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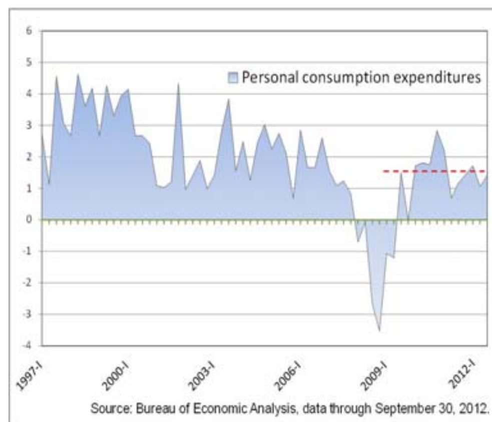
Despite Much Pessimism, Slow Growth Persists

The Mideast is exploding in violence while Europe and China are in the throes of an economic slowdown. The top domestic story for months was the U.S. fiscal cliff. Yet the fundamentals driving the economy remain fairly encouraging. Political leaders provided a half-solution to the issues at hand, and they have more work ahead. The economic recovery remains slow, but good enough to propel corporate earnings higher.

"This recovery is not fragile and it's not risking stall-speed," says Fritz Meyer, an independent economist. "We are three years into an economic recovery that has been persistent and steady. While it is subpar compared to previous recoveries, it's good enough to continue to drive higher corporate earnings, which is the key driver of stock prices."

Economic Growth Factors. Economic growth is largely attributable to four key factors: consumption, investment, government spending, and net exports. When you examine these four components, the overall trend supports continued economic growth. The charts below show the respective contributions to GDP growth that each of these four factors have made since 1997.

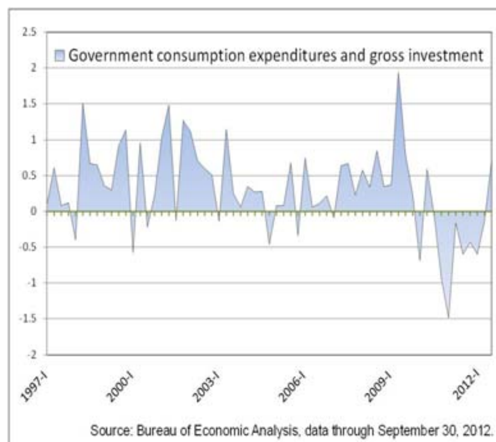
Consumption. The U.S. economy grew by about 2.7% in 3Q2012, and 1 percentage point of that growth came from consumption. The rate of growth in consumption in recent months was about one-half of 1% lower than the historical norm. However,



Source: Bureau of Economic Analysis, data through September 30, 2012.

consumption is holding up and is not too far off from its long-term historical rate.

Government spending. Government spending surged in 3Q2012, largely from a jump in



Source: Bureau of Economic Analysis, data through September 30, 2012.

defense spending, an historically volatile category. Longer-term it's hard to imagine that government spending won't continue to grow more or less in line with the past, although in the near-term, state and local fiscal restraints will weigh on the aggregate

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Market Worries Couldn't Stop Stocks in 2012

Despite numerous headlines throughout 2012 predicting dire consequences for financial markets—including the anxiety-producing "fiscal cliff" at year's end—the stock market finished the year quite nicely.

We march into 2013 with cautious optimism while also acknowledging that numerous obstacles remain. We expect markets to be volatile, particularly during ongoing negotiations and deadlines for increasing the national debt ceiling and avoiding the "budget sequester"—wide-ranging automatic spending cuts—that was delayed by the passage of the American Taxpayer Relief Act of 2012.

Some say that "the market climbs a wall of worry," and the general trend seems to be that as uncertainties are removed, companies are poised to respond favorably. Stay tuned!

In other news, Judy has launched an effort to educate and motivate people to prepare for that day when they would like to retire from gainful employment. If you or an employer you know would be interested in a 30 to 40 minute interactive program, give us a call.

We hope the holidays were kind to you and yours, and wish you well in 2013. We appreciate the confidence that our clients place in us, and the opportunity to help those you know who might benefit from our services.

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“Ghost Story” Can Haunt Your IRA

The rules for contributing to an IRA are relatively simple. You put in the money for each tax year by the required deadline—the tax return due date for the year of the contribution—and tell the account custodian how you want the funds invested. In addition, you might roll over funds to an IRA from a 401(k) or another kind of “qualified plan” at work when you change jobs or retire. That way, your money can continue to grow without being eroded by taxes until you make a withdrawal.

The rules for *distributions*, in contrast, are extremely complex. In particular, complications may arise as you approach the time for taking “required minimum distributions” (RMDs) from your IRA. Make the wrong moves and your heirs might be forced to receive payouts based on your “ghost life expectancy.”

