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FOCUS ON FINANCIAL FREEDOMSM

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What Happened to Savings in America?

Consider the following:

- America's personal savings rate — defined as savings divided by disposable income — has been falling steadily for more than two decades and is among the lowest in the industrialized world (Source: *Federal Reserve Bank of St. Louis Review*, November/December 2007).

- According to the U.S. Commerce Department's Bureau of Economic Analysis (BEA), Americans spent more than they saved in 2005, for the first time since the Great Depression (Source: Bankrate.com, March 2006).
- In a recent survey, nearly two-thirds of Americans admitted they don't save enough, and more than a third said they often (11%) or

sometimes (25%) spend more than they can afford (Source: Pew Research Center Publications, January 2007).

In the mid-1980s, the savings rate stood at more than 10%. As of March of this year, it was a measly 0.4% (Source: Employee Benefit Research Institute, March 2008). These and a host of other data point to a disturbing reality: America is experiencing a savings crisis that threatens its economic future.

Savings are the source of capital investment in new products and services that increase productivity and contribute directly to economic growth. As domestic sources have dwindled, U.S. business and government alike have had to rely on foreign sources of capital, resulting in a growing outflow of billions of dollars a year in the form of interest and dividend payments. Instead of the world's banker, the U.S. has become the world's largest debtor, with a growing trade deficit and a weakening dollar that threaten a shrinking economy, rising unemployment, and a lower standard of living.

What's Behind it All?

Economists point to a number of factors that are driving America's shrinking savings rate, including:

The wealth effect. Beginning in the early 1990s, American household

What Can You Do?

Turmoil in the financial markets has created a climate of uncertainty and anxiety. Many are paralyzed by declining account values, conflicting advice from experts, and the barrage of negative news. Be an informed financial consumer, but maintain your perspective.

Be deliberate and cautious about media consumption. One hour of focused attention to the daily financial news is more than adequate. Carefully weigh the advice of pundits who assert that "everyone should..."! Your situation is unique and must frame your financial strategy. No single response to the current situation is appropriate for everyone.

Accept that you cannot control market fluctuations, corporate failures, interest and inflation rates, and the effectiveness of government interventions. Focus your attention in areas where you can have a positive impact:

- Choose a financial professional who considers your perspective.
- Schedule a portfolio review. Reassess your risk tolerance and investments.
- Track and plan spending. If necessary, take steps to increase cash reserves.
- Explore tax-planning strategies for 2008 ASAP. It is not too late to plan!
- Review estate documents and beneficiaries on accounts and life insurance.
- Review ownership of property, accounts, bonds, and insurance policies.
- Organize your financial life!

Inertia is counterproductive. Focus now on strengthening your financial foundation! Call if you have any questions.

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Continued on page 2

Savings in America

Continued from page 1

wealth skyrocketed as a result of booms in the stock and real estate markets. It's an economic axiom that when household assets increase rapidly, people perceive less need to save while their appetites for spending increase.

Declining interest rates. After peaking in 1980 to 1981, interest rates began a long decline, fueling the economy by encouraging borrowing and spending while gradually discouraging saving. The prime rate, at 21.5% in 1980, fell to 4.0% in 2003, and 30-year mortgage rates declined from an average high of 16.63% in 1981 to 5.83% in 2003 (Source: *The Wall Street Journal*, 2008). Meanwhile, rates on six-month certificates of deposit slid from a high of 17.98% in 1981 to a scant 1.02% in 2003, and even now are hovering below 3% (Source: Federal Reserve, 2008).

Easier credit and ways to borrow. Creative financing mechanisms, including zero-down, interest-only, and adjustable-rate mortgages, home-equity lines of credit, and the securitization of debt, made it easier for consumers to borrow money to buy anything from homes for investment to cars, vacations, jewelry, and the latest in digital consumer electronics.

These were only the latest developments in a 63-year period of virtually unbroken U.S. prosperity that has reshaped America from a nation of savers to a nation of shoppers. Even policymakers recognize that the consumer is responsible for upward of 70% of all spending in the U.S. economy and is largely responsible for fueling GDP growth since the falloff in capital spending early in this decade.

The concern, however, is that in the midst of these mechanical disincentives to save, two-plus generations of Americans have forgotten how to postpone immediate gratification. Now that we have entered an extended period where assets may

no longer grow at the same rate as consumers have recently become accustomed, the fear is that the saving habit may not return to fuel needed investment in our economic future.

What Can We Do?

