Focus on Finance

Coping with a Slower Economy

Economics isn't called the "dismal science" for nothing. There's an old joke that accuses economists of having predicted 9 of the last 5 recessions (and yes, those figures are in the correct order). However, forecasting the direction of the economy can seem easy compared with trying to figure out how to weatherproof your finances. It can help to understand some of the questions that many investors ask themselves if they're concerned about the potential impact of slower growth.

Is it time to check my portfolio?
Changing consumption patterns can have implications for a variety of companies and industries, and create investing opportunities. Some investing sectors might be especially economically sensitive and might therefore suffer from any economic downturn. On the other hand, some industries or companies may actually benefit from a slower economy. For example, companies that produce high-end goods might be relatively immune from economic pressures--or maybe not. Shifts in spending patterns could also mean that consumers continue to spend money but choose less expensive alternatives, or focus more on getting the greatest value from each dollar.

If you rely on your investments for income, you may want to review how sensitive your portfolio might be to changes in interest rates. If the Federal Reserve Board sees greater danger from a slowing economy than from the possibility of higher inflation, lower interest rates could cut into your income. Conversely, if the Fed becomes increasingly concerned about inflation, rates could go up. It might be a good time to see whether the yields you're receiving are competitive, and what kind of impact on your monthly income you might expect from any changes in rates.

Should I review my asset allocation?
Now might also be a good time to reexamine how your assets are divided among various types of investments. If you decide you need to shift a portion of your portfolio, those changes don't necessarily have to be made all at once. Consider:

- Adjusting only a portion of your bond or stock holdings
- Using systematic investing to shift allocations overtime
- Investing any new money differently to increase your exposure to asset classes you may have neglected

How close am I to the edge financially?
The benefits of reducing debt should be pretty obvious, given the recent credit crisis. Troubles in the mortgage industry have driven home the importance of managing debt wisely. The last thing you need if you're worried about uncertain economic times is to lock yourself into spending patterns that push you beyond your means. Whether the economy is in robust health or seems to be catching the flu, it's never a bad idea to have a cushion against unexpected financial stress. An unanticipated medical emergency--and is there any other kind?--a sudden job loss, or anything else that affects your income stream can bring the effects of a slower economy home in a dramatic way.

If you're employed in a highly cyclical industry or one that's undergoing substantial changes, having a financial reserve becomes even more important. And if a lot of your retirement plan savings are invested in your employer's stock, think about whether your long-term finances might potentially face a double whammy. Serious financial trouble at your company could mean the possibility of layoffs, a drop in the value of your holdings--or both.

Have I planned for the unexpected?

If you're planning to retire in the next few years, consider the potential impact if you were to be "retired" prematurely. It's easy to assume you'll work until a certain date or earn income after retirement, but health concerns and the job market don't always permit that. Doing some "what if?" calculations with an earlier retirement date than you might otherwise choose could prepare you for what might happen if you were laid off and had difficulty finding new employment, or were unable to work for health reasons.

A transition to a post-retirement career is likely to be easier if you plan thoroughly. For example, launching a small business can be challenging under the best of circumstances; try to have as much of the groundwork laid as possible before relying on it for your entire income. Sales estimates that are more conservative than they might otherwise be may help minimize cash flow problems.

Asking questions such as these lets you hope for the best while preparing for the worst.

Reapplying for Social Security

What if you decide to apply for early Social Security benefits, but a few years into retirement, realize that a higher Social Security benefit would help you increase, and sustain, your standard of living? Fortunately, you're not necessarily locked into your decision to take your retirement benefit early. The Social Security Administration (SSA) allows you to withdraw your benefit application and reapply later if that would be to your advantage.

Why reapply?

Increasing your monthly Social Security retirement benefit is one of the main reasons you might want to withdraw your application and reapply. According to the SSA, most retirees file for Social Security benefits early, often at age 62. But the drawback to claiming benefits early is that your monthly benefit will be substantially less than it would be if you wait until full retirement age, or longer, to collect. For example, if your full retirement age is 66, your monthly benefit at age 62 will be approximately 25% less than it will be if you wait until your full retirement age of 66 to collect, and 43% less than if you wait until age 70. (Source: SSA chart, Effect of Early or Delayed Retirement on Retirement Benefits)

Once you have a clearer picture of your retirement income needs, you may decide to withdraw your initial application and reapply when you're older, so that you may receive a higher monthly Social Security benefit (adjusted annually for inflation) for the rest of your life. In addition, if you're married, your spouse will generally receive the greater of his or her own retirement benefit or your monthly benefit (including any cost-of-living increases) in the event of your death, so increasing your retirement benefit may translate into more survivor protection for your spouse.

You may also wish to withdraw your Social Security application if you decide to work and your income is enough to reduce or even eliminate your Social Security benefit, or if your Social Security income is increasing your tax liability.

How do you do it?

You can withdraw your initial benefit application by filing Form SSA-521, "Request for Withdrawal of Application" at your local Social Security office. However, there is a pretty big catch. If you withdraw your application after you begin receiving benefits, you're required to return--in a lump sum--all of the money that Social Security has paid you over the years. But any interest or investment earnings you've received as a result of saving or investing those benefits is yours to keep. If you paid taxes on the benefits you're now paying back, you may be eligible for an income tax credit or a deduction. You can find more information about the tax consequences in IRS Publication 915, Social Security and Equivalent Railroad Retirement Benefits.

