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Guide...Protect...Preserve

Japan's Two Lost Decades: Can It Happen In The U.S.?

Twenty years after Japan's "economic miracle" collapsed, the Asian nation still has not recovered its once-vaunted economic clout. Japan's debacle involved a spectacular jump in stock and real estate prices followed by an equally spectacular fall as those bubbles burst, much like the twin "pop" that sent the United States into a recessionary spiral in December 2007.

Does that mean Americans are doomed to spend the next two decades struggling to get their economic lives back? And what lessons can investors learn from the Japanese experience?

Echoes of a debacle in Japan. The start of Japan's so-called "lost decade" in 1990—which has stretched to two decades since that phrase was coined to describe Japan's extended economic malaise—was triggered by a period of irrational exuberance in the 1980s. Loose monetary policy fueled a rapid rise in stock and real estate prices. Driven by speculation, leveraged assets, and investing excess, Japanese industrial production rose by 50% during the 1980s, and by 1989 Japanese banks had become the largest in the world. When the bubble burst in 1990 and the economy collapsed, investors belatedly realized that much of the growth had been illusory.

The same thing happened in the United States during the period 2002 to 2007, as "easy money" policies, consumer spending, and foreign investment pushed real estate and stock prices ever upward—until the bubble burst, sending over-leveraged financial institutions to the brink of bankruptcy and the U.S. economy to the edge of systemic failure. Two years later, the U.S. jobless rate surpassed 10%, businesses have trouble obtaining credit, and government officials are weighing further intervention in the economy even as the national deficit soars to unprecedented levels.

From an investor's point of view, the story is illustrated vividly by looking at the most-quoted stock market averages in the two countries. Japan's Nikkei average hit an all-time high of 38,957.44 intraday Dec. 29, 1989, then fell off a cliff. In 2009, the Nikkei never exceeded 10,800, and it nearly fell below 7,000 in March. In the United States, the Dow Jones Industrial average soared to a record intraday high of 14,198.10 on Oct. 11, 2007, then plunged as the economy deteriorated, dropping as low as 6,547.05 in March 2009 before rallying back above 10,000 in the last few months of the year.

Why the U.S. should fare better. While the similarities between the countries' boom-and-bust debacles are striking, there are also fundamental differences. For instance, the U.S. crisis is unlikely to be as deep and long-lasting as the Japanese downturn largely because the U.S. boom period did not even approach the stupendous

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Moderation Is Wise In A Time Of Financial Upheaval

With nerves still frayed over the near-collapse of the world economic order in 2008, it's difficult to be optimistic. But it may be helpful to put the bad news about the American economy in perspective.

According to the World Bank, U.S. gross domestic product in 2009 totaled $14.25 trillion. That represented nearly a fifth of the world's total output of goods and services, even though we have less than one-twentieth of the world's population. Whatever its current troubles, the U.S. economy remains the world's mightiest. And though much of the financial and economic news has been bleak—with some respected economists suggesting that recent signs of growth could yet be supplanted by a new downturn—stock prices have continued the strong recovery that began during the spring of 2009. Just as the world was caught off guard by the suddenness and scope of the 2008 collapse, the months ahead could surprise to the upside.

Stocks' resurgence could make this an excellent time to reassess your risk profile. If you learned during the meltdown that you can't tolerate as much investment risk as you had thought, please make an appointment so we can consider changes to your portfolio. In general, we continue to counsel moderation and a broadly diversified approach to investments during this time of upheaval.

Mary Jane Callaghan &
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Your 401(k) Choices After A Layoff

If you're one of the millions of people who have received pink slips from their employers during these troubled economic times, things may look bleak. But there's something you can take with you from your old job—your 401(k) account—that could hold the key to better times ahead. Though there's no penalty for leaving your retirement funds where they are, you may be understandably reluctant to entrust the money to your ex-company, continue to pay what may be unreasonably high administrative fees, retain limited investment choices, and risk having uncertain access to your account if you decide to make changes in your investment choices.

So what are the alternatives? Participants in 401(k)s and other employer-sponsored retirement plans can normally choose from among three main options: taking a lump-sum distribution opting for annuity-type payments, or rolling the funds into an IRA or a 401(k) at your new job. There are pros and cons for each possibility.

1. Lump-sum distribution. If you're in desperate need of cash, this may be what you have to do. But it has several drawbacks. If you request a lump sum from your company, it's required to withhold 20% for federal taxes (and sometimes additional state withholdings), and you could owe more than that if you don't deposit the money in an IRA or another 401(k) within 60 days. You'll owe income tax on the amount of the distribution (which might push you into a higher tax bracket), plus you'll likely have to pay a 10% penalty if you haven't reached age 59½, bringing the total tax you pay on the amount received to almost 50%. Finally, of course, you'll be depleting your retirement savings well ahead of schedule.