Some of what needs to be done to stimulate American personal saving has recently been accomplished, but there's more to do. Some steps that would help turn the decline in personal savings around include:

Continue to encourage automatic 401(k) enrollment. The U.S. Pension Protection Act of 2006 made it easier for companies to enroll workers in 401(k) retirement saving plans without their prior permission. Instead of deciding to opt in to these tax-advantaged payroll savings plans, employees have the choice of opting out. Employers can determine that employees will defer a percentage of pay not to exceed 10%, mandate higher contribution levels over time, and direct the investment of employee contributions. The plans are growing in popularity with employers: a survey found that 23% of 401(k) sponsors are automatically enrolling participants, compared to 14% a year earlier (Source: Deloitte Annual Benchmarking Survey, 2008).

Publicize the split tax refund option. IRS regulations were updated for 2007 to allow taxpayers receiving a refund via electronic deposit to target up to three different accounts, including savings and IRAs. Observers note, however, that many people still aren't aware of the opportunity, which requires filing IRS Form 8888 with their return.

Expand the Savers' Tax Credit. Enacted in 2001, this provision offers taxpayers under specified income limits up to a \$2,000 tax credit for contributions to an IRA, 401(k), or other employer-sponsored retirement plan. Originally slated for extinction after 2005, the federal Savers' Tax Credit was made permanent by the 2006 Pension Protection Act. It also indexed income limits to

inflation, a previous shortcoming that contributed to only five million taxpayers taking advantage of it in 2005. Advocates call for expanding the credit to create refunds for lower-income savers who don't have a tax liability.

Create automatic payroll-based IRAs. The Retirement Made Simpler Coalition, backed by the American Association of Retired Persons and the Financial Industry Regulatory Authority (FINRA), advocates the creation of automatic workplace IRAs for the 57% of American workers who aren't covered by a 401(k) plan (Source: *The New York Times*, April 27, 2008). As with automatic 401(k) plans, employers would enroll participants automatically, but enable them to opt out. Investment management would be contracted to private sector financial institutions, which would maintain no-frills accounts making maximum use of electronic technology. Once account balances reached a predetermined amount, participants could roll over to full-service accounts at providers of their own choice.

Introduce government-matching contributions. Among the most radical proposals to stimulate saving comes from The Brookings Institution, a nonprofit public policy research center, and economists from MIT. They urge the federal government to scrap tax deductions for contributions to traditional IRAs and 401(k) plans in favor of universal 30% government-matching contributions. They argue that the proposal would be tax-revenue neutral, but stimulate greater savings among low- and middle-income households, who benefit less from tax deductions than high-income taxpayers.

Americans' rapidly declining rates of savings aren't just bad for the nation's economy — they're bad for your future, too. If you're not saving as much as you should be, let's create a plan to make saving a habit. Please call. ○○○

Protecting Your Family

Too many people in blended families assume that their estate will be distributed to their spouse and children when they die.

Without an up-to-date estate plan, you could end up bequeathing part of your estate to an ex-spouse, disinheriting your own children, leaving less than you intended to your current spouse, or paying too much in estate taxes. Fortunately, there are a number of estate planning tools that can help avoid these

unintended consequences.

- **Disinherit your ex-spouse** — To avoid accidentally bequeathing part of your estate to your ex-spouse, review how all assets are titled and check beneficiaries on all life insurance policies and retirement accounts. Update estate planning documents, removing your ex-spouse.
- **Protect your own children** — Consider a trust for the benefit of your children. Even if one or more of your children predeceases

your ex-spouse, their inheritance can go to their children or be split up among the trust's other beneficiaries.

- **Provide for your current spouse** — If you leave your estate to your current spouse without explicitly providing for your own children, your estate could end up in the hands of your spouse's children when he/she dies, leaving your children out of the picture. A qualified terminable interest property (QTIP) trust can help prevent that from happening. A QTIP trust can pay income and part of the principal to your current spouse for the remainder of his/her life, and then transfer the remaining assets to your children when your spouse dies.
- **Minimize estate taxes** — If an insurance policy is set up properly, the proceeds are distributed free of both income and estate taxes. Another benefit is that the life insurance policy can be used to pay proceeds to specific beneficiaries you designate.
- **Protect your individual assets** — If you're heading into marriage, a prenuptial agreement can detail what will happen to your individual assets in the event of divorce or death. Think carefully about holding property jointly. No matter what your estate planning documents state, property held in joint tenancy with rights of survivorship passes to the other owner.

Making estate-planning decisions in a blended family environment can be complex, but it is a subject that should not be ignored. Please call if you'd like to discuss this topic in more detail. ○○○



Who Should Own Your Life Insurance Policy?

