SETTING SAIL
THIRD QUARTER 2016

PESSIMIST OR OPTIMIST? WHICH IS BEST FOR YOU?

Being an optimist is pretty much a prerequesite for someone in our line of work. However, occasionally we'll hear that we're naïve or not paying attention to what's going on around us. After reading a Motley Fool article by Morgan Housel entitled "Why Does Pessimism Sound So Smart?" I had the following thoughts:

- Compared to pessimists, optimists may seem oblivious to risks, making pessimists seem more intelligent. Optimists, however, see risks as more transient matters or as opportunities. We expect that things will be bad on occasion, but that, in the long run, they'll get better.

- Pessimism (which builds on fear) often generates action, whereas optimism (built on faith) often means staying the course. Those using pessimism to motivate (usually to sell you something!) want to grab your attention and motivate you to do something (usually that will make them money) right now, before you have time to think about it. Having optimistic advisors tends to cost a lot less.

- Those with pessimistic attitudes often sound like they're trying to help you. However, the default setting is usually optimism (history bears this out!) and that person trying to capitalize on your fears isn't going to be much help.

- Most of the great accomplishments in world history (political, scientific, artistic, etc.) were accomplished by optimists. In fact, I think I'd be hard pressed to come up with more than a handful of "great people" who were avowed pessimists.

I like a comment of former British Prime Minister Tony Blair:

> "The difference between an optimist and a pessimist is not that the optimist believes that the world is wonderful and the pessimist believes it's beset by challenges; the difference is the pessimist believes we will be defeated by them; the optimist thinks the challenges can be overcome."

We think that as optimists we are your best choice for advisors!

SETTING SAIL is written by Joseph R. Call, CPA/PFS, CFP® and Alan S. Campbell, MBA, CFP® and published quarterly by **SPINNAKER FINANCIAL ADVISORS, LLC,** a Registered Investment Adviser. The firm provides ***fee-only*** wealth management services, including investment advisory and management services and comprehensive financial planning and consulting.

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IS A REVERSE MORTGAGE IN YOUR FUTURE?

We have previously written about the problems of reverse mortgages (RM). However, with recent regulation that has helped reduce costs and protect borrowers, there may be situations where a reverse mortgage may help you meet long-term financial goals.

The biggest problem with reverse mortgages continues to be cost. Based on data from the NRMLA website, the cost of the maximum line of credit available for a 65-year-old couple on a $200,000 home would be just over $6,900 if you limited the first year withdrawal to less than $58,766. If you withdrew more than that (the maximum withdrawal amount is slightly over $105,000) the fees could be up another $4,000. For comparison, a local bank offers a home equity line of credit (HELOC) with a much higher credit limit and with a 15 year term with no closing costs and a much lower effective interest rate.

So, why consider a RM (or a HELOC)? Primarily, to provide you another resource for cash flow needs during retirement when other resources (such as retirement or other investment accounts or social security) are less desirable. For example:

- Taking extra money from a qualified account (401k or IRA) might push you into much higher-than-normal tax brackets. Drawing on a RM (or a HELOC) might allow you to avoid those higher taxes.
- Your adjusted gross income (AGI) impacts your Medicare premium costs (Part B and Part D) as well as the taxability of social security benefits and deductibility of certain itemized deductions. Using loan proceeds instead of taxable items can reduce your AGI.
- Postponing drawing your social security benefits until age 70 will almost always result in larger benefits over the long-term. Using proceeds from a RM or a HELOC can defer the need to draw your benefits at an earlier age.
- Liquidating a portfolio during a bear market can significantly increase the risk that you'll run out of money over your lifetime. Using an RM or a HELOC you can defer selling portfolio positions until the market recovers (see the next article "How Bad Was It, Really?")

(In all of these cases, the benefits of using a RM or HELOC are maximized when the loans are paid back in subsequent years.)

What strategies might be considered in setting up a RM or HELOC **before** you need it?

- **Establish a HELOC before you retire**. Lenders don't appear to take into account whether a HELOC applicant is about to retire or not. Since HELOC's can run as long as fifteen years, setting one up at age 65, for example, would give you a credit line you could tap until you were 80.
- **If a reverse mortgage is clearly in your future, opening it now may be better than waiting**:
    - Most of the closing costs are based on the fair market value of your home at the time of the loan creation, not the amount of the loan. Creating the RM when values are low may save you money.
    - Once established, the "principal limit" continues to grow during retirement. For sufficiently long retirements, there is a reasonable possibility that the line of credit may grow to be larger than the value of the home. In such a case, by withdrawing the full line of credit, the borrower would essentially pre-sell the home at what could be a higher-than-market price.

