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Who Needs Estate Planning?

Why estate planning is so important, and not just for the rich.

You have an estate. It doesn't matter how limited (or unlimited) your means may be, and it doesn't matter if you own a mansion or a motor home.

Rich or poor, when you die, you leave behind an estate. For some, this can mean real property, cash, an investment portfolio and more. For others, it could be as straightforward as the $10 bill in their wallet and the clothes on their back. Either way, what you leave behind when you die is considered to be your "estate".

"But, I don't need estate planning … do I?" Let's think about that. If the estate is small, should you still plan? Well, even if you're just leaving behind the $10 bill in your wallet, who will inherit it? Do you have a spouse? Children? Is it theirs? Should it go to just one of them, or be split between them? If you don't decide, you could potentially be leaving behind a legacy of legal headaches to your survivors. This, quite simply, is what estate planning is all about – deciding how what you have now (money and assets) will be distributed after your lifetime.

Do you HAVE to create an estate plan? While it is absolutely *possible* to die without planning your estate, I wouldn't say that it is *advisable*. If you don't leave behind an estate plan, your family could face major legal issues and (possibly) bitter disputes. So in my opinion, everyone should do some form of estate planning. Your estate plan could include wills and trusts, life insurance, disability insurance, a living will, a pre- or post-nuptial agreement, long-term care insurance, power of attorney and more.

Why not just a will? Did you know that your heirs could encounter legal hassles … even if you have a will? Basically, a will tells the world what you'd like to have happen, but proper estate planning is what provides the tools to make those things happen. While your will may state who your beneficiaries are, those beneficiaries may still have to seek a court order to have assets transfer from your name to theirs, and in such a case, those assets won't lawfully belong to them until the court procedure (known as probate) concludes. Estate planning can include items like properly prepared and funded trusts, which could help your heirs to avoid probate.

Where do you begin? Call Dumont & Blake and we can help coordinate working with an estate planning attorney, a qualified tax professional, and lead a team effort to assist you in drafting your legal documents.

Social Security in 2014

Here are six things you need to know about Social Security for 2014. For clarity's sake, here is a rundown of the changes of 2014.

Social Security recipients are getting a raise – but not much of one. In 2014, the average monthly Social Security payment will increase by $19 due to a 1.5% cost-of-living adjustment, one of the smallest annual COLAs in the program's history. Since 1975, only seven COLAs have been less than 2%. Four of these seven COLAs have occurred in the past five years. The 2013 COLA was 1.7%.[1,2]

How does Social Security measure COLAs? It refers to the federal government's Consumer Price Index, specifically the CPI-W, which tracks how inflation affects urban wage earners and clerical workers. Social Security looks at the CPI-W from July to September of the present year to figure the Social Security COLA for next year, so the 2014 COLA reflects the very tame inflation measured in summer 2013.[1,2,3]

Does the CPI-W accurately measure the inflation pressures that seniors face? Some senior advocacy groups say it doesn't. The Senior Citizens League, a non-profit that lobbies for elders and retired veterans, contends that Social Security recipients have lost 34% of their purchasing power since 2000 because the CPI-W doesn't track rising health care expenses correctly.[3]

On its website, the Bureau of Labor Statistics admits that the CPI "differs in important ways from a complete cost-of-living measure." The CPI measures increases or decreases in rents, transportation costs, tuition, food, clothing, prescription drug and medical care costs, and the prices of consumer discretionary goods and services – 200 item categories in all. Still, some prices in the CPI rise faster than others; medical costs increased 2.4% from September 2012 to September 2013, and housing costs rose 2.3%.[2,3,4]

Chained CPI is not yet being used to determine COLAs. Some analysts and legislators would like Social Security COLAs to be based on chained CPI, a formula which assumes some consumers are buying cheaper/alternative products and services as prices rise. Supporters think that pegging Social Security COLAs to chained CPI could reduce the program's daunting shortfall by as much as 20% in the long term.[5,6]

The CPI-W is still the CPI of record, so to speak. That's good for retirees, as the Congressional Budget Office says that COLAs would be about 0.3% smaller if they were based on chained CPI. Perhaps this sounds bearable for one year, but according to AARP, a 62-year-old who retired and claimed Social Security in 2013 would be losing the equivalent of an entire month of income per year by age 92 if chained CPI were used to figure benefit increases.[5,6]

Groups like TSCL and AARP wouldn't mind basing the COLAs on the CPI-E, an alternative CPI that the BLS maintains to track prices most affecting consumers aged 62 and up. From 1982-2011, the CPI-E showed yearly inflation averaging 3.1% compared to 2.9% for the CPI-W.[4,5,6]

Social Security's maximum monthly benefit is increasing. In 2013, a Social Security recipient who had reached full retirement age could claim a maximum monthly benefit of $2,533. *(continued on page 2)*

Practice KISS Investing

Do you understand your investments? If you don't, you might be taking unnecessary risks.

