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Identifying Investment Risk And Coping With It

Are you a risk-taker? To realize rewards, you usually have to take some risks, especially when it comes to finances. But beyond understanding that investment risk and reward go hand in hand, it's important to know how they relate. What is the nature of risk, and how can you handle the different kinds of risk that could affect the performance of your investments?

What is the nature of risk? For many investors, risk is associated with the inherent volatility of the equities markets. You run the risk that your investments will perform worse this year than last year or worse than you anticipated or worse than the markets as a whole.

Risk means you have something to lose—the money you've put into a particular investment or the money you might have made if you had made different choices. You also could run the risk of throwing good money after bad, of buying more of something when the price is low only to see the value fall further.

Although risk and reward are related, there's no direct, predictable connection between the two. You could decide to take fewer risks and still lose money, or you might ratchet up your investment risk without cashing in on higher returns. Nevertheless, it's important to try to keep risk and reward in a balance that fits your situation.

What are the main types of risks? Financial experts often debate this question, but the pros generally agree that two significant risks facing investors are inflation and emotion.

1. Inflation risk. Essentially, this is the risk that money you earn will lose some of its purchasing power over time. For example, if you buy a five-year certificate of deposit (CD) from a reputable bank, there's relatively little risk that the bank won't live up to the terms of the CD. But there's a much bigger risk that the dollars you receive in five years won't buy as much as they would now.

If you're old enough to have experienced the 1980s, you might recall the days when money market funds paid interest at double-digit percentage rates. However, with double-digit inflation occurring at the same time, most savers barely stayed even.

Inflation risk can present problems to all investors, and especially to retirees. Someone who left work in 1978 might have felt pretty comfortable with a pension paying $40,000 a year. But that $40,000 was worth only about $12,200 in 2013, according to the Bureau of Labor Statistics. This represents a loss of almost three-quarters of the money's buying power.

One way to protect against inflation risk is to include an appropriate ratio of stocks and stock funds in your portfolio. Or, if you're more conservative, you might consider

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Be An Elephant And Downplay Talk Of Bulls And Bears

A funny thing happened during the recent run-up in the stock market: People began to forget what happened in 2008. That's when the market started a downward spiral that lasted almost two years before bottoming out and beginning the long crawl back.

Now that about five years have gone by, many experts are predicting that the recent bull market will continue, perhaps for several more years. On the other side of the coin, some naysayers are expecting a market correction, maybe one of significant proportions.

No one knows for sure what will happen next. But it helps to look back and remember both the good and the bad.

During the last financial crisis, the Standard & Poor's 500 Index took a walloping, declining by about 37%. But then the S&P 500 rebounded and was up about 25% annualized over the five-year period. The hopelessness and panic that gripped investors have given way to euphoria in some circles.

It's far better to keep an even keel. If you've been afraid to reenter the market, be aware that equities historically have proven to be a sound investment. Yet that's no reason to go overboard and sink every dollar you own into the market. Whether the bulls are running wild or the bears are growling, be more like an elephant: Remember the past.

With our assistance, you can chart a sensible path for the future.

Ron Howard, Mike Demko, Mike Weakley, Chris Cox and Diem Pham

Don't Outlive Your Money: 7 Tips *By Bob McGinty*

The scariest financial risk people face in life is running out of money at an old age. I'm 83 and I'm speaking from personal experience. After a long career as a newspaper editor, I retired in 1991 at the age of 60, with my wife, who is 14 years younger and retired in 2004. I've learned about financial matters the hard way, and I ghost-write articles like this one to earn some extra income. I'm not scared about running out of money in my lifetime, but I am fearful of not leaving enough money to my wife, who is much younger than I.

Let me share with you some financial lessons I've learned. Of course, these are my personal opinions, not anybody else's.

1. DO NOT elect to take Social Security benefits early. If you do take early benefits, you probably will be shortchanged on what you would have received in total payments over the rest of your lifetime. People are living longer these days. You will add 8% a year in payment totals after full retirement age if you can wait until age 70 to take benefits.

2. Downsize your home at the earliest opportunity. Once you become an empty nester, the odds are that you do not need a house as large as the one in which you now live. Sell it and buy a smaller one. Pay cash if at all possible.

3. Consider moving to a retirement community, which can be a highly desirable and cost-efficient place for the elderly to live. Your neighbors in such communities most likely are like-minded and in your age group. Also, such communities are especially designed for elderly living, and most are located near good health-care facilities. Plus, they offer social, educational and recreational facilities designed specifically for the elderly.

4. If you are not already out of debt, get out as soon as possible. When you are not in debt you can live on much less month to month, thereby lessening your chances of outliving your money.

5. If you have two cars, sell one. If you only have one, drive it twice as long as you did in the past. You probably will be driving less at this time in your life, and you can most likely drive your current car much longer without encountering excessive repair bills. If you are in the practice of making monthly car payments, once you've paid off your vehicle you can put all of the payments you would have made before into your savings.

