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Getting an Economic Grip

By Scott Burns and Laurence J. Kotlikoff

The patient suffered a cardiac arrest. A dangerous amount of time has passed. Although the heart may be restarted, most cardiac arrest patients suffer severe brain damage after such delay.

But we are perversely fortunate.

This patient is not human. It's our banking system. It will be restored to full functionality simply by restarting its heart and getting money to flow again. Brain function is irrelevant because the patient is brain-dead and always has been.

Knowing this, we need to change the questions we ask. Instead of asking what our government, political party, or banker can do for us, we need to ask: *What should we be doing for ourselves?*

Here's our list.

- **For most people, holding on is better than cashing out.** The stock market has always been a wild ride. It rewards those with strong stomachs and great patience. The crash of 1929, for instance, scared an entire generation. Yet by 1936 -- the middle of the Great Depression-- anyone who had invested $1 in large-cap stocks in early 1929 was holding $1.31, after adjusting for inflation. One year later the initial investment was worth only 83 cents in real terms. But by the time World War II ended, the initial $1 was worth $1.69. Sixty years later -- in 2005 -- that dollar was worth more than $100 in real purchasing power.

  That's a great ride, with huge bumps. And it continues. Between 1972 and 1974, an investment in equities lost nearly half its real value. Between 2000 and 2003, U.S. equities took another huge tumble -- almost 40 percent.

- **For young workers, this is an opportunity, not a disaster.** Younger workers with relatively secure employment should know this is no time to sell. Low stock prices mean this is a good time to contribute *more* to one's retirement plans. It will help to invest those contributions in low-cost stock index funds.

  There's only one caveat. Given the fiscal burden facing our government, contributing to a Roth rather than a regular 401(k) account may save you from higher future taxes.

- **If you are retired or near retirement, consider alternatives.** If you need to spend some of your wealth to cover living expenses, consider committing less to the stock market. If you are retired, or close to it, make sure your portfolio has a significant “buffer” of highly liquid fixed-income investments. We think inflation-protected Treasury bonds (TIPS) make good sense. Remember, even if only 25 percent of your investments are in fixed-income, you can avoid selling depressed equities at a low price for *5 to 6 years* simply by liquidating your fixed-income investments to cover living expenses.

- **Get the best deal from Social Security.** If you are retired or soon-to-be retired, you can get the best possible deal from Social Security by considering repaying the Social Security benefits received in the past and reapplying for higher benefits. You can also delay taking Social Security benefits, integrating that decision with the timing of retirement account withdrawals and deciding which account to tap first. Most important of all is determining how much one can safely spend. Our new book, “Spend 'til the End” (Simon & Schuster, $26), covers this in detail and focuses on making sure households have enough funds to maintain their living standard all the way to the end -- to their maximum ages of life.

- **If you are retired and invest aggressively, spend defensively.** If you are spending from your investments, the only way to protect your nest egg from wild market ups and downs is to be equally conservative with your spending. That means reducing your spending during a market decline. Basically, you are accepting a lower standard of living today in hope of a higher standard in the future.

- **Whatever your age, eliminate consumer debt.** Credit card companies have been raising interest rates and reducing credit limits. Banks have been raising interest rates on loans. Since these rates are significantly higher than what you can earn on your investments, anyone with consumer debt should work hard to eliminate it.

- **Think about keeping, or paying off, your mortgage.** It makes good sense to use non-retirement account assets to pay down your mortgage. Doing so is a completely safe investment. It may come as a surprise, but doing so may save taxes for retirees due to reduced taxation of Social Security benefits.

  The big caveat here is inflation. Inflation has been running about 6 percent over the past 12 months. If that continues, you probably don't want to pay down your long-term mortgage because you’ll be making payments in dollars of lower and lower purchasing power. So be ready, but wait.

On the web:
www.esplanner.com

Want a Good Raise? Retire. (August 1, 2008)
http://assetbuilder.com/blogs/scott_burns/archive/2008/08/01/want-a-good-raise-retire.aspx

Raise Your Living Standard--- Reapply for Social Security Benefits (February 15, 2008):
http://assetbuilder.com/blogs/scott_burns/archive/2008/02/15/raise-your-living-standard-reapply-for-social-security.aspx

The Nitwit Sector (August 10, 2007)
http://assetbuilder.com/blogs/scott_burns/archive/2007/08/10/the-nitwit-sector.aspx

A Real Life Case for Delaying Social Security Benefits (September 30, 2006):
http://assetbuilder.com/blogs/scott_burns/archive/2006/09/30/A-Real-Life-Case-for-Delaying-Social-Security-Benefits.aspx

Fine Tuning the Social Security Benefits Decision (January 29, 2006):
http://assetbuilder.com/blogs/scott_burns/archive/2006/01/29/Fine_2D00_Tuning-the-Social-Security-Benefits-Decision.aspx

The Payoff for Deferring Social Security Benefits (December 13, 2005)
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Real Life Maximizing of Social Security Benefits (November 22, 2005):
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Escaping the Social Security Gantlet (September 2, 2004)
http://assetbuilder.com/blogs/scott_burns/archive/2004/09/02/Escaping-the-Social-Security-Tax-Gantlet.aspx

How the Tax Torpedo Hits (February 11, 2003)
http://assetbuilder.com/blogs/scott_burns/archive/2003/02/11/How-The-Tax-Torpedo-Hits.aspx

Spend ‘til the End on Amazon:
http://www.amazon.com/Spend-Til-End-Revolutionary-Standard-Today/dp/1416548904/ref=pd_bbs_sr_1?ie=UTF8&s=books&qid=1223833412&sr=8-1

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