CYPRESS FINANCIAL REVIEW
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Cypress Financial Planning, LLC

Financial Tips for Seventysomethings…and Beyond

The previous six editions of the Cypress Financial Review have explored financial planning considerations for each decade of life. Having already covered issues for Twenty-, Thirty-, Forty-, Fifty-, and Sixtysomethings, today we will wrap up the series. We focus on Seventysomethings and beyond, individuals that are generally enjoying the fruits of much labor. Despite a high likelihood of retirement status, these individuals continue to face important financial considerations. Careful attention will allow these individuals to optimize their existing resources and mitigate looming risks. This article will focus on expense planning, income generation, health and life planning. For readers still anticipating this rewarding period in life, give some thought to your parents and other loved ones and arm yourselves with simple but critical points that may help you help them.

Expense Planning

Most Seventysomethings have run the race and are happily past the prime of their earned income years. Having spent decades earning the right to receive benefits through Social Security, defined benefit pensions, and hard earned savings, uncertainty and planning opportunities still remain. Simple questions highlight significant improbabilities: How long will you and your spouse live given improving medical treatments? How will the cost of living change in the future, particularly the cost of healthcare and taxes? How will the economy and financial markets perform over the next 20 or 30 years? While impossible to answer accurately, these questions offer interesting challenges and risks that careful consideration and analysis may help solve or mitigate.

A simple strategy and first line of defense to mitigate retirement sufficiency risk is setting a conservative annual spending rate. For example, when faced with a lifestyle decision that will require you to spend 5% of your nest egg versus 4%, choosing the latter will always provide a higher likelihood of success. Determining a spend that is sustainable takes fairly simple math and only requires a few conservative assumptions, including an annual rate of return, expected lifespan, and annual inflation. From there you can mathematically back into the highest allowable annual spending rate in order to ensure your nest egg lasts.

Unfortunately, retirees are faced with much more uncertainty now than most have faced before. Investment returns, lifespan, and inflation always carry unpredictable outcomes, from year-to-year and over the long term. Today, some economists are calling for runaway inflation due to extremely accommodative Federal Reserve Policy while others see deflation or falling prices as the greater

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risk. Healthcare costs are rising with no end in sight, but healthcare providers and technologists are finding new efficiencies and cost reductions every day. The outcomes are widely uncertain which makes financial planning for Seventysomethings, the biggest group of individuals retiring today, very precarious. This group may benefit by digging deeper into the possibilities and taking a more analytical approach to decision making. Financial planners typically stress test outcomes across various assumptions:

- If you live longer than expected, how many additional years of expense can you cover?
- What is the impact of rapidly increasing healthcare costs on your annual spending?
- How many more years of expense can you cover if you sell the house and downsize?
- How much money can you afford to give to your children without risking your own livelihood?
- How much can you spend in life and still have reasonable certainty that you can leave a legacy for your children and grandchildren?

These and other analyses highlight risks, opportunities, and trade-offs leading to more comfort in each spending decision.

Investing Your Nest Egg

As most Seventysomethings are retired, prolonging the nest egg is an extremely important topic. For most people this is not a time to focus on growth through riskier investments. The main portfolio concerns are income, downside protection, and liquidity. There are certainly some Seventysomethings with a "surplus" of assets and income that will cover expenses beyond the next 15 to 20 years. Those individuals may consider growth opportunities to mitigate extreme lifespan risk or grow assets for their heirs. But for most individuals whose stress tested expense situations illustrate possibilities of future deficits, avoiding undue risk is critical. Typically this means an asset allocation that is heavily weighted toward high quality, low-volatility assets that produce predictable and highly likely cash flows. The current unprecedented low interest rate environment is making this strategy very difficult for retirees. But we caution you that chasing yield in this environment through riskier bonds or running headlong into large equity allocations may not be wise. The situation retirees must try to avoid is being forced to spend down a significant chunk of investment principal due to an over allocation to stocks and risk assets during a severe bear market like we have seen during the past decade. Every situation is unique, but Seventysomethings should understand which risks are advisable and which are not. Often times, spending down some principal is more advisable than taking on risk, and running scenarios is a good way to make decisions.

