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Foresight

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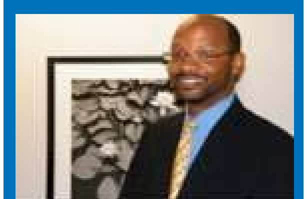

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Greetings!

While we all begin to prepare for the delights of family, food, and faith that are central to the upcoming holidays, in this Foresight I present food for thought to accompany your dinner. Each month I share thoughts on various topics in the world of personal finance, investing, economics, and business through my writings. May you find my musings informative, thought provoking, and enjoyable.

Happy Thanksgiving!!

Thoughtfully,

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How the Fed Could Save the Economy and Destroy the Currency

Is the glass half full? The Federal Reserve has committed to buying $600 billion worth of Treasury bonds between now and June, and it wants to purchase up to $900 billion in debt by the end of September 2011.[1] This second round of *quantitative easing* has been dubbed *QE2*. Basically, this effort would pump cash into the banking system to promote lending and some inflation, and it has the potential to help stocks, the housing market, consumer spending and employment. Let us all be reminded that the basic premise of the Fed lowering interest rates or in this case QE2 is that lower rates of interest leading to increased money supply in the economy will spur investors to invest, banks to loan, and businesses to hire workers and invest in their businesses, which *presto* creates positive economic activity.

Or is it half empty? Various economists, financial analysts, and business leaders are extremely worried about the impact of this tactic. They fear it may create another stock market bubble like the dot com bubble via an inflated equities market motivated by speculation and low interest rates instead of real earnings by growing businesses. Likewise, others see a commodities bubble that could burst dramatically in the years ahead much like the current housing market.

QE2 has already earned some prominent detractors. Bond market guru Bill Gross of PIMCO just called it "a Ponzi scheme" that will end the 30-year bull market in bonds (an event he has actually forecast for some time). Jim Rogers, the Quantum Fund co-founder who astutely called the worldwide bull market in commodities in 1999, recently labeled QE2 "petrol on the fire" of the commodities market and told an Oxford University audience that Fed chair Ben Bernanke "does not understand economics ... all he understands is printing money."[2, 3]

Will this help stocks & housing? The Fed's bond-buying program implies lower long-term interest rates, lower bond yields and a weaker dollar. In an environment with lower bond yields and paltry savings rates, investors are predisposed to enter asset classes such as real estate, stocks, commodities, venture capital or other equity type investments that offer higher returns then bonds (*of course the risks are also higher too*). If the stock and housing markets improve, that will certainly aid consumer confidence which, in turn, should aid consumer spending and thus uplift the economy.

Of course on Main Street, there are two speed bumps on the way to that rosy domestic destination. A lack of customers and/or demand (especially in the housing market) and unemployment; as those that have been laid-off, are working for less income, or are afraid of being laid-off do not make good consumers. Additionally, even with mortgage rates at all-time lows, loan requirements today are far tougher than in the past 5 years for those that seek to purchase a new or existing home. Thus the Fed's strategy may have a tough time navigating these economic obstacles.

Why are other nations arguing against it? QE2 could invite a global trade war. A weak greenback means a big advantage for U.S. exports. Our products will be cheaper in other nations thanks to the increase in the money supply holding down the value of the dollar. Correspondingly, imported goods will cost us more and we will buy less of them. That's terrible news for nations such as Brazil, Canada, China, Germany, Russia, Japan, France, Great Britain and Hong Kong, all of whom are counting on stable currency exchange rates and particularly for exported goods to aid in their economic recoveries.

"It's the wrong way to prevent or solve problems by adding more liquidity. Excessive, permanent money creation in my opinion is an indirect manipulation of an exchange rate." - Germany's Economy Minister, Rainer Bruederle.[4]

If U.S. interest rates are too low for too long, investors may try the emerging markets and/or the commodities markets seeking higher returns. So the commodities markets and the emerging markets could get even hotter as they become flooded with cheaper US dollars looking for higher investment returns.

"I agree that there's suggestion that aggressive quantitative easing in the United States would create devaluation pressure on the US currency." - Canada's Finance Minister, Jim Flaherty.[5]

If that happens, it would also imply higher prices for oil, crops and raw materials in the United States, which would look like inflation at the grocery store or the gas-pump to Main Street and long-term hamper our economy. Of course, many financial analysts and economists think the commodities markets will keep advancing with or without influences like QE2 because there is simply too much global demand and not enough available supply.

Is this the "Hail Mary" play? I think James Grant of Grant's Interest Rate Observer, considered one of the most astute and independent thinkers on macroeconomic and monetary analysis, may have best summed up "*the risks"* the Fed is undertaking by moving forward with QE2.

"The intended consequences of this intervention include lower interest rates, higher stock prices, a perkier Consumer Price Index and more hiring. The unintended consequences remain to be seen. A partial list of unwanted possibilities includes an overvalued stock market (followed by a crash), a collapsing dollar, an unscripted surge in consumer prices (followed by higher interest rates), a populist revolt against zero-percent savings rates and wall-to-wall European tourists on the sidewalks of Manhattan.

