

Psychological Issues Of Sudden Wealth

Sure, it's better to be rich. But sudden wealth can strain relations with siblings, add stress to a marriage, and lead to undisciplined, sometimes ruinous spending.

In a now famous 1967 study, Dr. Thomas Holmes and Dr. Richard Rahe created a system for measuring stress levels caused by different life events. The study, which originally rated 43 events and was updated to include a total of 87, found the death of a child to be the most stressful thing that can happen, whereas an increase or decrease in net worth ranked a barely respectable 27th. But the researchers found a change in wealth to be more stressful than having a child run away from home, getting demoted at work, moving to a different town, getting married, having sexual difficulties, or retiring.

Eileen Gallo, Ph.D., a psychotherapist in Los Angeles who specializes in counseling wealthy individuals, conducted a two-year study of the psychological impact of sudden wealth on 25 families from 1995 to 1997, and has since enlarged

the study to cover an additional 25 sudden-wealth experiences. According to Gallo, although some 14% of her subjects described their experiences as primarily negative and 9% ranked them as neutral, 76% looked upon their windfalls as positive or primarily positive events.

However, Gallo's subjects all were referred to her by lawyers, financial advisors, or other professionals. "My sense is that an advisor makes it easier for people to adjust," says Gallo. She notes that some research into the impact of sudden wealth has found it to be a far more negative experience. A 1978 study by Philip Brickman, Dan Coates, and Ronnie Janoff-Bulman, for example, discovered that lottery winners were not significantly happier than other people were. On the contrary, those who had struck it rich turned out to be less able to enjoy everyday pleasures than were victims of crippling accidents. For the lottery winners, who'd had the peak experience of seeing their numbers come up, every other pleasure seemed anticlimactic.

Gallo says she was surprised by the number of people who reported

"extremely adverse experiences" with siblings. In fact, almost half of those she interviewed said they had sibling problems. "For those who already have stress in a relationship with a brother or sister, sudden wealth seems to add distance or make the relationship go downhill," Gallo says. Issues may arise over vacations, with those who fail to take a sibling along or who leave behind a sister- or brother-in-law often sparking disappointment or resentment.

Families in general reported a variety of problems, Gallo says. Married couples sometimes fought because one spouse wanted to move to a new neighborhood and start living it up while the other preferred to carry on as before. Gallo says couples with young children often asked such questions as, "How much money will it take to ruin a child?"

The people who cope best with sudden wealth, Gallo says, are those who had a healthy attitude about saving and spending before they got rich. They're not only happier, she says, but also less likely to go on spending binges that lay waste to their newly acquired fortunes. ●

December 1955 still had \$1,113,000 at the end of 1955. Someone who retired at the end of 1927 with that same portfolio and withdrawal rate would have run out of money before 30 years was out.

Plan To Die. Hubbard says many retirees who assume they will live into their 90s are being unrealistic. He notes that a typical 65-year-old male in average health is expected to live only into his early 80s. When making your calculations, factor in your own health and whether others in your family have lived to a ripe old age.

Everyone's Different. No two situations are alike. Only by creating a retirement blueprint that fits your particular needs and goals will you gain the peace of mind that comes with planning. ●

High-Grade Corporate Bond index. The results are the average of 25 overlapping 30-year payout periods. January 1946 through December 1975 was the first 30-year period, January 1947 through December 1976 was the second, and so on, with the final period ending in December 1999. The portfolio sustained the fixed 7% payout in all 25 of the 30-year spans. Adjusting for inflation, however, reduces the sustainable withdrawal rate to 4% to 5%.

History. Past performance doesn't guarantee future results, but it's the best we've got, says Hubbard.

You Need Luck. It's better to be lucky than smart. Someone with a \$1 million portfolio of 75% stocks and 25% bonds who withdrew \$70,000 a year from January 1926 through

Nest Egg Draw Down

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you and your spouse may slow down a bit. Expect expenses to rise in the final few years, when medical costs are likely to take off.