For IRA owners, the “required beginning date” (RBD) for RMDs is April 1st of the year after the year in which they turn age 70½. For instance, if someone reaches that age on June 1, 2013, the RBD is April 15, 2014. The amount of the RMD is based on the value of your accounts on December 31st of the tax year of the RMD—in this example, 2013—and is calculated according to an IRS-approved life expectancy table. And here’s where things get complicated.

If you die *before* the RBD and have designated a “qualified beneficiary” such as a child or spouse, the RMDs are generally based on the beneficiary’s life expectancy. (Surviving spouses also have the option of rolling over the funds into their own IRAs.) However, if you haven’t designated a beneficiary or you named a “non-qualified beneficiary” such as your estate, the IRA must be emptied out in five years. Conversely, if an IRA owner dies *after* the RBD, payments to a beneficiary are still based on the beneficiary’s life expectancy, but payments to a non-qualified beneficiary must use the owner’s ghost life expectancy.

A ghost life expectancy isn’t as scary as it sounds. It’s how long the IRA owner would be expected to live—if he or she hadn’t already died. But using an older owner’s life expectancy table will still drain the IRA faster than usual.

Suppose that Walter Mason, age 80 and single, has $750,000 in his IRA. Walter named his estate as the beneficiary of his IRA. He died on July 1, 2013 without taking an RMD for the 2013 tax year.

Because Walter designated a non-qualified beneficiary, RMDs for 2013 and future years will be based on his ghost life expectancy. The payment for 2013 under the single-life expectancy table is $40,107. Under this method, payments will be greater than the amounts that would have been required if Walter had designated a qualified beneficiary.

Good planning can minimize the impact of RMDs and help preserve your retirement nest egg. ●

Avoid These Investment Mistakes

One thing that can be puzzling about stock market investors who have struggled in the past: They make some of the same mistakes over and over. Here are seven prime examples.

1. You try to “time” the stock market. Typically, timing strategies are based on selling stocks when you believe the market has topped out and buying when you think it has hit rock bottom. The problem is that nobody—and we mean NOBODY—has a crystal ball that’s foolproof. It’s far better to stick with a well-diversified, balanced portfolio based on your personal circumstances.

2. You have zero patience. If you’re looking for instant gratification, the stock market will disappoint you more often than not. Just as for the tortoise and the hare, slow and steady usually wins the race, while those who act too swiftly finish behind. Be content to hold some stocks for a long time before you reap rewards.

3. You refuse to recognize reality. All too often, investors operate with blinders on, but the cold hard facts can’t be ignored. If you have a favorite stock you were convinced would turn a profit and it simply hasn’t worked out, don’t throw good money after bad. Dump the losers and hold on to the winners without allowing emotion to rule the day.

4. You put all of your eggs into one basket. No matter what the projections are for any particular stock, sector or asset type, it’s not smart to bet your entire wealth on its performance. Diversification is a key element of a sensible plan for virtually every investor. It’s all about balancing the search for reward with the need to reduce risk. Although there’s less chance you’ll make a killing if you diversify, you reduce your exposure to a catastrophe.

5. You overemphasize past performance. It may be boilerplate

Give Yourself The Greatest Gift Of All

If you are nearing retirement, the greatest gift you can give yourself is to become debt free. When you don't owe anything on your credit cards or a mortgage, there's no interest to pay and no monthly payments to drain away dollars that you'd much rather spend on things you really need or want. You'll be amazed at how much extra money this will put at your disposal.

But unless you win the lottery or get a big inheritance, becoming debt free requires careful financial planning, sound investment choices, determination, commitment—and, in most cases, several years to get the job done.

Where do you start? Begin by taking a look at the Big Three:

1. Credit card debt
2. Car payments
3. Home mortgage

Get rid of your plastic debt first. Credit cards tend to carry high interest rates, and using a card to pay for everything from groceries to online purchases can build up a large account balance almost before you know it. Paying down that debt probably will require a systematic plan—for example, budgeting for a particular monthly payment and making it religiously until your balance hits zero. But it also will help if you at least temporarily stop using your credit cards. You can start paying with plastic again once you've reached your goal, but even then, make sure you're able to pay all that you owe each month. Many accounts don't charge interest if you pay the full balance, and you'll avoid rebuilding the debt that you've worked so hard to eliminate.

Next, turn to your car loans. You may not be paying as high an interest rate on these as on your credit card accounts, but the monthly payments still can be substantial. If you adjusted your budget to free up extra money to retire credit card balances, you could now use that cash to accelerate paying off your vehicle loans. Keep your cars as long as the upkeep costs don't become prohibitive, and then consider using savings rather than another loan to buy replacements.

