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Medical Inflation Saddling Retirees With Higher Costs

Nothing brings home the need to craft a viable retirement savings plan more forcefully than the ever-increasing cost of long-term health care. Even the global economic meltdown failed to bring any relief, as the cost of care continued to rise in 2009. According to a study by MetLife, private room nursing home rates rose 3.3% to an average of \$219 per day or \$79,935 per year in 2009; assisted living costs also climbed 3.3% to an average of \$103 per day or \$37,572 a year; hiring a home health aide jumped 5% to an average of \$21 an hour; and adult day care rose 4.7% to an average of \$67 a day (\$24,455 per year). All of those increases surpassed the 2009 inflation rate of 2.7%, consequently, your retirement plan needs to take into account that medical inflation is likely to continue to outpace rises in overall consumer prices.

Seven out of 10 Americans who reach age 65 will need some type of long-term care, according to the U.S. Department of Health and Human Services, and Medicare normally doesn't cover the cost of that care. These strategies could help you prepare for what can be a bankrupting expense.

Start a Health Savings Account.

HSAs are medical savings accounts that offer tax incentives, and they are available in most states to those who enroll in a high deductible health plan. There are annual contribution limits, but you do not have to pay federal income taxes on contributions, and unspent funds roll over and accumulate year after year. If you can avoid withdrawing funds

for medical expenses during the early years, an HSA may build into a significant tax-free health care fund for your retirement years. The money in an HSA can be invested, and if it's withdrawn to pay health care expenses it isn't taxed. For 2010, individuals may contribute up to \$3,050, families may contribute up to \$6,150, and there is a \$1,000 catch-up provision for those over age 55.



Buy Long-Term Care Insurance. LTC insurance covers help with "activities of daily living" and, depending on the policy you buy, will pay for nursing

home care as well as home care and services such as adult day care. Companies that sell LTC policies offer a vast array of options for this complex insurance. The cost depends on your age, the services your policy covers, how long benefits will be paid, whether you opt for inflation protection, and other factors. You must be in good health to buy most policies.

States regulate LTC insurance, and most make it difficult for insurers to raise rates. Yet the cost of your policy may ultimately rise as companies struggle to pay benefits in the face of rising costs and a population that lives longer and longer, and some insurers could fail to make good on their promises. Carefully compare insurers and policies before making a purchase.

Increase Your Savings. Managing your pre-retirement budget, moving to a lower-cost region of the country, and reducing expenditures during retirement

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2010 Five Star Wealth Manager Award

If you've picked up the current issue of 5280 Magazine, you may have noticed that Colleen has been selected as a Five-Star Wealth Manager for the Denver area. We are particularly proud to have been included in this group as less than 4% of the wealth managers in the area were chosen.

Over 120,000 households and financial professionals were surveyed and advisors were rated based on nine criteria: customer service, integrity, knowledge/experience, communication, value for fee charged, meeting of financial objectives, post-sale service, quality of recommendations, overall service, and overall satisfaction. The top advisors were then further scrutinized by a panel of planning professionals before the final selections were made.

While it is great to be publicly recognized, what is most important to us is the service we provide to our clients, whether it is developing financial strategies to meet future goals or managing investment assets for the long term.

We're committed to making sure that our clients not only receive expert financial advice but that they are also an integral part of the planning process. We have found that a client-centered approach to financial planning and investment management leads to the most successful outcomes. Cookie-cutter solutions just aren't that useful.

If you are interested in customized financial planning and investment management, give a call and find out what our clients already know.

Colleen & Rob

Inflation-Protected Bonds Are Still Bonds

One major threat to fixed-income investments—and to the retirees who depend on various kinds of bonds to deliver cash to pay their bills and support their lifestyle—is inflation. When the cost of living rises, a dollar doesn't go as far as it did before, and your savings may not last as long as you'd hoped. A special kind of investment—Treasury Inflation-Protected Securities, or TIPS—addresses that risk directly, by adjusting bond principal to keep pace with changes in the Consumer Price Index (CPI). Yet while TIPS may have a place in many portfolios, they're not a cure-all. TIPS are still bonds, and they're still subject to non-inflation risks that can hurt their value.