6. If you are part of a close-knit family, do not move very far from your children and grandchildren. Life-changing occurrences such as death, divorce and disabilities are easier experiences when you have the support of family members around you all the time.

7. Finally, and most important of all: Continue to save all that you possibly can. The amount that you can save if you follow the previous six recommendations may be considerable. Where and how should you invest it? Seek out a financial advisor that you are sure you can trust and that you are sure is competent, and turn investment decisions over to him or her. ●

Bob McGinty is a retired newspaper editor who occasionally ghost-writes articles for financial advisors.

What To Do After Your Bucket List

You hear a lot about how much money you should save to live the lifestyle you desire when you retire. But equally important, and maybe even more so, is the question of how you are going to live in retirement.

After you have checked off all of the items on your bucket list and taken all of the trips you can afford, how do you spend the rest of your time (which now is all leisure)? This happens to be a question some people overlook as they enter their retirement years, but it is critically important for pre-retirees to consider.

People are living longer these days, so you may be looking at a retirement period of 20 years, or even more. You will have a lot of leisure time. A long retirement period can take you into the advanced elderly years, a time when many retirees are physically unable to work part-time, serve as volunteers, or even keep up with their gardening. And watching TV, playing computer games, and emailing your friends and family can get boring when you do it all day—for a few years.

So, what can you do?

One answer is to move to a retirement community. This definitely could be a consideration when planning your retirement. Retirement communities are designed to alleviate a boring (and life-shortening) lifestyle. Found throughout the United States, they often are located close to medical facilities—another important consideration because you probably will require increased medical attention as you grow older.

Many people entering their retirement years want to remain near family members. So if you're considering a retirement community, you may want to look somewhere that's close to much of your family.

Six other things you may want to consider if you choose to move to a retirement community:

1. Facilities. What does the community offer in addition to the omnipresent community clubhouse? Many communities feature activities and facilities designed

What $2 Million Gets In Retirement

People often ask how much money they will need to meet their retirement goals. But let's turn this common question on its head: What will $2 million actually get you in retirement? This is an interesting query because (a) many people believe that $2 million is a comfortable amount to meet their retirement goals and (b) it allows us to examine the different ways in which a hypothetical couple can use $2 million without running out of money.

As with any retirement calculation, this one involves numerous assumptions. Nevertheless, as long as the assumptions are reasonable—for example, using 6% for equity returns rather than the 10% figure that many illustrations often include—it's possible to arrive at a conservative estimate of how much money you might need to retire comfortably.

Let's start with these assumptions for our hypothetical couple:

Inflation (CPI)	3.00%
Current Age of Both People	65
Age at Retirement	65
Age When Both People Have Passed Away	95
Social Security at Age 67 (combined)	$35,000 per year
Average Savings Rate	None (Already Retired)
Total Investment Balance Today	$2 million (50% in Taxable, 50% in IRAs)
Recurring Annual Expenses in Retirement	$70,000
Investment Mix Before Retirement	70% U.S. Value Stocks, 30% Medium-Term Treasuries
Return Assumption Value Stocks	6% per year
Standard Deviation Value Stocks	16.20%
Return Assumption Treasuries	1.5% per year
Standard Deviation Treasuries	7.20%

Before generating a retirement plan for this couple, it's important to clarify what constitutes "success" in this situation. Because we live in a dynamic world, especially when it comes to investing, we'll look at this question in terms of probability, using something known as a Monte Carlo analysis, which factors in thousands of scenarios with widely varying assumptions and investment returns in every year. For purposes of this example, we'll define success as a probability of at least 85% that the couple's funds won't run out during their retirement.

Using our assumptions for this hypothetical couple, the Monte Carlo analysis shows a 97% probability that they won't exhaust their savings. That easily meets our definition of success and suggests that they might be able to spend more than $70,000 a year and still succeed, based on the 85% threshold.

So, how much can this couple spend per year and still have an 85% chance of achieving their retirement goals? Running through a few scenarios provided an answer of $81,000. That's the amount they can spend each year and still have an 85% chance of never running out of money.

This raises another question: Is there a way for this hypothetical couple to spend $81,000 annually in retirement while also *raising* their probability of never running out of money? There are really just two ways to accomplish that, assuming that going back to work isn't a desirable option for them:

1. They could choose investments that deliver higher returns without increased volatility; or

2. They could look for investments that have the same returns, but less volatility.

One potential way to reduce volatility while maintaining reasonable levels of return is to acquire high-quality, dividend-paying stocks that have a history of increasing their dividends. If the volatility level is reduced from 16% to 13% per year, based on historical rates, the probability that this couple never will run out of money jumps from 85% to 93%. This significant leap is due to the fact that they are investing more heavily in stable, solid, dividend-paying stocks rather than in investment vehicles exposed to greater volatility.

Of course, everyone operates under a different set of circumstances. You might need to change several things from this base-bones example to meet your retirement goals. But it is difficult, if not impossible, to tell whether you will be able to retire comfortably until you sit down and actually run through the numbers. When that occurs, some interesting scenarios may emerge to help you see what you need to do to meet your goals.