The process of determining an exact asset allocation requires complete understanding of goals, needs, risk tolerance, and time horizon of unique situations and personalities. Some people may have heard a general rule of thumb that an asset allocation ratio can be determined by subtracting your age from 100. So for a 75 year old, this would mean 25% in stocks and 25% in bonds. The view at Cypress is that rules of thumb like this are too simplistic – investment portfolios should be more precisely tailored for each individual circumstance. Seventysomethings are best served to speak with a professional that can give guidance on historical and reasonable future assumptions. Also, one can gauge the amount of "risk" allocation by thinking about their current circumstances.

Take less risk in your portfolio if:

- You have little buffer between current income and necessary income to live.
- You felt very uncomfortable or even sold stocks in 2008-09 when your portfolio was significantly reduced.
- You will need a significant portion of your principal to live in the next 5 to 7 years.

Consider allocating a small portion of your portfolio to risk if:

- Your income from all sources, including Social Security, pensions, and qualified plans greatly exceeds your annual spending needs.
- You would not be emotionally affected day-to-day if a portion of your portfolio had a similar draw down to that of 2008, a 35% decline or more.

- You need little or none of your principal in the next 5 to 7 years.
- You remained disciplined during the recent Financial Crisis and rode stocks back to their current levels.

Income Planning

In addition to determining and maintaining a sustainable spending strategy, Seventysomethings should pay special attention to their income. From an income perspective, asset allocation will focus on bonds. Ensuring high after tax income is the goal which will guide investors toward tax exempt municipal bonds and taxable bonds. The asset allocation strategy will include both absolute yield considerations and after-tax yield considerations. Allocating efficiently depending on the type of account – taxable, tax-free, or tax-deferred – will be an important exercise.

Actively considering a withdrawal strategy is another important exercise. Most often, retirees are encouraged to employ the following withdrawal order:

1) Required minimum distributions
2) Taxable investment portfolios including traditional brokerage or advisory accounts
3) Tax deferred investment portfolios including 401(k) plans, Traditional IRA's, etc
4) Tax free investments, most notably, Roth IRA's

First, this withdrawal strategy prioritizes any required minimum distributions on tax-deferred accounts and social security to avoid penalties as high as 50%. Taxable investments are tapped next as the long-term capital gains tax is less than ordinary income tax rates. Third, the strategy recommends tax deferred investments, taxed at ordinary rates. Finally, tax free investments should be used as they are not subject to required minimum distributions and can benefit from tax deferral indefinitely. Furthermore, accounts like the Roth IRA can be passed on to heirs without tax consequence or required minimum distribution.

While these basic guidelines are usually reasonably effective, several dynamic strategies may allow investors to achieve better tax efficiency. One strategy that we focus on at Cypress is to pay close attention to a clients' marginal tax rate. Identifying where to draw the next needed dollar without triggering more significant tax rates can reap dividends over the long term. This strategy will cause some individuals to tap tax free investments earlier. Other strategies include withdrawal decisions that ensure Social Security benefits are taxed as little as possible and selling long-term stock holdings during low marginal tax years to take advantage of opportunities in capital gains tax rules. Like all financial planning, withdrawal decisions and strategies should be designed uniquely for each individual. An individual's marginal tax rates, types of retirement accounts, gross expense levels, distribution of assets across each type of account, and many other factors require customized analysis for the most effective recommendations.

Health and Life Planning

While we reserved health and life planning for last, this category deserves high priority. Most individuals underestimate the impact of changing circumstances, laws, and goals on the strategies already in place. Seventysomethings should absolutely spend time revisiting their plans to improve financial security during life and also for desirable and efficient distribution of their assets when life is through.

To ensure continued quality of life, long-term care insurance is worth serious consideration. Studies by the U.S. Department of Health and Human Services state that individuals reaching age 65 have a 40 percent chance of entering a nursing home for long term care and 10 percent will have a stay longer than 5 years. Many more individuals will receive care in home from family members and visiting nurses. Health and personal care as we age can become extremely costly and draining on retirement and other assets, not to mention the physical and emotional stress that this care causes spouses and family members. Investigating early and prior to any change in condition is critical to eligibility and price. An independent financial planner can identify suitability and necessity of all types of insurances. This area is very complex and tough to navigate, but in the right circumstance, proper planning can ensure a better quality of life for you, a spouse, or other loved ones involved.