Once vehicle debt is eliminated, you're ready to tackle the big one: your monthly home mortgage payments. Expert opinions differ about whether it's wise to pay off a mortgage as quickly as possible. If inflation rises at a rapid pace, for example, it may be better to keep the mortgage, because you'll make future payments with dollars that have lost some of their value. Also, interest rates on home loans are extremely low now, and you could lock in a rock-bottom rate that will reduce your long-term interest expenses. But if you're planning to stay in your home indefinitely and you like the idea of a debt-free retirement, you could refinance for a shorter loan term or make extra principal payments to pay off the house more quickly.

If you don't plan to stay in your current home, the expense of refinancing may not be warranted, and depending on how much equity you've built up, you may be able to eliminate your mortgage by downsizing to a less expensive home. Moving away from an area with high housing costs could make a big difference, and you might realize enough on the sale of your current home to retire the mortgage and pay cash for your next property. And though depressed values in many areas mean you may not get top dollar for your current home, you'll likely pay less for the new one than you would during boom times for real estate.

If you take this approach, and if you've lived in your home for quite a while, it could make sense to make targeted renovations to prepare for a sale. You'll almost certainly want to do some exterior and interior painting and make other cosmetic improvements that will show off the house to its best advantage. Undertaking larger improvements—putting in a new kitchen or bathrooms, for example—may be less likely to pay off immediately, though that can depend on your local market.

In any case, you'll need to choose your contractors and designers with great care. That's especially true in retirement-heavy states such as Florida, Texas, Arizona, Nevada, and California, where homeowners sometimes have had to contend with fly-by-night outfits that do substandard work or leave projects undone.

To avoid problems, get multiple estimates for the work you're doing and interview each candidate carefully. Ask to talk with other homeowners who've used the contractors' services and take a look at the finished projects if you can. All of this takes time, but it will be well worth it if you find someone who does good work at a competitive price.

Eliminating all of your debt could take several years, so the sooner you get started, the more likely you'll achieve your goal before you retire. Good luck!●

language in investment prospectuses and related materials, but it's also true: "Past performance is not necessarily indicative of future results." Don't build your portfolio around particular stocks just because they've been profitable without evaluating their current and future prospects.

6. You ignore the impact of taxes. It only makes sense to consider the tax ramifications of your investment decisions—especially now, with investment and income tax rates set to rise in 2013 and the arrival of a new 3.8% Medicare surtax for high-income investors. But it also can be a mistake to let taxes drive your decisions. Weigh all of the relevant economic factors when you buy or sell stocks.

7. You don't have a plan. Many investors take a hit-or-miss approach to their portfolio. They buy and sell on whims without coordinating their activities. But you're more likely to be successful if you develop an overall plan that is suitable for your situation. Having a strategy and having the discipline to stick with it is the hallmark of successful investing. We would be glad to provide whatever assistance you need. ●

Slow Growth Persists

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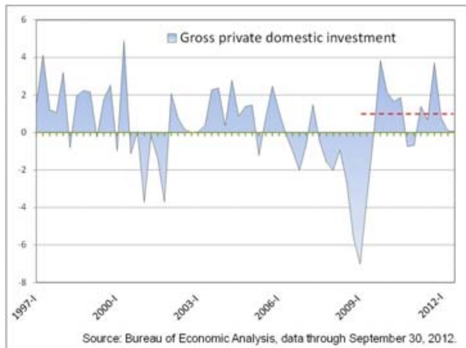
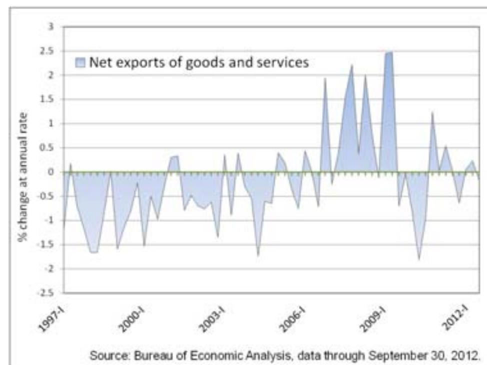
government spending figures.

Investment. Gross private domestic investment includes construction—both residential and commercial — plus inventories held by corporations and other corporate spending. Here again, the picture does not portend a booming economy. But it's untrue to say companies have not been investing. Private investment has contributed just below 1% annually to the growth in the economy since the 2008 recession. Moreover, private investment fluctuates and an occasional dip amid a recovery is not unusual or alarming.



Source: Bureau of Economic Analysis, data through September 30, 2012.

Net Exports. This key swing-factor in economic growth expanded in 3Q2012, helping to propel GDP a good deal higher than the preliminary 2% that was reported. The substitution of domestic oil production for imported oil is a favorable development for the net exports contribution to GDP.



Source: Bureau of Economic Analysis, data through September 30, 2012.

While pessimism abounds, the economic data show an economy growing slowly and resulting in improved corporate earnings — a key driver of stock prices. ●

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