



Japan's Two Lost Decades: Can It Happen In The U.S.?

Twenty years after Japan's "economic miracle" collapsed, the Asian nation still has not recovered its once-vaunted economic clout. Japan's debacle involved a spectacular jump in stock and real estate prices followed by an equally

spectacular fall as those bubbles burst, much like the twin "pop" that sent the United States into a recessionary spiral in December 2007.

Does that mean Americans are doomed to spend the next two decades struggling to get their economic lives back? And what lessons can investors learn from the Japanese experience?

Echoes of a debacle in Japan. The start of Japan's so-called "lost decade" in 1990—which has stretched to two decades since that phrase was coined to describe Japan's extended economic malaise—was triggered by a period of irrational exuberance in the 1980s. Loose monetary policy fueled a rapid rise in stock and real estate prices. Driven by speculation, leveraged assets, and investing excess, Japanese industrial production rose by 50% during the 1980s, and by 1989 Japanese banks had become the largest in the world. When the bubble burst in 1990 and the economy collapsed, investors belatedly realized that much of the growth had been illusory.

The same thing happened in the United States during the period 2002 to 2007, as "easy money" policies, consumer spending, and foreign

investment pushed real estate and stock prices ever upward—until the bubble burst, sending over-leveraged financial institutions to the brink of bankruptcy and the U.S. economy to the edge of systemic failure. Two years later, the U.S. jobless rate surpassed 10%,

businesses have trouble obtaining credit, and government officials are weighing further intervention in the economy even as the national deficit soars to unprecedented levels.



From an investor's point of view, the story is illustrated vividly by looking at the most-quoted stock market averages in the two countries. Japan's Nikkei average hit an all-time high of 38,957.44 intraday Dec. 29, 1989, then fell off a cliff. In 2009, the Nikkei never exceeded 10,800, and it nearly fell below 7,000 in March. In the United States, the Dow Jones Industrial average soared to a record intraday high of 14,198.10 on Oct. 11, 2007, then plunged as the economy deteriorated, dropping as low as 6,547.05 in March 2009 before rallying back above 10,000 in the last few months of the year.

Why the U.S. should fare better. While the similarities between the countries' boom-and-bust debacles are striking, there are also fundamental differences. For instance, the U.S. crisis is unlikely to be as deep and long-lasting as the Japanese downturn largely because the U.S. boom period did not even approach the stupendous

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Conversion Hype Around Roth IRAs Is Overdone

Since the Roth IRA was established in 1997, individuals and couples with more than \$100,000 of modified adjusted gross income have been out of luck. Because they couldn't squeeze under that ceiling for converting a traditional IRA to a Roth IRA, they've been deprived of the Roth's tax-free income, protection from required minimum distributions, and hefty estate tax benefits. But the Tax Increase Prevention and Reconciliation Act of 2005 eliminated the income restriction beginning this year, and now millions of affluent households – holding about half of all IRA assets – are eligible.

The media storm has been under way for months, with stories and ad campaigns all talking about converting. But the factors affecting whether you should seize this opportunity aren't as simplistic as they're generally portrayed. Converting hinges on three key variables: your tax savings on avoiding required distributions on your traditional IRAs, which kick in at age 70½; your tax rate in the years ahead; and the amount of cash you have outside your IRAs to pay income tax on a conversion.

The benefits of a Roth IRA conversion can be significant for the right client. But after reviewing this issue for all of our clients, we concluded that a full or partial Roth conversion only makes sense for a few. We will contact you shortly with our recommendation for your personal situation.

*All the best,
Jim & Chris*

Beware Of Homeowner's Insurance Gaps

Disaster may strike your home when you least expect it. There could be damage from flooding, an earthquake, termites, or even mold—just to name a few possibilities. And though you probably assume repairs will be covered by your homeowner's insurance policy, they may not be. Your policy may exclude more events than you realize. Even when you are covered—for, say, flood damage—there may be “gaps” in your coverage that limit the amount you can recover.

The good news is that a typical homeowner's policy covers losses resulting from fires, tornadoes, and severe storms. But the list of what it normally doesn't cover may surprise you. For instance, coverage may not extend to floods and earthquakes, although you can usually add a policy rider for such events. The rider's cost will vary based on whether you reside in a high-risk area.

Similarly, if you have to clean up a mess created by a water or sewage backup, the expense won't be covered by standard homeowner's insurance. But here, too, you can purchase a special rider to avoid this headache, often for less than \$100 a year.

The list of other types of damage that usually aren't covered range from mold to insect and termite infestations to acts of terrorism, war, and nuclear attack. Dig your policy out of your files and take a few minutes to assess your risk exposure for these events.

Even if you're covered for damage—through standard insurance or a rider—payments from the insurance company are based on the property's replacement cost, not its fair market value. Also, if your home is destroyed and it's insured for

less than the replacement value, you'll have to pay some of the rebuilding cost. In addition, deductibles and maximum dollar caps may affect reimbursements for possessions that are destroyed or stolen.