Properly used, a RM or HELOC can be a valuable tool to help preserve both cash flow and wealth during your retirement years!

The purpose of this article is not to provide an in-depth analysis of how reverse mortgages work. One of the better websites I've come across is that of the National Reverse Mortgage Lenders Association (NRMLA), www.reversemortgage.org. Although this organization represents lenders, it appears that the information regarding reverse mortgages is pretty comprehensive and helpful. However, here's a very brief overview of RMs:

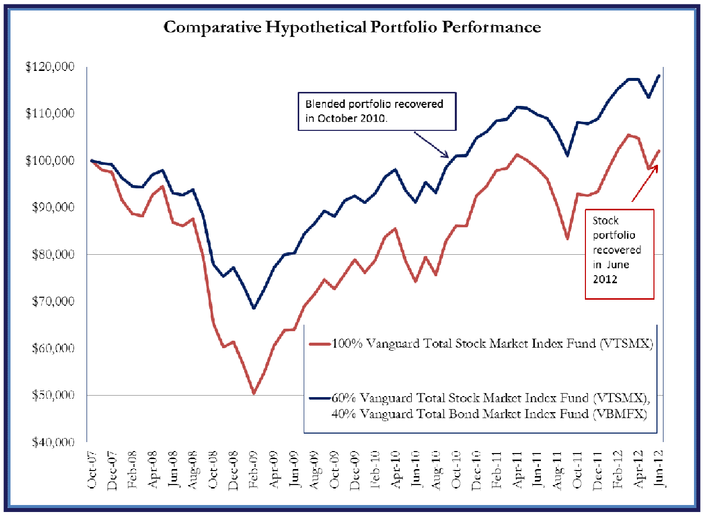
• Reverse mortgages are available for those over 62 years old who own their home (even if there is a balance outstanding on an existing mortgage).

• Any amounts received from the loan are not required to be repaid until certain triggering events, typically sale of the home, death of the borrower(s), or if the borrower no longer lives in the home. No repayments of any kind are required during the term of the loan.

• When a triggering event occurs, the loan (along with unpaid accrued interest and other fees) is payable in full within a year (typically through the sale of the home). Neither the borrower nor his/her heirs are liable for any shortfall between the sales proceeds and the balance of the mortgage.

How Bad Was It, Really?

In today's uncertain investment markets it is easy to be very fearful, especially when we have a fairly recent memory of the 2007-2009 bear market. Sometimes, our memories can play tricks on us when we only focus on one part of the market's behavior: the decline!



And decline the market did! The attached chart shows the values of two hypothetical portfolios: one that was 100% in the Vanguard Total Stock Market Index Fund (VTSMX) and the other a blended 60% in VTSMX and 40% in the Vanguard Total Bond Market Index Fund (VBMFX). (The data also reflects a 1% annual management fee, and the blended account reflects quarterly rebalancing when a position is off 10% or more from its target.)

From an initial value of $100,000 at November 1, 2007, the VTSMX portfolio dropped to $50,442 (almost 50%!) by the end of February 2009 (16 months later). But, it made a "permanent recovery" to the initial amount by June 2012 (41 months later), with a value at that time of $102,095. (It actually hit $101,331 by the end of April 2011, but it slumped back to below $100,000 for several months thereafter.)

Fortunately, we don't advise 100% stock portfolios! From the same starting period and amount, the blended portfolio dropped to "only" $68,523 (just over 31%) by February 2009. More importantly, it "permanently recovered" to its original $100,000 in October 2010, only 19 months from the end of the bear market. By the time the stock portfolio had reached its June 2012 level of $102,095, the blended portfolio had grown to $118,115—a difference of over $16,000!

There are a couple of lessons to be remembered:

- **A bear market isn't the end of the world**. The 2007-2009 bear market was followed by the 2009 – (still ongoing!) bull market and portfolios recovered from their steep declines reasonably quickly. While bear markets do happen, they also end and portfolios recover, sometimes relatively rapidly.
- **A diversified portfolio protects you in (at least) two ways**: it reduces the amount of declines and shortens the recovery period. When you listen to the financial news on TV or the radio, remember that they're only focusing on one part of your portfolio, not the entire thing!