As for interest rates, they are already low enough to coax another cycle of imprudent lending and borrowing. It gives one pause that the Fed, with all its massed brain power, failed to anticipate even a little of the troubles of 2007-09".

With interest rates at nearly 0% and one round of bond-buying already in the history books, the Fed doesn't have many options left to jump-start the economy. Here's to its latest move giving the recovery more traction (the proverbial shot in the arm) and not becoming a shot in the foot.

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What You Need To Do For Your Social Security

Now or later? When it comes to the question of Social Security income, the choice looms large. Should you apply now to get earlier payments? Or wait for a few years to get larger checks? These questions have been significantly amplified over the last few years due to rightful concerns about the ongoing solvency of the Social Security System. Though it is very tempting to weigh in on the issue of solvency, specifically from a mathematical and actuarial viewpoint, by comparing the current number of workers to retirees receiving benefits, and juxtaposing this data to the future trends... However, today I will focus on providing you with the fundamental framework to answer the question of Now or Later as while a major variable (solvency)does exist it should not be the *sole or most important determinant for those retiring within the next 5 years*.

Consider what you know (and don't know). You know how much retirement money you have; you may have a clear projection of retirement income from other potential financial resources. Other factors aren't as foreseeable. You don't know exactly how long you will live, or if extra medical care will be required during your retirement. You may never fully stop working. Since no one can predict their own lifespan you can't predict your lifetime Social Security payout, however every year approximately 3 months before your birthday you will receive your Social Security Earnings Statement which provides a current projection of your benefits at both early and full retirement. You can visit www.socialsecurity.gov/retire2/agereduction.htm for further information on when you can receive full retirement benefits.

How much smaller will your check be if you apply at 62? This varies, for example a baby boomer born in 1949 reaches the full retirement age at 66. If that 61-year-old baby boomer decides to retire in 2011 at 62, his/her monthly Social Security benefit will be reduced 25%. That boomer's spouse in the future would receive a 30% reduction in monthly benefits as a surviving spouse .[1]

Should that same boomer elect to work past full retirement age, their benefit checks will increase by 8.0% for every additional full year spent in the workforce. (To be precise, benefits increase by .67% for every month worked past full retirement age.)[2] So it really may pay to work longer.

Remember the earnings limit. Let's put our hypothetical 61-year-old baby boomer through another example. Our boomer decides to apply for Social Security at age 62 in 2011, yet stays in the workforce. If he/she earns more than $14,160 in 2011, the Social Security Administration will withhold $1 of every $2 earned over that amount. $14,160 is the 2011 earnings limit, unchanged from 2010.[3] The earnings cap disappears at full retirement age (66 in this case). If our boomer keeps working past 66, he or she may keep 100% of Social Security benefits regardless of earned income level.[3]

How does the SSA define "income"? If you work for yourself, the SSA considers your net earnings from self-employment to be your income. If you work for an employer, your wages equal your earned income. (Different rules apply for those who get Social Security disability benefits or Supplemental Security Income checks.)[4]

Please note that the SSA does not count investment earnings, interest, pensions, annuities and capital gains toward the current $14,160 earnings limit.[4]

Read the fine print. If you reach full retirement age in 2011, then the SSA will deduct $1 from your benefits for each $3 you earn above $37,680 in the months preceding the month you reach full retirement age.[4] So if you hit full retirement age early in 2011, you are less likely to be hit with this withholding.

Did you know that the SSA may define you as retired even if you aren't? This actually amounts to the SSA giving you a break. In 2011 if you are eligible for Social Security benefits the SSA will consider you "retired" if: a) you are under full retirement age for the entire year and b) your monthly earnings are $1,180 or less. If you are self-employed, eligible to receive benefits and under full retirement age for the entire year, the SSA generally considers you "retired" if you work less than 15 hours a week at your business.[2, 4]

Here's the upside of all that: if you meet the tests mentioned in the preceding paragraph, you are eligible to receive a full Social Security check for any whole month of 2011 in which you are "retired" under these definitions. You can receive that check no matter what your earnings come to for all of 2011.[4]

Learn more at socialsecurity.gov. The SSA website is packed with user-friendly information. One last little reminder: if you don't sign up for Social Security at full retirement age, make sure that you at least sign up for Medicare at age 65.

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Financial Management Strategies, LLC (FMS) is a Registered Investment Advisory firm in the State of Maryland. Providing its advisory services to both institutions and individuals.

Mr. Petiri is a Registered Investment Advisor. His nearly two decades of financial experience covers virtually all areas of finance from tax, insurance, stockbrokerage, personal financial planning and personal banking to corporate credit, business planning and consumer lending. Mr. Petiri has frequently appeared on WEAA (88.9 FM) as a financial commentator, on his local ABC affiliate regarding the 2008 & 2009 economic downturn, interviewed by the Investment News magazine, has written for the Journal of Personal Finance, and publishes a monthly financial advice column called the Foresight. He serves on the Finance Committee of Associated Black Charities. Walid is a devoted parent to his son and daughter and a member of Bethel African Methodist Episcopal Church.