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The Dollar Is Weak And It Has Affected U.S. Investors

For many Americans, the dollar's decline during the past few years has sparked anxiety about the economy and international competitiveness. But for investors, the dollar's recent weakness has brought more good news than bad, serving to multiply the returns of investors in many foreign stock and bond funds. The likelihood that the greenback will continue to lose ground could be a reason to increase a portfolio's international exposure. Yet any bet on the future direction of currency markets is chancy at best.

What's behind the dollar's recent slide? A major factor is record U.S. trade and current account deficits that now exceed 6% of the U.S. gross domestic product (GDP). The U.S. is spending far more than it earns, and that increases the number of dollars in foreign hands. That trend, coupled with the impact of strengthening European economies, pushed the dollar down more than 11% against the euro in 2006, and by more than 55% since May 2001. Moreover, during the past five years, the dollar has fallen more than 25% against the Canadian dollar and 8% against the Japanese yen.

The dollar's future direction is tougher to gauge. In early 2007, robust U.S. economic data appeared to reduce the likelihood the Federal Reserve would cut short-term interest rates, and that led the dollar to gain value against other currencies. That early performance, along with other factors, led Neil Miller, a London-based currency analyst at Bank of New York, to revise his 2007 forecast for the dollar upward, though he expected any appreciation to be limited by the U.S. current account deficit. Barring any "exogenous shocks," such as new wars or sharply escalating oil prices, David Gilmore, of Connecticut research firm Foreign Exchange Analytics, expected the dollar to hold relatively steady for the time being. While Gilmore had thought a repeat of last year's 12% to 13% declines versus European currencies was "probably not in the cards," the dollar had indeed fallen about half that amount during the first five months of 2007.

Ongoing pressures on the dollar are significant. For one thing, though it continues to be the world's favored reserve currency, central banks have begun to diversify their holdings, according to Ashraf Laidi, currency analyst with CMC Markets. For example, China has reduced from 85% to less than 70% the proportion of its $1 trillion in foreign exchange reserves held in U.S. dollars, and Russia and Great Britain have followed similar strategies. Moreover, the European Central Bank and the Bank of England have been raising interest rates at a time when the U.S. Federal Reserve has been holding rates steady. Higher rates tend to attract currency investors and boost local currency values.

Whatever happens next, however, it's clear the dollar's recent weakness has been a boon for much of the U.S. economy. It has reduced prices of exports and drawn in bargain-hunting foreign tourists. It has also given record numbers of U.S. investors a good reason to look abroad for returns from international

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You Don't Need To Be A Big Firm To Be A Great Firm

Everyone knows that the assembly line forever changed the American economy. We went from producing one car at a time to producing many cars faster. But in financial services, a mass-production assembly-line system does not work well. And that is the difference between a giant Wall Street firm and a small independent firm like ours.

It's like the difference between a fast-food chain and a restaurant that features fine dining. While fast food is great for many people, others want their meals prepared more carefully. They appreciate the quality, care and service they get from eating at a good restaurant.

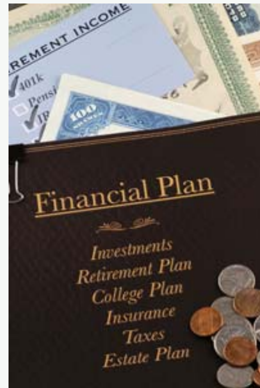
Our firm's advice is carefully crafted. There is no production line working on a financial plan. There are no anonymous cooks preparing what we offer you. You know the people producing your plan, you understand the process that goes into delivering the advice we give to you. There is no corporate mentality enforcing production goals.

To be great in delivering personal finance advice, you don't need to be big. In fact, being a small boutique is an advantage. Being independent of a big corporation with its own agenda and assembly-line process is one of the reasons we can deliver to you sensible, unbiased advice and fantastic personal service.

Colleen & Rob

Transfer The Risk Of Outliving Your Money

How much of your retirement nest egg can you afford to spend each year without running the risk of outliving your savings? Despite considerable ongoing research to identify a maximum safe withdrawal rate, there's no consensus, and most estimates are discouragingly low, often less than 5%. That means if you've saved $1 million, for example, you'll have to live on $50,000 a year or less (not including Social Security).