Before purchasing a life insurance policy, give careful thought to who should own the policy. While life insurance proceeds aren't subject to income taxes, they can be subject to estate taxes if the policy isn't structured properly. Four common ways to own a life insurance policy include:

- **By the insured** — If you own the policy, the insurance proceeds will be considered part of your taxable estate and may be subject to estate taxes, provided your estate exceeds certain limits.
- **By the insured's spouse** — The insurance proceeds won't be included in your taxable estate if your spouse both owns the policy and is the beneficiary. However, if someone else is named beneficiary, such as a child, the proceeds will be considered a gift and may be subject to gift taxes.
- **By a person other than the insured's spouse** — Under these circumstances, the insurance proceeds won't be included in your taxable estate. However, if you pay the insurance premiums, premiums in excess of \$12,000 in 2008 may be considered taxable gifts. In situations with two or more beneficiaries, you may want to gift the money for the premiums to the beneficiaries to qualify for the annual gift-tax exclusion. Minor children can't own insurance policies in most states, so you may have to set up a custodial account if the owners are minors.
- **By a trust** — When a trust owns the policy, the proceeds aren't considered part of your taxable estate if the trust is irrevocable, meaning that you can't change the terms or terminate the trust. The same tax rules apply to trusts as those applicable to a person other than your spouse, but you can often structure more flexibility into a trust arrangement. ○○○

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7 Steps for a Financially Healthy Marriage

Financial stress can come from many sources, but one of the most difficult is when one spouse is a spender and the other a saver. We come into marriage with attitudes toward money deeply engrained in our psyche, and they're not easily changed. But don't despair — if you find yourself engaged in a struggle with a spouse who is your opposite when it comes to saving and spending, there are steps you can take to achieve balance and harmony.

1. Agree to be a team. You married to spend your lives together, so it shouldn't be difficult to start with this understanding, even if it may seem hard to reconcile with your money behavior. To be a team, you have to act like a team, and that starts by giving up individual possessiveness about money — there's no "your money" and "my money." It needs to be "our money."

2. Agree on your goals. Start your teamwork by articulating your long-term goals; they're the most important and the easiest to agree upon. Long-term goals might include living the lifestyle you want



in retirement and educating your children. Be sure to be specific. Articulating specific long-term goals involves knowing how much those dreams are going to cost and precisely when they will occur. You need dates and dollar figures.

Once you've reached an agreement on your long-term goals, try to set out the same kind of specific plans for your intermediate- and short-term goals.

3. Practice full disclosure. Being a team means each of you is empowered to act on behalf of the other with implicit approval. That requires that each of you has full command of the facts — how much money you make, how much you owe, and how much you spend. Share the balances in any individual accounts you may hold, like checking and credit cards. You need to be completely honest with each other, even if you make a mistake now and then.

4. Budget and pay bills together. Create a monthly budget that compares the total of your bills and expected out-of-pocket expenses with every penny of incoming and available cash. Include an itemized list of your debts and scheduled payment amounts, as well as your asset accounts and their balances.

Thoroughness is a key determinant of your success, so don't overlook anything, especially significant

one-time expenses like gifts or big nights out. Create a catch-all category of out-of-pocket expenses called "miscellaneous" for the little things you might forget — or those that are small and hard to pin down.

5. Update your checkbook(s). One way spenders rationalize their behavior is by keeping themselves in the dark about how much they really have to spend. If you're going to be faithful to the budgeting process in Step 4, you have to keep careful track of your cash on hand, and that means being sure your checkbook entries are up to date.

6. Agree on spending rules. You and your spouse need to agree on how much you can spend on purchases without consulting the other. Beyond this preset amount, you should talk about the purchase in advance and adjust your budget spreadsheet accordingly.

7. Create an investment plan. Everybody should have a professionally prepared plan, but for couples with polarized spending and saving habits, it's especially important. Apart from the fact that a professional can provide the expertise and tools you may lack, he/she will serve as an impartial third party to help defuse your money debates.

For help creating that investment plan, please call. ○○○

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Working one additional year boosts annual retirement income by an average of 9% (Source: The Urban Institute, 2008).

In a recent survey, 28% of employed adults 45 or older said they planned never to retire (Source: Society of Actuaries, 2008).

According to a new study, approximately one-third of workers age 55 to 64 (32%) said they postponed plans to retire due to stock market losses. Some 30% of those age 65 or older said they have been

Did You Know?

forced to put off retirement (Source: AARP, 2008).

Over the past year, an estimated 75% of U.S. homes have declined in value, 19% increased in value, and 6% were unchanged (Source: Zillow Inc., 2008).

In 2004, 32% of individuals between the ages of 65 and 74 had a mortgage on their primary residence, up from 19% in 1992 (Source: Federal Reserve, 2008).

Approximately 79% of Americans said their savings effort was inadequate, citing large regular expenses (72%), unexpected expenses (72%), low or unreliable income (66%), and large consumer debts (60%) as reasons for not saving enough (Source: Consumer Federation of America, 2007).

Only 39% of active workers have more than \$50,000 saved for retirement. Among retirees, 51% have less than \$10,000 saved (Source: 2008 Retirement Confidence Survey). ○○○