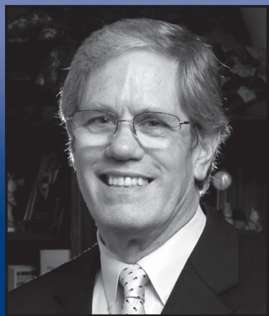

# The Thoughtful Investor

A publication of William R. Skeeters

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## A Bad News Five-Year Anniversary

This fall marks the 5th anniversary of the longest and most accommodating spell of monetary policy in the history of the United States, with the federal funds rate about as low as it can be – 0.25% annually.

Whether the anniversary is a cause for celebration or concern is a question of benefit. For retirees and savers, there's little to celebrate. Low interest rates have devastated many retirement plans, forced individuals into riskier investments to try to maintain the earning power of their savings, and inadvertently spurred a dramatic increase in investment fraud.

For stock investors, the anniversary looks quite a bit better. From the end of 2008 through August 2013, the S&P 500 had risen 80%. Low interest rates also produced records returns for bond investors over the last five years. But the length of time the low rates have been in effect signals vulnerability for these gains.

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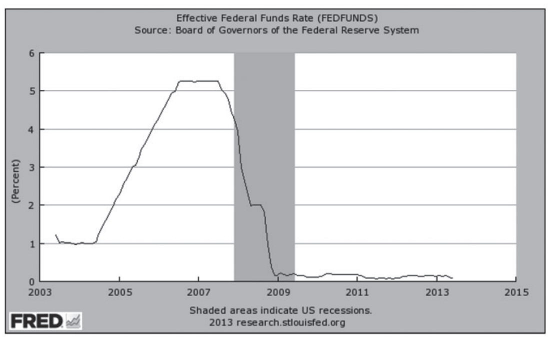


## What to Do If You Receive a Windfall

If you are between the ages of 55 to 68, there's a good chance an inheritance will be coming your way in the next few years. Two-thirds of boomer households are estimated to inherit $8.4 trillion, $2 trillion of which has already been received with $6 trillion yet to come. The median inheritance is estimated at $64,000.[1]

Sudden wealth may seem like sudden fun, and the alleviation of financial worries, but it doesn't always turn out well. The psychiatric community has even coined a name for the problem – *Sudden Wealth Syndrome*.

In addition, history shows that great wealth rarely makes it past the third generation. Inheritors, especially those who are new to the financial windfall phenomenon, typically spend their inheritance in record time. The same applies to many lottery winners, professional athletes, and other sudden lump sum recipients.

Becoming suddenly wealthy is also a source of considerable stress, with symptoms including feeling isolated from former friends, guilt over one's good fortune, and an extreme fear of losing all the money.

With that said, what should you do if you receive a windfall, be it inheritance or a great investment?

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1 The MetLife Study of Inheritance and Wealth Transfer to Baby Boomers, A Study by the Center for Retirement Research at Boston College for the MetLife Mature Market Institute, December 2010.

## Set Email Alerts on Your Accounts

A simple precaution that could help you detect fraud in your credit card, checking, investment and/or saving accounts is to set email alerts that let you know:

(1) If a major transaction has taken place in an account
(2) Changes over a certain limit in an account
(3) Payment deadlines
(4) Receipt of payment or deposit
(5) Daily balances
(6) Changes to your account information
(7) and much more based on your provider.

Depending upon your bank, custodian or credit card provider, you may be able to have text messages sent to your phone if transactions out of the ordinary happen in your account.

The downside is a few more messages to review in your inbox, but the upside is an opportunity to detect potential problems quickly, while there is still time to limit damage to your account or your credit.

To set email and text messages, log in to your provider's online site and look under account preferences. If this doesn't work, call account services and find out how you can set account alerts.

## What to Do If You Receive a Windfall — *continued from page 1*

### (1) Set aside the bulk for the funds for a while.

Yes, you can treat yourself to one or two small luxuries, but don't make any major decisions until you have had a chance for the excitement to wane and hard reality to set in. One of those realities is that what may seem like a lot of money initially may not be that much by the time taxes and estate settlement costs are paid. A million dollars isn't what it used to be, and it can be very easy to spend in a very short time.

