FIRST QUARTER
MARCH 31, 2014

DEIGHAN
WEALTH ADVISORS

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20 Years

Deighan Wealth Advisors
1994-2014

MARKET COMMENTARY

Volatility is back. You may have missed it since the MSCI All Country World Index actually eked out 1.2% for the first quarter of 2014 and the US S&P 500 delivered 1.8%. However, both stock indices were down a worrisome 5% mid-quarter, raising concerns that we may be in for a market correction. US bonds as measured by the Barclays Capital Aggregate Index marched pretty steadily upward cushioning the volatility of the stock side of the portfolios and delivering 1.8% for the quarter. If you never looked at your portfolio mid-quarter, the suggestion that we live in volatile times may seem like much ado about nothing, but if you were heavy in stocks, and needed to draw on your portfolio on February 2, 2014 you would certainly have noticed. Upside volatility is fun, but as we learned in 2008, downside volatility can be a real sticking point.

So, if volatility is back, then what can we expect in the months ahead? We have had a strong 2013 comeback in the equity markets of developed nations worldwide, but the emerging markets that were so hot just a few years ago lost almost 13% for the year. Everything is connected and concerns over the emerging market slowdown have now spilled over into the economies of developed nations still finding their way out of the woods following the 2008 worldwide meltdown. The specific trigger for the mid-quarter pullback in worldwide equity markets may have been the early year Eurozone inflation reports suggesting continued price weakness, coupled with reports out of China showing further economic contraction. The stress in the emerging markets was evident worldwide. Argentina devalued its currency, and Turkey was forced to raise its interest rates sharply to halt a currency decline. Brazil ended the quarter with a debt downgrade when S&P cut their sovereign debt rating to BBB minus. Fortunately, encouraging news that Japan is making headway against years of deflation and stagflation, coupled with signs of economic resiliency in the US and parts of Europe, helped buoy most equity markets back into positive territory. News that China plans to address its downturn with infrastructure initiatives was additional welcome news at the end of the quarter.

Certainly there are challenges everywhere, but in the US, five years of corporate deleveraging, low interest rates, low inflation (especially low wage inflation), and increased energy independence, have put us in a reasonable place to bring back jobs from overseas. Many analysts, including Liz Ann Sonders, Chief Investment Strategist at Schwab, are calling for cautious optimism, pointing to a shrinking US deficit that may even disappear for awhile in 2016. Still, we have many structural issues. Low wages and low inflation may be good for consumers who have decent jobs, but it is tough on the many workers and their families who live near or below the poverty line including many of our youngest workers with heavy college debt. Large financial institutions still have far from transparent financials, and the regulations in place to prevent further abuses are weak and clumsy. Finally, although the Fed's balance sheet is huge, Sonders points out that on the plus side, velocity of money remains low. In other words, the Fed is slowing its support of the economy. Europe and Japan have made economic improvements as well, but they lag the US in recovery. Europe struggles with drag caused by the weaker economies in the EU and Japan struggles with its energy challenges. On balance, the developed nations are making progress, but we live in a very connected

"SO, IF VOLATILITY IS BACK, THEN WHAT CAN WE EXPECT IN THE MONTHS AHEAD?"

world, and the problems of emerging market nations including China, India, Brazil and Russia will continue to weigh on us along with problems of our own making. As these issues rise to the top, they often trigger sharp market responses.

Speaking of Russia, it looms as a large dark cloud over Eastern Europe and Asia. Political tensions are high given Russia's intervention in Crimea, and pressure on the Ukraine. It is pretty clear that Vladimir Putin would love to restore Russia to its territorial greatness. As a result, Russia is forcing its ardor on neighboring countries much to the displeasure of the West which has imposed economic sanctions. Europe is heavily dependent on Russia for oil and natural gas, but spring is in the air and current reserves may get Europe through long enough to allow the economic sanctions to have their intended effect. Recent events have taken a harsh toll on the Russian equity markets resulting in a 14% downturn for the quarter.

"POLITICAL TENSIONS ARE HIGH GIVEN RUSSIA'S INTERVENTION IN CRIMEA."

So, what is to be done to reduce risk of downside volatility in a troubled world? Twenty years ago when Jenifer Wilson and I founded Deighan Wealth Advisors we knew we were stepping into a volatile business. We had already experienced Black Monday on October 19, 1987 when the S&P 500 dropped 25% in the space of a week, but as uncomfortable as that event was, the stock market recovered relatively quickly showing a positive year-end for 1987 and an even better one for 1988. We took heart and over the ensuing twenty years we have helped clients through many volatile market environments. In 1994, just as we started, we looked back to a bad year for bonds, when the Fed tightened five times over the course of the year to battle rising inflation numbers. Each time the Fed hiked interest rates, bond values plummeted, and stocks barely stayed positive. It was a tough year. However, the Fed's strategy worked. The jobless rate and inflation dropped, and most importantly, compensation growth slowed. As a result, both bonds and stocks bounced out of the 1994 slump laying the foundation for a five year stock market climb to the 1999 tech stock bubble. Of course, that bubble burst miserably in March 2000 and the S&P 500 melted down 30% to its trough in September 2001. During this period, bonds rallied and cash held true, holding up the portfolios for diversified investors. We survived the 2000-2001 stock slump only to plow right in to another irrationally exuberant bull market that ended with the 2008 market crash when the S&P 500 dropped 36%, while the 10-year US bond soared 20% as investors fled to perceived safety. Then, 2009 brought an about face with the S&P 500 seesawing up almost 26% while the 10 year US bond delivered -11%.

