

August 2010 Issue

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Consider Long-Term-Care Insurance

Life expectancies have increased significantly and are expected to continue to increase in the future. As people age, they are more likely to develop conditions that limit their ability to live independently. However, it is estimated that only 14% of households have purchased long-term-care insurance (Source: *Long-Term Care Costs and the National Retirement Risk Index*, March 2009).

How likely is it that you'll need long-term-care insurance? It is estimated that approximately one third of individuals age 65 and older will require at least three months of nursing home care, 24% more than one year of care, and 9% more than five years (Source: *What Is the Distribution of Lifetime Health Care Costs from Age 65?*, March 2010). Those figures do not include individuals who require home care services. In 2008, the average annual cost of a nursing home was \$71,000 (Source: *What Is the Distribution of Lifetime Health Care Costs from Age 65?*, March 2010).

Who needs long-term-care insurance? If your assets, not including your home, equal at least \$2 million, you can probably fund long-term-care costs with those assets, although you may not want to deplete your assets for this care. Those with very few assets will probably be covered by Medicaid. It is the people between these two extremes who should consider long-term-care insurance. This coverage may be especially important for women, who tend to outlive their husbands.

If you're considering long-term-care insurance, review these points:

- **Purchase the insurance at a relatively young age.** You should probably purchase the insurance by the time you are in your 50s or early 60s. After that, the premiums get much more expensive. Also, if you develop a serious health condition, you may not be able to purchase the insurance.
- **Check for inflation provisions.** Since you may not receive benefits for many years and costs for long-term care have been increasing significantly in recent years, check inflation protection in your policy. You can obtain simple or compound inflation protection. Simple protection increases the benefit amount by a specific percentage of the original benefit each year. Compound inflation increases the benefit on a compounded basis, so it provides substantially more protection. Another option is to make sure your policy contains an annual renewal option, so you can buy additional coverage in the future.
- **Obtain insurance from a stable insurance company.** You want to obtain insurance from a company that is sure to be around for the long term.
- **Make sure the policy terms are reasonable.** Many people choose a benefit period of three years, to cover the average nursing home stay. However, due to the substantial costs associated with long-term care, you may want to select a longer period. Benefits should be paid in as many situations as possible, including skilled care, intermediate care, custodial care, home health care, and adult day care. Many people prefer to remain at home for as long as possible, so make sure that the policy covers a wide range of home services. Review the waiting period carefully to ensure a good balance between premium costs and out-of-pocket costs.
- **Review carefully the level of assistance needed to qualify for benefits.** Typically, benefits are paid when you are unable to perform two of six activities of daily living, including bathing, eating, using the bathroom, moving back and forth from a chair to a bed, and remaining continent. Typically, benefits are also triggered when a cognitive impairment, such as Alzheimer's disease, requires substantial supervision.
- **Determine how benefits are paid.** Some policies pay a set daily amount, regardless of your actual costs. This may be a good alternative if you are staying at home and want to compensate a friend or family member for helping you. Other policies will only pay your actual out-of-pocket expenses up to a daily limit or may only pay reasonable and customary costs. Find out how you prove you're entitled to benefits. Some plans require an in-house doctor to review your health, while other plans allow your own doctor's review.
- **Review new policy provisions.** Long-term-care policies are relatively new, so policy riders are evolving. Make sure to check out new provisions, such as the ability to combine a life insurance and long-term-care policy, an accelerated premium provision that allows you to stop making premiums after a certain number of years, or a provision that returns premiums if you die without using benefits. Also look into partnership policies, which allow you to qualify for Medicaid after exhausting the

policy's benefit, while keeping more assets than normally allowed by Medicaid.

- **Consider sharing a policy with your spouse.** Some companies now offer policies that allow spouses to share the policy, which can operate in several ways. Spouses may take out separate policies, with a rider allowing the spouses to use each other's unused benefits. Another alternative is to purchase one policy that both spouses can use. A third alternative gives each spouse a specified amount of benefits plus a third amount that can be drawn on by each spouse.
- **Check the policy's tax status.** A qualified policy allows you to deduct a certain percentage of the premium, depending on your age, as a medical expense on your tax return. Medical expenses are deductible to the extent they exceed 7.5% of your adjusted gross income. Also, payouts from qualified policies are received free from federal income taxes.

