

Investor Insights & Outlook

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Saving for an Emergency

According to a recent survey conducted by Bankrate.com, 28% of Americans have no emergency fund, up from 24% a year ago. About 49% of people surveyed said they had no emergency savings or less than three months' expenses.

The traditional prescription for life's financial emergencies is to hold three to six months' worth of living expenses in cash. Only 25% of those surveyed said they had enough to cover six months' or more of expenses. In a low-yielding environment, many are concerned that keeping aside six months' of emergency savings is a lot of money to have sitting in the bank earning next to nothing. While this is a valid concern, customizing your emergency fund to fit your personal situation may serve as a viable solution.

Consider holding a larger emergency fund (six months to a year) if you have a high paying job, are self-

employed, work on a freelance/contract basis, have dependents, have a nonworking spouse, have high fixed expenses (mortgage, auto loan, tuition bills), or have a pre-existing medical condition that could result in hefty health-care bills if you were forced to purchase private health insurance. On the flip side, you may be able to get by with a smaller emergency fund if you:

1. Have a good degree of career flexibility because you are in a lower-paying position and/or haven't yet developed a specialized career path.
2. Have other sources of income that could help defray a large share of household expenses, such as a working spouse.
3. Have a great degree of lifestyle flexibility (for example, you would be willing to relocate).

Source: Bankrate.com Financial Security Index survey, June 25, 2012.



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Questions to Ask Before Paying Off a Mortgage

The decision to pay off a mortgage or invest in the market is far from black and white. For those who are close to retirement and already have plenty of other liquid financial assets, paying off a mortgage could be a wise use of cash. Such homeowners aren't likely to be saving a lot because of their mortgage-interest deductions, which tend to be more valuable early in the life of the loan than in the later years, and their investment-asset mixes might be skewing toward low-returning cash and bonds, not stocks. Moreover, many retirees concur that reducing their in-retirement overhead by retiring debt reduces worries and frees up cash for travel and other pursuits. For others, however, a mortgage pay down might not be the right answer. Although it might seem comforting to own your home free and clear, there's invariably a trade-off involved. You're reducing your investments in more liquid assets in favor of an asset that's not liquid at all. A happy medium for many households might be to balance modest prepayments of mortgage principal with ongoing contributions to retirement-plan accounts. Here are some questions to think through as you make this important decision for your household.

Is your retirement plan on track? Before paying off a mortgage you may want to spend some time evaluating the viability of your retirement plan. Paying off a mortgage rather than investing in the market may mean having fewer liquid assets for retirement. However, with lower household expenses, you may be able to step up your future retirement-plan contributions; having a paid-off home will also mean that your in-retirement costs may be lower. Time horizon is an important aspect of decision-making here. Those with more years until retirement can better harness the compounding benefits of investment assets, whereas those nearing or in retirement and expecting to begin drawing on their investment assets might not get such a big bang from investing more.

What's your investment mix, and where are you holding it? The composition of your investment assets and where you hold them are also important considerations. The case for investing in the market rather than prepaying the mortgage gets even stronger if you hold your investments within the confines of a tax-sheltered vehicle and/or you're earning matching

dollars on your contributions. On the flip side, portfolios that are heavy on cash and fixed-income securities, especially those that are fully taxable from year to year, are less likely to out earn mortgage interest rates.

How diversified are you? Some homeowners think of their houses as a retirement-savings vehicle: When it comes time to retire, they'll cash in their equity and downsize to a smaller place. However, the past several years have taught many homeowners that's easier said than done. Many haven't been able to sell when they wanted, and they also haven't been able to receive anything close to the prices they were expecting. Pairing home equity with more liquid stock and bond assets may give you a lot more flexibility to ride out downturns in the housing market.

How much is your mortgage-interest deduction saving you? Many homeowners assume that it's wise to hang on to their mortgages because of the tax deduction they can take on their interest. But that deduction shrinks as the years go by because home loans are front-loaded toward interest payments. People who have been able to pay down a mortgage for many years may be overestimating the amount of taxes they're saving by having a mortgage, and itemizing deductions may not be saving them much versus the standard deduction.

Diversification does not eliminate the risk of experiencing investment losses. Government bonds are guaranteed by the full faith and credit of the U.S. government as to the timely payment of principal and interest, while stocks are not guaranteed and have been more volatile than bonds. Please consult with a financial and tax professional for advice specific to your situation.