But there is a way to do considerably better, though it comes with its own trade-offs. An insurance product known as an immediate annuity lets you exchange cash for a promised monthly payment that keeps coming as long as your heart keeps beating. A recent quote for a 60-year-old New York male from ImmediateAnnuities.com, an online broker, would convert a $1 million investment into a guaranteed lifetime monthly payment of $6,115. That's considerably more than the monthly draw of $4,167 you'd get at a 5% annual withdrawal rate.

An immediate annuity, in effect, lets you transfer your risk of outliving your money to an insurance company. It's the kind of deal you get from Social Security (and may still get from a corporate pension plan, though there are fewer and fewer of those). In all of these cases, you're promised a relatively generous lifetime payout because the payer—an insurance company, the government, or your employer—knows it won't have to make good on all its promises. Many people will die relatively soon, ending the payer's obligation. That leaves more money for those who live longer.

The most obvious problem with this equation is that you could die early. Suppose that a 60-year-old New Yorker hands over his million and dies a year later. He has received a grand total of $73,380—and his heirs get nothing. To reduce that risk, insurers typically offer a variety of guarantees. For example, the New Yorker could purchase an annuity paying $5,652 a month that also promises at least 20 years of payments, with payouts going to his designated beneficiaries if he dies before that time. Or he could buy a joint policy with his 60-year-old spouse that gives them $5,256 a month for as long as either is alive; to get a 20-year guarantee, they could accept a lower monthly payout of $5,027.

Immediate annuities have other risks beyond the owner's early death. Your money is irrevocably tied up, unavailable even in an emergency. Moreover, the insurance company could go out of business, or interest rates could rise steeply after you've locked in a low rate. One way to spread such risks is to "ladder" your annuities, buying from a few different companies over several years. That way, if an insurer defaults or interest rates change, only part of your savings will be affected—and in any case, you'll likely want only a portion of your nest egg in annuities. In addition, immediate annuities usually don't have inflation protection, and the buying power of your monthly payments can be eroded sharply by inflation. A handful of carriers do offer inflation protection, however.

The potential benefits of immediate annuities are alluring. They turn savings into paycheck-like income, and you could buy an annuity large enough to cover most or all of your fixed expenses. With those costs covered, you might feel comfortable taking slightly more risk with the rest of your portfolio, potentially increasing long-term gains. ●

A Consumer-Directed Health Plan May Sound Like A Panacea,

President Bush is all for them, and many health economists believe health savings accounts and other "consumer-directed" health plans (CDHPs) could help expand health coverage to the uninsured while reining in runaway medical costs. The basic idea is to buy a low-premium, high-deductible policy that protects you from the catastrophic costs of a serious injury or illness but leaves you to pay for much of your everyday care. That, in turn, is supposed to make you a savvier medical consumer who doesn't run to the doctor for every headache or runny nose. Yet the trade-offs of a CDHP may not be to your liking, particularly as you grow older and find yourself needing more frequent and costly medical care.

From a policy perspective, CDHPs seem to be on the right track. According to "Consumer-Directed Health Plan Report—Early Evidence Is Promising," from consultant McKinsey & Company, the number of Americans covered by CDHPs more than doubled during the six months ending March 2005. There may be several reasons, however, not to jump on the bandwagon.

While it's true CDHPs can save you money on insurance premiums, that's less of a selling point for wealthier families than for the population at large. Moreover, what you don't spend on premiums may come out of your pocket as you meet the high deductible. According to a survey conducted by the Commonwealth Fund and the Employee Benefit Research Institute (EBRI) in December 2005, individuals in CDHPs and traditional health plans tend to have similar rates of health care use. But those in CDHPs are significantly more likely to spend a large share of income on out-of-pocket health expenses than are those in comprehensive health plans. In the survey, 31% of those in CDHPs spent 5% or more of annual income on out-of-pocket costs and premiums,

Retirement Spending Just Isn't The Same

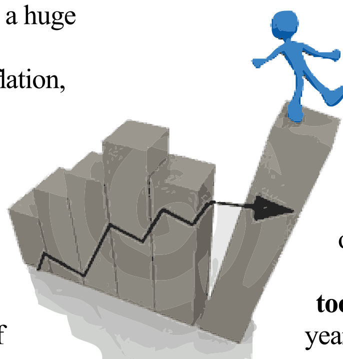
Since the Depression, most Americans have been guided by a simple retirement spending strategy: Don't touch your principal, and sell stocks only as a last resort. The approach worked well for many generations, when retirement seldom lasted more than a decade and people could live comfortably on bond interest, stock dividends, and a monthly pension payment. But times have changed. Today's retirees live longer and bear much more of the responsibility of paying for retirement, and simply depending on income spun off by investments may not work.

