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## The Prudent INVESTOR

JULY 2011

### How the Housing Market Impacts Retirement Planning

**A**cross the entire country, home values have dropped in the last few years — in some areas significantly. The news isn't all bad though:

- ✓ The impact is regional — some markets are much less affected than others.
- ✓ Some of the worst markets appear to have bottomed.
- ✓ Great homes in great neighborhoods are still in demand.
- ✓ New housing starts have been at a record low, which is good for existing home sales.
- ✓ In many areas, higher-end homes are not as hard hit as moderate to low-end homes.

And finally, activity will not



stop — people will move, buy, and sell. Homes are in fact selling now, and that activity will continue to pick up as unemployment decreases and the economy recovers.

According to the Case/Shiller Index, which tracks U.S. housing values, home prices have traditionally followed a slow but steady incline. The upward spike we experienced from 2005 to 2007 was quite the anomaly and not one we're likely to see again in the baby boomer lifespan.

This may impact you in several ways. Perhaps your home no longer provides as great a backup retirement income plan as you may have anticipated or will provide a smaller inheritance for your children. Or perhaps you've considered relocating to a senior community but have delayed that move to wait and sell your home when prices recover.

However, it's not likely we'll return to the overvalued housing

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#### A Dream Is Not a Plan

**Y**ear after year, funding retirement consistently comes up in surveys as the most worrisome financial concern on people's minds. Yet, most people spend more time planning a vacation than they do planning for retirement. The difference between these two approaches is that one way involves setting a goal and managing money to reach it. The other is an impulse based on dreams, wishes, and hope. To be more than a dream, an investment goal includes the following:

- ✓ **Time horizon:** When will you need it?
- ✓ **Amount:** How much money will you need?
- ✓ **Term:** For how long will you need it?
- ✓ **Resources:** How much do you already have put aside, and how much more can you put aside every year?
- ✓ **Rate of Return:** What rate of return will you need?

The investment choices you make and the investment returns you earn will be heavily dependent on your answers to the preceding questions. Please call if you'd like help with this analysis. ○○○

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## How the Housing

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bubble of 2006. Even though it feels like we've experienced this tremendous drop in value, consider what your home was worth back around 2003–2004. At the national level, we've not only returned to those levels but are in fact near where they would be had prices simply continued their slow, steady climb without the spike.

If you can erase from your mind the potential gains had you sold your house in 2006, chances are that your home has still proven to be a sound long-term investment.

### Future Homebuyers

According to the 2010 Urban Land Institute Report entitled, *Housing in America: The Next Decade*, going forward, the rate of house appreciation is likely to revert closer to the long-term norms (pre-2006) of 0.75% to 1% per year over the rate of inflation — not double-digit annual increases.

As the national unemployment rate remains high, the rate of home ownership will drop — since buying a home limits the ability to move to areas with jobs.

The report estimates that 15% of homes with mortgages will be foreclosed by the end of 2010. Furthermore, as many as 15 million Americans now have impaired credit scores that will limit their ability to purchase a home for the next 10 years.

As far as staying in a home until housing prices increase, consider the



potential homebuyer of the future — and whether your house will appeal to this market.

✓ Generation Y is young in their careers and highly impacted by job instability, flat or declining incomes, and tightened credit, so it is more apt to rent longer than the baby boomers.

✓ Generation X has learned difficult economic lessons while nearing mid-career. These 30+ folks are less apt to “trade up” from modest housing, choosing instead to save and invest their money.

✓ The flood of future immigrants, expected to save the labor shortage caused by retiring baby boomers, are less likely to command high salaries and buy upscale homes.

✓ Baby boomers will spend the next couple of decades recouping income and investment losses suffered in recent years and be less inclined to “trade up” to more expensive homes.

### Current Investment Advice

In the news recently, financial experts have cautioned homeowners and homebuyers that a house should no longer be considered a high-performing asset, but rather a place to enjoy living over a long period of time. There are a couple of reasons for this.

First of all, economists want to promote consumerism — encourage people to continue buying homes. No one wants to hear that real estate prices will continue to fall or stay flat or that there won't be enough people in future generations to buy all the houses baby boomers will vacate when they downsize, move to senior communities, or simply pass away.