In terms of liability exposure, one way to avoid dire consequences is to supplement your current coverage with an umbrella liability policy. As the name implies, the

umbrella policy sits on top of your homeowner's and auto insurance policies to provide additional protection. For instance, if a neighbor slips and is injured on your icy sidewalk or a tree topples onto a car parked in front of your home, an umbrella policy may pick up the slack.

Just like other forms of insurance, you'll need to shop around for the best umbrella policy. And keep in mind that umbrella coverage kicks in only after other insurance is exhausted, and umbrella



policies usually carry deductibles equal to the required underlying limits for the auto and homeowners policies. Still, the cost of umbrella coverage usually isn't prohibitively expensive. You may be able to obtain \$1 million in liability coverage for \$200 to \$300 a year. And you may get a discount for using the same carrier. That could prove a small price to pay for plugging the gaps in policies. ●

Should Retirees Carry A Mortgage?

Your home mortgage is likely to be the biggest debt you ever take on. And if you've moved or refinanced a few times since your first home loan, you may be years or even decades away from owning your house free and clear. But that begs the question: What about retirement? If you're getting ready to retire or already have stopped working, does it make financial sense to keep making monthly payments? Or should you use some of your savings to retire that debt?

Traditionally, paying off the mortgage was a pre-retirement objective, but the recent trend has been to carry the debt longer. A study by the

Center for Retirement Research at Boston College found that in 2007, 41% of households with people in their 60s still had a mortgage, even though more than half owned sufficient assets to repay the loan.

Why would you hold a mortgage in retirement? Depending on your situation, you may value the tax benefits and liquidity. Consider these four critical factors.

1. Investment returns. Recently, the average 30-year fixed rate for mortgages has been between 5% and 5½%. You might keep your mortgage if you think you can do better investing the money you would spend to retire it.

But retirees who invest heavily in low-risk vehicles such as bank certificates of deposit (CDs) and Treasury securities are likely to come up short. And though stocks and mutual funds may provide higher rates of return, they carry greater risks, and if your portfolio plummets, you could have trouble making mortgage payments.

2. Tax breaks. You can generally write off mortgage interest if you itemize deductions. But people who claim the standard deduction—and that's almost two out of every three taxpayers—receive no tax benefit from mortgage interest payments. So if you're not an itemizer, it may make

Sandwich Generation Estate Planning

For the millions of baby boomers in the “sandwich generation,” these are worrisome times. Sandwiched between the financial needs of parents and children, they often end up having to contribute to both, and there may be particular urgency when elderly parents need to get their estate plans in order. Often, parents have put off making vital decisions, and face a future of uncertain means, declining control over their own lives, and increasing dependence on younger family members.

One way to address these issues is to view estate planning as a family affair. You could start by setting aside time for everyone involved—yourself, your spouse, and any siblings—to discuss the main aspects. But be prepared for a frank, often awkward discussion of sensitive concerns. Your parents or in-laws may regard this as an intrusion into their personal affairs, and emotions are likely to run high.

You probably won't solve everything in one meeting. Rather, it's likely to be the beginning of a long process. At some point, too, you may want to begin talking with your children, to let them know what's happening and to keep them up to date on your own estate planning.

Here are several things to discuss with your parents:

Do they have an up-to-date will?

sense to pay off the mortgage. Also keep in mind that the tax benefit of itemized deductions will be reduced if your income is high.

3. Retirement accounts. It's generally not a good idea to pay off your mortgage if you have to invade your retirement accounts to do it. The money you pull out of a 401(k) plan or an

IRA will be reduced by taxes—at ordinary income rates of as high as 35%—plus you'll be hit with an additional 10% penalty if you're under age 59½. And you'll be left with fewer



Most estate plans start with a will, and even if your parents have one (many don't), it may need to be updated to reflect changes in family circumstances, your parents' desires about how assets will be distributed, and frequent recent shifts in tax and estate laws. There could be new grandchildren to account for, or a divorce. You'll need the help of an experienced estate planning attorney, but first you'll have to persuade your parents to share this very personal document with you. Emphasize that your only goal is to make sure their wishes are successfully carried out.

Where's the money? A parent or in-law could have assets in many different accounts, and account information and statements may not be neatly filed in one easily accessible location. To make sure nothing is lost, you may want to take an inventory of all of the key documents. This will likely include bank account records, life and disability insurance policies, retirement plan and IRA statements, and the like. It's a good idea to assemble all of the pertinent information, including account and policy numbers and contact names, in one document and make copies for you and your parents or in-laws. Also note whether any accounts are in joint name or designated as “transfer on death” accounts, which will not pass under the terms of a will but rather to the

funds to draw upon during retirement.

4. Refinancing. One alternative to paying off the mortgage may be to refinance it at a lower interest rate. That can reduce your payments, or you could use the opportunity to pull out equity you've built. But the deep decline in real estate values has underscored the risks of financial strategies built around home loans.

Choosing what to do about your mortgage is a major financial decision. We can help you choose the best approach for your situation. ●

designated person on the account.

