

The Economy

October 11, 2008

In recent weeks we can all agree that financial fear and unrest for most of America is at an all time high. Many of the financial institutions and products that were once believed to be unbreakable foundations have crumbled.

For many years now Americans have been advised to build their financial foundation on 2 primary assets - **their home and their 401(k)'s (retirement plans)**. The vast majority of these retirement plans are invested directly in the market.

How is that working for them today?

The real-estate market has tumbled and now we've watched this past week's debacle in the stock market take away over a trillion dollars of wealth. Credit is tightening and the confidence index is at an all time low. What else could go wrong?

Less than 2 month ago, while channel surfing, I happened upon Suzie Orman's show. Suzie Orman is touted as one of America's renowned financial advisors. Her advice to a caller was, "Put all you can into your 401(k) and then with your discretionary money put it towards your mortgage."

Good advice? Let's see....

YOUR HOME:

This caller undoubtedly has lost value in their home. My bet is that every extra payment made has been lost. Equity in a home is NOT a safe strategy. Having cash for emergencies, opportunity, and choices IS a safe strategy. If this caller needs to access some of their equity to get through the "hard times," what do you think their chances are in going to the bank for a loan right now?

What if this caller had separated their equity, in a safe account, from their home? Would they need to go to the local bank for a loan? NO! Could they potentially ride out the storm? YES! Would they have some opportunity to invest in other assets while the market is down? Yes!

Sadly, nearly 70% of all retirees have the majority of their net worth tied up in their home. With banks unable to loan funds because of the credit crunch, real-estate prices down substantially, how are they going to access their money to live on during retirement or emergencies? This next wave of home selling, by the baby boomers needing to raise cash in order to retire may deteriorate prices even further. Many retirees have to put their retirement plans on a permanent hiatus.

RETIREMENT PLANS:

What assets are not tied up in our homes, are in many cases inside of a 401(k) or an IRA retirement plan. This is not just for those who are retiring or are retired, but includes almost every working family in America. Nearly all retirement plans have exposure to the stock market. The DOW lost over 22% this week. In January 2008 the DOW was above 13,500 and as of Friday it was near 8400.

If you had a \$100,000 retirement account and it drops 40% it is now worth \$60,000. The market has to return not 40%, but **66%** just to get back to your original \$100,000. This can take years and may take decades. Warren Buffet has suggested that over the next 10 years the market will, at best, return 6-7%. That was before this financial disaster, so all bets are off now. But even using those numbers it would take 10-12 years to regain your original \$100,000.

Those who have bought into the financial planning communities theory of “diversification” and “asset allocation” have now come to realize that those are just words to make us feel good about taking risk, but in actuality do very little to avoid risk to our portfolios.

TAXES:

It seems inevitable that tax rates must rise. There is no possible way for the government to meet its future obligations without a massive tax increase. Some estimates say that America owes 53 TRILLION dollars in future obligations with no money saved at all. Tax increase may be slow in coming, but they are coming. The alternative is unthinkable to every politician, which is to decrease spending (that’s a novel thought, spend less) and decrease benefits to social security and Medicare benefits. The path of least resistance is raise taxes and they may even add an additional tax to retirement plan distributions. The laws are in place all they have to do is declare an *emergency*. Are we there yet?

INTEREST RATES:

Interest rates have been artificially low for years. It is just a matter of time before China and other countries demand increased interest rates or sell the debt they own. For them to sell their debt could mean financial disaster for our country. In addition as credit becomes more difficult to get, the supply and demand forces will push interest rates upwards. The FED has been manipulating interest rates, but that cannot last, and interest rates will have to rise. Bond holders beware; this will have a negative impact on your underlying values and the longer your duration, the greater the impact.

SOLUTION:

The *Banking Process* should be moved to the center, as the foundation in which all other assets are built around. You cannot afford to wait until the market recovers; you **HAVE** to build your foundation as quickly as possible, get your private banking system capitalized, and use it for your personal and business needs. You *must* increase your wealth, and be in control of your financial destiny, and have access to cash in case of emergency or opportunity.

Our clients who have implemented this strategy are resting on a solid foundation despite the current financial crisis. They have access to cash without having to fill out an application and ask the corner bank for a loan. They do not have to sell their home as a distressed sell because they can’t make their payments. They also have cash to take advantage of some of the opportunities that may come their way in this crisis.

In addition they are continually depositing money into an account that, if handled properly, can legally shelter them from taxes. However, this takes time, so the sooner you capitalize your own banking system the more tax advantages you may have. This is HUGE and cannot be over emphasized.

If you are not involved in the banking process, it’s time to evaluate where your funds are now and the most advantageous way to capitalize your banking system. If you are not rethinking your retirement plans and/or your home mortgage, you should be!

This is the conversation you should have as soon as possible, if you haven’t already. There really is no time to waste. The “banking process” is not something that can be established overnight. You need to get started, so when funds are needed they will be there, and you and your family can be self-reliant for generations to come.

If you have any questions or thoughts, feel free to call or email me.

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