's Oscar®, named Alaska Airlines' Mileage Pal as program of the year for the third time in a row, with Southwest Airlines' Rapid Rewards in second place. Winship also likes American's AAdvantage program and United's Mileage Plus. Among affinity credit cards, the Starwood Preferred Guest card issued by American Express, the Citibank AAdvantage MasterCard, and the American Express Blue Key card are his favorites. See www.frequentflier.com for more detailed comparisons among card programs. ●

Which Card's For You?

All frequent flier credit card programs are not created equal. Here's how the card types stack up.

	Airline Cards	Hotel Cards	Multi-program Cards	Bank Cards
Fees	Medium	Low to Medium	High	Low
Strengths	● Miles can be combined with miles from other program partners (airline, hotels, etc.) to quickly reach award thresholds such as free flights and elite status	● Low cost ● Hotel stays are readily available (and worth more than flight rewards, because hotel rates have increased more than airfares)	● Flexibility to convert points to miles programs in selected airline and hotel ● Wide choice of awards ● Points don't expire	● Low cost ● No blackout dates on award travel ● Wide choice of airlines for award travel
Weaknesses	● Points earning and redemption limited to a single program ● Blackout dates and capacity controls limit award availability	● Hotel programs generally offer lower mileage earning rates than other cards; it's generally easier to earn free hotel stays than free flights	● High annual fees ● Fees to convert points to airline miles; no fees for hotel points ● Amex points cannot be converted to American or United miles	● Cannot be combined with airline miles ● Award tickets require 21-day advance booking and cannot exceed a set dollar value ● Miles expire
Recommended Role	● Primary card for frequent flyers who concentrate activity in a single airline program	● Secondary card for frequent flyers, to add free hotel nights to free flights from airline programs	● Primary card for frequent travelers who must participate in multiple airline programs ● Secondary card for frequent flyers who participate in multiple hotel programs	● Primary card for consumers who earn the bulk of their miles using a credit card

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Volatility Is Back

(Continued from page 1)

The sudden credit crunch spurred the Fed on August 17 to lower the discount rate—the rate at which the U.S. central bank lends to commercial banks—a full half percentage point. Little money is actually borrowed from the Fed at the discount rate, but this largely symbolic move demonstrated that the Fed, which had been thought more likely to raise interest rates than to lower them, had suddenly changed direction. The Fed followed up by reducing other key rates.

Even before this market correction, however, stocks were not wildly overpriced by historic standards. One key measure of stock value is the market's price-to-earnings (p-e) multiple. Since 1935, investors have been willing to pay an average of $15.80 for every dollar of profit on stocks in the Standard & Poor's 500 stock index—in other words, the ratio of stock prices to corporate earnings was 15.8. When the stock market peaked on July 20, its price-to-earnings ratio was above average, at 18.3, but relatively low compared with other recent bull market highs. For instance, during the bull market that ended in 2000, the p-e ratio of the S&P 500 topped out at 34. Investors seven years ago were willing to pay almost twice as much for every dollar of corporate profit as they were this summer.

As worrisome as volatile markets may be, they're nothing new. Some research speculates that ancient Babylon suffered through a rough stretch between 1740 and 1700 BC, when costs more than tripled, and a run on donkeys in Roman Egypt around 200 AD pushed up the price of the animals eightfold.

These days, the markets are still jumpier than they were a year ago, but the shifting balance has helped the Dow and S&P 500 climb back to their July highs and even beyond. There's less mystery about what the Federal Reserve and other central banks will do, p-e ratios have retreated a bit (making stocks seem cheaper on an earnings basis), and some of the most irrational exuberance has gotten a dose of reality as investors remember just what risk means.

Hopefully, dissecting the summer decline calms any fears you may have. As long as your investment portfolio remains aligned with your long-term financial goals and attitude toward risk, you're likely not too upset about the stock market correction. But if you are still concerned, please give us a call. ●

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