Why 6% to 8%? According to research Hubbard and his colleagues published recently in the Journal of Retirement Planning, a \$1 million portfolio with a 75% stock position and 25% bond allocation was worth an average of \$3.3 million at the end of 30 years after fixed withdrawals of 7% (\$70,000 a year) in monthly increments. This was based on historical returns from January 1946 through December 1999 on the Standard & Poor's 500 stock index and Salomon Bros./Ibbotson Long-Term



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Drawing Down On Your Nest Egg In Retirement

What is a prudent withdrawal rate from your retirement fund? There are a lot of opinions on this topic. However, Carl M. Hubbard, professor of finance at Trinity University in San Antonio, has been thinking about this issue a lot. Since 1997, Hubbard, along with two colleagues, professors Philip L. Cooley and Daniel T. Walz, has authored three studies on sustainable retirement portfolio withdrawal rates, and their research has been published in scholarly and professional journals.

Hubbard and his colleagues conclude that retirees can generally plan on fixed annual withdrawals of between 6% and 8% of a portfolio, assuming 50% to 75% of assets are kept in large-company stocks and the balance in high-grade corporate bonds. That's a 4% to 5% withdrawal rate if you are adjusting annually for inflation.

With impeccable academic credentials and a record of developing empirical evidence to support practical advice on retirement, Hubbard has many other insights about retirement planning. He shared several in a recent interview.

On Stocks. Hubbard says a 50% to 75% large-cap stock position is generally optimal. Putting more in stocks can actually hurt some retirement portfolios because of the volatility of equities. If you must sell stocks when they are down sharply, you'll consume principal, and even a brisk market recovery won't be as helpful to your nest egg.

On Fixed Income. Hubbard says conservative retirees should consider

placing up to a year's expenses in a money market fund, which can be tapped when stocks are down. Placing the balance of a retirement fund's fixed-income allocation in bonds also cushions stock volatility. When your stocks drop in value, you can rebalance by selling bonds. For a retiree in the withdrawal phase of a portfolio, rebalancing back to your targeted allocation during a down market means selling assets that have lost the least or gained the most.

Market Psychology. "When the stock market was very good, as it was through early 2000, many suggested that we needed to revise upward our historical studies because the 'new economy' was not reflected in the market's history," says Hubbard. "Now, after a couple of bear market years, we're hearing people say that using long-term historical returns to project the future is overly optimistic. I think that people often depend too much on the current environment to project future market returns."

Defer To The Bear. If you're about to retire and stocks are in a bear market, consider delaying retirement. Withdrawing principal during a bear market can sharply erode your nest egg at an early stage of retirement, and that could adversely affect your long-term sustainable withdrawal rate.

Retirement Stages. In the years right after you retire, plan on spending about as much as you did immediately before you retired. The first five to seven years of retirement tend to be the most active. The subsequent five years or so should be less expensive because

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Investors Seem Never To Learn Lessons Of The Past

Stay with asset allocation and don't get carried away with what's been "hot" in the investment arena. There are quite a number of examples that illustrate how "rear view mirror" investing can lead to poor performance.

In the mid-1970's, bonds and cash equivalents looked attractive based on their prior five-year performance, while stocks were not very appealing. But over the next five years, stocks were the place to be.

In the mid-1980's, real estate ranked as one of the most dazzling investments, while foreign stocks did poorly. During the last half of the 80's, foreign stocks rallied while real estate fell. And in the late 80's, Japan was considered to be the hero in the world market with its stocks averaging over 40% per year through 1989. However, in the 90's, these gains disappeared with a net loss in Japanese stocks for the decade.

The lesson is simple but difficult to stick with: The best way to achieve long-term success is not in stock picking and not in market timing. Without doubt, these approaches have their current heroes and incredible stories. But, the great pathway to long-term success comes from sound, sustained investment policy: setting the right asset mix and staying with it. It's what we want to accomplish with each of our clients.

Past performance does not guarantee future results.

What's Your Estate Planning IQ?

Estate planning is about as much fun as planning your own funeral, but it can save your loved ones enormous difficulty, not to mention serious money. So here's a quiz to determine whether you know enough about this important topic. More than three wrong answers indicates you should avoid dying.

