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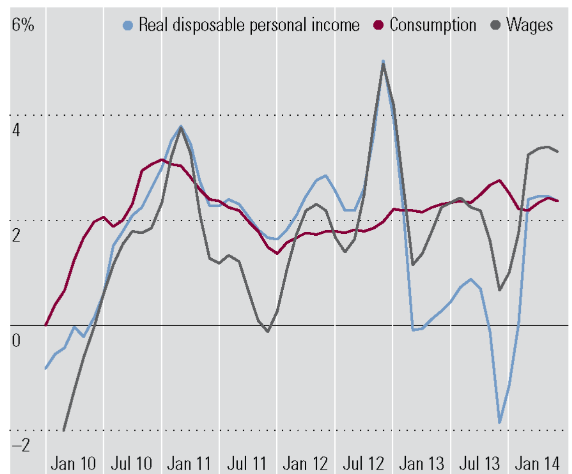
Consumption Remains Slow, But Stable as Income Fluctuates

Consumption is perhaps one of the best measures of economic activity because of its size (just under 70% of GDP). Without increasing consumption, businesses won't build more goods, hire more workers or invest in more equipment. The red line on the chart measures year-over-year growth in consumption, and it has been steady over the last couple of years at just over 2% growth on average. That's not wildly different than the tendency of GDP growth as expressed by year-over-year data. Note that consumers tend to continue deep-rooted spending patterns despite volatility in wages and real disposable personal income. Apparently, consumers are borrowing money, digging into savings or selling stocks to temporarily fund excess spending. However, despite the fact that income and spending can diverge in the short run, it will be difficult for consumers to outspend income in the long run.

Year-Over-Year, 3-Month Average Growth



Source: Bureau of Economic Analysis. Numbers are inflation-adjusted.

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Financial Corner

Welcome to our Quarterly Newsletter! We hope you find the information useful and enlightening.

This month, we will discuss stable consumption trends, proper estate planning and longevity, and the likelihood of high inflation.

Feel free to share this newsletter with interested friends. We thank you for your kind referrals.

Concerned About Longevity? Three Mistakes to Avoid

Longevity is often cheered as an achievement, but the downside of living well beyond one's average life expectancy is that it can strain (or worse, completely deplete) an individual's financial resources. The first step in addressing longevity risk is to evaluate just how great the odds are that either you or your spouse will have a much longer-than-average life span. Health considerations, family longevity history, employment choices, and income level may all be factors. If you've assessed these considerations and are concerned about longevity risk--or if you've determined that you'd simply rather be safe than sorry--here are three key mistakes to avoid.

Mistake 1: Holding a Too-Conservative Portfolio. When investors think about reducing risk in their portfolios, they often set their sights on curtailing short-term volatility—the risk that their portfolios will lose 10% or even 20% in a given year. But a too-conservative portfolio (one that emphasizes cash and bonds at the expense of stocks) can actually enhance shortfall risk while keeping a lid on short-term volatility. But, right now, interest rates have much more room to move up than they do down, which may reduce the opportunity for bond-price appreciation during the next decade. With such low returns, retirees with too-safe portfolios may not even outearn the inflation rate over time.

Mistake 2: Not Delaying Social Security Filing.* Because it provides an inflation-adjusted income stream for the rest of your life, Social Security is designed to provide you with at least some money coming in the door even if your investment portfolio runs low (or out) during your later years. If you file early (you're eligible to do so as early as age 62), you permanently reduce your annual benefit from the program.

Delayed filing, on the other hand, has the opposite effect, amping up the value of your hedge. Not only will your benefits last as long as you do, but they'll be higher, perhaps even substantially so, as well. Those who delay filing until age 70 may receive an annual benefit that's more than 30% higher than what they would have received had they filed at full retirement age (currently 66) and more than 50% higher than their benefit had they filed at age 62.

Mistake 3: Not Adjusting Withdrawal-Rate Assumptions. Just as savings rates are the main determinant of success during the accumulation years (much more than investment selection, in fact), spending rate is one of the central determinants of retirement plans' viability.

The 4% rule, which indicates that you can withdraw 4% of your total portfolio balance in year 1 of retirement, then annually inflation-adjust that dollar amount to determine each subsequent year's portfolio payout, is a decent starting point in the sustainable withdrawal-rate discussion. But it's important to tweak your withdrawal rate based on your own situation. If you have a sparkling health record and it looks likely that you'll be retired longer than the 30-year withdrawal period that underpins the 4% rule, you may be better off starting a bit lower.

In a similar vein, it's important to not set and forget your retirement-plan variables, such as your spending rate and your asset allocation, because retirement progresses and new information becomes available about your health and potential longevity, market valuations, and so forth.

