STRATEGIC Wealth Advisors

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A Quick Guide to Home Equity Loans

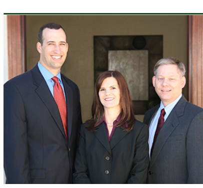
If you as a consumer need an additional line of credit, a home equity loan, also known as a second mortgage where your home serves as collateral, is one of several options that you can choose from. There are two major advantages of home equity loans. First, the interest rate on home equity loans is usually lower than credit cards and other consumer loans. Second, you can usually deduct the interest on home equity loans, unlike other loans. There are two types of home equity loans—fixed-rate loans and lines of credit.

A fixed-rate loan provides a single, lump-sum payment to the borrower, and is repaid over a fixed period of time at a pre-determined interest rate. This is useful if you know how much you would need and when you would be able to pay off the loan.

A home equity line of credit (HELOC) is a variable rate loan that works like a credit card. Borrowers are pre-approved for a specific spending limit and can withdraw money when needed via a credit card or special checks. Similar to a fixed-rate loan, the outstanding loan amount must be repaid in full at the end of the term. However, unlike a fixed-rate loan, HELOC interest rates float up or down, generally adjusted based on the current prime rate. A HELOC is a convenient way to cover short-term, recurring costs, such as quarterly tuition for a four-year college degree.

Although home equity loans do provide attractive rates of financing, we caution consumers to think twice about the reasons why one would need an additional line of credit. If you are thinking about using a home equity loan for day-to-day expenses, one should examine whether you are overspending and possibly sinking deeper into debt. If you end up taking out more money than your house is worth, the interest paid on the loan above the value of the home is not tax deductible.

What's Happening at SWA



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For the second year in a row, SWA is sponsoring, and our very own Jim Schwartz is organizing, a three-day conference for the widowed community, titled 'Tools for the "New Normal" Journey'.

The conference features over 30 speakers who will cover topics on grief coping strategies, dating, car and home care, Social Security, health insurance, cooking for one, grief and spirituality, tax and legal issues, and many others. Small support groups integrated into the conference are new this year as is a viewing of the documentary Walking Through Grief.

Please let your clients, colleagues, friends, and family know of this important event. Consider sending a financially distressed widow or widower to the conference by purchasing a scholarship for them. Early registration discounts are available through September 12th. Additional details and registration are available at WidowedCommunity.org or WCESS.org.

Keeping It Real

Inflation has averaged 3.1% over the last 30 years. This might not seem like much, but this reported figure only tracks total goods and services purchased by the typical consumer. This is a good measure for the economy at large, but it may not be representative for individuals whose lifestyles and buying habits differ from the typical consumer.

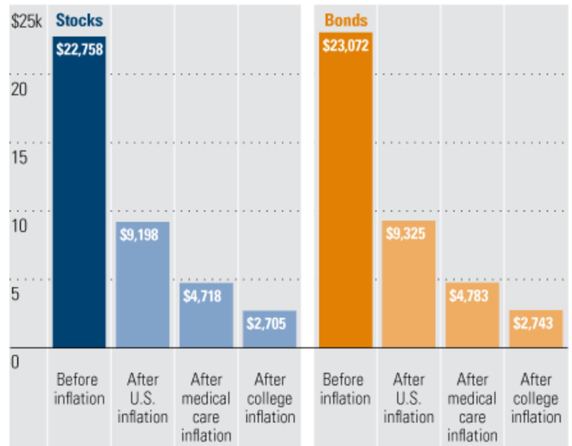
Goal-based investors may experience higher inflation. People who need to focus on savings for college or medical care may be left short, as the cost for such items often tends to rise at a faster rate than the average cost of living. Those investors might not be able to keep pace with rising costs if they do not take their real inflation rate into account when planning their investment goals.

The image illustrates the effect of three types of inflation on an investment of $1,000 in stocks and bonds: overall U.S. inflation, medical-care inflation, and college inflation. After 30 years, inflation has considerably reduced the wealth of the original investment. For example, the $1,000 invested in stocks and bonds only grew to $9,198 and $9,325, respectively, after adjusting for U.S. inflation. Alas, even more bad news for a family with children or a baby boomer nearing retirement.

Further, of the two asset classes considered, bonds provided more growth after inflation, which is unusual. Investors wishing to keep pace with inflation would typically consider a larger allocation to stocks or explore other investments that protect against inflation. However, due to the two major crises and associated stock market declines experienced during the "lost decade," stocks performed more weakly than bonds.

Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Government bonds are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest, while stocks are not guaranteed and have been more volatile than bonds. Holding a portfolio of securities for the long term does not ensure a profitable outcome and investing in securities always involves risk of loss. The rates used in the analysis and their corresponding compound annual growth rates are the consumer price index for: all urban consumers (CPI-U) (3.1%), medical care (5.4%), and college tuition and fees (7.4%).

Investment of $1,000 in Stocks and Bonds Before and After Inflation Rates, 1982–2011



Source: Stocks—Standard & Poor's 500®, which is an unmanaged group of securities and is considered to be representative of the U.S. stock market in general; Bonds—20-year U.S. government bond; Historical inflation—Consumer Price Index; Growth rates of CPI categories—non-seasonally adjusted U.S. city averages from the Bureau of Labor Statistics.

Retirees: Non-Traditional Investment Risks

Volatile markets pose several challenges for retirees who rely on receiving a livable income stream from their investments. Interest rates are low and likely to stay low for the foreseeable future, making cash and high-quality bonds a safe parking place for now. Amid such a challenging environment, it's hard to blame retired investors for looking beyond traditional investments like stocks, bonds, and cash, or the mutual funds and exchange-traded funds that invest in these securities.

Many investors have flocked to gold and other precious metals, while others have gravitated toward investment types like life settlements, distressed real estate investments, and private mortgage investments. Such non-traditional investments might hold the promise of higher returns compared with traditional asset classes, but there is often a trade-off of higher risks and/or costs. Moreover, investors in non-traditional investments might not benefit from the same liquidity, transparency, and regulatory oversight that investors in traditional assets have. The following three asset types have picked up traction, but it is important to understand the risks before entrusting your hard-earned cash to them.

Life Settlements: A life settlement originates when a life insurance policyholder, often an elderly or terminally ill person, sells his or her interest in the policy to a third party, usually at a level that is well below the policy's stated death benefit. The third party then resells, often by issuing securities, that interest to investors who in turn must keep the policy in effect by paying its premiums. When the originally insured person dies, the owner of the security collects the death benefit. The rate of return on a life-settlement investment will hinge on when the originally insured person dies. If death occurs within his or her estimated life expectancy, the return will be relatively high. But if the original policy owner lives well beyond the expected time frame, a life settlement can be a poor investment. Not only will it take a while to pay off, but the investor will have to fork over premiums on a regular basis.

Distressed Real Estate: Distressed properties typically sell at prices lower than what the owners paid and may be under foreclosure; their prices may also be low in absolute terms. As with investing in any other security type, seeking low valuations is a key way to bring down your risk, but distressed real estate investing is far from a low-risk endeavor. Distressed properties may require substantial additional investment before they can be rented or resold, and there is no guarantee that a seemingly low-priced property won't fall further still. Finally, real estate can be illiquid, and for smaller investors can be cost-prohibitive to build a diversified portfolio of properties.

Private Mortgages: The troubled housing market has given rise to another real estate-related investment, the private mortgage. In contrast to a loan extended by a bank or financial institution, a private mortgage is funded by individuals, groups of individuals, or a corporation that specializes in making such loans. A private mortgage holder may be able to earn a substantially higher interest rate than he or she can earn on cash or high-quality bond investment. At the same time, the risks of a private mortgage loan are also a lot higher than cash or bonds, even though the loan is secured by the property. Individuals usually turn to the private mortgage market because they can't secure bank financing; thus, they might have poor credit or limited down payments. Those risks can be exacerbated because it can be difficult to diversify in the private mortgage market.

Retirees should exercise caution when investing in non-traditional assets. It is important to understand that investors in these non-traditional assets might have to give up transparency, liquidity, and regulatory oversight.

Monthly Market Commentary

Much of July consisted of market participants eagerly awaiting announcements from the U.S. Federal Reserve and the European Central Bank (ECB). The main expectation was for some form of concrete action to revitalize lackluster economies in the wake of the global slowdown. Markets soared after ECB chief Mario Draghi made strong statements, including how the ECB was "ready to do whatever it takes to preserve the euro," but unfortunately fell sharply again when the ECB failed to actually provide any strong policy support to troubled Eurozone economies. Earnings season showed corporate earnings mostly came in better than expected, though revenue was mostly light as the European crisis continued to affect many companies.