### (2) Talk to your financial adviser.

Money tends to come with a lot of complexities from gift taxes to income taxes, estate issues and more. Understanding the tax repercussions of your inheritance is essential. You also need to look at how your windfall can be used to meet your long-term needs. Should it supplement a retirement savings shortage? Do you have loans that can be paid off? What about delayed maintenance on your home or other properties? Do you want to set funds aside for long-term care, or for a family member with special needs?

Rather than a windfall, your inheritance may be a lifeline that you don't want to slip away.

> *An estimated 70% of Americans who experience a sudden windfall will lose that money within a few years.*
>
> National Endowment for Financial Education

### (3) Consider rolling over retirement accounts into an Inherited IRA.

If you are the beneficiary of a tax-deferred retirement account, you may want to continue tax deferral by rolling the account into an Inherited IRA (spouses can roll an inherited retirement account into their own IRA which restarts the clock on when mandatory distributions are required). Annual withdrawals are required from an Inherited IRA based on the life expectancy of the beneficiary, potentially "stretching" tax deferral.

Cashing out an inherited retirement account can be costly because all funds withdrawn from an inherited IRA are taxed as personal income (unless it is a Roth IRA, in which case withdrawals are free of federal taxes). Re-titling the account as an Inherited IRA allows you to postpone paying taxes and allows you to continue tax deferral of contributions and gains.

### (4) Think about what you want the money to do for you.

Perhaps you would like to quit work and retire. Or maybe you would like to start a new business. Before you make a decision, create a budget and make certain your windfall is sufficient to meet your needs. Get good advice on what kind of funding you might need for your goals.

If your goal is to worry less about financial issues because you know you have money in reserve, then you need to make certain your money is invested wisely to preserve capital.

### (5) Separate your windfall from your other accounts.

When windfalls are mingled with other daily accounts, it's harder to keep track of whether or not you are spending the money effectively. For example, mingled with your checking account, you tend to lose your sense of how much you are spending.

Separating your new wealth from your normal daily spending can also be a good way to avoid the requests of friends and relatives for money. When you have an extra $1,000 or $10,000 in your checking account, the impulse is to be a little more generous. When those funds have to be withdrawn from a separate account, a new level of judgment steps in.

### (6) Treat yourself within reason.

In the end, money in the bank isn't a lot of fun. There's nothing wrong with taking a portion of your windfall and treating yourself to something you've always wanted as long as you've followed the steps above. By taking your time and thinking through money issues, you will know how much might actually be "spare" money and you can set a limit to keep yourself from overspending.

In a nutshell, the more the windfall, the more you have to remember to…

- stick to a budget,
- invest wisely,
- learn to say no and
- be prepared to potentially lose friends while riding an emotional roller-coaster of joy, anxiety, guilt and distrust.

## Where Did the Money Go?

Lottery winners, professional athletes, entertainers and heirs are among those most likely to lose their windfall in record time.

Woolworth heiress Barbara Woolworth Hutton blew through as much as half a billion (in today's dollars) and seven husbands before dying with a reported net worth of just $3,500.

Former boxing champ Mike Tyson's fortune at one point was estimated to stand at $400 million. Today he maintains he is broke and living week to week.

Musician Michael Jackson comfortably earned between $50 million and $100 million per year from 1985-1995 only to file for bankruptcy in 2007.

Lottery winners are notorious for sad endings from bankruptcy to drug addiction, lawsuits and even murder. In less than a decade, Sharon Tirabassi lost $10,569,00.10 (Canadian) that she won through the Ontario lottery. Suzanne Mullins opted for yearly payouts instead of a lump sum when she won the U.S. lotto in 1993 but soon began using future payouts as collateral for a loan, switched to a lump sum payment, never paid off the debt and ended up sued for more than remained. Lara and Robert Griffith won a $2.76 million lottery jackpot. Six years later the money and their marriage were history. In the mid-1980s, Evelyn Adams won the lottery twice only to gamble it away. And the list goes on…

# Put Negative Thinking to Work

Sometimes the best way to approach life isn't positive thinking, but negative thinking.