TIPS were created in 1997 as a variation on garden-variety U.S. government bonds. Like regular Treasuries, TIPS have a fixed interest rate or coupon that determines how much income they'll provide until they mature. But the principal of TIPS adjusts up or down every month as the CPI rises or falls. If inflation rises, so does the

principal, and the fixed return on that larger amount means additional income for the bondholder. When TIPS mature, the government pays you the adjusted principal (or the original amount, in the unlikely event that the CPI has fallen during the bond's term).



These bonds' prices and yields factor in an expectation that inflation will rise. That's why, recently, the yield on a 10-year Treasury was about two and a half times the yield on a 10-year TIPS. The only reason to accept the much lower current return on the TIPS is if you expect its principal, and thus its effective yield and its total return, to rise significantly during

the time you own the inflation-protected bond. If consumer prices rise less than expected, that 10-year Treasury may turn out to have been a better deal.

But mild inflation isn't the only risk that these bonds bring. Because TIPS are bonds, interest rates are also part of the equation. When real interest rates rise, newly issued bonds will offer higher yields. That reduces demand for existing bonds' below-market yields, and lower demand translates into lower prices. That's why it's often said that bond prices and yields move in opposite directions.

It's not clear when, and how quickly, inflation may accelerate. But almost everyone believes interest rates are on their way up from what have been very low levels. That means the prices of bonds—including TIPS—will suffer. And while TIPS can help diversify a bond portfolio, and could serve as a hedge against inflation, deciding whether to add them to your investment mix is complicated. We can help you consider your options in light of your financial situation and goals. ●

Do You Know Estate Planning Basics?

With the future of the estate tax up in the air, you may be tempted to neglect estate planning. The federal tax on inherited wealth is currently scheduled to be repealed in 2010, only to return in 2011 under less favorable terms. Congress will most assuredly resolve this issue before year-end, perhaps exempting all but the wealthiest families from estate tax liability. Yet whatever the fate of the law, having a thoughtful, effective estate plan will continue to be crucial.

At a minimum, you need a legally enforceable will that lays out how you want your assets to be distributed. An accompanying, non-binding letter of

instruction could further spell out your wishes. You may also want to establish one or more trusts designed to minimize taxes, manage assets for minors, provide asset protection for heirs, implement philanthropic plans, or protect assets from creditors. And a living will (or health care proxy) could provide valuable direction on end-of-life health care.

Are you familiar with estate planning basics? Use this quiz to test your knowledge.

1. Which of the following is true?

- a) A will is legally valid only if drafted by an attorney.
- b) You can transfer jointly owned property through a will.

- c) A will may appoint a guardian for minor children.
- d) Your property must go through probate if you don't have a will.

2. When can a will be changed and remain legally enforceable?

- a) Only if the changes are recorded by an attorney
- b) Only when the heirs named in the will provide their consent
- c) Any time before your death or mental incompetence
- d) Never

3. In 2009, the federal estate tax exemption was:

- a) \$1 million
- b) \$2 million
- c) \$3.5 million
- d) Zero

Studying The Mind And Your Money

In the illustration to the right, which of the two straight-line segments is longer? If you're like most people (and if you didn't cheat by pulling out a ruler), you'll say the one on the bottom appears longer.

In fact, the two lines are exactly the same length. Trouble is, your brain is trained to take a shortcut to solve the problem. The arrows facing each other on the lower line give the illusion of depth, which makes that straight-line segment appear farther away, and that tricks the brain into believing the line is longer.

Economists are finding that people make similar types of mental mistakes with their money. "Behavioral finance," the study of such human foibles in financial dealings, is booming in academia. Researchers in this burgeoning field are revealing that it is common for people to take ill-advised mental shortcuts in making financial decisions. Here are some significant findings of recent behavioral finance studies:

Naive Diversification.