GDP: Second quarter real GDP growth came in at an anemic, but not surprising 1.5%, down from a revised 2.0% in the first quarter. A slowdown in consumer spending and a rise in imports were the main causes of this deceleration. While many have questioned whether the U.S. might already be in a recession, the latest GDP results do not currently reveal that. At the same time, it is difficult to argue that the U.S. economy is booming.

Employment: Investors breathed a huge sigh of relief as 172,000 jobs were added in July, up from a revised 73,000 jobs in June. Most of the job growth came from business services, restaurants, health care, and manufacturing while government hiring shrank by 9,000. Unfortunately, the construction industry continued to contract from poor construction hiring in the commercial sector. The unemployment rate inched upwards slightly to 8.3%.

Housing: Housing data continued to show improvements, as July builder sentiment made its largest single-month increase in a decade. June housing starts set a new recovery high after rising 29% year-over-year, and June existing home inventories remained about 20% below year-ago levels. While low inventories have started to weigh on existing home sales, which fell 5.4% from May to June, lower inventory levels also caused a dramatic rise in median prices. Morningstar economists believe that while it is unfortunate housing is improving at such a slow pace, it still has a lot of room to expand and may drive the economy even higher as exports and manufacturing begin to slow.

Manufacturing: The purchasing manager reports in July indicated paltry gains for both U.S. and China manufacturing, while the Eurozone continued to show broad-based weakness with a 37-month low reading as European companies continued to cut employment and inventories in the face of further expected declines. More importantly, slowdowns in France and Germany suggest that further weakness lies ahead.

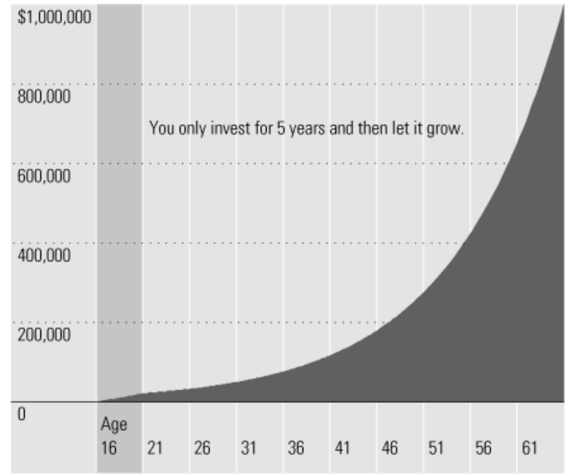
Auto: Auto sales were a big help for the economy in both the December 2011 quarter and the March 2012 quarter, but were essentially flat from March to June. With July's vehicle sales of 14 million units, the auto industry continued to hold steady and will most likely not be a big help in the second half of 2012. Although sales did not accelerate, more sales were made to consumers instead of corporate fleets or rental car companies. It is worthwhile to note that consumer sales tend to occur at higher prices and are considered more indicative of economic strength.

Inflation: June's CPI report showed that medical services and apparel prices increased, while overall energy and airline prices fell. Droughts in the Midwest continued, which could mean even higher corn and soybean prices that may further drive up the prices of items (such as pork and chicken) higher up the food chain. Unfortunately, this may hurt consumers, who were just beginning to get ahead of inflation.

Retirement: The Next Generation

If you had a dollar for every time you heard the phrase "Start investing early," you could retire with a million. If you actually acted on that phrase, you are probably retiring with more. Now is the time to encourage your children and grandchildren to start saving as soon as they get their first job. Let's assume that your teenage child or grandchild is employed for five years from age 16 to age 21. During this time, he or she saves $276 per month ($3,315 per year) and invests the money in a Roth IRA (paying taxes, of course, but at a low tax bracket). This may be a serious sacrifice for a teenager, so any contribution from you would be of great help. Assuming the money returns the historical equivalent of a diversified 60% stock/40% bond portfolio, your child can retire at 65 with $1 million tax-free, without having to invest another dollar after age 21.

Retiring With $1 Million



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Source: Stocks in this example are represented by the Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the stock market in general. Bonds are represented by the 20-year U.S. government bond. An investment cannot be made directly in an index. The data assumes reinvestment of all income and does not account for taxes or transaction costs. The diversified portfolio was rebalanced every 12 months. The return used for calculations was the average of 50-year rolling returns for 1926–2010.

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