"Dividends, Social Security checks, and clipping coupons aren't enough for most people," says Moshe A. Milevsky, who teaches retirement income planning and risk management at York University in Toronto. "It's unavoidable that you're going to have to consume capital. The question then becomes how to do it intelligently." Finding a way to use your nest egg wisely—drawing it down gradually without depleting it during your lifetime—means taking into account many facts of retirement life.

Inflation can be a game-breaker. "Most people don't understand inflation," observes Mitch Anthony, author of The New Retirementality. "But to see what it will do in the future, look backwards. Consider the cost of a gallon of gas or a postage stamp 30 years ago. Remember your first paycheck? What kind of life would you have living on that paycheck today? Well, that's what you'll be facing 30 years from now. If you don't get your arms around inflation, you're in trouble."

Retirement spending needs may be higher than you expect. Future levels of spending, too, may be hard to gauge. It's easy to underestimate what you'll need. Health care costs are rising faster than the general inflation rate. Your family could experience an unexpected problem, such as a child needing support. Separating your expenses into discrete goals with specific timelines and then factoring in the appropriate inflation rate is wise. You can't take one lump sum and inflate it for 30 years. Do it in pieces, because different costs rise at different rates. That didn't matter when people lived just five or 10 years after retirement. But it can make a huge difference today.

Taxes matter. Like inflation, taxes eat into retirement income, and it's essential to have a retirement plan that minimizes their impact. One major tax-related question involves which source of capital to tap first. The general rule of thumb is to sell from taxable accounts first, tax-deferred accounts next, and tax-free accounts last. Redeeming investments in taxable accounts may result in capital gains, but those are taxed at a much lower rate than income from a 401(k) or IRA. "There's a delicate balance between trying to keep assets tax sheltered and the risk of pushing yourself into a higher tax bracket and losing more of your Social Security benefits," warns Milevsky.



Risk isn't always a four-letter word. Living into your 90s means taking investment risks. But longer retirement time spans also mean weighing different kinds of risk. Bonds, long a favorite retirement asset, generate income and tend to be less risky than stocks. Over three decades or more, however, bonds have barely kept up with inflation, and that poses another risk—of running out of money. "The whole 'don't tap the principal' idea can be damaging if it leads you to hold the wrong assets," says Milevsky. "If you're 57, say, and have 30 years to live, you can afford the risk of owning stocks."

Real estate is an asset, too. "During the past 10 to 15 years, our homes have been excellent investments, and our income planning should reflect that, says Bob Curtis, whose company makes MoneyGuidePro, software for wealth managers. Today, real estate is part of your overall available assets." You don't want to treat your home like other investments, but tapping your home's equity through a home equity loan, reverse mortgage or by downsizing to a smaller house is worthy of consideration.

A cash cushion creates comfort. Whereas during your working years you may need to set aside enough cash to cover six months of expenses, during retirement a cushion of one to two years may be better. "This is about meeting emotional needs," Curtis says. "Cash gives you an anchor. If the market turns bad, you'll be more comfortable sticking with your financial plan if you know you have that cash buffer." ●

But May Not Be Right For You

compared with just 12% of those in comprehensive health plans.

You may also simply be happier with a comprehensive plan. According to the Commonwealth Fund/EBRI survey, 63% of individuals with comprehensive health plans were extremely or very satisfied, compared with 42% of CDHP enrollees. That could be because CDHP enrollees are more likely to avoid or delay health care than those with comprehensive plans. According to the Commonwealth/EBRI survey, 35% of people in CDHPs avoided going to the doctor when they were sick, compared with 17% of those in comprehensive plans.

That, of course, is how it's supposed to work, with CDHP enrollees having a financial incentive to avoid unnecessary care. But the line between what's needed and what's not may often blur for health-care consumers. And some policy experts worry that failing to get preventive care or catch medical problems at an early stage could lead to much more serious problems—and much higher costs—down the road. Until more is known about the long-term success or failure of the CDHP concept, it may make sense to spring for a traditional health plan. ●

Financial Faux Pas By Business Owners

Many business owners are so busy running their companies that they neglect personal business issues. Are you making any of these financial planning faux pas?