Questions to Ask Before Venturing Into a Self-Directed IRA

A self-directed IRA enables investors to buy into asset classes that are often outside of the purview of fund companies and brokerage firms. These investments may include non-publicly traded real estate, private equity, and partnerships and joint ventures that may exhibit radically different performance patterns than stocks and bonds, a quality that bear-market-battered investors could be craving. In some respects, all IRAs are self-directed, in that as the account owner, you're entirely in control of what you put inside of your account. And on the surface, self-directed IRAs have features that are comfortably similar to conventional IRAs that hold stocks, bonds, or mutual funds. The contribution limits are the same, rollovers from other IRAs are permitted, and you can opt for a traditional or Roth version. However, investing in a self-directed IRA isn't as simple as sending a check and tuning out; far from it. In addition to analyzing the merits of a prospective self-directed IRA investment, it's also important to consider how the inclusion of a single, possibly large, and undiversified investment interacts with your other holdings. You also need to be aware of the different rules governing these accounts because you could run into serious trouble if you run afoul of them. Here are some of the key questions to consider before taking the plunge into the world of self-directed IRAs.

What will it cost? If you hold stocks or mutual funds in an IRA, your costs will be pretty transparent: mutual fund management fees and any commissions you might pay to buy and sell. Self-directed IRAs charge another layer of fees because you must go through a custodian, who in turn will invest in the assets on your behalf. As a result, there's typically a setup fee for a self-directed IRA as well as ongoing administrative costs; these costs can vary widely by custodian, so you really need to do your homework. Of course, investing in mutual funds or individual stocks isn't free, but taken together, the extra costs associated with self-directed IRAs mean that your investments will need to perform that much better than traditional stocks and funds just to pull ahead.

How does it fit with the rest of your portfolio? Even if you're sold on the merits of an investment you'd like to put inside of a self-directed IRA, such as a rental property, it's still important to consider how it fits

with your overall portfolio. Are you sinking a disproportionate amount of your money into a single asset?

Do you thoroughly understand the rules? Self-directed IRAs come with a separate set of rules, the majority of which are designed to prohibit self-dealing, which is, essentially, obtaining use from an asset even though you're receiving a tax deferral on it. If the Internal Revenue Service learns of self-dealing, the entire sum in that IRA could be considered taxable and subject to the 10% early withdrawal penalty.

Funds in a traditional IRA grow tax-deferred and are taxed at ordinary income tax rates when withdrawn. Contributions to a Roth IRA are not tax-deductible, but funds grow tax-free, and can be withdrawn tax free if assets are held for five years. A 10% federal tax penalty may apply for withdrawals prior to age 59 1/2. Please consult with a financial or tax professional for advice specific to your situation. Diversification does not eliminate the risk of experiencing investment losses. Government bonds are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest, while returns and principal invested in stocks, commodities and real estate are not guaranteed. Real estate investment options are subject to certain risks, such as risks associated with general and local economic conditions, interest rate fluctuation, credit risks, liquidity risks and corporate structure. Investors should read the prospectus and carefully consider a fund's investment objectives, risks, fees, and expenses before investing.

What's the Number?

"The 2012 Retirement Confidence Survey: Job Insecurity, Debt Weigh on Retirement Confidence, Savings," published by the Employee Benefit Research Institute in March 2012, includes the following highlights.

- 1) Only 14% of Americans are very confident they will have enough money to live comfortably in retirement. 42% of Americans identify job uncertainty as the most pressing financial issue facing Americans today.
- 2) 60% of workers report that the total value of their household's savings and investments, excluding the value of their primary home and any defined benefit plans, is less than \$25,000.
- 3) 37% of workers in 2012 said they expected to retire after age 65, up from 11% in 1991. 62% of workers and 37% of retirees consider their current level of debt

to be a problem.

4) 56% of workers report they and/or their spouse have not tried to calculate how much money they will need to have saved by the time they retire so that they can live comfortably in retirement.

5) 16% of workers and 11% of retirees are very confident that their investments will grow in value. But 67% of workers state that they are a little or a lot behind schedule when asked to evaluate their progress in planning and saving for retirement.

6) 24% of retirees are very confident about having enough money to cover medical expenses in retirement, and 18% of retirees are very confident about having enough money to pay for long-term care in retirement.

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