



# Wealth Architecture™ Digest

*Often people do not plan because they see only what is, and they do not have a vision of what can be. Something is always possible. We believe that, with vision, the possibilities are almost unlimited.*

## Managing Your Wealth in a Post Great-Recession Reality

Managing wealth is not the same as managing assets. For individuals, wealth encompasses a myriad of assets. It involves financial capital – financial assets as well as hard assets like real property and precious metals. In addition, personal wealth includes intellectual capital, the learning, experiences, and values you pass on to future generations. The economic and emotional consequences of the Great Recession of 2008-2009 have changed the dynamics of managing personal wealth, and the purpose of this paper is to address ways you can respond to the changes.

### The New Realities of the World

*The world before 2008.* We often hear about business cycles, generational cohorts, and how the future, while unpredictable as to any specific time period, is overall a fairly consistent continuation of past cycles. I am not referring to specific investments or markets, but to a larger dynamic of how we and our families live in a rapidly changing world. The dot-com bubble popped in early 2000 and was followed by painful global stock market corrections exacerbated by the September 11, 2001 attacks, and by major terrorist attack in Bali in late 2002. The global equity markets bottomed in March, 2003 as the invasion of Iraq began, having lost 40-50% over the previous three years.

Regardless of the political turmoil with wars in Iraq and Afghanistan, and new terrorist attacking in Madrid and London, global stock markets climbed inexorably upwards from the February 2003 lows, reaching all-time highs in October-November, 2007. The S&P 500 Index rose over 75%<sup>1</sup> while the MSCI-

EAFE rose 192% and the MSCI Emerging Markets Index rose 391%<sup>2</sup>. Obviously, everything must have looked rosy as virtually all equity indexes were at record highs, interest rates were quite low, and employment was stable in most countries.

While the stock markets around the world dropped and recovered between early 2000 and late 2007, the US housing market boomed. The S&P Case-Shiller Home Price Index<sup>3</sup> Composite had risen 88% over the 6 ½ years ending 12/06, with Miami +174%, Los Angeles +164%, and Las Vegas +125%, and decreased only slightly into the third quarter of 2007. So, everything looked pretty good for personal balance sheets; stocks were at record highs, home values were through the roof, and unemployment was muted.

*The world after 2007.* But then the music stopped. The global economy that over the past decade had been fueled by a combination of low interest rates, increased borrowing, high consumer spending and new housing construction began to slow. By December, 2007 the U.S. entered a recession that became the steepest and deepest in a generation. From December, 2007 through December, 2009 almost 8,000,000 jobs were lost in the U.S. The housing prices that had risen so high over the previous seven years crashed, bringing banks down with them. As of the end of March, 2010 the Case-Shiller Index mentioned earlier registered housing prices down 55% in Las Vegas, 48% in Miami, 50% in Phoenix, and 29% across the 20-city composite. The Phoenix and Las Vegas values had dropped to mid-2000 values.

*(Continued on page 2)*

(Continued from page 1)

Unfortunately for personal wealth, this doesn't tell the whole story. The Federal Reserve issues quarterly reports on mortgage debt outstanding. At the end of 2000 the mortgage debt on residences of 1-4 units (mostly single family homes) was \$5.13 trillion. By March, 2010 this had ballooned to \$10.7 trillion, just over where it was in 2006 when housing *values* were nearly double where they are today. Three-and-a-half years ago Americans had significant *equity* in their homes, even as they had borrowed heavily against them. Home values may have dropped 30-50% from the highs, but for the majority of homeowners with mortgages, their equity has dropped by **more than 100%**.

As housing prices dropped and the recession took hold financial markets around the world also collapsed. With the failure of AIG and Lehman Brothers in September, 2008 credit markets seized; banks, auto companies, insurance companies and others teetered on extinction. Globally, governments around the world responded by pouring trillions of dollars into their economies (China committed 12.2% of GDP to keep its economy moving and the US 5.4%). Increased government guarantees of bank deposits, money funds, commercial paper, etc. were put in place to prevent a catastrophic run on the banks.

