STRATEGIC Wealth Advisors

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Saving for an Emergency

According to a recent survey conducted by Bankrate.com, 28% of Americans have no emergency fund, up from 24% a year ago. About 49% of people surveyed said they had no emergency savings or less than three months' expenses.

The traditional prescription for life's financial emergencies is to hold three to six months' worth of living expenses in cash. Only 25% of those surveyed said they had enough to cover six months' or more of expenses. In a low-yielding environment, many are concerned that keeping aside six months' of emergency savings is a lot of money to have sitting in the bank earning next to nothing. While this is a valid concern, customizing your emergency fund to fit your personal situation may serve as a viable solution.

Consider holding a larger emergency fund (six months to a year) if you have a high paying job, are self-employed, work on a freelance/contract basis, have dependents, have a nonworking spouse, have high fixed expenses (mortgage, auto loan, tuition bills), or have a pre-existing medical condition that could result in hefty health-care bills if you were forced to purchase private health insurance. On the flip side, you may be able to get by with a smaller emergency fund if you:

1. Have a good degree of career flexibility because you are in a lower-paying position and/or haven't yet developed a specialized career path.

2. Have other sources of income that could help defray a large share of household expenses, such as a working spouse.

3. Have a great degree of lifestyle flexibility (for example, you would be willing to relocate).

Source: Bankrate.com Financial Security Index survey, June 25, 2012.

What's Happening at SWA

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In today's technology dominated world, your child's identity could be obtained through phishing, social networking sites, free online video games and software downloads. However, there are a few steps you can take to reduce the risk of identity theft.

1. Consider installing anti-virus and anti-spyware software on your family's computers.

2. Turn off geotagging and learn about the privacy settings on your child's phone. Pictures taken with smartphones may contain geotagging details which show the child's exact coordinates, such as her home, at the time she took the picture. This information is available on pictures uploaded to social networking sites.

3. Request a credit report on your child. Rotating through the three main credit agencies allows the parent to obtain a free credit report every four months. A minor should have no credit history.

Contact SWA or visit www.NotMYkid.org for more information.

Monthly Market Commentary

January saw a mixed bag of economic news for both bulls and bears to feast on—negative GDP report, positive employment adjustments, and a good long-term housing trend overshadowed by inventory shortages of homes, new or used, in the short-term. Morningstar economists believe that the market's positive reaction to the seemingly bearish but actually bullish GDP report was the correct interpretation. However, bad weather, the bad GDP report, the temporary shortage of home inventories, and the increased payroll tax and tax refund delays will likely weigh on upcoming economic reports.

GDP: The first estimate of GDP indicated that the economy shrank 0.1% in the fourth quarter of 2012, compared with growth of 3.1% in the third quarter. Consumption, business investment, and housing components of GDP all did better than expected, while government and inventories were the main detractors. While the negative GDP number was shocking, closer examination suggested that government bill payers and overly cautious businesses were largely to blame for an otherwise excellent report.

Employment: January employment grew at a satisfactory pace, with 157,000 jobs added. More importantly, significant annual revisions showed exceptionally strong employment growth in the fourth quarter of 2012. Construction and retail were standout performers after the adjustments, while most other categories did not show meaningful changes. Employment growth for the whole of 2012 averaged 181,000 per month, up from 153,000 per month prior to the upward revisions. Unfortunately, the U.S. economy has still only just recovered 5.5 million of the 8.7 million jobs lost during the recession. The unemployment rate in January inched upwards to 7.9% from 7.8% the month before.

Housing: Housing starts soared in December, coming in at 954,000 units compared with just 851,000 units the previous month. The good news is the growth was geographically dispersed and included nice improvements in both single-family homes and apartments; the bad news is that current housing starts are still well below 50-year averages (about 1.5 million units). On the other hand, new-home sales in December came in at 369,000 units sold compared with the recovery record of 398,000 in November. In case you were wondering why there is such a huge variance between housing starts and new-home sales, the biggest difference is that new-home sales only reflect single-family homes while housing starts include a range of single-family homes to giant multifamily apartment buildings. Since the bottom of the housing crash, non-single family home starts have more than quadrupled, while single-family starts were up an impressive but more modest 66%.

