Johnston Investment Counsel

Trusted Fiduciaries & Fee-Only Advisors

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When Is Market Volatility Most Dangerous?

Though a market downturn generally isn't fun for most people, its timing can have a greater impact on some investors than on others. For example, a market downturn can have greater significance for retirees than for those who are still accumulating assets. And it has the most impact if it occurs early in retirement. Why? Because of something known as the "sequence of returns"--basically, the order in which events affect a portfolio.

For retirees, timing is everything

To understand the importance of the sequence of returns, let's look at two hypothetical retirees, both of whom start retirement with a $200,000 portfolio. Each year on January 1, Jim withdraws $10,000 for living expenses; so does Pam. During the first 10 years, each earns an average annualized 6% return (though the actual yearly returns fluctuate), and both experience a 3-year bear market. With the same average annual returns, the same withdrawals, and the same bear market, both should end up with the same balance, right?

They don't, and here's why: though both portfolios earned the same annual returns, the order in which those returns were received was reversed. The 3-year decline hit Jim in the first 3 years; Pam went through the bear market at the end of her 10 years.

	Jim's Return	Jim's Balance	Pam's Return	Pam's Balance
Year 1	-5%	$180,500	15%	$218,500
Year 2	-2%	$167,090	12%	$233,520
Year 3	-1%	$155,519	14%	$254,813
Year 4	3%	$149,885	8%	$264,398
Year 5	7%	$149,677	9%	$277,294
Year 6	9%	$152,247	7%	$286,004
Year 7	8%	$153,627	3%	$284,284
Year 8	14%	$163,735	-1%	$271,541
Year 9	12%	$172,183	-2%	$256,311
Year 10	15%	$186,511	-5%	$233,995

As you can see, Pam's account balance at the end of 10 years is more than $47,000 higher than Jim's. That means that even if both portfolios earned no return at all in the future, Pam would be able to continue to withdraw her $10,000 a year for almost 5 years longer than Jim. This is a hypothetical example for illustrative purposes only, of course, and doesn't represent the results of any actual investment, but it demonstrates the timing challenge new retirees can face.

Weighing income and longevity

If you're in or near retirement, you have to think both short-term and long-term. You need to consider not only your own longevity, but also whether your portfolio will last as long as you do. To do that requires balancing portfolio longevity with the need for immediate income.

The math involved in the sequence of returns dictates that if you're either withdrawing money from your portfolio or about to start, you'll want to pay especially close attention to the level of risk you face. After the 2008 market crash, many individual investors fled equities and invested instead in bonds. Along with actions by the Federal Reserve, that demand helped push interest rates to all-time lows.

However, when interest rates begin to rise, investors will face falling bond prices. And yet if you avoid both stocks and bonds entirely, current super-low interest rates might not provide enough income. Achieving the right combination of safety, income, and growth is one of the key tasks of retirement investing.

Seeking balance

You obviously can't control the timing of a market downturn, but you might have some control over its long-term impact on your portfolio. If your timing is flexible and you're unlucky enough to get hit with a downturn at the wrong time, you might consider postponing retirement until the worst has passed. Any additional earnings obviously will help rebuild your portfolio, while postponing withdrawals might help soften any impact from an unfortunate sequence of returns. And reducing withdrawal amounts, especially in the early retirement years, also could help your portfolio heal more quickly.

See disclaimer on final page

Choosing a Retirement Community

Homes available within retirement communities can be as diverse as the communities themselves, and range from small apartments in the city to luxury homes on the ocean. No matter which type of home you choose, make sure it will meet your needs both now and in the future.

Perhaps you've seen ads for a new "over 55" luxury condominium development in your town. Or another winter of shoveling has finally convinced you that it's time to move to a warmer climate. You're looking forward to life in a retirement community, but with so many options, how do you choose the right one?

Beginning the search

The first step is to think about where you want to live, how you want to spend your retirement years, and what type of home you can realistically afford. All retirement communities are designed with the needs of older adults in mind, but they provide different living arrangements, activities, and services.

One option that's become increasingly popular is the "active adult" community. Usually centered around a fitness facility, a clubhouse, or a golf course, this type of community offers many social and recreational opportunities, such as clubs, meals, and walking trails.

Other retirement complexes are geared toward individuals who want flexible living arrangements and services. These complexes may contain a variety of housing types, including independent-living, assisted-living, and long-term care facilities. They often offer extended assistance with daily tasks such as shopping and housekeeping, and emphasize easy access to health care.