Life insurance should be revisited at this stage as well. The need for life insurance generally decreases as an individual ages so reviewing the details on existing policies is critical. Most often, retirees are over insured and may improve cash flow by shedding existing policy premiums or utilize the cash value of an existing policy.
Estate planning documents such as a will and possibly trusts need to be reviewed or established. As tax laws and personal situations change drastically over time, most individuals can make vast improvements in their plans. Included in this review should be titling of assets. Ownership of homes, investment properties, brokerage accounts, retirement accounts, and pensions will all have an impact on how assets will flow. Coordinating this process is challenging given the amount of details, but a financial planner and attorney can usually help identify issues with the current state of plans and recommend alternative strategies for improving outcomes.

Wrap Up
This edition of the Cypress Financial Review concludes our series on financial planning for each decade. While there are certainly priorities that each individual should focus on during each decade, the reality of financial planning is that starting earlier is typically better. For those Thirtysomethings, it is wise to understand the issues you will face in retirement several decades away. And for those Seventysomethings, it is wise to learn and apply techniques in retirement as well as pass on knowledge to children and grandchildren that may benefit from the lesson. In the end, financial planning is a unique task for all individuals given the variety of goals and financial circumstances. Our aim at Cypress Financial Planning is to help all readers explore financial decisions in greater depth and trigger the curiosity to investigate their own situation. We certainly hope this series has been an interesting review and provided some introspection into your own situation or to pass on to a loved one that may benefit.

Third Quarter 2012 Economic and Investment Review

What a difference a year makes! July, August, and September of 2011 were extremely volatile months for the stock market. Investors feared a default on the nation's debt due to Congress' inability to prudently negotiate and raise our debt ceiling. On the contrary, the third quarter of 2012 had a relatively calm and steady march upward for stocks, driven by slowly improving economic data and major stimulus programs by US and European Central Banks. With election season in full swing, attention is shifting toward the course of our nation for the next four years with the two candidates offer strikingly divergent plans for economic growth.

Stock Market Performance
Thanks to a torrid first quarter, the US stock market as measured by the Standard & Poor's 500 Index ended the first half of the year already up 8.3%. While a fairly healthy annual return in its own right, the third quarter tacked on another 5.8%. The Dow Jones Industrial Average does not have the benefit of a few exceptionally strong performing companies, notably Apple with a YTD gain of 64.7%. As a result, this benchmark has risen slightly less to 10.0% through the first three quarters of 2012. An interesting side note: on September 24th, UnitedHealth Group replaced Kraft Foods in the 30-member Dow Jones, the first change to the 116-year-old index since 2009. International stock markets also had a very strong quarter. Developed international stock markets had the benefit of a major bailout from the European Central Bank and rallied 6.1%. The more volatile emerging markets rose an even greater 7.0% as measured by the MSCI Emerging Markets index.

US Economy
The US economy continues to muddle along in slow growth mode. Second quarter GDP was revised downward to a 1.3% annualized rate. While data for third quarter growth will not be released for a few weeks, expectations are not very high. Housing data has been a surprising bright spot in recent months, with home prices finally beginning to creep upward. However, the unemployment rate remains stubbornly high. At 7.8%, much of the small decrease we have seen in the past few months has been due to discouraged job seekers leaving the workforce as opposed to robust job creation. Corporations are feeling the pain from this challenging economy, as market bellwether FedEx sees factories making fewer items and slashed its earnings forecast for the coming year.