Manufacturing: Although U.S. manufacturing isn't generally important enough to move the economic needle at this stage of the recovery, news in the last week of January was surprisingly and uniformly positive. Morningstar economists believe that given continued strong consumer purchases and improvements in China, a rebounding manufacturing sector should come as no surprise. However, the most recent GDP report does suggest that the manufacturers badly misgauged consumer demand in late 2012, and had shrunk inventories when they probably should have been expanding them. Outside the U.S., manufacturing in China and Europe has recently improved as well, with January's data indicating 24- and 10-month highs, respectively.

Auto: Excellent auto sales in January (15.28 million units) also proved to be encouraging news for the economy, with year-over-year sales up 14%. This number came very close to the highest month of 2012, which was November (15.5 million units), although November's number was aided by restocking after Hurricane Sandy.

Questions to Ask Before Paying Off a Mortgage

The decision to pay off a mortgage or invest in the market is far from black and white. For those who are close to retirement and already have plenty of other liquid financial assets, paying off a mortgage could be a wise use of cash. Such homeowners aren't likely to be saving a lot because of their mortgage-interest deductions, which tend to be more valuable early in the life of the loan than in the later years, and their investment-asset mixes might be skewing toward low-returning cash and bonds, not stocks. Moreover, many retirees concur that reducing their in-retirement overhead by retiring debt reduces worries and frees up cash for travel and other pursuits. For others, however, a mortgage pay down might not be the right answer. Although it might seem comforting to own your home free and clear, there's invariably a trade-off involved. You're reducing your investments in more liquid assets in favor of an asset that's not liquid at all. A happy medium for many households might be to balance modest prepayments of mortgage principal with ongoing contributions to retirement-plan accounts. Here are some questions to think through as you make this important decision for your household.

Is your retirement plan on track? Before paying off a mortgage you may want to spend some time evaluating the viability of your retirement plan. Paying off a mortgage rather than investing in the market may mean having fewer liquid assets for retirement. However, with lower household expenses, you may be able to step up your future retirement-plan contributions; having a paid-off home will also mean that your in-retirement costs may be lower. Time horizon is an important aspect of decision-making here. Those with more years until retirement can better harness the compounding benefits of investment assets, whereas those nearing or in retirement and expecting to begin drawing on their investment assets might not get such a big bang from investing more.

What's your investment mix, and where are you holding it? The composition of your investment assets and where you hold them are also important considerations. The case for investing in the market rather than prepaying the mortgage gets even stronger if you hold your investments within the confines of a tax-sheltered vehicle and/or you're earning matching dollars on your contributions. On the flip side, portfolios that are heavy on cash and fixed-income securities, especially those that are fully taxable from year to year, are less likely to out earn mortgage interest rates.

How diversified are you? Some homeowners think of their houses as a retirement-savings vehicle: When it comes time to retire, they'll cash in their equity and downsize to a smaller place. However, the past several years have taught many homeowners that's easier said than done. Many haven't been able to sell when they wanted, and they also haven't been able to receive anything close to the prices they were expecting. Pairing home equity with more liquid stock and bond assets may give you a lot more flexibility to ride out downturns in the housing market.

How much is your mortgage-interest deduction saving you? Many homeowners assume that it's wise to hang on to their mortgages because of the tax deduction they can take on their interest. But that deduction shrinks as the years go by because home loans are front -loaded toward interest payments. People who have been able to pay down a mortgage for many years may be overestimating the amount of taxes they're saving by having a mortgage, and itemizing deductions may not be saving them much versus the standard deduction.