While the recession *technically* ended in the third quarter of 2009, U.S. unemployment has not abated, hovering near 10%. More critical is the stunning increase in long-term unemployed. In October, 2007 the Congressional Budget Office started that "long-term" unemployed (those unemployed for more than 26 weeks) was 8% of the total unemployed, while the numbers released June 4, 2010 by the Bureau of Labor Statistics (BLS) shows *46% of those unemployed* have been unemployed more than 26 weeks – an incredible 6.7 million people.

BLS reports that the labor force (over age 16 and eligible to work) has increased by 12 million, (to 154 million people) over the past 10 years, but with the current unemployment, the total number working has increased only 3 million. Over a million new people *enter* the labor force, net, each year. Before the unemployment rate can drop, the economy must create a million new jobs, with the rate dropping only when even more jobs are created. Given that most manufacturing, and many service jobs (call centers, tax return preparation, etc) have been moved overseas, it will likely take the development of new industries before we can create sufficient well-paying, middle class jobs here at home. So how does this affect ***you and the management of your wealth?***

### **Rethinking Wealth With the New Realities**

Managing wealth cannot be done in a vacuum. The changes wrought by the recession and the reduction in personal asset values have a real impact on how you move forward. Choices need to be made as you balance multiple needs and desires. Those without children have a simpler set of issues than those with. People with solid *pensions* may have fewer concerns than those with 401(k) plans or IRAs, primarily because pensions have a set income, while the other plans have balances that will vary.

On June 5, 2010 *The Wall Street Journal* reported, "One new survey of 1,000 parents of 23- to 28-year-olds sponsored by Charles Schwab Corp. found that 41% are providing at least some financial support to an adult child. The parents cited college debt and employment issues as the main reasons." For many of these affected parents, the money used to "help" adult children is coming from

(Continued on page 3)

(Continued from page 2)

resources that would likely be designated for retirement income. Many of these same parents are in what some refer to as the “sandwich generation,” those caring at some level for their children *and* their parents. Their children in the 20s and 30s need help, and their parents in their 80s and 90s require time and often financial assistance.

Conventional wisdom has always been that once a person is older, and retired (say age 80) that they should not take much risk, and should live as much as possible off the income that can be generated by their assets. For many that means certificates of deposit or treasury bills. As CDs vary greatly by locale and the banks’ need to attract deposits, I looked at the benchmark: six month treasury bills going back to June, 2005. Based on the data from [ustreas.gov](http://ustreas.gov), I calculated how much annual income (I realize that each six months the rate changes, but this gives a good idea) a retired person would receive over one year on \$1 million of six month treasuries starting at the end of June. Here is the problem:

2005-2006	\$33,400
2006-2007	\$52,400
2007-2008	\$49,300
2008-2009	\$21,700
2009-2010	\$ 3,500
Current	\$ 1,800

Mom might have been getting along fine on \$52,000, but certainly can’t make it on \$1,800. And, of course, for those older adults who don’t have \$1 million of liquid investment around, the problem is much greater, and the need for help from their near-to-retirement children increases. The older generation is using reverse mortgages for cash flow assistance, as well as more retirement annuities, but this all means less inheritance for the middle generation.

Except for the uber-wealthy the now vs. future conundrum is very real. It really means redefining the part that money plays in their lives. For those whose sense of self has been largely defined by the material wealth they’ve enjoyed, or the high income they’ve had, it may be very difficult to face the new realities. For a while it may be easiest to simply be in denial of the need to rethink what is most important and focus time and energy on revising plans. Also, by expanding the definition of “wealth” to include the intellectual capital, the family values mentioned earlier, a more realistic plan can be developed.