1. Neglecting to diversify. It makes sense to invest in what you know. But you don't want to be too overweight in any single area. If your wealth mostly comes from your own business, then gravitating toward investments in your industry could leave you vulnerable. Try to look at your business as just one of many investments, spreading broadly among industries with a history of doing well when yours has faltered.

Liquidity is another good reason not to concentrate your wealth in your business. If you need cash for a home renovation, for instance, and your company generates enough to provide it, you could take a larger salary. However, that means paying more income tax. In contrast, cash raised by selling securities is taxed at the lower capital gains rate.

2. Failing to fund your retirement plan. Reinvesting profits in your business is important, but not at the expense of establishing a generous retirement plan. Directing the maximum of pre-tax dollars into a retirement account is a great way to diversify out of your business, and it's more reliable than counting on the sale of your business to fund retirement.

3. Going it alone. If you're like most entrepreneurs, you are your business—and running it all yourself works fine for now. But illness or death could ruin the company and your family's future. You may need to broaden the company structure. A board of directors could give you access to additional expertise while making you more comfortable delegating responsibility. Setting up your business to continue without you makes it more valuable to potential buyers.

4. No succession plan. You may expect one or more of your children to succeed you, but they may have other plans or be ill-suited for the job. If the company does stay in the family, don't wait too long to begin transferring control. During a transition period, you can work alongside your heirs apparent, sharing your savvy and contacts.

If the business will go to an outsider or a business partner, you need an exit strategy, a timetable, and a funding plan for the transfer. Insurance on your life can help your business partners pay your family for your share in the business if you were to suddenly pass on.

5. Leaving a committee in charge. Leaving equal shares of your business to several heirs may seem fair, but it could be disastrous for the company. Without one person at the reins, clashes are likely. Decide who is the best choice to lead and then look for other ways to transfer wealth to the others—non-business assets or cash from life insurance proceeds.

6. Leaving assets exposed. Owning your business's building can be convenient and profitable. But set up the building in a separate corporation and lease back your space. That way, if someone slips on the sidewalk, your business may be insulated from an adverse court judgment. As the company grows, consider an excess liability policy, and annually review and update your disability and life insurance coverage.

The common thread of all six mistakes: A lack of planning. ●

Weak Dollar Affects Investors

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stock and bond funds. According to the Investment Company Institute, a trade group for mutual funds, more than $12 billion flowed from investors to international funds in 2006, while funds that invest mostly in the U.S. saw an outflow of $169 million.

"Currency factors were a big reason for the gains of international funds in 2006," says Greg Wolper, a senior analyst at Chicago-based Morningstar. A weak dollar puffs up international fund returns for U.S. investors, Wolper says. For example, Britain's blue-chip FTSE 100 index gained 12.5% in 2006 if measured in pounds sterling. But in U.S. dollar terms, it jumped 27%. Similarly, the Morgan Stanley Capital International Europe index rose 15.9% in local currencies compared with 33.7% in U.S. dollar terms.

To take advantage of such discrepancies, you need to invest in funds that don't use hedging strategies to minimize the differences. Most international stock funds are unhedged, Wolper says, while most international bond funds do hedge currency exposures. Read the fine print in fund prospectuses to gauge their currency policies, Wolper suggests. "Some funds may hedge only occasionally," he notes.

But Wolper also cautions against investing based solely on how you expect currencies to perform. "Because it's so difficult to know what the dollar's direction will be, it doesn't make sense for a guess about currencies to be the deciding factor when choosing a fund," Wolper says.

Of course, if the U.S. dollar is in a permanent tailspin, that could threaten the long-term value of retirement savings concentrated in dollar investments. But Laidi is one of many currency experts who doesn't expect the dollar to collapse. More likely, he says, is that the U.S. currency will eventually strengthen, and overseas equity markets, which have been hot for several years, may decline. If that happens, U.S. investors with portfolios tilted too much toward international funds could miss out on domestic returns. So the wise course, as always, is to diversify holdings. ●

Past performance is not a guarantee of future returns, and currency changes will not affect portfolios the same way they have in the recent past. Investments in the markets and indexes mentioned in this article will differ from your portfolio's performance. International investment involves additional risks beyond currency fluctuations and is not suitable for all investors.

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