KISS means "keep it simple, stupid." Two of the most renowned investors who have ever lived – Warren Buffett and Peter Lynch – have followed this principle in building their fortunes. As Lynch famously put it, "Know what you own, and know why you own it." Those who study the so-called "Oracle of Omaha" say that Buffett's preference has been for businesses that can be explained in a single sentence.[1,2]

Whether you are big on value investing or not, these nuggets of wisdom ring true. If you don't understand the investments that you own, or you can't easily explain how they work, then you may be opening a door to some unwarranted risk (and regret).

What was the great lesson of the bear market of 2008-09? If some investments grow so complex that even banks and brokerages didn't fully comprehend their risks, doesn't it follow that it might not be right for ordinary investors? Unfortunately, as memories of bear markets fade, memories of the pain and folly associated with such investments fade as well.

How simple are your investments? Shouldn't they be transparent and liquid? Few individual investors need non-traded or illiquid investments. Even so, a notably optimistic market climate can inspire investment in illiquid and non-traded options. These investments may have their merits, but they also have their drawbacks. Here are some examples…

Life settlements. These investments have been pitched as having the potential for double-digit returns with no stock market correlation. That sounds great, but what about their downside?

At the root, a life settlement occurs when a person sells his or her whole life insurance policy to a third party, as he or she can't make the premium payments any longer or just needs cash for retirement. The result? A lump sum that is somewhere between the cash surrender value of the policy and its death benefit. The buyer of the policy (the financial institution) keeps it in force by taking over the premium payments.[3,4]

When you invest in life settlements, you basically invest in the life insurance policies of senior citizens. The institutional investor who owns these policies is betting, more or less, that these seniors will die before they are supposed to die. If they live longer than expected, the institutional investor loses the actuarial bet. Creepy? Yes, and these investments are unregulated in some states. Due to bad underwriting and/or increasing longevity, you could end up with a much lower return than advertised or even a loss. Moreover, do you need an illiquid investment with an undefined time horizon that may not be regulated where you live?[4,5]

Non-traded REITs. Real estate investment trusts (REITs) offer "small" investors a chance to buy fractional ownership shares of a real estate portfolio, as well as the potential for solid annual returns and tax advantages – but not all REITs are traded on national securities exchanges. Investing in a non-traded REIT has its hazards. Many non-traded REITs are structured so that there will be a "liquidity event" in their future – either they go public or liquidate at that time. Until that time, however, an investor in a non-traded REIT faces illiquidity risk, no guarantee of a distribution, and the possibility of major fluctuations in the per-share price. Front-end fees on non-traded REITs may also be higher than those for exchange-traded REITs, and dent the return so that it ends up being lower than that of an exchange-traded REIT.[6]

Mortgage-backed securities. Yes, they are still being offered as potentially high-yielding alternatives to Treasuries. These securities are akin to bonds, and they are created through a multi-phase process. First, banks sell groups of home loans to issuers. The issuers pool the home loans together into mortgage-backed securities – that is, securities collateralized with residential mortgages. In selling these securities to institutional investors, the issuers are essentially selling portions of the mortgage pool featuring different levels of risk and expected return. These portions or "tranches" are known as derivatives, and the derivatives feature different levels of prepayment risk – the risk that the borrowers in the given "tranch" will make more than the minimum mortgage payment per month, thereby lowering the interest on their loans. After all these steps are taken, residential mortgage payments end up being the revenue stream for the institutional investor.[7,8]

When you have a strong housing market (and low interest rates), an MBS may seem attractive. When homeowners start to miss payments or default on their mortgages ... well, think back to 2008. If you lack the stomach to try and understand embedded options, option-adjusted spreads, zero-volatility spreads and other MBS jargon, then stay back from the MBS market and explore more liquid ways to invest in this sector.[7,8]

Keep it simple, stupid – not a bad thing to keep in mind as you invest these days.

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Social Security in 2014 *(continued from page 1)*

In 2014, the limit will be $2,642.[1]

So is Social Security's annual earnings limit. This limit is only faced by Social Security recipients who have yet to reach the month in which they turn 66. In 2013, retirees younger than 66 were able to earn up to $15,120 before having $1 in retirement benefits temporarily withheld for every $2 above that level. In 2014, the annual earnings limit rises to $15,480. Social Security recipients who will turn 66 in 2014 can earn up to $41,400; if their earnings break through that ceiling, they will have $1 of their benefits temporarily withheld for every $3 above that level. Once you get to the month in which you celebrate your 66th birthday, you can earn any amount of income thereafter without a withholding penalty.[1]

On the job, the wage base for Social Security taxes is rising. American workers will pay a 6.2% payroll tax on the initial $117,000 of their incomes in 2014. The 2013 payroll tax cap was set at $113,700. About 6% of working Americans will pay more in Social Security tax next year as a consequence of this seemingly insignificant adjustment.[1,6]

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