

Los Angeles Times



RISING ABOVE LAS VEGAS

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 From the Los Angeles Times

## Surviving the ups and downs of a ferocious market

Is the financial crisis preying on your retirement portfolio? We offer advice to help investors at four stages of life keep their goals intact.

By Martin Zimmerman  
 Los Angeles Times Staff Writer

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These are the times that try men's (and women's) financial plans. ¶ With Wall Street stumbling through its second bear market in less than a decade, government officials estimated recently that Americans' retirement accounts have lost more than \$2 trillion in value in the last year. More than half the people surveyed recently by the Associated Press said they'd have to work longer than planned before they could afford to retire. ¶ The Times asked certified financial planners Darius Gagne and David DeWolf of Quantum Wealth Management in Culver City to analyze the challenges faced by four Southern California clients in their 20s, 30s, 50s and 70s. The names have been changed, but the personal and financial details are drawn from real life. ¶ The roster of issues facing the four households will be familiar to many Californians. ¶ Falling housing prices are pushing more homeowners into foreclosure and robbing many families of the financial backstop that provided comfort during the last bear market, which lasted from 2000 to 2002. The credit crunch has dried up access to auto loans, credit cards and other lending -- and even shaken confidence in money-market funds and bank savings accounts, which have long been seen as safe, no-brainer investments. ¶ Meanwhile, unemployment is rising, adding angst over job security to the blender of worries. ¶ How do you deal with it all? With financial markets in turmoil and the economy slumping, you may need to make significant changes in your living and spending patterns to reach your savings targets. Some goals may have to be downsized, others abandoned.

Although everyone's situation is unique, a few overriding themes emerge.

\* It's OK to worry, but try not to panic. If you're more than 10 years away from retirement and your savings are properly diversified, you should be able to ride this out and recover your losses when the market eventually turns around.

Even people who are closer to retirement or even in retirement probably can survive financially if their portfolios have at least 50% of their money in bonds or other fixed-income investments.

If stock losses in your 401(k) plan are keeping you up at night, don't sell and lock in losses on money you won't be seeing for 25 years. You can shift new contributions to safer investments if that will help you sleep better, but you're also in danger of missing a chance to buy stocks when they're relatively cheap.

\* Don't freeze up, either. If you're 62 and made the mistake of having all your money invested in Google Inc. shares (down about 46% this year), you probably need to cash out some at a loss and move those assets into a safe haven.

If you're lucky enough to have more than \$250,000 in your bank account, move some funds to another bank so you'll stay under the new limit for Federal Deposit Insurance Corp. coverage.

\* Spend less, borrow less. It's more imperative than ever to live within your means and save as much as possible. If that means skipping expensive dinners, forgoing big-ticket Christmas gifts and losing the premium cable channels, so be it (they canceled "The Sopranos" anyway). Pay off credit card debt, and charge only as much as you can pay in full each month. Tap lines of credit and emergency savings only when absolutely necessary.

\* Make hard choices. Expensive private colleges can provide an edge for your kids, but without serious financial aid, sending them there can put you in the poorhouse.

A good state school or even community college may be a sensible option if your savings have been battered by the downturn.

Likewise, you might "need" a new car, but there are probably several years of life -- if not prestige -- left in your 8-year-old Accord.

And now, some more specific situations:

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 From the Los Angeles Times

## CASE 1

### At 27, funding his future and saving for a home

October 19, 2008

Brett's top priority should be to pay off his credit card debt, which yields an immediate 15% return on his money. Next comes the emergency fund, which generally should hold enough cash to cover four months of expenses -- around \$8,000 in Brett's case. His bank account gets him most of the way there, but he needs to top it off as soon as possible.

With housing in a slump and businesses girding for a recession, architecture work is starting to dry up. He should continue putting money in his 401(k), although funding a Roth IRA (maximum annual contribution: \$5,000) is an option if there's extra cash.

At his age, he should maintain an aggressive investment stance in his retirement accounts: 80% in stocks, 10% in hard assets such as commodities or real estate (as an inflation hedge) and 10% in bonds.

With any money left over, Brett can begin saving for a house by investing in mutual funds through a low-cost provider such as Vanguard, although he should take a more cautious approach because he'll probably tap that money within 10 years.

Brett

Brett, 27, is single with no children. He works as an associate at an architecture firm and rents an apartment in Silver Lake.

Assets

- \* 401(k): \$7,500
- \* Bank savings account: \$5,000

Debt

- \* Credit cards (15% interest rate): \$3,500
- \* Auto loan (5.5%): \$15,000
- \* Student loans (4.6%): \$20,000

Annual income

\$50,000

Annual savings

401(k): \$6,000

Objectives

- \* Manage debt
- \* Establish "rainy day" fund
- \* Set up a long-term savings plan to buy a home and fund retirement

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## CASE 2

### Mortgage showdown among hard choices for 30-somethings

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For Angie and Jason, keeping the house is Job 1. And like many homeowners these days, they face a daunting challenge. When the interest obligation on their adjustable-rate mortgage resets next year, their monthly house payment could rise to as much as \$5,348 from \$3,450, based on today's rates.

With the value of their house down nearly 10% since they bought it, refinancing will be difficult. If they can't refinance into a fixed-rate loan, they should try to negotiate a new loan with their lender, who may be willing to cooperate to avoid yet another foreclosure. If that fails and they end up with the bigger mortgage payment, they should scour their household budget for ways to cut costs.

They need to invest their brokerage account fairly conservatively so it can provide a backstop in case they're in danger of missing a monthly house payment. (It's probably premature to consider trading down to a smaller house -- and mortgage payment -- at this point and might not make financial sense anyway given the current turmoil in the housing market.)