This is for informational purposes only and should not be construed as legal, tax, or financial planning advice. Please consult a legal, tax, and/or financial professional for advice specific to your individual circumstances. Asset allocation and diversification are methods used to help manage risk. They do not ensure a profit or protect against a loss. Returns and principal invested in securities are not guaranteed, and stocks have been more volatile than bonds.

*Source: Social Security Administration.

How to Widow-Proof (or Widower-Proof) Your Portfolio

Plenty of people who pass away or become debilitated leave their spouses with overly complicated financial plans, too little information, and no clear instructions about where to turn for help. Below are some of the key ways to make sure that doesn't happen to your family.

1) Start the Conversation. Even if your spouse is happily hands-off, it's important that he or she is looped in on the basics of your financial plan, including how much you have, your chief financial assets, and what type of withdrawal rate your portfolio can safely support. Alternatively, or in addition to having a money conversation with your spouse, share at least the basic information about your finances with your most financially literate (and trustworthy) child.

2) Simplify. Assuming a financial plan includes a well-thought-out asset allocation and reasonable intra-asset-class diversification, less may be more in terms of the number of individual holdings. That's particularly true if you're concerned about your spouse's ability to manage the portfolio on his or her own.Of course, multiple accounts with multiple providers may be inevitable in some households, but collapsing your overall number of accounts (and the holdings within them) could be a good starting point on the road to portfolio simplification.

3) Shape Up (and Share) Your Record-Keeping System. Organizing files in broad, easy-to-understand categories (for example "Investments," "Insurance," and so on) is a good starting point, with subfiles for each account. Another good idea is to create a master directory, which can be either electronic or paper. It should contain financial assets such as bank, fund, and brokerage accounts; company-retirement plan and pension fund details; real estate holdings, and business interests. Alongside or beneath each account name, include account numbers, URLs, passwords, key contacts, and phone numbers. Include similar details for debts you owe and insurance policies. Having such a document can be a good way to provide your spouse with a 3,000-foot view of your household's finances; just be sure to tell him/her where to find this document and keep it password-protected or under lock and key.

4) Provide Guidance on Where to Go for Cash. Many surviving spouses may not have adequate cash reserves to fund their near-term living expenses. Stashing too much of your portfolio in cash may carry a steep opportunity cost right now, but every retiree household should aim to keep at least two years' worth of living expenses in true cash. It's also important to provide your spouse with guidance on which assets are most liquid and appropriate to tap in a pinch and which are less so.

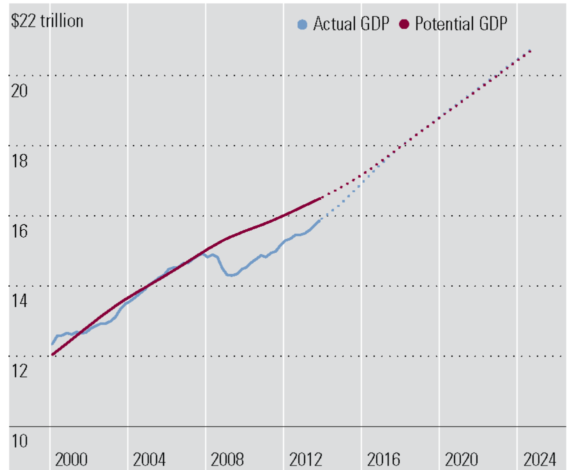
5) Put It on Autopilot. Putting as much of your investment plan on autopilot as possible can allow your portfolio to run itself for a time if need be. A key benefit is that you'll be less tempted to override your carefully laid investment plan at an inopportune time, but another is ease of use. Investigate what options your investment provider has for automating your investment program. Switching on features such as automatic required minimum distributions is a good example of this idea.

6) Help Identify a Suitable Advisor. Many individuals with spouses who are disengaged financially take comfort in knowing that their spouse will be able to turn to an advisor after they're gone. If you think your spouse will eventually need to turn to an advisor, it doesn't hurt to begin the search for a qualified advisor while you're still around to help with the screening.

Output Potential Gap Suggests Limited Inflation Risk

Outside of food and drugs, the prospect of high inflation remains dim. The output gap, which compares current and forecasted Gross Domestic Product levels to the estimated potential of the economy, remains at one of its widest levels in history. Every major, sustained bout of inflation in the Post-War era has occurred when the economy has been running above its theoretical capacity. The Congressional Budget Office, the keeper of this key metric, believes that the economy will not operate up to its full capacity until 2017, as shown in the chart. CBO considers unemployment, demographics, capital investment, and productivity, making it a much more comprehensive measure than simpler capacity utilization metrics. Besides the output gap, Morningstar economists believe that monetary and fiscal policy, as well as commodity prices, could also influence inflation levels going forward.

Potential Versus Actual GDP



This article contains certain forward-looking statements which involve known and unknown risks, uncertainties, and other factors that may cause the actual results to differ materially from any future results expressed or implied by those projected statements. Past performance does not guarantee future results. Source: Congressional Budget Office.

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