The Greek philosopher Seneca the Stoic offered the following advice to individuals who feared losing their wealth, "Set aside a certain number of days, during which you shall be content with the scantiest and cheapest fare, with coarse and rough dress; saying to yourself the while: 'Is this the condition that I feared?'"

Thinking in sober detail about your worst-case scenarios actually allows you to put in place tools to cope with that situation. For example, imagine you are dead…what is happening to the assets you have accumulated over the years, to the people you care about, or even the family dog? By facing the negative, you have an opportunity to act to minimize repercussions that you want to avoid. Those actions may include updating your will, putting insurance in place, setting up guardianships, etc. If instead, you take the positive thinking approach and imagine that you will live to 100, you've probably made the situation much worse.

Facing the negative can also help you appreciate what you have now. With wildfires taking up much of the news recently, have you thought of what would happen if your home burned down? Your first thought may be to prioritize what should be rescued if all you have is a car to move your possessions. Did that just give you a greater understanding of what you truly treasure? Imagining a seared landscape surrounding you can make the current reality beautiful.

An old friend's coping mechanism with the fear of breast cancer was to take out a $1 million insurance policy. Now she knew that cancer would not impoverish her family, her husband would be able to afford help in raising their children and her salary would be replaced in the family budget. Her major fears were addressed and no longer a reason for worry.

Worried about retiring without enough money? Take the negative approach and start wondering how in the world you will make money to live on if you did lose your investments. Perhaps your solution may be to keep a source of active income by continuing to work. That work doesn't have to be the job you've held professionally but perhaps a side interest, a means of putting personal knowledge to work. Could you drive senior citizens to appointments, teach at the community college, sell your art on street corners? For a fascinating opportunity to watch older specialists in collectibles find objects they later resell through dedicated channels such as ebay, take up visiting estate auctions.

The downside to negative thinking is when you don't take the next step of developing a coping mechanism. When you put in place mechanisms to deal with your concerns, the odds are your life will be a lot happier.

> ***"Remembering that you are going to die is the best way that I know to avoid the trap of thinking you have something to lose."***
>
> Steve Jobs

# A Bad News Five-Year Anniversary *— continued from page 1*

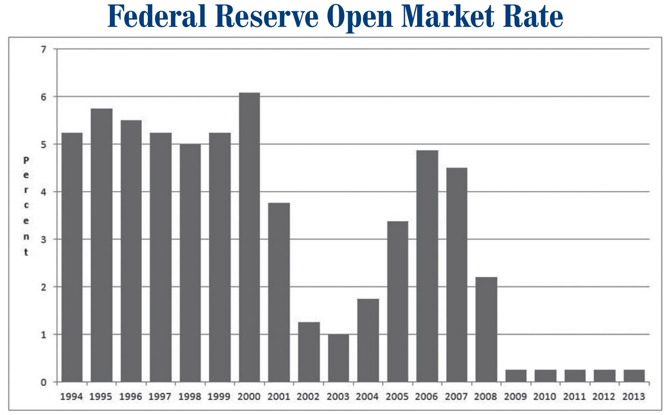
American economist Hyman Minsky pointed out that the problem is *stability leads to instability*. The longer a condition or trend exists, the more systems, individuals and businesses adapt to the condition, producing unstable financial arrangements. Thus, says Minsky, the longer the period of stability, the higher the potential risk for even greater instability when market participants must change their behavior.

Given that everything tends to return to the mean, that presents a further problem because today's rates are so far out of whack with historical data. For the last 20 years, the Federal Reserve Open Market Rate has averaged 3.7%. That is almost 15 times the current rate.