Decision 2012

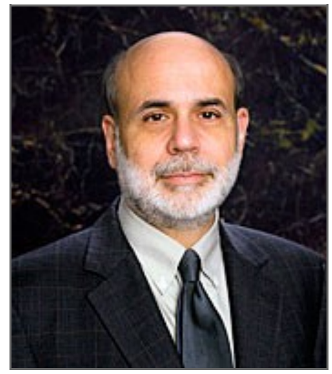
"A democracy cannot exist as a permanent form of government. It can only exist until the voters discover that they can vote themselves largesse from the public treasury. From that moment on, the majority always votes for the candidates promising the most benefits from the public treasury with the result that a democracy always collapses over loose fiscal policy, always followed by a dictatorship. The average age of the world's greatest civilizations has been 200 years."
- Alexis de Tocqueville

A quote from the early 1800's appears to have significant validity present day. As the election approaches, we are set to choose between two candidates who are living out this warning. Democratic incumbent Barack Obama has significantly expanded the size of government without a commensurate increase in revenue, resulting in the largest fiscal deficits in our nation's history. Republican candidate Mitt Romney promises to slash tax rates across the board without a commensurate decrease in spending. The voters favor the candidate making the best promises while our national debt is ballooning out of control. Regardless of this fact, one of these two men will be our next president, so it is helpful to see a more detailed explanation of their plans for the financial health of our nation.

	Barack Obama	**Mitt Romney**
Taxes	• Keep current income tax rates in place for those earning less than $250k, increase taxes to pre-Bush levels for higher earners • New 3.8% Medicare tax on investment income for households earning more than $250k	• Permanent 20% cut in income tax rates across the board • Eliminate taxes on investment income for households under $200k AGI, maintain current rates for the rest • Cut corporate tax rate to 25%
Spending	• Cut $4 trillion from the deficit • Reduce defense spending • Maintain Obamacare and Medicare programs based on laws passed during first term	• Goal to bring federal spending down to below 20% of GDP, in-line with historical trends • Cut non-security discretionary spending by 5% • Repeal Obamacare • Decrease federal employee compensation by 30%-40% to align with private sector
Job Creation	• Aims to eliminate tax breaks for companies that ship jobs overseas • Goal to create 1 million new manufacturing jobs by 2016 • Goal to train 2 million workers • Cut growth of college tuition in half over next 10 years	• Aims to bring clarity and predictability to such areas as tax rates, energy policy, labor regulations and trade. • Reduce regulations that make the cost of doing business in the US too high. • Reduce the size and reach of the government to allow for free market forces

Federal Reserve Stimulus "QE-Forever"

In Goethe's 1831 drama *Faust*, a bankrupt emperor is persuaded by the devil to print and spend large quantities of paper money as a quick fix for his country's financial problems. As a consequence, his nation ultimately unravels and falls into chaos. In an eerily similar fashion to this fictional drama, western governments today have relied upon quantitative easing (money printing) instead of undertaking necessary structural reforms. Basic economic principles of supply and demand teach us that these stimulus programs in which multiple trillions of currency are added to the financial system cause the value of that currency relative to goods and services to decrease. If inflation were to rear its ugly head, central banks would be forced to reverse course and raise interest rates. Higher interest rates tend to slow growth and depending on the health of the economy, may tip a nation back into a recession.



Federal Reserve Chairman Ben Bernanke

On September 13th, the Federal Reserve ignored the risks of future inflation and announced their own stimulus program whereby they will begin purchasing $40bn per month in mortgage securities to keep mortgage rates low. The intention is to fuel an increase in home prices, create extra cash flow for families by reducing mortgage outlays, and encourage more investment through borrowing. This program has been widely criticized, however. Most experts believe that interest rates are already low enough and that tighter lending standards have prevented people from receiving the loans they want as opposed to interest rates being too high.

European Sovereign Debt Crisis

Two and a half years into the European financial crisis, investors are hoping that the latest "bazooka" bailout program will be enough to move the region forward. On September 6th, the European Central Bank announced a new program to buy unlimited amounts of government bonds. The bailout will also contain a requirement to meet strict fiscal reform conditions. Stocks rallied and yields on ailing government bonds plummeted on the announcement. While this program lowers the interest rate that countries such as Spain and Italy have to pay on their debt, it does little else to address the fact that these countries still face severe economic headwinds and deep fiscal deficits in the years to come. A September 28 report shows that Spanish banks need around $77bn of extra capitalization to return to health, as a huge decline in the property market created losses on their mortgage holdings. The other large at-risk nation, Italy, is mired in a recession and recently stated that their economy will contract twice as much in 2012 as previously forecast. The ECB's requirement to enact severe austerity is a tough pill to swallow and is a further headwind to robust growth.