2. Annuity-type payments. With this option, you're still on the hook for tax payments and a possible early withdrawal penalty, but at least the tax liability will be spread out over the years you receive payments. Typically, the amount you get is calculated according to your life expectancy or the joint life expectancies of you and your spouse. If you choose, payments may continue until the death of the second spouse.

3. Rollover. This has obvious advantages. Not only will you have more investment choices, but the transfer—to a traditional IRA or to another employer plan at your new job—isn't taxed, and your money can continue to compound on a tax-deferred basis until you make withdrawals during retirement. Just be sure to complete the rollover within 60 days of taking the money from your old 401(k), and keep in mind that your former employer will still automatically withhold 20% of your balance. To avoid that levy, which you can't recoup until you file your tax return, arrange for a trustee-to-trustee transfer directly from your old account to the new one. Best of all, this option helps your money keep to its appointed task—saving for a secure retirement. ●

Succession Planning After The Crisis

The recession took its toll on businesses of all sizes, and the impact went beyond dwindling cash flow. Small-business succession plans—and their role in personal estate plans—have also been affected, and you may need to revisit your blueprint for leaving the company and make adjustments to address a changed economic landscape. But you might also find ways to turn the downturn to your advantage.

A succession plan maps out guidelines for when you're ready to call it quits. You may intend to hand over the reins to one or more new leaders gradually, staying on for awhile as an advisor, or you could plan to get out altogether. The plan may be to have a family member succeed you, or you could promote another company employee or sell to an outside group.

One crucial element of any succession plan is a buy-sell agreement that establishes how the value of the business will be determined when you leave. But in the wake of the economic downturn, your company may well be worth less than it was a few years ago. If you're counting on proceeds from a sale to fund your retirement, you could decide to delay your exit until the company's value rebounds, or you might need to look for other income sources, perhaps from part-time consulting for other businesses that could supplement the sale proceeds.

If you're transferring all or part of the business to family members, however, a decline in its value could be helpful. Assuming the company profits from the economic rebound, shares you give away now should be worth more later, maximizing the impact of current tax-free gifts.

Suppose you and your spouse have equal interests in a business that was worth $5 million in 2007 but is now valued at $3 million. Each of you is entitled to a $1 million lifetime gift-tax exemption, and you might use the

Financial Planning Is A Family Affair

Having one spouse handle most family financial matters may feel like an equitable division of labor—with the husband, say, monitoring accounts and making investment decisions while the wife manages other household affairs. But it's an approach that could be damaging in the long run. Divorce or death could plunge the remaining spouse into unfamiliar waters—unable, perhaps, even to find crucial information about life insurance and retirement accounts. And if children have been left out of financial discussions, they may fail to appreciate the family's situation and be ill prepared to take on adult financial responsibilities.

Like it or not, most women will one day handle their own finances. According to the Social Security Administration, women live four years longer during retirement than men do, on average, and they comprise almost 60% of Social Security beneficiaries. At age 65, only 43% of women are married, compared with three out of four men. Divorce plays a major role as well. In 2005, the marriage rate was 7.5 per 1,000 people, according to the U.S. Census Bureau, while the divorce rate was 3.6 per 1,000.

It's not that most women are financial novices. According to a recent survey by Oppenheimer Funds, six in 10 wives balance the family checkbook, while more than half pay household bills. The same survey found that 43% considered themselves somewhat or very knowledgeable about investing. Yet that still leaves more than half of women facing a steep learning curve if they're suddenly forced to handle investment responsibilities.

And even when both spouses are around, having one of them take responsibility for a family's finances can be perilous. If family members don't understand their economic situation—how much money comes in each month, what gets spent on fixed expenses as well as discretionary purchases, what the family's short- and long-term saving goals are—it's difficult for them to behave responsibly, and arguments about spending are likely. And if the husband, say, has sole charge of family investments, he may take more risk than if both spouses were responsible for their investments. Taking a flyer on a stock tip is easy when you're sitting alone at your computer; explaining why that sure bet tanked is much harder, as you'll have to do if you and your spouse regularly review account statements.

Failing to bring children into the financial loop could also have unhappy consequences. In many families, money spent on the kids accounts for a large part of the budget, and showering them with extras—from sports camps and music lessons to private school tuition and vacations abroad—may give them unrealistic views about money. Lack of financial grounding at home may be one reason so many kids have problems with credit cards when they head off to college. According to a 2009 study by student lender Sallie Mae, the average student now has four credit cards and debt of more than $3,000. Six in 10 students in the study said they were surprised at how high their account balances had grown, and 40% said they'd charged things knowing they didn't have enough money to pay the bills.