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Using Conservative Assumptions

How can you ensure you'll have sufficient funds to last your entire retirement? So many of the variables used to calculate this amount seem uncertain. What is a reasonable rate of return for your investments over the long term? How long will you live, knowing life expectancies are increasing? How much can you count on from Social Security and pension plans? If you're concerned about running out of money during retirement, you need to be very conservative with your assumptions. Some tips to consider include:

- **Assume your retirement income needs to be at least 100% of your current income.** Most rules of thumb indicate you'll need between 70% and 100%, but figure on at least 100% to be safe. Nowadays, retirees want to travel, pursue hobbies, and live an active lifestyle, which generally means you'll need the higher end of these estimates.
- **Add a few years to your life expectancy.** You should probably plan on living until at least age 85 or 90. If your family has a history of longevity, add a few more years to these figures. While you may find it hard to believe that you'll live that long, you don't want to reach age 75 or 80 and find out you've run out of money. At that point, you might not be able to return to work.

- **Reduce your estimates of Social Security benefits.** The Social Security Administration sends benefit statements every year around your birthday, telling you how much to expect in benefits. While Social Security is currently in sound financial condition, that is expected to change after all the baby boomers retire. To be safe, count on benefits that are somewhat less than the Social Security Administration is estimating, and don't plan on adjustments for inflation.
- **Cut back on living expenses now.** This has a two-fold impact on your retirement. First, it frees up money to set aside for retirement. Second, you get used to a lower standard of living, which should also reduce your expected lifestyle for retirement.
- **Reach retirement with no debt.** Mortgage and consumer debt payments consume a significant portion of most people's income. Pay off all those debts by retirement and you significantly reduce your cost of living.
- **Forget about early retirement.** Saving enough to last from age 65 to age 85 or 90 is a difficult task. Trying to retire at age 55 or 60 is just not practical for most individuals, unless you're willing to significantly reduce your lifestyle. Working a few more years can go a long way in helping to fund your retirement. Those years are typically your highest earning years, so hopefully you'll save significant sums during that period. Also, every year you work is one year you don't have to support yourself with your retirement savings.
- **Consider working during retirement.** Especially during the early years of retirement, you should consider working at least on a part-time basis. Even modest earnings can help significantly with retirement expenses.
- **Plan on taking conservative withdrawals from your retirement assets.** Don't plan on taking out more than 3% to 4% of your balance annually. Your funds should last for decades with that level of withdrawal.

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Don't Make These Selling Mistakes

An important part of any investment strategy is developing a methodology for ultimately selling your investments. Unfortunately, many investors sell based on emotional factors, making one of several mistakes:

- **Holding on to an investment with a loss.** Psychologically, it's difficult for investors to sell an investment with a loss. Many prefer to wait until the investment at least gets back to a break-even level. However, that may

never happen or may take a long time to do so. Take a hard look at the investment and consider selling if you can reinvest in an investment with better prospects.

- **Hanging on to capture more gain.** When an investment has increased dramatically, you may be reluctant to sell, even if you feel its price has gone too high too fast. There's always the risk you'll sell and the price will keep going up. But sometimes it's best to protect your gains and sell while you're ahead.
- **Not setting price targets.** One way to take the emotion out of selling is to set high and low price targets for reevaluating an investment. You don't have to sell when the investment reaches those targets, but at least review whether you should sell. Sticking with rigid rules for selling when an investment declines by a certain percentage can help ensure you sell before incurring substantial losses.
- **Trying to time the market.** It's difficult to predict when the market will rise and fall. Even if the stock market is following a general trend, there will be up and down trading days. Trying to buy and sell stocks based on those daily fluctuations is difficult.
- **Worrying too much about taxes.** Taxes can consume a significant portion of your investment gains. Even if you have long-term capital gains, 15% of your gains will go to the federal government in capital gains taxes (taxpayers in the 10% or 15% tax bracket pay 0% in 2010). However, avoiding taxes may not be a good reason to hold on to an investment. There are typically strategies that can be used to help offset the tax burden, but there's not much you can do about a loss in investment value. If it's time to sell an investment, you should probably do so, even if you have to pay taxes on your gains.
- **Not paying attention to your investments.** Your portfolio needs to be evaluated on a periodic basis, or you could miss signals that it may be time to sell. You should reevaluate an investment when the company changes management, when the company is acquired or merges with another company, when a strong competitor enters the market, or when several top executives sell large blocks of stock.

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Improving Your Credit Score

As lenders have clamped down on issuing credit, your credit score now has a more significant impact on loans available to you, the interest rate and fees you'll

pay, and other terms of the loan. Thus, it is more important than ever to understand your credit score and how you can improve it.

When lenders evaluate a credit application, they usually request both your credit report and your credit score, which is a mathematical calculation based on the information on your credit report. The score is intended to rate your credit risk, although other factors, such as your income, length of employment, and years in your home, are also considered.

