Mentor Monthly Missive

April 2012 | Vol. No. 5 | Financial Planning News

The Problem with Pensions

Large U.S. corporations found out long ago that promising retired employees a lifetime of income was a losing deal. Although pensions are nice benefits that can help attract and retain employees, and can assure retirees comfortable lifestyles in their golden years, they are expensive and risky.

In 1979, 38% of private-sector workers were covered by defined-benefit pension plans, according to the Employee Benefit Research Institute. In 2008 the number had fallen to just 15%. What is it that private employers know that public employers either don't know or refuse to acknowledge? It's that by its very nature, the defined-benefit pension is unsustainable. Contributions by the employer to keep the plan afloat are based on a future that no one can know. In fact, the reason so many private pension plans have failed or been abandoned is that predictions about life expectancies and investment returns have been way off their marks.

To the public pension plans (which cover municipal, public-school and university employees) add politics, and you have a real mess. Elected officials have traded sweet pension benefits for votes, the victims being taxpayers and other public programs whose funding is reduced while the officials prop up public pension plans. Illinois' "temporary" 67% income tax increase last year was directed toward pensions. We will lay odds that Illinois taxpayers will never see a 3% state income tax again.

The best that anyone, especially public employees, can do right now to prepare for the fallout from the pension debacle is to direct a healthy dose of skepticism toward promises of future benefits. They must prepare themselves for living on less. They should save and invest outside the pension plan and count on working longer. Because when the dust settles, the check may not, after all, be in the mail.

Meet our Wealth Managers

John S. Davis, CFP
President
john@mentoradvisers.com
630-530-1191
www.mentoradvisers.com

Mentor Capital Management Inc. was founded in response to the belief that a consumer's best interests are served when his or her financial planner is Fee Only. Advisors of Mentor Capital strive to provide objective, prudent and thoughtful advice to clients based on their personal goals and objectives.

John S. Davis is Mentor's founder, president and chief investment officer. A graduate of the University of Missouri, Columbia, he is a Certified Financial Planner licensee and a Registered Investment Advisory Firm Principal.

Daniel B. Carey is vice president of Mentor Capital and a member of its board of directors. A graduate of the University of Notre Dame, he is a Certified Financial Planner licensee and a Registered Investment Advisory Firm Representative.

Social Insecurity

All of us who work feel the bite that Social Security taxes take out of our paycheck. Most of us take comfort in the hope that when we retire, Social Security will be there, giving back all the money that we paid into the system over the course of our careers. Isn't that how it works?

Well, the short answer is no, it doesn't work that way. The Social Security taxes deducted from your paycheck are not sitting in a special account someplace, earmarked to be returned to you upon your retirement. Instead, the taxes you pay today are used to pay benefits to today's beneficiaries, just as when you retire, the benefits you receive will come from the taxes paid by people who are still working. This arrangement works as long as there are enough people sending in taxes; it doesn't work so well if the number of current workers per retiree is decreasing.

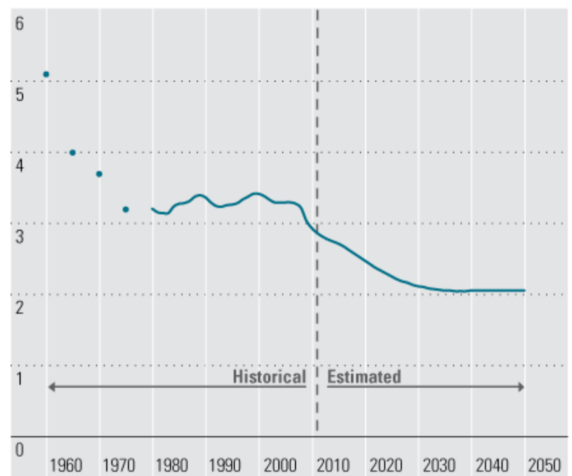
The baby boomer generation (those born between 1946 and 1964) have started to retire in 2010. This large group's retiring, coupled with increasing life expectancies and decreasing birth rates, means that the number of retirees will grow faster than the number of workers. According to the Social Security Administration, the number of workers sending in Social Security taxes to pay each retiree's benefits has plummeted from 42 workers per beneficiary in 1945 to 2.9 in 2011. What is more is that this number is projected to go down even further to 2.1 workers per beneficiary by 2035. Since the ratio of workers to retirees is expected to continue declining, a shortfall in future Social Security funding is likely.

Annual cost for the Social Security program is projected to exceed non-interest income in 2011 and remain higher throughout the remainder of the long-range period. Social Security funds are projected to increase through 2022, and then to decline and become exhausted and unable to pay scheduled benefits in full on a timely basis in 2036.

What does all this mean for you? Well, that depends on how old you are and what changes the United States government decides to implement. If you are nearing retirement, it is unlikely that your Social Security benefits will change dramatically. Younger workers, however, are more likely to see sweeping changes in the way Social Security works in the form of higher taxes, lower benefits, or a combination of the two.