We can tell you from personal experience that market volatility is not only back, it has always been with us. There is no silver bullet to avoid it. Market timing attempts do not work. Countless studies have affirmed this. As Northern Trust Company advised in their 2014 Q1 Review: *Volatility Happens*, "We encourage investors to reduce their sensitivity to volatility. Through proper allocation between risk control assets and risk assets investors can position themselves to ride out the volatility inherent in risk assets." In short, while we are cautiously optimistic that the growth side of client portfolios can grow further in 2014; pullbacks along the way are normal and should be expected. Following a strong year for stocks, the chances for pullbacks are higher, which is why respecting the role of the risk control side of the portfolio is so important. While the "risk control" side of the portfolio may seem boring and uninspired, we have only to look back to the painful years 2000, 2001, and 2008 to see the value of a diversified portfolio. So, while we hope for political stability and economic growth in 2014, we will also help clients be prepared to ride out the inevitable downside dips. We will do this by paying special attention to cash levels in the case of retired and nearly retired clients to avoid selling growth securities in a down market. This is why we continually ask clients if there are upcoming cash needs or capital expenditures on the horizon. We will continue to diversify client portfolios across asset classes, and perhaps most important of all, we will prepare clients to endure market volatility. From everyone here at Deighan Wealth Advisors, we wish you a happy, healthy Spring!

THE SOCIAL SECURITY RUMBA

Spring may be in the air, but the challenges of the past winter have taken a toll, and many clients are starting to consider hanging up more than their roof rakes. As a result, retirement questions abound and the topic of Social Security has risen to the top of popular client queries. "When should I take it? How should I take it? How can I determine what my benefit will be? Can I still make earned income? Will it be taxable?" These are just a few of the questions clients have been asking of late. The fact is, the rules are many, but they are pretty clear. We will go over the basic dance steps here, but for those seriously planning ahead, be sure to call us and go to *www.ssa.gov* for more detailed information.

Social Security as a retirement benefit began in January 1937, the same year that the Social Security tax was initiated. Medicare and disability and widows/orphans benefits followed in later years. In the 1930's the normal retirement age for workers who paid in to the Social Security system was 65, but for workers born after 1943, that has changed. For

workers born between 1943 and 1954, full retirement age is 66 years. For those born between 1955 and 1959, full retirement age is 66 plus an incremental number of months until for those born after 1960, when full retirement age is 67. At full retirement, workers who have paid in and earned enough credits are eligible for Social Security. If you were born in 1929 or later, you need 40 credits, essentially ten years of work paying in to the system to be eligible to receive Social Security benefits.

Must I wait until full retirement age to receive benefits? No. Covered workers can retire as early as age 62 and receive a reduced benefit. For example, let's assume a 60 year-old worker, Chris, born in 1954 is considering retirement. If Chris were to retire at age 66, he would get a full retirement benefit. If he were to retire at age 62, his retirement benefit would be reduced by 25%. Conversely, those who defer taking Social Security past full retirement age will enjoy an increased benefit that grows at approximately 8% annually until age 70. After age 70, there is no increase in benefits; thus there is no financial benefit in waiting beyond age 70 to receive Social Security retirement benefits. In theory, according to the SSA, "As a general rule, early or late retirement will give you about the same total Social Security benefits over your lifetime. If you retire early, the monthly benefit amounts will be smaller to take into account the longer period you will receive them. If you retire late, you will get benefits for a shorter period of time but the monthly amounts will be larger to make up for the months when you did not receive anything. There are advantages and disadvantages to taking your benefit before your full retirement age. The advantage is that you collect benefits for a longer period of time. The disadvantage is your benefit is reduced." So, the big question becomes, "When should I collect my benefits?" The answer is, naturally, "It depends on many factors." Here are some to consider:

If you are still working, be careful about the timing of your benefits. If you are still working but eligible for retirement benefits (over age 62), but under full retirement age (age 66 and up), you should think twice about collecting benefits. For every $2 of earned income an early retiree makes over $15,480, the Social Security system will deduct $1. For example, if our worker Chris were to receive $2,000 a month at full retirement, Chris could expect to receive $1,500 a month ($18,000 annually) upon retiring at age 62. If he were to continue working at age 62 while collecting benefits earning $20,000 a year, he can expect Social Security to be reduced by $2,260 to $15,740 for the year. This is not at all a good deal because Chris has already locked in a lower payout for life and is sacrificing some of that lower payout with no reward. For this reason, we seldom suggest collecting early Social Security retirement benefits if there is a significant chance of earned income before reaching full retirement age. It is important to understand that earned income is not investment income; earned income generally results in a W-2 or gives rise to self-employment tax due. Once a worker reaches full retirement age, there is no penalty for earned income. Thus, active members of the workforce in their 60's might want to delay receiving Social Security retirement benefits until full retirement age.