For a long time financial planners have created investment and cash flow projections using models that assume specific “expected” rates of return and volatility. The assumptions most often are based on historic data, and then are “stressed” by running *Monte Carlo Simulations* that will show what percentage of the time the portfolio will provide the desired results through an expected date of death. If I told you that “it is 80% likely that you won’t run out of money over the next 30 years,” would that be good enough? Would it feel the same or worse if the results were that “you have a 1-in-5 chance of running out of money?”

I have heard it said that “politics is the art of the *possible*.” The same could be said of wealth management, as sometimes it is not possible to accomplish all the desires one might have. With the highly improbable events – that actually happened -- during the past decade, and the ongoing feeling of uncertainty, it becomes more important than ever to rethink *needs* versus *wants*, spending money now versus later, and personal financial independence versus passing on a *financial* legacy.

## Beware the “It’s Deductible” Trap

Over the past year or so many clients and friends have approached me for advise as to the benefit of having a mortgage on their homes, given the current low interest rates. Even though they may have a low, or no mortgage, they wonder if having the debt makes sense because it’s deductible and will save some taxes.

I believe this is a trap you want to avoid. First, it is important to remember that the tax savings, at most, may offset 45% of the interest element of the payment. The mortgage is an ongoing liability and creates some risk. In today’s interest rate environment, paying off (or not taking on) a 5% mortgage, is like earning 5%. Not having to make a payment is similar to receiving a payment. Currently, money in the bank earns less than 1%, so paying off a 5% loan puts you way ahead.

The other reason some people think they should keep a mortgage, or get a new one, is to have money available for investment that could earn more than the interest rate on the mortgage. Leverage is an old idea, but why take the risk with your home. Be careful.

---

## FINANCIAL CATALYST GROUP

4030 Moorpark Avenue, Suite 105  
San Jose, California 95117  
Phone: 408-261-7600  
Fax: 408-273-6399

Richard Haas and Judith Puette are Registered Representatives offering securities and Investment Advisory Services through NFP Securities, Inc., Member FINRA/SIPC. NFP Securities, Inc. and Financial Catalyst Group are not affiliated.

*Financial Catalyst Group was founded in 1977 to help successful people articulate their goals, and realize their dreams to protect and preserve their hard-earned wealth. At Financial Catalyst Group we provide Wealth Architecture™ services that result in the implementation of value-added plans for the responsible transfer of wealth through the generations. We specialize in working with families that desire to provide a legacy to their families and their communities, making gifts instead of paying transfer taxes. We work closely with these families and their advisors to form a strong, results-oriented team.*

<sup>1</sup>The S&P 500 Index represents approximately 85% of the market value of all US stocks. Performance calculation taken from [finance.google.com](http://finance.google.com)

<sup>2</sup>The MSCI Indexes are constructed by MSCI/Barra. The EAFE is a developed market index of listed companies in Europe, Australia, and the Far East. The emerging markets index covers stocks in 21 emerging markets. Performance and other information from [mscibarra.com](http://mscibarra.com).

<sup>3</sup>The S&P Case-Shiller Home Price Index measures the residential housing market, tracking changes in the value of residential real estate in 20 metropolitan regions across the United States. Source: [standardandpoors.com](http://standardandpoors.com)

**Gross Domestic Product (GDP) measures the total market value of all final goods and services produced in a country in a given year. Unless otherwise noted, market statistics and data used in this newsletter were obtained from [finance.google.com](http://finance.google.com), and interest rate information was derived from [www.treasurydirect.gov](http://www.treasurydirect.gov).**

The opinions expressed are those of the writer and are subject to change with economic and market conditions. They are not meant as specific investment advice. Market forecasts cannot be guaranteed and may not come to pass. Indexes are unmanaged and cannot be directly invested into. Diversification and asset allocation do not guarantee against loss. S&P 500 Index is an unmanaged group of securities considered to be representative of the stock market in general. Indices are unmanaged and cannot be directly invested into.