Second, they also want consumers to seek out other investment vehicles rather than pour money into an expensive home with an exorbitant mortgage. This will serve to flow more money into



capital markets to help fund public companies, thus improving the unemployment rate.

In today's environment, taking on a modest mortgage and paying it off before retirement is the goal. At that time, and based on individual situations, you will have the option to downsize your residence and use the equity to help fund your retirement, or stay in the home until you pass away and let your home's value serve as an inheritance.

### A Harder Working Asset

The question in today's homeowner market isn't how much the value of your home has dropped, but rather will your house sell? Well-built homes in highly sought-after neighborhoods can sell for a fair price in today's market. People with the means to qualify for a mortgage are interested in trading up to the community they want to be in *at a fair price* — as opposed to an inflated one. If you put a house on today's market at or near its 2006-inflated rate, it's not likely to sell.

And for an empty-nester/pre-retiree who would do well to downsize, you can most certainly scoop up a smaller, quality home suitable for your needs while home prices and interest rates are low.

The only question left for you is can you secure a strong, long-term rate of return or a guaranteed source of retirement income if you downsize and receive an influx of cash? Please call so we can discuss how today's home values can lead to tomorrow's retirement income opportunities. ○○○

## Calculating Your Life Insurance Needs

**W**hile life insurance can serve a variety of purposes, one of the most common is to maintain your family's standard of living in case you die. Thus, you need to purchase an appropriate amount of insurance to ensure your family is adequately protected. Many rules of thumb exist, such as five to seven times your annual income, but don't rely on rules of thumb to determine your coverage. These rules don't take into account your individual circumstances, so they could leave you with an inadequate amount of insurance.

Your insurance needs will probably change over time. When you are a young, single adult, you may have little reason to purchase life insurance. As you start a family, your insurance needs will be greater, since other family members are depending on your income. As your children become independent, your insurance needs may decline. However, at that point, you may need life insurance for other purposes, such as to help fund estate taxes or for a business buyout.

To determine how much insurance you need, consider these questions:

### **What lifestyle do you want to provide for your spouse and dependents after your death?**

Review your needs in detail, taking a look at things like:

- ✔ Do you want to provide the same standard of living, including things like vacations and club memberships? Will your spouse and children live in the same house?
- ✔ Will the family have to make different child care arrangements?
- ✔ Do you want to provide for college educations for your children?
- ✔ If your spouse doesn't work, do you want that to continue,

or do you expect him/her to work after your death? If you expect your spouse to work, what is a reasonable amount of income to expect him/her to earn?

- ✔ Do you need to consider the support of elderly parents or other relatives?
- ✔ How long must your family live off the insurance proceeds? Will your current retirement fund provide enough income for your spouse to live on after retirement, or do you need to provide income until his/her death?
- ✔ Do you want to pay off a mortgage or other debt with insurance proceeds?
- ✔ Do you have estate tax considerations you want to address with life insurance?

**How much will that lifestyle cost?** Come up with an estimate of how much this lifestyle will cost.

Include all of your current expenses that would remain the same, as well as any new expenses you have identified, such as for child care. Remember to factor in hidden costs, such as providing for health insurance that was paid for by your employer. For large debts, such as a mortgage, determine whether it makes sense to pay the loan off in full or to continue making monthly payments.

**How much life insurance do you need?** First, consider what other income sources your spouse and/or dependents will have. This could include your spouse's earnings, retirement plans, Social Security benefits, savings, and investments. Life insurance proceeds will be needed to provide the difference.

Please call if you'd like help assessing your life insurance needs. ○○○

## Finding Money to Save

**E**veryone knows that they should be saving at least 10% of their gross income for retirement, but that can seem like an impossible goal after paying all your bills. However, don't just figure that you can't come close to saving 10% of your income without looking at the after-tax cost.

For instance, assume you earn \$50,000 annually, and your employer matches 50 cents for every dollar you contribute to the 401(k) plan, up to 6% of your pay. So, if you put 6% of your pay, or \$3,000, in the plan, your employer will match 3%, or \$1,500. Your contribution really costs less than 6%, because the money is taken out before income taxes. If you are in the 25% tax bracket, your \$3,000 contribution will save \$750 in taxes, or 1.5% of your pay. So, between your contributions and your employer's match, you will

contribute 9% of your pay toward retirement, but it will only cost you 4.5% of your pay.