Credit scores are often referred to as FICO scores, since they are produced from software developed by Fair, Isaac and Company (FICO). While all of the major credit reporting agencies use FICO scores, your score from each agency can differ because information on your credit report differs by agency. Your FICO score is used in more than 75% of mortgage lending decisions and by 90% of the largest lenders (Source: MSN Money, December 29, 2008).

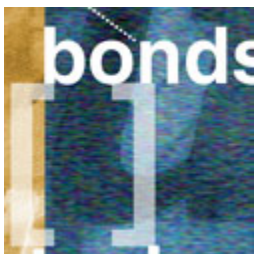
FICO scores range from 300 to 850, with higher scores indicating lower levels of credit risk. The major factors affecting your FICO score include:

- **How you pay your bills** - A significant portion of your FICO score is based on how you pay your bills. How consistently do you make your payments on time? If you've paid bills late, how many times were you late? How late were you? How much money did you owe? Have you ever had a debt in collection? What was the size of the debt? Have you ever filed for bankruptcy?
- **Your total outstanding debt** - Outstanding debt is debt of all kinds, including mortgages, car loans, credit cards, home-equity lines of credit, and any other loans that are reported to a credit agency. Another important factor here is how much unused but available credit you have on your credit cards. The absolute amount of available credit you have is less important than how close you are to maxing out the credit you've been granted. The highest scores go to people who use credit sparingly and keep balances low. Ideally, you should use no more than 30% of your available limit, with 10% being even better.
- **Length of your credit history** - The longer you've had and used credit, the higher your score. You get even more points if you have established long-term credit with the same lenders - a reason why you might not want to close long-term credit cards, even if you don't use them very much.
- **Mix of credit types** - Your score is higher if you have a variety of fixed payment loans and revolving credit.
- **Recent applications for credit** - A number of applications for credit over a short period of time raises a red flag for lenders, as it is often a sign that a person is in a cash flow crunch. The FICO formula takes points away for this. Multiple applications for a specific type of credit in a concentrated time frame - when you're rate shopping for a mortgage, for example - won't count against your credit score.

Typically, scores of 720 and above receive the best deals on interest rates. Based on the way the FICO score is calculated, there are strategies to improve your score if you're not at that level:

- **Review your credit report.** Your FICO score is based on your credit report, so you should get copies of your report from each of the three main reporting agencies and make sure there are no errors. You are entitled to one free report every year from each of the agencies. Your information can vary by agency, so don't just look at one. Contact the agency if you find any mistakes.
- **Make sure all your bills are paid on time.** Check your credit report to see if there are any late notices. If so and you have a good credit rating, ask the lender to remove the notice.
- **Reduce your credit utilization ratio.** You receive a better score when your outstanding debt as a percentage of your available debt is lower. Make sure your credit utilization never goes over 50%. If you can't pay down your debt, ask your lender to increase your available credit. This will have the same result as paying down your debt, but make sure you aren't tempted to use that additional credit.
- **Don't close credit cards you don't use.** This has the result of increasing your credit utilization ratio because you have less available debt. However, if you have too many credit cards, typically over five, close the newest ones. Too many credit cards make lenders uneasy.
- **Consider an installment loan.** FICO scores reward people who use both revolving credit accounts and installment loans. Thus, using an installment loan, such as a car loan or mortgage, can increase your score.
- **Minimize requests for additional credit.** Inquiries regarding additional debt appear in your credit file and hurt your credit score.

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Why Do You Need Bonds?

Why should you consider bonds for your investment portfolio? The primary reasons include:

- **Bonds add diversification to your portfolio.** One strategy to help counter the effects of stock market volatility is to add investments to your portfolio that aren't highly correlated with the stock market. Historically,

stocks have a low positive correlation with corporate and government bonds.

- **Bonds offer fixed, periodic interest payments and the return of your principal at maturity.** Thus, even in the event of a significant market decline, you receive some return in the form of interest payments, and you receive your principal at maturity.
- **Bonds are often better suited to short- and medium-term financial goals.** If you need your money in a few years, you may not want to keep those funds in stocks, since a major stock market decline could occur when you need your money.

Most investors will hold stocks, bonds, and cash in their investment portfolios. How much you should allocate to the bond portion will depend on your circumstances, but over time that percentage is likely to change. For instance, young investors are likely to be more concerned with growth, so bonds may only make up a small percentage of their portfolio. On the other hand, those who are retired or close to retirement are likely to own a higher percentage of bonds as safety of principal and a steady income stream become more important. In general, the percentage of bonds you own should increase as you become more averse to putting your capital at risk.

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