We continue to be focused on broadly diversified portfolios that focus on long-term results. While we are certain there will be bear markets again in the future, we continue to be optimistic that, once again, portfolios will recover!

On a Personal Note . . .

On recent trips to Salt Lake and Boise to visit out-of-the-area clients, Joe and I found these two fantastic lunch spots.

Art City Trolley – Located in Springville, UT, a quiet burg known as "Art City" just south of Provo, the Art City Trolley literally has an old train car attached to the front of the building. Originally, the entire restaurant fit inside the trolley car, but success has brought growth which required more room. A casual dining restaurant, they offer sandwiches, burgers, salads, and quesadillas. The sandwiches and burgers come with a choice of fries, garlic fries, onion rings, or mac & cheese. I had the So-Cal burger which could also be called the Millennial Fantasy burger as it had all the currently trending toppings including bacon, guacamole, and jalapenos on a pretzel bun. It was as delicious as it sounds.

Kahootz Steak & Ale House – A relatively casual dining experience, Kahootz offers a mix of lunch items like sandwiches along with dinner entrees including steaks and pastas. Located on Main St. in Meridian, ID, Kahootz served traditional plates along with some of their own creations. I was in the mood to experiment so I tried the Garage Grinder, an open-faced sandwich filled with juicy steak tips, onions, peppers, broccoli, and Swiss cheese. The steak tips made the sandwich. Joe had the fish tacos which he highly recommends as well. Someday, I'd like to go back for dinner to try their steaks.

FINISHING AN ESTATE PLAN IS THE HARDEST PART

Even though our chances of not ever dying are slim to none, the (hopefully) not urgent nature of death can be a headwind to starting and completing an estate plan that covers what we wish for our children and assets. Often, we think of estate planning as meeting with an attorney to have wills, powers of attorney and perhaps trust documents set up. While this is all accurate, there are other steps that we must take to finish the estate plan.

For example, wills explain what happens to our assets that pass through probate. However, a number of assets pass on according to their beneficiary designation which supersedes the will. These include life insurance proceeds, retirement accounts, bank or investment accounts with a "Transfer on Death" designation, and joint accounts with rights of survivorship. For many estates, these assets represent significant portions of the entire estate and will pass on to whoever is listed as the beneficiary, or surviving joint owner, rather than through the will.

Some wills include provisions to create a trust at death that has specific rules governing when the beneficiaries can access the funds for their own protection. This is known as a testamentary trust. My own will creates a testamentary trust to take care of our young children in the event that my wife and I die at the same time. Like many people, a significant portion of our estate would be in life insurance proceeds and retirement accounts. If these instruments named the children as contingent beneficiaries rather than the trust, the funds would be available to the children at age 18 rather than the directions that are in the trust document.

Sometimes we see accounts that are jointly owned by a parent and one of their adult children. There are a few convenient reasons to do this, but most joint accounts automatically transfer to the surviving account owner upon the death of the other owner. This means that one child legally owns the entire account regardless of the will. Even if the surviving owner has a good relationship with their siblings, dividing up the account amongst the family is considered a gift which may incur gift tax implications.

In some cases, an estate plan calls for setting up a trust now rather than at death. This is generally known as a living trust. The trust document spells out what should happen to the trust assets in the event that the owners or "grantors" become incapacitated or die. However, the trust instructions only apply to assets that are transferred to or retitled in the name in the trust. This means that bank and investment accounts, real estate, automobiles, and other titled assets need to be placed in the trust in order to accomplish the goals of setting up a trust in the first place. During a recent client review, a client indicated that he probably hadn't transferred an out-of-state vacation property into the trust. Avoiding probate in a second state is one of the main reasons to set up a living trust. We investigated and discovered that it had indeed been titled in the trust, but that the main residence and adjoining farmland still remained outside of the trust which had been set up 20 years ago.

Most people do not enjoy estate planning or the painful details that must be taken care of after the documents are signed. If you would like us to review your estate plan to make sure that your assets will transfer according to your wishes, let us know and we can provide this service to you.

"The 1828 Noah Webster Dictionary identifies the optimist in complimentary terms, but says nothing about the pessimist. The word 'pessimist' was not in our vocabulary at that time. It's a modern 'invention' which I believe we should 'dis-invent'."

--Zig Zigler (1926-2012), American author, salesman, and motivational speaker.