Other questions to consider in timing your Social Security benefits include: How is your health? How long did your parents live? Certainly, if you are in poor health, you may wish to start benefits earlier. However, one must always consider healthcare costs too. Medicare begins at age 65. If you have employer paid or partial paid health insurance, the cost of insurance if you retire and are under age 65 might consume most or all of your retirement income. Especially in these instances, it is important to run the numbers before you make a retirement decision.

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SOUNDBYTES

Deighan Wealth Advisors was a proud sponsor of Bangor Symphony Orchestra's March 2nd concert, which featured *Appalachian Spring* by Aaron Copland. We thought it might herald the season, but alas, winter stayed on!

Jean Deighan attended Schwab Market Outlook 2014 in Boston, where Liz Ann Sonders, Chief Investment Strategist for Charles Schwab & Co., Inc. and others discussed worldwide economic and market prospects.

As part of our firm's commitment to continuing education, Megan Freedman traveled to Denver, CO to attend a training session for financial planning software *MoneyGuidePro*. Jean Deighan traveled to Pittsburgh, PA for the same training.

Jenifer Wilson, President of Bangor Rotary Club, was featured on several television and radio stations to promote the club's major fundraiser, *Music Off Broadway*, the proceeds of which will benefit Sarah's House-Cancer Hospitality House of Maine.

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THE SOCIAL SECURITY RUMBA

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On the other hand, it is important to recognize that people are living longer. Again, according to *www.ssa.gov*, "A man who turned 65 in 2013 can expect to live about another 18.9 years (age 83.9). A woman who turned 65 the same year can expect to live about another 20.9 years (age 85.9), and those are just averages. About one out of every four 65-year-olds today will live past age 90. One out of 10 will live past age 95." For some who think they will live long lives, they might wish to defer taking benefits until age 70. If Chris was scheduled to receive a full retirement benefit of $2,000 a month, deferring to age 70 would result in a retirement benefit of $2,720 monthly. Of course, Chris would not pull ahead in terms of the cumulative benefit received until his mid 80's. So, by waiting Chris gained a more generous monthly payment for his later years, which might be important if he has limited retirement resources, but by waiting he also gave up the enjoyment of the income in younger, more active years. Timing of Social Security benefits is a personal decision. Just be sure to prepare yourself with as much information as possible.

May I collect Social Security based on my spouse's income? Yes. You may collect either your own Social Security or one-half of your spouse's benefit. Furthermore, you may collect Social Security based on the income of a divorced spouse if you were married ten years or more. There are benefits for widows and children of deceased workers too, but in the interest of space, please call if you would like more information on survivor's benefits. Social Security planning between married couples can make a big difference in retirement cash flow, especially when both are eligible for benefits. One worker can file for benefits and the other defer, but in these instances, the benefit is locked once the filing decision is implemented. One approach, called the "file and suspend" strategy, provides some cash flow, but allows benefits to continue to grow for both spouses. Let's revisit Chris and his spouse Pat's situation. Chris and Pat have both reached full retirement age of 66. They are both still working, but would like a little more income to either save or use for discretionary spending. Let's assume again that Chris's benefit at full retirement age (FRA) would be $2,000 a month, while Pat's FRA benefit is $1,200. Chris can file for benefits but "suspend" taking benefits which allows the benefit to continue to grow until Chris actually starts taking the benefit. Pat, as Chris's spouse can then take a spousal benefit of one-half of Chris's FRA benefit, or $1,000 a month. This is almost the amount of Pat's benefit, but Pat's benefit will continue to grow at 8% annually until Pat reaches age 70, at which point, the benefit maxes out and both spouses gain nothing by waiting and should commence taking their benefits. Clearly, this is a fancy dance step, and must be carefully executed. Furthermore, while this strategy may maximize the Social Security benefits received if both Chris and Pat live into their 90's, they are deferring enjoying their benefits which will disappear if they don't live long. Also, there is considerable political risk that Congress may change the rules mid-stream and undo all of the best laid plans. Again, timing of benefits is a personal decision.

Finally, if you regret your decision to start receiving Social Security benefits early, then there is a one-year window of opportunity to withdraw your application and repay all the benefits you've received. It will be considered a complete "do-over" as though you never filed.

There are many things to consider before filing for Social Security benefits. We encourage you to visit *www.ssa.gov* as the information on the government website is useful and is generally clearly presented. As always, we stand by to help clients navigate the tricky steps associated with Social Security decisions. There is no one right answer for everyone. The best result for each client involves a highly personalized set of decisions. Let us know when you are ready to Rumba!

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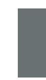

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