For example, increasingly popular options for those 62 or older, who meet financial and health thresholds, are continuing care retirement communities (CCRCs) and fee-for-service continuing care retirement communities (FFSCCRCs). These adult communities offer, under one contract (and usually all in one location), an independent living unit (typically an apartment or cottage), residential amenities, and access to a continuum of long-term care services as residents' health and social needs change over time. These are just some of the options--many others are available.

The cost of convenience

Homes available within retirement communities can be as diverse as the communities themselves, and range from small apartments in the city to luxury homes on the ocean. No matter which type of home you choose, make sure it will meet your needs both now and in the future. More and more homes in retirement communities are incorporating universal design features, a trend that's likely to continue. These features include one-level living, extra lighting, easy-to-open doors and cabinets, and security systems that make day-to-day living simpler and safer for people of all ages.

But the convenience of retirement living usually comes at a price. That price includes not only rental or mortgage payments, utilities, and insurance, but also any up-front or ongoing fees you'll owe. For example, a retirement community may charge a hefty fee for "buying in" to the community. One ongoing fee you may need to factor in is a homeowners or community association fee that may add hundreds, or even thousands, of dollars to your monthly housing costs. In general, the higher this fee, the more services or amenities are included, but make sure you understand what you're getting for your money. And don't forget about taxes. Even states with no state income tax may have high property taxes, sales and restaurant taxes, or "hidden" taxes on luxury goods or investments. A financial professional or tax advisor can help you determine the impact taxes will have on your finances.

And so that there are no unpleasant surprises, you should also consider the potential for costs to rise. Living in a community where costs for housing and services are constantly on the upswing is at best annoying, and at worst, financially devastating.

Try before you buy

Popular communities often have waiting lists, so it's a good idea to do your homework in advance. Start with a visit. If you're traveling out of town, find out if the community you're visiting offers a special travel package for potential residents--many do. If you're searching locally, visit each prospective community at least two or three times.

A checklist of questions to ask can come in handy when researching retirement communities. Here are a few items to include:

- Is the property well maintained?
- Is the atmosphere casual or formal?
- What social, recreational, and educational activities are available?
- Is public transportation nearby, or is van service available?
- Are pets allowed?
- Are guests restricted?
- Is medical care provided?
- Which services are included, and which are available at additional cost?
- Has the facility been accredited?

Most importantly, talk to residents and staff about their experiences--you'll get a much more realistic picture of life in a retirement community than you can glean from a brochure.

Should You Buy or Lease Your Next Vehicle?

After declining dramatically a few years ago, auto sales are up, leasing offers are back, and incentives and deals abound. So if you're in the market for a new vehicle, should you buy it or lease it? To decide, you'll need to consider how each option fits into your lifestyle and your budget. This chart shows some points to compare.

Buying or leasing tips

- *Shop wisely. Advertised deals may be too good to be true once you read the fine print. To qualify for the deal, you may need to meet certain requirements, or pay more money up front.*
- *To get the best deal, be prepared to negotiate the price of the vehicle and the terms of any loan or lease offer.*
- *Read any contract you're asked to sign, and make sure you understand any terms or conditions.*
- *Calculate both the short-term and long-term costs associated with each option.*

	Buying considerations	**Leasing considerations**
Ownership	When the vehicle is paid for, it's yours. You can keep it as long as you want, and any retained value (equity) is yours to keep.	You don't own the car--the leasing company does. You must return the vehicle at the end of the lease or choose to buy it at a predetermined residual value; you have no equity.
Monthly payments	You will have a monthly payment if you finance it; the payment will vary based on the amount financed, the interest rate, and the loan term.	When comparing similar vehicles with equal costs, the monthly payment for a lease is typically significantly lower than a loan payment. This may enable you to drive a more expensive vehicle.
Mileage	Drive as many miles as you want; a vehicle with higher mileage, though, may be worth less when you trade in or sell your vehicle.	Your lease will spell out how many miles you can drive before excess mileage charges apply (typical mileage limits range from 12,000 to 15,000).
Maintenance	When you sell your vehicle, condition matters, so you may receive less if it hasn't been well maintained. As your vehicle ages, repair bills may be greater, something you generally won't encounter if you lease.	You generally have to service the vehicle according to the manufacturer's recommendations. You'll also need to return your vehicle with normal wear and tear (according to the leasing company's definition), so you may be charged for dents and scratches that seem insignificant.
Up-front costs	These may include the total negotiated cost of the vehicle (or a down payment on that cost), taxes, title, and insurance.	Inception fees may include an acquisition fee, a capitalized cost reduction amount (down payment), security deposit, first month's payment, taxes, and title fees.
Value	You'll need to consider resale value. All vehicles depreciate, but some depreciate faster than others. If you decide to trade in or sell the vehicle, any value left will be money in your pocket, so it may pay off to choose a vehicle that holds its value.	A vehicle that holds its value is generally less expensive to lease because your payment is based on the predicted depreciation. And because you're returning it at the end of the lease, you don't need to worry about owning a depreciating asset.
Insurance	If your vehicle is financed, the lien holder may require you to carry a certain amount of insurance; otherwise, the amount of insurance you'll need will depend on personal factors and state insurance requirements.	You'll be required to carry a certain amount of insurance, sometimes more than if you bought the vehicle. Many leases require GAP insurance that covers the difference between an insurance payout and the vehicle's value if your vehicle is stolen or totaled. GAP insurance may be included in the lease.
The end of the road	You may want to sell or trade in the vehicle, but the timing is up to you. If you want, you can keep the vehicle for many years, or sell it whenever you need the cash.	At the end of the lease, you must return the vehicle or opt to buy it according to the lease terms. Returning the vehicle early may be an option, but it's likely you'll pay a hefty fee to do so. If you still need a vehicle, you'll need to start the leasing (or buying) process all over.