1. Estate planning is when you:

- a. Plan donations of your home or other assets to charity
- b. Make gifts to family members
- c. Plan the distribution of your assets to reduce estate taxes
- d. All of the above

2. Which is a way to give away your home and reduce estate taxes:

- a. A Limited Liability Residence Agreement
- b. Qualified Second Mortgage
- c. Personal Residence Trust
- d. None of the above

3. A taxable estate consists of:

- a. All property you own at death except IRAs and other retirement plan assets
- b. All property you own at death
- c. All property you own at death excluding your principal residence
- d. All property you own at death that is not discussed in your will

4. Which statement(s) about Family Limited Partnerships is (are) true? FLPs:

- 1. Caused huge investment losses in the 1980s
- 2. Are a valuable estate planning tool
- 3. Can allow you to discount the value of an asset
- 4. Make assets illiquid and are therefore not recommended
 - a. 1
 - b. 1 & 4
 - c. 3
 - d. 2 and 3

5. A Revocable Living Trust:

- a. Is key to reducing estate taxes
- b. Does not reduce estate taxes any more than a will does
- c. Can expose your assets to probate at death
- d. Can protect a spouse's estate from taxation

6. Your Roth IRA:

- a. Has no estate planning value
- b. Can give heirs tax-free income
- c. Is terminated and fully taxed at your death
- d. Is exempt from all income and estate tax

7. The estate tax laws say:

- a. Everyone gets an exemption from estate taxes of \$1.5 million
- b. At death, one spouse can generally pass an unlimited amount to another

spouse

- c. An estate of more than \$2.5 million will be taxed at the 48% rate
- d. All of the above

8. Which is the best way to gift assets to your children to reduce estate taxes:

- a. A Qualified Deferred Annuity
- b. A Rabbi Trust
- c. Cash denominated in small bills
- d. None of the above

9. Which of the following is not an estate planning technique:

- a. Charitable Remainder Trust
- b. Irrevocable Life Insurance Trust
- c. Bypass Credit Shelter Trust
- d. None of the above

10. If you give \$1 million to your children when you're age 60 and it grows over the next 20 years to \$4 million until you die at age 80, you not only got the \$1 million out of your estate, but all of the appreciation on it, too.

- a. True
- b. False

Answers: 1. d, 2. c, 3. b, 4. d, 5. b, 6. b, 7. d, 8. d, 9. d, 10. a

Is A Reverse Mortgage Right For You?

With interest rates at three-decade lows, mortgage lenders are doing a brisk business in new mortgages, refinancings, and home equity loans and credit lines. But for many older homeowners, those bargains don't hold much appeal. They own their homes free and clear, and though they may need some cash to help with maintenance costs and living expenses, a normal home equity loan would bring its own monthly payments. That's the last thing they need, at a time when retirement income has been hurt by slumping equity markets and those same rock-bottom interest rates.

A reverse mortgage, on the other hand, could solve several problems. Available to homeowners who are at least 62 and have paid off most or all of their existing home loans, this comparatively obscure borrowing scheme switches the normal direction of mortgage payments. The lender pays the homeowner—in monthly installments, a lump sum, or via a credit line—rather than the other way around. Because this money is the proceeds from a loan, it isn't taxed. And although some reverse mortgages carry a fixed term, after which the principal must be repaid, most guarantee that you can remain in the

house and avoid repayment until you sell the home or die. And you or your heirs will never owe more than the house is worth.

The downside? Interest rates and fees tend to be higher than they are for traditional home loans. And with interest compounding as the years go by, there may be little home equity left to pass along to your heirs. Then there's the complexity—these loans have so many variables that lenders typically require would-be borrowers to speak with a reverse mortgage counselor, who will lay out the different permutations and the costs associated with each. Still, under the right circumstances, these loans can be useful financial tools. Here are some factors to consider.