While individuals and businesses may intuitively grasp that rates can and will move higher, that doesn't always appear to be the case for government entities. Higher rates will have a dramatic effect on the cost of government borrowing, putting more pressure on revenue generation or in the case of the federal government, printing money to cover interest payments. Upping tax collections inevitably depresses economic activity because consumers and businesses have less to spend, while printing money leads to inflation and its painful side effects.

The temptation is to simply keep rates at their artificially low level and avoid the pain. But then we come back to Minsky's theorem — the longer the period of stability, the higher the potential risk for even greater instability. It should be an interesting five years ahead.

**Federal Reserve Open Market Rate**




*Source http://www.federalreserve.gov/monetarypolicy/openmarket.htm*

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# Titling and Ownership of Retirement and Education Accounts

In our last issue, we talked about different forms of ownership for investment accounts and how they affect your estate.

The forms of ownership left unmentioned include some very large accounts – retirement accounts and educational savings accounts. With this newsletter, we would like to correct the omission…

## Ownership of a Retirement Account

Retirement accounts, such as 401(k), IRA, Roth accounts, SEP, KEOGH, SIMPLE and other account forms are always held in the name of the individual. It is in the **beneficiary designations** that ownership of the accounts gets more complicated. A beneficiary designation establishes who will receive any remaining balance in your account at your death. The beneficiary designation takes precedence over any other estate documents, such as wills, tangible personal property lists, etc., with the possible exception of spousal rights. Without a designated beneficiary, the account becomes part of the estate and is subject to probate.

If you are married, there are some limits on who you can name as a beneficiary. No matter where you live, federal law dictates that your surviving spouse be the primary beneficiary of your 401(k) plan benefit unless he/she agrees, in writing, to your selection of a different beneficiary. If you live in a *community property* state, your spouse owns half of your retirement account as community property, regardless of whether he or she is named as a beneficiary.

A retirement account can have as many beneficiaries (with a designated percent of the account value) as the owner would like, taking into account any spousal ownership. In addition, you can establish contingency beneficiaries. These individuals would inherit if a primary beneficiary dies prior to the death of the original account owner.

The tax treatment of a retirement account inheritance depends upon the beneficiary's relationship to the original account owner. As long as there is a named beneficiary on the account, it is not subject to probate and passes directly to the beneficiary. However, the assets in the account may be included in the estate tax calculation.

When a spouse inherits a retirement account, he/she can continue tax deferral on the account by (1) rolling over the account into a rollover IRA in their name or (2) continuing the account as an Inherited IRA, in which case the withdrawal requirements of the original owner continue.

Nonspouse beneficiaries have three options:

1. Cash out all or part of the retirement account, paying income taxes on the disbursement.
2. Convert all or part of the account into an *Inherited IRAz* subject to annual distribution requirements based on the life expectancy of the beneficiary, and continue tax deferral.
3. Disclaim part or all of the inherited retirement account. By disclaiming an inherited account, the account would pass to the contingency beneficiary, or lacking a contingent beneficiary to the estate or, depending upon the account documents, a surviving spouse.

## Ownership of Education Accounts

Coverdell Education Savings Accounts may be owned by the student or the student's parent(s) but must have a designated student beneficiary. For a contribution to be eligible under the program, the beneficiary must be under age 18 or else qualify as a special needs beneficiary. As a result, the parent(s) would initially own the account with the student as the designated beneficiary. After age 18, the account could be transferred to the student's ownership. Regardless, the ESA must distribute all funds to the beneficiary by age 30, unless the beneficial interest in the ESA is transferred to another qualifying beneficiary.

529 accounts are held in the name of the donor. This could be individual or joint ownership. If the account owner dies, the terms of the 529 plan control who becomes the new account owner. Some states permit the account owner to name a contingent account owner. In other states, account ownership may pass to the designated beneficiary. Without a designated successor owner or beneficiary, the account may be considered part of the account owner's probate estate and may pass according to a will.

Generally, the account owner(s) retains control of the 529 account and may be able to name a new beneficiary or else make a withdrawal from the account.