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I recently incurred a significant amount of credit card debt. How should I begin to pay it off?

The best way to pay off credit card debt is with a single lump-sum payment, which would allow you to get back on solid financial ground quickly, without having to pay additional interest. Sources of funds that can be used for a lump-sum payoff include any substantial windfall, such as an inheritance or employment bonus. However, most individuals find themselves getting into credit card debt due to a lack of funds in the first place, so this may not be an option for everyone.

If you have multiple credit cards that carry outstanding balances, the next best strategy is to prioritize your repayment and systematically pay off your credit card debt. Start by making a list of your credit cards, and prioritizing them according to their interest rates. Send the largest payment possible to the card with the highest interest rate. Be sure to continue making payments on your other cards until the card with the highest interest rate is paid off. You can then focus your repayment efforts on the card with the next highest interest rate, and so on, until they're all paid off.

Another option is to transfer your balances to a card that carries a lower interest rate. Balance transfers can allow you to reduce interest fees and pay more against your existing balance. One of the dangers with this method lies in the fact that an excessive amount of balance transfers can end up having a negative impact on your credit score.

If you own a home and have enough equity, you may be able to use a home equity loan to pay off your credit card debt. The interest on home equity loans is typically lower than credit card interest rates and is usually tax deductible. While home equity loans can be an effective way to pay off debt, you'll need to be careful not to incur additional debt, particularly if you end up having an available line of credit.

Finally, whenever you're attempting to tackle a significant amount of credit card debt, always be sure to pay more than the required minimum payments. Otherwise, you'll continue to carry the bulk of your balance forward for many years without actually reducing your overall balance. You can refer to your monthly statement for more detailed information on the impact minimum payments will have on your credit card balance.

I recently came across an error on my credit report. Is there any way I can fix it?

Good credit is an important part of your overall financial well-being. It can impact everything from the interest rates you'll pay to being a prerequisite for employment. As a result, you'll want to try to fix any errors on your credit report and have them removed as soon as possible.

Your first step should be to contact the credit reporting agency in writing to indicate that you are disputing the information contained on your credit report. The credit reporting agency usually has 30 days to complete an investigation of the disputed information. Once the credit reporting agency investigation is complete, they must provide you with written results of their investigation.

If, during its investigation, the credit reporting agency confirms that your credit report does contain errors, the information on your report either must be removed or corrected.

If the investigation does not resolve the issue, you still have a couple of options. First, you can try to mitigate the disputed information by adding a 100-word consumer statement to your credit bureau file. Even though consumer statements are often dismissed or ignored by potential creditors, it can at least provide you with a chance to tell your side of the story. You can also try to resolve the issue with the creditor that submitted the inaccurate information in the first place. The creditor will be obligated to investigate the disputed issue and notify you of its findings.

If you believe that the error is the result of identity theft, you may need to take additional steps to try and resolve the issue, such as placing a fraud alert or security freeze on your credit report. You can visit the Federal Trade Commission (FTC) website at www.ftc.gov for more information on the various identity theft protections that might be available to you.

Finally, due to the amount of paperwork and steps involved, fixing a credit report error can often be a time-consuming and emotionally draining process. If at any time you believe that your credit reporting rights are being violated, you can file a complaint with the Consumer Financial Protection Bureau (CFPB) at www.consumerfinance.gov.

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