What if you don't have a 401(k) plan at work? Take a look at individual retirement accounts (IRAs). While you won't get an employer match, you can contribute to a deductible IRA, if eligible, and contribute pretax dollars, which reduces your contribution's cost by your marginal income tax rate. In 2011, you can contribute a maximum of \$5,000 to an IRA and individuals over age 50 can make an additional \$1,000 catch-up contribution. Or, you may prefer to contribute to a Roth IRA. While you won't get a current income tax deduction for your contribution, you can make qualified distributions free from federal income taxes.

Please call if you'd like help with this analysis. ○○○

## Which Goal Is More Important?

**W**ith limited resources for saving, which is the more important financial goal — saving for your retirement or saving for your child's college education? While many parents want to pay the entire cost of their child's college education, the reality is that there are a variety of ways to pay for that education — personal savings, financial aid, and loans. Unfortunately, there aren't similar options for your retirement. No one is likely to loan you money if you haven't saved enough for retirement. You may want to maximize your retirement savings, realizing that there are ways to use those savings to help with education costs. How can that strategy help when it comes time to send your child to college?

✓ **Your retirement savings won't be considered in financial aid formulas.** The federal financial aid formula does not consider retirement accounts, including 401(k) plans and individual retirement accounts (IRAs), when calculating your expected family contribution. For other assets, the formula assumes that 5.6% of the parents' assets and 20% of the student's assets will be used annually for college costs. Thus, you may actually increase your financial aid award by saving in retirement accounts.

✓ **You can still use these retirement assets to help pay for college costs.** Money in IRAs can be withdrawn to pay higher-education expenses before age 59½ without incurring the 10% federal tax penalty, although income taxes will be assessed on the taxable portion of the distribution. If the money is withdrawn from a Roth IRA, your contributions can be withdrawn at any time without penalty or taxes, while earnings can be withdrawn before age 59½ by paying income taxes but not the 10% tax penalty. With 401(k) plans, you typically can't withdraw the money before retirement age unless it is for a hardship withdrawal, but you can borrow funds, if permitted by the plan. If you don't need the money to finance college costs, you can leave it in your retirement plans to continue to grow for your retirement.

If you'd like to discuss the role your retirement accounts should have in financing your children's college educations, please call.

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*A Snyder*  
*Matt Kelly*  
*K. J. [Signature]*



## Staggered Retirements

**O**ften, spouses don't retire at the same time. Keep these points in mind if you are in that situation:

✓ **Try to minimize withdrawals from retirement accounts.** It's a good opportunity to test your retirement budget.

✓ **Utilize all available benefits from the working spouse's employer.** One of the most significant retirement expenses is health insurance. So, before one spouse retires, find out if that spouse is eligible for health insurance benefits.

✓ **Delay Social Security benefits.** Especially if you are retiring before full retirement age, it typically makes financial sense to delay Social Security benefits. For a significant number of married couples, the man is older, has higher earnings, and will not live as long as the woman. Because the surviving spouse can elect to receive 100% of the other spouse's benefits, it typically makes sense for the man to wait until age 70 to claim Social Security benefits.

✓ **Consider all defined-benefit plan payment options.** If you are lucky enough to be covered by a traditional pension plan at work, make sure to consider all the payment options carefully before selecting one. ○○○

## Financial Thoughts

**M**ore than half of Americans between the ages of 45 and 70 have no financial plan to protect themselves against the possibility of outliving their assets if they live longer than expected. More than one-third are worried about running out of money during retirement, but only 20% plan to purchase an annuity or another form of guaranteed lifetime income (Source: Society of

Actuaries, 2011).

Approximately 56% of survey participants said they would manage their money differently if they could go back to the time before the recession of 2008–09. A wide majority said they would spend less and save more, live within their means, and take more personal responsibility for money management. Most said they would have paid down their

debt and used cash instead of credit cards. (Source: TD Ameritrade, 2011).

Of those between the ages of 18 and 30, only 50% of those workers eligible to participate in a retirement plan do so. Among those who do, only 41% contribute enough to take full advantage of the company match (Source: AON Hewitt, 2011). ○○○