There's so much to consider

Not everyone will come out ahead by withdrawing an application for retirement benefits, then reapplying--you'll need to consider your own financial circumstances. Obviously, the requirement to pay back benefits will limit the number of people who can take advantage of this opportunity. And even if you can afford to pay back your benefits, you must be willing to accept the risk that if you die, you or your spouse may not recoup the amount you've paid back. But reapplying for benefits may be worth considering if you need to maximize your lifetime income and provide higher survivor's benefits for your spouse.

2008 Year-End Tax Planning Tips

Despite passing three major pieces of tax legislation in the past year, Congress is still considering a host of expired and expiring provisions. While it's likely that several of these provisions will be renewed for the 2008 tax year, the uncertainty creates a challenging planning environment. With the window of opportunity for many tax-saving moves closing on December 31, it makes sense to focus on the basics, while staying ready to take advantage of any late-breaking legislative developments.

Timing is everything

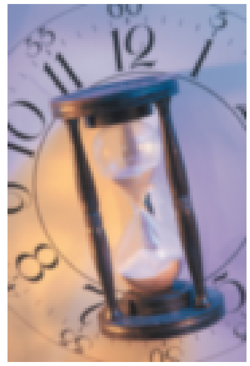
Year-end tax planning is as much about the 2009 tax year as it is about the 2008 tax year. There's a real opportunity for tax savings when you can predict that you'll be paying taxes at a lower rate (for example, if your income will be significantly different) in one year than in the other. If that's the case, some simple year-end moves can pay off in a big way.

For example, you may be able to defer a year-end bonus, or delay the collection of business debts, rents, and payments for services. Similarly, you may be able to accelerate deductions into 2008 by paying some deductible expenses in December rather than in January.

Alternative minimum tax (AMT) facts

If you're subject to the AMT, traditional year-end maneuvers, like deferring income and accelerating deductions, can actually hurt you. The AMT--essentially a separate federal income tax system with its own rates and rules--effectively disallows a number of itemized deductions, making it a significant consideration when it comes to year-end moves. For example, if you're subject to the AMT in 2008, prepaying 2009 state and local taxes won't help your 2008 tax situation, but could hurt your 2009 bottom line.

Legislation signed into law in December 2007 brought the most recent in a long series of temporary "fixes" for the AMT, but this temporary fix (in the form of increased AMT exemption amounts) expired at the end of 2007. If Congress doesn't act, the number of taxpayers subject to AMT could reach 25.7 million in 2008 (Source: Joint Committee on Taxation, JCX-38-07, June 25, 2007). Congress is likely to take some action, but the specifics are uncertain, making it important to stay up-to-date on any new developments.



Don't overlook IRA and retirement plan opportunities

Traditional IRAs (assuming you qualify to make deductible contributions) and employer-sponsored retirement plans, such as 401(k) plans, allow you to contribute funds pretax, reducing your 2008 income. Contributions you make to a Roth IRA or Roth 401(k) aren't deductible, so there's no benefit for 2008, but qualified Roth distributions are completely free from federal income tax--making these retirement savings vehicles very appealing.

For 2008, the maximum amount you can contribute to an IRA has increased to $5,000, and you can contribute up to $15,500 to a 401(k) plan. If you're age 50 or older, you can contribute up to $6,000 to an IRA, and up to $20,500 to a 401(k). The window to make 2008 contributions to your 401(k) closes at the end of the year, while you can generally make 2008 contributions to your IRA until April 15, 2009.

If you qualify, consider whether it makes sense to convert some or all of your traditional IRA assets to a Roth IRA. Funds that you convert, to the extent the funds represent investment earnings and deductible contributions, are considered taxable income. Nevertheless, the potential future tax benefit could outweigh the current tax bill.

Expired provisions likely to be renewed

In addition to AMT relief, watch for action on other provisions that expired at the end of 2007, but are likely to be renewed, including:

- Election to take an itemized deduction for state and local sales tax in lieu of state and local income tax
- Above-the-line deduction for qualified tuition and related expenses
- Above-the-line deduction for certain expenses of elementary and secondary school teachers
- Tax-free distributions from IRAs for charitable purposes of up to $100,000 per person, per year

It's always difficult, at best, to anticipate what Congress will do. In an election year, it's even more unpredictable. If the last few years are any indication, though, it's not unreasonable to assume that we might see some legislation late in the year, so stay alert.

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Hillard Rest Associates
260 Newport Center Drive
Newport Beach, CA 92660

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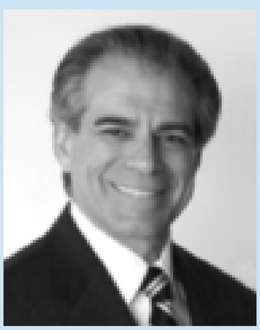

Hillard Rest
CFP

Hillard Rest is a well-known expert in those matters concerning "Retirement Income Planning" and "Wealth Preservation strategies." He strives to educate his clients on how to invest profitably and avoid loss by providing conservative options. Hillard earned the coveted recognition of Certified Financial Planner professional in 1987.

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