Participants in 401(k) plans tend to diversify their holdings by dividing them up equally among the options in their plans, rather than by seeking

choices that match their risk tolerance and financial goals. "Experiments suggest that the array of funds offered



to plan participants can have a surprisingly strong influence on the assets they end up owning," according to a study by Prof. Shlomo Benartzi of UCLA and Prof. Richard Thaler of the University of Chicago. The professors studied the mutual fund choices made by participants in a TWA 401(k) plan versus those in a University of California 401(k). The TWA plan offered five stock funds and one bond fund, and participants invested 75% of their money in stocks, well above the national average of 57%. In contrast, the University of California plan offered one stock fund and four bond funds and employees invested only 34% in stocks.

Representativeness. "People thinking about what stocks to buy often think it's as simple as finding good companies," says Prof. Hersh Shefrin, of Santa Clara University. "That's a mental shortcut. You rely on stereotypes to make a

judgment about your investments." Just because a company makes good products or has a good image doesn't mean its stock will be a good investment.

Sell Reluctance. Investors tend to hold their losers too long because that helps them avoid having to confront their regret for having bought them in the first place. Prof. Terrance Odean of the University of California at Davis studied tens of thousands of investor accounts at a major discount brokerage. "People are reluctant to realize their losses," says Odean. "Psychologically, it makes sense. I've lived through this myself, where I've bought things and they went way down and I didn't want to sell them."

Trading Too Much. Odean's research also indicates that investors sell their winners too quickly and tend to trade too much. "I found that what investors bought, on average, performed less well than what they sold," says Odean. "Trading did not enhance their wealth." Odean tracked stocks newly purchased by investors versus their previous holdings, and found the new purchases on average underperformed the previously held stock by 3% over a one-year time horizon — and that was without factoring in the cost of the trades. Shefrin says active traders are overconfident. "Most of us think we know more than we actually do when it comes to a difficult task like investing," he says.

Story Stocks. Behavioral finance experts also say that investors tend to buy what's hot because it makes for good conversation at parties. What fun is it to buy a diversified portfolio that grows slowly, when you can buy a hot stock that can jump 300% in value in a few months? Trouble is, with a portfolio overweighted in story stocks, you may not live happily ever after. ●

4. In 2010, the annual gift tax exclusion shelters gifts to individuals of up to:

- a) \$10,000 c) \$1 million
- b) \$13,000 d) Zero

5. For estate tax purposes, the value of assets is based on:

- a) Their fair market value on the date of the owner's death (or six months from that date)
- b) The amount received from the sale of those assets
- c) The assets' original cost
- d) The value stated in the owner's will

6. A "power of attorney" is best described as:

- a) A bequest in a legally validated will
- b) A document authorizing an agent to act on your behalf
- c) A document allowing life support

- systems to be shut down
- d) The use of a lawyer in estate planning matters

7. Which of the following is not true?

- a) The value of your principal residence is excluded from your estate.
- b) The value of property transferred to your spouse is exempt from estate tax at your death.
- c) A testamentary trust takes effect when you die.
- d) A will normally determines who will care for minor children.

If you have questions about estate planning or need to refine your plan, please give us a call. We can work with you and your attorney to make sure all of your needs are met.●

Answers: 1-c; 2-c; 3-c; 4-b; 5-a; 6-b; 7-a

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. ●



Retirees With Higher Costs

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all could help you build a bigger nest egg that may be able to cover the rising cost of long-term care. Or you could work a few years longer than planned, thus adding to your savings and reducing the length of your retirement. Even then, however, a nursing home stay soon after you leave work could be devastating, draining your savings when income from your job has ended.

Live a Healthy Lifestyle. Exercise, eat right, avoid alcohol and tobacco, and keep stress at bay if you want to increase the odds of remaining healthy during your retirement years. Paying attention to your health can pay big dividends during retirement, helping you spend less money on health care in the early

years. The funds you save will earn interest for several years and will grow to help defray the eventual costs of long-term care. And if you're fortunate enough never to need extended nursing care, you'll have more to pass along to your heirs.

The ever-increasing cost of long-term health care is one of the biggest threats to your financial security during your retirement years. Not having LTC insurance or sufficient funds set aside to pay for care can force you and your family into making no-win financial choices, which could include officially impoverishing yourself in

order to qualify for Medicaid, the joint federal-state health program for the poor that pays for most long-term care. Facing all of these issues can be daunting and complex. We can help you consider your options as part of creating a sound, effective retirement plan. ●