Transparency and a willingness to talk about family finances can go a long way toward minimizing such problems. If family members understand that setting aside a certain amount each month is crucial to pay for the kids' college and the parents' retirement, they may be more inclined to stick to the budget. Having spouses agree on an investment strategy and then reviewing progress and making needed adjustments can also help. Regardless of each spouse's role in the family finances, maintaining an up-to-date list of accounts, insurance policies, and other financial essentials—and making sure everyone in the family knows where to find the list—can be crucial if the financial decision-maker suddenly dies or becomes incapacitated.

Yet as important as it is for families to work together, many don't. According to a recent study of couples by Fidelity Investments, just four in 10 said they collaborated with spouses on decisions about retirement saving and investing, and only 15% thought that if they died, their spouses would be prepared to take over the family finances. If you need help getting on the same page, we may be able to help. ●

combined amount now to transfer two-thirds of the business to your heirs. Before the recession, a $2 million transfer would have left $3 million that could be subject to estate tax. Each spouse can also transfer an additional $13,000 annually to each heir, so this can add up if there are multiple beneficiaries.

Other estate planning techniques can capitalize on a business's temporarily reduced value. For example, an intentionally defective grantor trust (IDGT) can effectively freeze the value of shares at current levels. Or, with a grantor retained annuity trust (GRAT), the assumed value of a future gift to your heirs will be reduced not only by the low current value of the business but also by today's rock-bottom interest rates. That could limit or eliminate your gift-tax liability. We can work with you and your attorney to evaluate your succession plan and consider whether these or other techniques and strategies could be financially advantageous. ●

Do You Know Your Health Care Facts?

Reforming the nation's health care system was the biggest single political issue of the past two years, prompting an unprecedented level of interest and debate. Unfortunately, the level of misunderstanding, on both sides, remains nearly as high as the level of passion.

How informed are you when it comes to health care? Take this quiz to find out:

1) Where does the U.S. rank worldwide in terms of health care, according to the World Health Organization?*
- a) 1st c) 37th
- b) 5th d) 56th

2) What percentage of the U.S. gross domestic product consists of health care expenditures?
- a) 8% c) 24%
- b) 16% d) 39%

3) Federal spending on Medicare and Medicaid is what percentage of U.S. gross domestic product?
- a) 4% c) 12%
- b) 8% d) 18%

4) What percentage of Americans under age 65 has health care insurance through their employer?
- a) 34% c) 76%
- b) 63% d) 88%

5) What percentage of Americans under age 65 purchases health care insurance privately, directly from an insurer?
- a) 1% c) 8%
- b) 4% d) 16%

6) What percentage of national health expenditures comes directly out of the consumers' pockets, through deductibles, co-payments, and payments for services not covered by insurance?
- a) 2% c) 13%
- b) 7% d) 18%

7) Which of the following statements about Health Savings Accounts is true?
- a) Contributions are made on a pre-tax basis.
- b) The funds roll over and accumulate year over year if not spent.
- c) The funds can be invested, similar to funds in an individual retirement account.
- d) All of the above
- e) None of the above

8) The Medicare Trustees recently announced that the Medicare system is likely to start running out of money in what year?
- a) 2012 c) 2025
- b) 2017 d) 2038

If you have questions about health care insurance, Medicare, or any other health-related issue, please give us a call. We can work with you and your attorney to make sure all of your needs are met.

***The World Health Organization rankings are from 2000, when the group stopped compiling the data, citing the complexity of the task.**

Answers: 1-c; 2-b; 3-a; 4-b; 5-b; 6-c; 7-d; 8-b.

Japan's Lost Decades

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price increases seen in 1980s Japan. During the 1990s, Japanese real estate lost an average two-thirds of its value. In contrast, U.S. real estate prices are expected to fall 30% to 40%, although some areas, including Las Vegas, Phoenix, and Miami, have seen steeper declines.

Moreover, the U.S. economic structure is more open and fluid than that of Japan, where banks and major industries had a tendency to sweep problems under the rug. In the United States, major banks have quickly (with the push of the government) written off billions in bad debt in an attempt to get a recovery going without unnecessary delay.

But the most basic difference between Japan in 1990 and the United States today lies in the speed in which interest rates were lowered. American economists, most notably current U.S. Federal Reserve Chairman Ben Bernanke, have criticized Japan's central bank for failing to reduce interest rates quickly enough during the early 1990s, with the delay spawning rampant, long-lasting deflation. Eager to avoid that mistake, the Fed has taken several steps to cut interest rates and keep money flowing. And both the Bush and Obama administrations have pumped billions of dollars into the U.S. economy in the form of corporate bailouts and economic stimulus plans.

Even though the crisis in the United States seems unlikely to mirror the Japanese experience, it's impossible to know what will happen to stocks, real estate, commodities, and currencies in the near term. That's why we advise you to continue protecting yourself from the vicissitudes of the stock market and the world economy by remaining broadly diversified in your investments. That's the best way to ensure you are in a good position to benefit when the economy starts coming back to life. ●

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