Wealth Hazards

| *Avoid* | *Manage* | *Recover* |

What You Don't Know May Be Hazardous To Your Wealth

4th Quarter 2009 Volume II, Issue 4

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What's a Wealth Hazard? Basically, it's a risk or a threat to your financial health. They come in all shapes & sizes and very often in disguise.

Which of life's Wealth Hazards are Avoidable, Manageable, and Recoverable? That's what our new book is all about. Here is what we mean when we talk about life's wealth hazards and how to Avoid, Manage, and Recover from them.

Avoid. To identify risks or threats to your financial health and to take steps to prevent or reduce the early effects of the event. When you attempt to Avoid a wealth hazard, you are on the offensive.

Manage. To address the effects of the wealth hazard and take action to contain it, redirect it, and eliminate it if possible. When you try to Manage a wealth hazard you are on the offensive.

Recover. Sometimes a wealth hazard is so fast-moving that there is little or no time to Avoid or Manage it proactively. In that scenario, you must react to Recover from it's effects. The process of repairing the damage from a wealth hazard may be lengthy or it may be quick. The key question is how seriously it impacted your financial health. While you Recover from a wealth hazard, you are on the defensive.

A Time to Save, A Time to Refinance

The biggest asset that most people have is their primary residence. That said, some people are finding themselves in trouble due to local real estate market problems or financial difficulties they've encountered that now threaten their ability to pay their mortgage. When you refinance, you typically change the payment by reducing the interest rate and changing the number of periods remaining to repay your loan. The general rule of thumb is that you should refinance only when you expect to be in your home for at least another three to four years and if you can reduce your interest rate by one percentage point. On a $250,000 mortgage with an interest rate of 6.25 percent, you'd pay $1,539 per month versus a $250,000 re-financed mortgage at 5.25 percent, which you'd pay about $1,381 per month, or a savings of $56,880 interest over thirty years. Watch out for application costs, appraisal fees, points to be paid, and other charges that can creep into your upfront costs or your monthly payment. To get the best interest rate you'll need to have 20 percent or more equity in your home. If you're concerned about the value of your home holding up when it's appraised, you should be. Appraisers are now under fire by lenders, real estate agents, private mortgage insurance firms, and even homeowners who are all claiming that appraisers failed to properly value homes and that lenders and homeowners relied upon their appraisal to complete the sales transaction. Needless to say, appraisers are feeling reluctant to step back into the line of fire and get sued or prosecuted for professional malpractice. There are two firms that track home values you can use to estimate the value of your home before you apply to refinance. Zillow.com and Trulia.com provide real estate sales data by zip code using public record information. You can look at what homes have sold for in your local area and determine if your home is likely to appraise at the price that you need to maintain 20 percent equity.

The next issue to be clear on is your credit score. To get a good interest rate, you need a 720. Credit scores range from 350 to 850 and as your score increases the interest rate decreases. The cut-off for getting any mortgage is now around 620. During the real estate market's bubble, you could get financed with a credit score of 580; that is no longer possible. You should check your credit score before you apply to make sure that you have no surprises. You can get your credit report and score from Equifax, True Credit, or Experian. These are the big three of credit reporting agencies and most likely who your lender will pull your credit report and score from. The underwriting process is now back to normal, meaning that full documentation is once again standard operating procedure. You will need to provide tax returns and W-2 wage statements for the past two years. If you're unemployed or have a new job, you shouldn't waste your time. You'll have to wait until you've been on the job for a few months to apply. You will need to provide bank statements and investment account documentation for the past three months. Most lenders want to see that you have three months of living expenses available to you should you lose your job.

If you determine that your credit score or equity in your home is not adequate to refinance with a traditional lender, you should consider a loan modification under the Making Home Affordable program offered by the Obama administration. The program will drop the interest rate to about 2 percent for the next five years, and then the lender is allowed to increase the interest rate by 1 percent a year until it reaches the prevailing market rate at the time your modification was made. All applicants must make the new payments on time during a three-month trial period in order to qualify for the five-year program. The first mortgage cannot exceed $ 729,750 and the new monthly payment cannot be greater than 31 percent of the borrower's pretax income. The first mortgage cannot exceed 105 percent of the value of your home. You can find out more about the features of this program at www.makinghomeaffordable.gov.

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The Numbers

- DOW 10,428 up 18.9% year to date
- NASDAQ 2,269 up 43.7% year to date
- S&P 500 1,115 up 19% year to date

A few words from the Editor

Wealth Hazards was established to help people Avoid, Manage, and Recover from life's wealth hazards. There are too many hazards to list, so our approach will be to share with you examples that you can use to better understand how to apply these principals to the challenges that each of us will face from time to time. If you have any questions, comments, or concerns feel free to contact us at ask@wealthhazards.com.

Thomas Hertog, Editor

When Are You Ready to Retire?

If you're like most people, your quick answer is "when I've got enough money to last". But behind this reflexive response is very often some revealing information that influences and shapes our expectations of what our retirement will be like. Gone are the images of sitting in a rocking chair with a glass of cold lemonade while family and friends laugh and play in the background. If you believe what most surveys say about today's 45- to 65-year-old crowd, the rocking chair will be traded in for a surfboard, and the family and friends will have to find their own way to happy days. How many retirement planning commercials show "youthful-looking" seniors driving around in their sports car trying to find that parking spot nearest to the front of the diner with the best early bird meal? Marketers are preaching to the choir when they say that the baby boomers will redefine retirement and what senior lifestyles will be like twenty years from now. So what do we need to know now and how can we move forward when times are uncertain?

There are three big issues to understand and manage for your retirement. First is expenses, how much you will spend in retirement. Second is your health and estimating how long you'll live in retirement. Third is your income and the quality and reliability of the payment stream to you. We address each of these three issues in our new book, *Wealth Hazards-Surviving the Recovery*.

Most planners say that you should aim to withdraw 3 to 5 percent a year of your retirement assets in order to preserve your income-producing principal and to be able to sustain your lifestyle in the event that you live beyond your initial expectations. A withdrawal rate of 3 percent will allow withdrawals for 30+ years and a 5 percent rate allows for 20 years of withdrawals. Normally, your first year withdrawal does not include an adjustment for inflation. The second year and every year thereafter of withdrawals can include the prevailing rate of inflation. For example if your retirement assets total $500,000 and you withdraw 5 percent or $25,000 the first year, then you would withdraw $25,000 plus the rate of inflation the second year. If inflation is running at 3 percent, you would add 3 percent to your $25,000 and your total withdrawal would be $25,750. For purposes of this example, we have ignored the investment return on the remaining asset balance, but the benefit to taking only 5 percent a year from your balance is that your investment returns, less inflation, may be very close to a net change of nearly zero, and you could find that your assets last much longer than you expected. You can always spend more than you forecast to spend if you find that your income-producing assets are generating more distributable income than planned.

The Wealth Hazards newsletter is published after the end of each quarter in January, April, July, and October. All material is copyrighted and may not be used without written permission. You may contact us at newsletters@wealthhazards.com if you have any questions.

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