Diversification does not eliminate the risk of experiencing investment losses. Government bonds are guaranteed by the full faith and credit of the U.S. government as to the timely payment of principal and interest, while stocks are not guaranteed and have been more volatile than bonds. Please consult with a financial and tax professional for advice specific to your situation.

Investing in Human Capital

When trying to establish an individual's net worth, most people think first and foremost about financial capital—how much someone's house is worth or how much money he or she has in the bank. There is, however, a second component to personal and professional value that's a little more difficult to measure: human capital.

Human capital represents the sum of a person's knowledge, education, skills, abilities, and experience that can create value for this person in the future. In this sense, investing in human capital is very similar to investing in other, more tangible, types of capital. When you buy a mutual fund for a certain price, you buy it because you hope it will increase in value and you will make money in the future. When you pay a certain price for a college education, you do so because this will provide you a very valuable set of skills that will increase your value and help you make more money when you enter the job market.

There are multiple examples of human capital in your everyday life. Your doctor, for example, invested time and effort in medical school to build his knowledge of the human body and to acquire the ability to perform complex surgeries: This is his human capital. The colleague sitting next to you at work is taking night classes in order to apply for a managerial position: She, too, is building her human capital.

Education and training: In general, the two most important contributors to human capital are education and training. It is widely acknowledged that, for the most part, people with a college education have higher salaries than high-school graduates; Ph.D. and master's degree holders can earn even more. Once you have graduated from school, however, it doesn't mean that your learning process has to stop. You can continue to learn through on-the-job training or on your own. Going to school, learning a foreign language, building a network of professional relationships—these are all examples of investment in human capital. In today's "knowledge economy," this is extremely important.

Medical care: There are also other, more indirect components. If you don't take good care of yourself or you don't have access to quality medical care, the consequences can severely impair the human capital you worked so hard to build. You won't be able to perform to the best of your abilities if you are sick, or if you are feeling depressed or unmotivated. For this reason, improving physical and emotional health can also be a way to invest in human capital.

Migration: For a long time, people have moved from less-developed to developed countries searching for a better life. Today, more than ever, globalization encourages international movement; from Mexico and South America into the U.S., from Eastern Europe and North Africa into Western Europe, people move to go to school, work, and build a life somewhere other than their home. This continued movement is based mainly on the belief that developed economies offer better potential for personal development and a better set of opportunities than developing economies. For this reason, migration is an important element in human capital development. Even more interesting is perhaps the fact that the economic development of a country seems to be closely related to its investment in human capital.

As a conclusion, after reading this article, take a moment and think about something you could do (and would like to do) to strengthen your human capital. Even small steps count, like reading a book about a subject that's unfamiliar to you, or taking an online training course. After all, if you are careful where you invest your money, you should be even more diligent about investing in yourself.

What's the Number?

"The 2012 Retirement Confidence Survey: Job Insecurity, Debt Weigh on Retirement Confidence, Savings," published by the Employee Benefit Research Institute in March 2012, includes the following highlights.

1) Only 14% of Americans are very confident they will have enough money to live comfortably in retirement. 42% of Americans identify job uncertainty as the most pressing financial issue facing Americans today.

2) 60% of workers report that the total value of their household's savings and investments, excluding the value of their primary home and any defined benefit plans, is less than $25,000.

3) 37% of workers in 2012 said they expected to retire after age 65, up from 11% in 1991. 62% of workers and 37% of retirees consider their current level of debt to be a problem.

4) 56% of workers report they and/or their spouse have not tried to calculate how much money they will need to have saved by the time they retire so that they can live comfortably in retirement.

5) 16% of workers and 11% of retirees are very confident that their investments will grow in value. But 67% of workers state that they are a little or a lot behind schedule when asked to evaluate their progress in planning and saving for retirement.

6) 24% of retirees are very confident about having enough money to cover medical expenses in retirement, and 18% of retirees are very confident about having enough money to pay for long-term care in retirement.

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