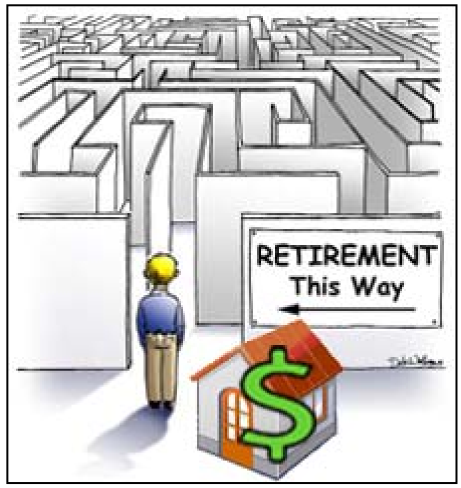
Reprinted from the
Lexington Minuteman

COROMANDEL WEALTH MANAGEMENT

October 2012

Money For Nothin'…

Navigating the Retirement Maze



By now most everyone is familiar with "Quantitative Easing 3" (QE3), the Federal Reserve's latest effort to ostensibly revive the economy. It's really more like "QE-Infinity", as the Fed Chairman has refused to specify when they plans to discontinue their massive purchases of mortgage-backed securities, only that they'll keep doing it "for a considerable time after the economy strengthens."

In all likelihood, this latest round of bond buying will have minimal effect on the economy, other than pumping up the stock market by coercing investors to shun record low-yielding bonds for riskier equity alternatives. The most pernicious effect of the Fed's efforts to keep interest rates at historic lows, though, is transferring wealth from retirees who live off of the interest from bonds and CDs, to the banks and financial institutions that get zero-rate loans. Based on statements from the Fed, this situation is likely to persist through 2016.

The obvious conclusion is that this is a lousy time to be a lender – owners of bonds, CDs, other interest generating investments – but a fantastic time to be a borrower. Although financial advisors typically frown upon their clients taking on more debt, this is the perfect time to do it.

… Because the Debt's For Free

Why did IBM, McDonald's, and Disney, companies with excellent credit ratings and are consistently profitable, recently issue debt offerings? Because the interest rates are so low that they couldn't *not* borrow, in case they might need the excess cash over the next several years for acquisitions or expansion. Why should you consider doing the same? Because you might need the cash in the next ten years – college tuition, home expansion, paying off high rate credit cards, starting a business – and your home provides the perfect vehicle for obtaining low-cost financing.

Fixed rate home loans have reached the point where families are refinancing again less than two years after their previous refinancing. Today, a 30-year fixed rate non-jumbo loan is around 3.75%; a 15-year fixed rate 2.75%. Considering that inflation has averaged just below 3% over the past 25 years, this means that what economists refer to as the "real rate" of loans – the interest rate minus the rate of inflation – is essentially zero. In other words, free money. Thus, for most people, refinancing your mortgage today is a no-brainer.

Being Smart About Debt

While debt is often viewed as bad, it's what makes business growth possible. Debt can also benefit families, provided that they use it responsibly and have the means to pay it back on time. Don't make the mistake of opting for even cheaper adjustable rate loans, particularly if you're planning to pay it back over 10 to 30 years. You'll regret the decision when interest rates finally begin to return to more normal levels and your monthly loan repayments start increasing.

There is nothing wrong with tapping excess equity in your house for future cash needs – mortgages can usually be obtained for up to 80% of assessed value – as long as you stick with these guidelines:

- Don't spend it on something unrelated to your primary need. You want the money to be there when you need it.
- Do NOT invest it in the stock market with the idea that you'll end up with even more when you're ready to tap it. Repeat after me: "The stock market is very, very risky." Instead, park the proceeds in safe, interest-bearing low-risk bonds or funds that provide you with some return while you wait for the need to use the cash.
- Make sure that your projected cash flow can handle the higher payments from the extra money borrowed. Never forget that it's your home that's being pledged as collateral.
- Be sure to pay down the balance of your loan prior to retirement. Debt and retirement don't mix well.

Disappearing Tax Break

One benefit I neglected to mention is the tax deductibility of your mortgage interest payments, which makes your effective interest rate even lower. This was a deliberate omission, though, as this may disappear for some home owners when Congress gets around to rewriting the tax laws. Tax experts believe that the interest deduction for primary residence loans under a specified limit may survive. However, second homes and loans made to so-called wealthy families (over $250K in AGI) have a good chance of losing some or all of their deductibility over the next several years.

So be sure to take advantage of the Fed's "free money" program while you can. Refinance your mortgage at today's rock bottom rates, take out excess funds if you will need them in the foreseeable future, but make sure that you borrow and spend responsibly.

George Gagliardi is a financial planner with Coromandel Wealth Management in Lexington, where he helps clients develop and implement investment and retirement strategies. He is affiliated with Trust Advisory Group, Ltd., a Registered Investment Advisor, and can be reached at (781) 728-9001 or george@CoromandelWM.com. *This article is intended for general information purposes only, and may not be appropriate for your specific circumstances. Investment advice is particular to each individual, and should only be given after an individual situation has been reviewed.*