Which kind of loan? Although reverse mortgages are available from many lenders nationwide, there are currently only three types: the Home Equity Conversion Mortgage (HECM), insured by the Federal Housing Administration; the HomeKeeper, from Fannie Mae; and the Financial Freedom Cash Account, from Financial Freedom Senior Funding Corp., a subsidiary of Lehman Brothers Bank. All provide funds according to formulas based on the homeowner's age and the value of his or her home; the older you are,

the larger the percentage of your home's value you can tap. But the programs differ widely in terms of the maximum payout you can receive—currently about \$260,000 for the HECM (significantly less where living costs are low), \$300,000 for the HomeKeeper, and no preset ceiling for the Financial Freedom product.

What you'll pay. None of these programs requires much in the way of out-of-pocket closing costs—generally, you can finance everything and add it to what you or your heirs will owe when the loan comes due. The interest rate, too, has less immediate impact than with a conventional mortgage. But high fees and interest can cut deeply into the mortgage proceeds. The HECM and Fannie Mae's HomeKeeper, normally cheaper than the Financial Freedom product, come with similar costs: an origination fee of 2% of the value of your house, and another 2%, along with a half-percentage-point hike in your interest rate, to cover mortgage insurance. The lender is also allowed to charge a \$30 to \$35 monthly servicing fee.

Interest rates for the HECM and HomeKeeper are adjustable and linked to the yield on a one-year Treasury; recently, rates were about 3.9% for a rate that adjusts yearly, and 3.3% for one that is recalculated every month. The Financial Freedom Cash Account, which may appeal to those who want to pull more equity out of a high-priced home, carries higher rates.

What about the alternatives?

If you own an expensive home, you can take a much larger loan at a better interest rate if you opt for a traditional home equity loan or line of credit. You'll just need to be able to make the payments. Another option is to sell your house, invest the equity, and buy or rent a smaller, cheaper place. Reverse mortgages are best suited to cash-strapped older homeowners whose priority is to stay put and remain financially independent. ●

Spies, The Super Rich And Movie Stars Use Offshore Trusts

Offshore trusts aren't only for spies, the super-rich, and movie stars. They're also for ordinary folks—doctors, lawyers, business owners, and real estate investors, among others—who are at risk of being sued and want to protect their assets.

In our litigious society, shielding assets from legal judgment is no more radical than insuring against fire, burglary, or auto accidents. It costs about \$30,000 to set up an offshore trust and \$3,000 a year to maintain.

Your need for an offshore trust has less to do with how much money you have than with your potential

exposure to a liability lawsuit. A doctor with a family practice may feel less threatened than a plastic surgeon, for example, and a real estate investor who owns several apartment buildings may feel more of a need for asset protection than someone who owns farmland, even if the holdings are of equal value.

An offshore trust may come in handy during divorce proceedings, too, and it could benefit a director on the board of a publicly held company or a business owner who sells his company. In any of these situations, a properly structured trust could save you

from financial ruin.

All states except Alaska, Delaware, Missouri, Nevada, Rhode Island, Utah and Colorado have laws saying a trust created for your own benefit is not shielded from a creditor's claims. You could establish a trust in one of those states and house your assets there. But if you're sued outside of those states and hit with a judgment, the courts where you were sued may not respect the trust laws governing your trust.

According to Gideon Rothschild, chairman of the American Bar Association's Asset Protection Committee, approximately 17 foreign

But Asset Protection Is For Others, Too

jurisdictions now promote offshore trusts, some of which can be used for asset protection purposes. The Cook Islands in the South Pacific is most well known, but others include Belize, Gibraltar, and Nevis.

Some of these havens do not recognize foreign judgments. So if a U.S. court finds you financially liable, these countries will not enforce the judgment. Some have short statutes of limitations. By the time a creditor locates your assets, it may be too late to sue you in one of these jurisdictions.

If you're uncomfortable about moving your assets to a faraway

place, you could have the trust assets located offshore but managed by a U.S.-based manager. Or, the trust could invest in U.S. securities, with a foreign bank as custodian. You could even use a U.S. custodian to hold title of the trust assets until you need to move them offshore. However, maintaining the assets in the U.S. may compromise the protection against an extremely persistent creditor.

And watch for offshore trust scams, especially those great tax schemes. Genuine offshore trusts are generally tax-neutral. Spies, the super-rich, or movie stars know that. ●