How are assets being managed?

Pulling together account documents also provides a good opportunity to check on your relatives' investments. Do their holdings seem appropriate given their advancing age, financial needs, and risk tolerance? If there are many similar accounts, you might want to suggest consolidating them to simplify their management.

Are tax records in order? As part of this process, look at tax issues, and determine the tax basis of securities that may have been purchased decades earlier. It's also a good idea to know where your parents' tax records are kept and who their accountant is.

What are their wishes about health care? This can be a particularly touchy subject, so tread carefully, but it's also extremely important. Try to establish guidelines for what will happen if a relative is disabled or suddenly loses a spouse. If extra care is needed, do they prefer to have someone come into their home, or would they rather move into assisted-living or live with a family member? Laying the groundwork now for such major changes could help make a later transition somewhat easier. Also encourage your parents and in-laws to establish a living will and durable power of attorney that sets out their preferences for end-of-life care and specifies someone to handle health-care decisions if they're no longer able to make them. A general power of attorney is also needed for management of assets.

This list hardly covers everything you'll need to discuss, but it may help get you started. For affluent families, intergenerational issues are likely to be much more complex, perhaps including a variety of trust arrangements and sophisticated estate planning strategies. We can work with you and your parents to assess asset allocation plans, tax strategies, and other elements of their financial lives. And, of course, we're also happy to help you take stock of your own estate plan and the provisions you want to make for your children. ●

Social Security Benefit Cuts Are Likely

You've been paying into the Social Security system your entire adult life. At some point, you expect to retire and collect your fair share of benefits. But will the money be there?

Many experts believe Social Security benefits will be reduced or watered down through taxes and other adjustments during the next few decades. Because you may receive less from Social Security, you may need to save more in other retirement accounts.

The Social Security Administration (SSA) says the program's annual costs will exceed its revenues in 2016. And while the SSA projects that the system's trust fund will be able to cover the shortfall through 2037, that's down four years from last year's estimate. And with unemployment still rising—leading to lower tax revenues to fund Social Security benefits—the deficit could worsen, putting pressure on future payments to retirees.

How will Social Security's future play out? The system's financial situation is clearly deteriorating as there are fewer workers to fund

retirement benefits for the huge baby boom generation, and there's little appetite for yet another taxpayer-funded bailout of a cash-strapped government program. Yet the likelihood that Congress would actually approve cuts to a program long known as the third rail of American politics also seems low. If benefit reductions come, it may be through the action of a bipartisan commission charged with solving the system's financial woes.

In the meantime, de facto cuts have already begun. An earlier Social Security commission recommended raising the full retirement age from 65, and current rules are gradually increasing the full retirement age to 67 for those born in 1960 or later. You can still choose to begin taking benefits as early as age 62, but you'll receive sharply lower monthly amounts than if you had waited until today's older full retirement age.

Rising Medicare premiums,

normally deducted from a recipient's Social Security payments, also serve to undercut cost-of-living benefit increases. Moreover, you're increasingly likely to be taxed on a

portion of your Social Security benefits. While only about 30% of current beneficiaries are taxed on benefits, that's projected to rise to 42% by 2020, and high-income retirees may pay tax on up to 85% of benefit payments.

In this volatile environment it is prudent not to rely too heavily on Social Security to provide a large percentage of your retirement income. With the system's future uncertain, your benefits could fall, and even the loss of, say, \$1,000 a month could have a negative impact on your retirement plan. We can help you reexamine your retirement income projections, recommend strategies for replacing what you might lose from Social Security, and show you strategies for reducing the amount of taxable Social Security benefits. ●



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price increases seen in 1980s Japan. During the 1990s, Japanese real estate lost an average two-thirds of its value. In contrast, U.S. real estate prices are expected to fall 30% to 40%, although some areas, including Las Vegas, Phoenix, and Miami, have seen steeper declines.

Moreover, the U.S. economic structure is more open and fluid than that of Japan, where banks and major industries had a tendency to sweep problems under the rug. In the United States, major banks have quickly (with the push of the government) written off billions in bad debt in an attempt to get a recovery going without unnecessary delay.

But the most basic difference between Japan in 1990 and the United States today lies in the speed in which interest rates were lowered. American economists, most notably current U.S. Federal Reserve Chairman Ben Bernanke, have criticized Japan's central bank for failing to reduce interest rates quickly enough during the early 1990s, with the delay spawning rampant, long-lasting deflation. Eager to avoid that mistake, the Fed has taken several steps to cut interest rates and keep money flowing. And both the Bush and Obama administrations have pumped billions of dollars into the U.S. economy in the



form of corporate bailouts and economic stimulus plans.

Even though the crisis in the United States seems unlikely to mirror the Japanese experience, it's impossible to know what will happen to stocks, real estate, commodities, and currencies in the near term. That's

why we advise you to continue protecting yourself from the vicissitudes of the stock market and the world economy by remaining broadly diversified in your investments. That's the best way to ensure you are in a good position to benefit when the economy starts coming back to life. ●