Once the mortgage situation stabilizes, the couple's priority should be paying off their credit cards, then setting up low-cost 529 college savings accounts for their kids. (Gagne recommends plans offered by the state of Utah that combine good investment choices with low costs.)

If possible, they should continue contributing to their 401(k) plans (allocation: 65% stocks, 15% hard assets, 20% bonds), even if it means ratcheting back their children's educational expectations. It provides a valuable tax break, and getting a jump on retirement saving is essential.

Ideally, Angie and Jason should each up their contributions \$5,500 a year to the legal maximum, but that's probably not realistic given the challenges they face on the home front.

Angie and Jason

Angie, 36, and Jason, 38, are married with two children, ages 4 and 6. Angie sells Internet advertising, and Jason is an independent film producer. They own a three-bedroom house in Culver City.

Assets

- \* 401(k) plans: \$30,000
- \* Bank savings account: \$8,000
- \* IRAs: \$15,000
- \* Brokerage accounts: \$75,000
- \* House: \$800,000, down from \$875,000 purchase price in 2003

Debt

- \* Mortgage (5.75% interest-only ARM; rate adjusts starting next year): \$700,000
- \* Balance on home equity line of credit (5.8%): \$25,000
- \* Credit cards (12%): \$10,000
- \* Two auto loans (5.9%): \$25,000

Annual combined income

\$165,000

Annual savings

- \* 401(k) plans: \$10,000 each
- \* Brokerage account: \$10,000

Objectives

- \* Deal with higher mortgage payments
- \* Get a handle on spending
- \* Save for kids' education
- \* Develop long-term investment and retirement strategy

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From the Los Angeles Times

### CASE 3

## Affluent in midlife, with a bleeding investment portfolio

October 19, 2008

Even before the recent market turmoil, the average American nearing retirement had only \$60,000 in his or her 401(k). The value of Judy and Drew's nest egg has shrunk by six times that amount since the first of the year. They still have about \$1.5 million invested in mutual funds in their profit-sharing plan, brokerage account and IRAs. But losing almost \$400,000 would shake anybody up -- especially if they were planning to retire in the near future.

"They have some panic," said Gagne, the financial planner. "They've asked the question, 'Should we stop the hemorrhaging and get out now?' " His answer: No. Their portfolio is well-diversified (50% equities, 10% real estate and commodities, 40% bonds), which is why their losses this year have been about a third lower than the overall stock market's. In fact, because stock losses have probably thrown their asset allocation out of balance, they should consider shifting some money from bonds to stocks (using mutual funds in their profit-sharing plan or IRAs to avoid a tax hit).

Judy and Drew might consider "harvesting" some tax losses to offset future capital gains by selling one or two loser funds in their taxable brokerage account. But they should reinvest the proceeds in similar funds to maintain the desired asset allocation. No one knows how long the current bear market will last, but history tells us that being out of stocks is no place to be when the market eventually turns around. "An investor sitting on the sideline is almost sure to miss the largest gains, which have almost always occurred in the months immediately following the drops," Gagne said.

Judy and Drew

Judy, 55, and Drew, 59, are married with two adult children and a third in college. Drew is a partner in a law firm; Judy does not work. They own a house in Hermosa Beach.

Assets

- \* Employer's profit-sharing plan: \$850,000
- \* Bank savings account: \$25,000
- \* IRAs: \$80,000
- \* Brokerage account held in their family trust: \$600,000
- \* House: \$2 million

Debt

- \* Mortgage (6%, 20 years left): \$160,000

Annual income

\$400,000

Annual savings

- \* Profit sharing: \$45,000
- \* After-tax savings: \$25,000 into their brokerage account

Objectives

- \* Drew would like to retire in three to five years
- \* Protect the value of their investment portfolio

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 From the Los Angeles Times

#### CASE 4

### Rethinking longtime holdings and passing down her wealth

October 19, 2008

Lilly has a diversity problem -- a couple of them, actually. First, too much of her net worth is tied up in the stock of her late husband's company. Second, a significant source of her monthly income -- rent payments -- is dependent on a single apartment building.

She should resolve the first issue by selling most, if not all, of the stock. Even though the shares have fallen 35% this year, Gagne said it was important to salvage the gains Lilly still has, pay the capital gains taxes (which will be lower because of the recent decline) and immediately reinvest the money in mutual funds that fit her asset allocation goals (40% stocks, 5% commodities and 55% bonds).

"A 74-year-old lady shouldn't have so much of her wealth tied up in a single stock," Gagne said, "and the advice would be to sell it, whether we were in a bull market or a bear market."

As for the apartment building, Lilly should work with her financial planner and a real estate broker experienced in so-called 1031 exchanges to essentially swap the apartment building for an ownership stake in a group of rental properties. That would spread her ownership risk among several buildings, relieve her of the chore of managing the property and provide a tax break (1031 exchanges are tax-deferred transactions).

She also should take out a home equity line of credit on her house that she can tap in emergencies. (She should be able to get one despite the current credit crunch because she has good credit and owns her home free and clear.)

Finally, Lilly needs to meet with her planner and an estate attorney to work out a detailed plan for passing her wealth on to her children and grandchildren.

Lilly

Lilly, 74, is a widow with three adult children and four grandchildren. She is retired and owns a house in Sherman Oaks.

Assets

- \* Brokerage account: \$200,000 in public stock of late husband's company
- \* IRA: \$145,000
- \* House: \$850,000
- \* Apartment building: \$1.9 million

Debt

- \* Mortgage on apartment building: \$1.3 million

Annual income

- \* Social Security: \$15,000
- \* Rental income: \$30,000
- \* IRA distributions: \$20,000 (of which \$6,000 is the IRS required minimum distribution)

Objectives

- \* Concerned about the threat of inflation
- \* Passing her wealth to her children

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