Bottom line: Will $2 million be enough to sustain you through your retirement years? We can help you plug in the figures to give you a better grasp of your personal situation and then tailor your plan to your specific needs. ●

especially for retirees, such as swimming pools, tennis courts, bocce courts, arts and crafts courses, photography clubs, home-state clubs, woodworking shops, computer rooms, card rooms, bingo games, movies, little theater, community dinners, and special events. Some even provide golf courses.

2. Fees and taxes. Make sure you are financially comfortable with homeowner association fees, insurance rates, and property taxes (if applicable).

3. Resale value. What is the real estate sales history of the community? Have home and condo valuations generally trended upward during the years of its existence? Have home and condo prices recovered somewhat from the real estate bust of a few years ago?

4. Shopping. Is the community located near stores and shopping centers?

5. Restaurants. A lot of retirees like to eat out as frequently as they can afford. Are good restaurants conveniently located? Do many of these restaurants offer "early bird" menus at a discount?

6. Transportation. Some senior citizens may choose to give up their drivers' licenses as they enter the upper years of old age. Having public transportation available could be an important consideration.

And finally, what about the question of how much money you should save for your retirement? A better question may be: How much will you need to pay your retirement expenses each month? We can help you with that answer. And we can help you plan the retirement lifestyle choices that best suit you. ●

Fill Up Tax Brackets To The Brim

Remember the days before self-service when you could drive your car to a gas pump and tell the attendant to “fill ’er up”? There are good reasons to take the same approach to selling securities before the end of the year. If you’re careful to fill up your lower tax brackets with long-term capital gains, you can pocket some cash and pay little, if anything, in federal income tax.

Before you start filling up tax brackets, it’s important to understand the basic tax rules affecting capital gains.

Currently, there are six federal income tax brackets ranging from 10% to 39.6%. Most “ordinary income,” as well as short-term capital gains from sales of assets you hold a year or less, is taxed under this graduated rate structure. But long-term capital gains from selling securities you’ve owned longer than a year may be taxed at three capital gain rates:

- The 0% rate applies to long-term capital gains of investors in the two lowest brackets (10% and 15%).
- The 15% rate applies to long-term gains of those in the middle three brackets (25%, 28%, and 35%).
- The 20% rate applies to long-term gains of investors in the top bracket (39.6%).

With the tax system’s graduated rate structure, even investors whose capital gains eventually will push them into the 39.6% tax bracket may be able to benefit from having part of their capital gains taxed at the lower 0% and 15% rates. That’s what tax bracket management is all about.

The best way to explain the concept of filling up tax brackets with long-term gains may be with an example.

Hypothetical facts: Suppose that 2014 will be a low-income year for you because of losses from your S corporation or other business circumstances. Not including your investment income, your taxable income on a joint federal return should be only $50,000, but the upper threshold of the 15% bracket is $73,800. That leaves room for another $23,800 of income ($73,800 - $50,000) before you reach the 25% bracket—and the 15% bracket for long-term capital gains. So if you pull down a $23,800 long-term gain before year-end, the entire amount will be taxed at the 0% rate.

What’s more, consider that the upper threshold for the 35% rate is $457,600. Any other long-term gains below that threshold will be taxed at the 15% rate.

Of course, there are other factors to consider, including the 3.8% surtax on net investment income. Also, be aware that capital losses offset capital gains plus up to $3,000 of annual ordinary income. But the long and the short of it all is: You can manage your tax brackets to maximize favorable tax rates for long-term capital gains. ●

Identifying Investment Risk

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inflation-protection bonds. History has shown, however, that holding even a modest equity stake may increase returns without undue risk when compared to a pure fixed-income portfolio.

2. Emotional risk. It’s easy to let emotions rule decision-making. Almost everyone is subject to bouts of fear and greed, and investors have an innate tendency to be overconfident about their ability to choose winning positions. But simply doing what feels right—or avoiding what feels wrong—can lead to adverse results.

Consider an investor who sits on the sidelines during a bull market, nervous about following the crowd—a tendency that indeed can be counterproductive. But finally the investor gets tired of losing out and jumps in, buying at the top of the market and without carefully considering the fundamentals of particular investments. Others get into trouble when the market is falling and they sell solid holdings in a panic, losing out on the chance to benefit when they rebound.

The best protection against emotion is to have a carefully considered investment plan and to try to stick with it even when markets are highly volatile. Having a balance of bond funds for stability and income and stocks for growth can help smooth out inevitable market bumps.

How do you manage risk? Everybody has a different risk tolerance. A good approach for managing yours is to stick to investment fundamentals. That may be as simple as refocusing on the key principles of diversification and asset allocation.

Diversification spreads your investments over a broad mix of asset classes, an approach that has the potential to reduce risk. Asset allocation is the process of assigning percentages to those asset classes based on your particular needs and risk tolerance, and then rebalancing your holdings regularly to keep them close to their assigned allotments.

There’s no way to avoid risk completely, but you still can generate earnings while staying within your comfort zone. We’re here to provide guidance. ●