Bear in mind that Social Security was never intended to provide Americans with all of the income they would need in retirement. Social Security is only one leg of a three-legged stool that also includes pension plans and personal savings. With concerns mounting over the stability of one leg of the stool, you need to take control of your retirement by investing in personal savings plans such as IRAs and 401(k)s.

Ratio of Workers to Beneficiary



Source: The 2011 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds, May 2011, Social Security Administration.

Monthly Market Commentary

Most of the economic news released during the past few weeks pointed toward slow but steady progress in the U.S. economy, despite some market volatility that was attributed to news out of the Federal Reserve. Markets rallied based on a Ben Bernanke speech that suggested the economy was not out of the woods yet and that quantitative easing remained an option if things worsened. Markets also collapsed on the release of the minutes from the Federal Reserve Open Market Committee, which indicated that the economy was stronger than the Fed had anticipated and offered no hints that more quantitative easing was being considered.

Employment: March saw a disappointing 120,000 jobs being added; the lower number was mainly a result of a large decline in private-sector retail jobs and the continued contraction of the public sector. This is a significant drop from the revised 240,000 jobs in February and revised 275,000 jobs in January. The unemployment rate fell slightly, to 8.2%.

Manufacturing: Manufacturing data in February remained mixed but still showed an improvement from January, at least in terms of durable-goods orders. As export demand weakens and growth slows in the auto sector later this spring, Morningstar economists are not expecting a lot of growth (or declines) from manufacturing in 2012. The economic key continues to remain in the hands of U.S. consumers, with a potential added boost from housing and construction markets.

Housing: Real estate data continued to be relatively inconclusive as abnormal weather wreaked havoc on the data, causing most real estate numbers to show better results on a year-over-year basis than on a month-to-month basis. The Case-Shiller Home Price Index (seasonally adjusted) for the three months ending in January was flat compared with December, while the year-over-year numbers showed some improvement. Month-to-month pending contracts for February were down 0.5% and have now declined for two of the last three months, while year-to-year pending contracts were up a stunning 9.2%.

Although the media remains thoroughly confused, with many outlets featuring month-to-month weakness while others ran headlines trumpeting a new boom based on the year-over-year numbers, Morningstar economists believe that the truth lies somewhere in the middle.

Retail: The International Council of Shopping Centers reported 4.1% year-over-year same-store sales growth in March, matching the gains in February. Warm weather and an earlier Easter helped boost the numbers, with both apparel and department stores showing an improved growth rate.

Quarter-end insights: The first quarter of 2012 saw the U.S. economy gaining strength as other world economies slowed. Morningstar economists believe that slow but steady U.S. GDP growth, moderating inflation, and rising employment growth may be on tap for the remainder of the year. While better employment has helped a number of sectors, including housing, restaurants and even health care, other sectors such as industrials continued to worry about slowing demand from Europe and China. Slowdowns in these regions may be harmful to individual companies but not necessarily to the overall U.S. economy—many of those goods are not produced in the U.S. Overall, companies poised to benefit from a relatively strong U.S. economy with limited exposure to non-U.S. markets may be better performers. This includes small-cap companies that typically had a smaller portion of their revenues from non-U.S. sources. Around the world, government data suggests that China's typical 10% growth rate is likely to fall to 7.5%. A slowdown in China combined with a less generous U.S. Federal Reserve will likely bring in commodity prices, significantly affecting commodity-based economies (such as Australia and Brazil) as well as capital goods-related exporters (such as Germany).

Securing Your Portfolio

There are a number of ways you can protect your portfolio and your financial well being. Chief among them are insurance, estate planning and protection from identity theft. While nobody likes to talk about insurance (except, of course, those who sell it), some individuals should protect themselves with some basic policies. Here are a few examples.

It's a good idea to purchase a life insurance policy when you have a child. You'll want enough coverage to pay off the mortgage and get the kid(s) through college. Health insurance, of course, is a must. Many people jeopardize their retirement planning by not factoring in the cost of health insurance before Medicare kicks in. If you retire before age 65, be sure to investigate the costs. Disability insurance will help you get through an extended period of time without work. Long-term disability coverage typically provides 60% to 70% of your current income should you run into this unfortunate situation. Also, carrying the appropriate property and casualty insurance (homeowner's, auto, for example) can help you avoid liability lawsuits.

Once you have insurance covered, protect your estate. By neglecting the proper estate documents, you run the risk of damaging your assets. A simple will should suffice for many people. Failure to have a will in place upon your death can mean that your spouse or kids won't get what you intended for them. An attorney can put together a will for you or provide you with more information.

And remember: Always protect your identity. We all know how bad it can be to lose a wallet. Identity theft is even worse, and the number of incidents is unfortunately on the rise. A few simple steps can help prevent this from happening: Invest in a shredder and use it on financial papers, and get a copy of your credit report and verify the information on it.

MENTOR CAPITAL

John S. Davis, CFP
President

Mentor Capital Management Inc.
105 S. York Street
Suite 450
Elmhurst, Illinois 60126

john@mentoradvisers.com
www.mentoradvisers.com

Tel:630-530-1191
Fax:630-530-1442