

# FINANCIAL PLANNING *Outlook*



3RD QUARTER, 2010

## New Income Strategies for a Low Rate Environment

By William Van Keulen, CFP®



Will the next financial bubble be in the historically boring and reliable bond market? Over the past two months, bond yields have reached record lows, with the bellwether U.S. Treasury note hitting

an all-time low yield of 0.304 percent in early October. With unemployment still soaring and investors seeking the safe haven of bond funds, bond prices – which, remember, move in the opposite direction of their yields – are being driven to historically high levels.

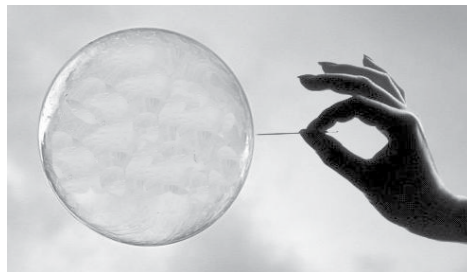
This is all happening because the Federal Reserve is pulling every lever it has to keep rates low, and because investors prefer those low interest rates to the perceived risk in stocks in this still-sluggish recovery. The result is that a mix of quality bonds scheduled to mature over the next 10 years might return as little as 2 percent. If interest rates rise in that period, which is very possible, that 2 percent return could be worth virtually nothing. This is borderline irrational

– especially when you consider that there are investments other than bonds that can potentially deliver comparable income.

That's why we have enhanced our existing income strategy for this precarious environment, relying on alternatives to the increasingly "frothy" price of bonds. We're looking at different classes of stocks, at real estate investment trusts, at convertible bonds that can be eventually converted to stock – anything with the potential to deliver the kind of income investors have traditionally gotten from bonds alone, but no longer possible in the current environment.

To be sure, there is some upside to the bond bubble. For one thing, any bonds purchased over the past three years have probably gained in the neighborhood of 10 to 20 percent. But even though portfolio statements are showing an increase in value, this rise is largely illusory. As those bonds

near their maturity date, those price increases will evaporate. Bond issuers are obligated to pay back only par value at maturity, not the current inflated market value. So if you see six-year



[CONTINUED ON PAGE 2](#)

Be financially  
confident.®

**CARNICK  
& COMPANY**  
PERSONAL FINANCIAL ADVISORS

*History tells us that market bubbles create  
behavior that rarely makes sense.*





# Mortgage Mess Dead Ahead

By William Moyer, CFA



We started seeing reports in late summer about strange happenings: ▶ Banks trying to foreclose on home owners who paid cash for their home and had no mortgage; ▶ Multiple mortgage servicers foreclosing on the same property; ▶ Situations where mortgage payments that were never recorded although the borrower has the receipt for payment; ▶ Banks forging documents to fraudulently establish proper chain of title where there is none, or even using false documents that had been notarized.

Without sufficient resources to handle the massive amount of foreclosure cases, the mortgage servicers expedited the process by shipping off thousands of mortgage documents to foreclosure mills where 'robo-signers' were employed to sign affidavits without proper review and submitting them with inaccurate data. These 'robo-signers' signed off on

as many as 7000 per month.

Most mortgage servicers are subsidiaries of large entities like Bank of America, Citigroup, Wells Fargo, JP Morgan Chase, and Ally Bank (formerly GMAC). Bank of America recently announced a foreclosure moratorium in all 50 states. And thankfully, President Obama recently vetoed a bill, HR 3808, (a bill that passed both House and Senate without debate and with no record of how each member voted) that would have made it easier for banks to foreclose. Keep in mind that BofA purchased CountryWide, which was notorious for originating sub-prime, 'liar loans', and Option Arms. And the same sham transactions were rampant at Washington Mutual, now owned by JP Morgan Chase.

This is a problem of the banks own making. During the housing bubble, Wall Street's demand for mortgages was insatiable. They needed mortgages to bundle into collateralized debt obligations (CDOs) and mortgage backed securities (MBSs). These securities were

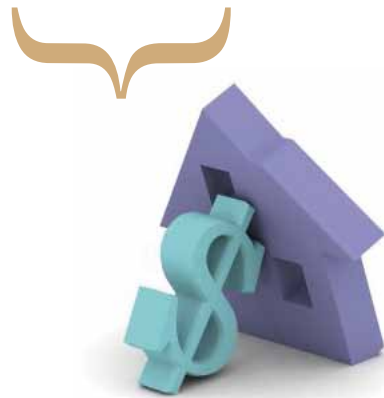
then sold to pension funds, mutual funds, and other investors who needed a decent return on principal. And needless to say, the banks made oceans of money on the transactions. But now, after all these mortgages were bundled up into securities, sliced into various tranches, and sold off to investors worldwide, it is becoming nearly impossible to figure out who actually owns the note to the house, let alone who has physical possession of the actual loan documents. In 45 of 50 states, if you don't own the note, you can't foreclose.

By the way, the CDOs and MBSs are the same securities they brought to the rating agencies (Moody's, S&P, Fitch) for triple-A status. No need to comment on whether these were indeed AAA quality securities as we know the answer to that. But at the time this was going on, during the peak of the housing bubble, there was little or no concern whether the borrowers actually qualified. In fact, there is one argument that says the banks knew most borrowers could not pay or refinance when the adjustable mortgage rate reset, and the banks fully expected to take ownership of homes when the loans were originated. In other words, this was one giant fraud.

Another part of this mess is the often overlooked 'title insurance' that borrowers pay when signing all the loan documents. Title insurance companies are refusing to touch resales on foreclosed properties from the servicers with documentation problems. They do not want to expose themselves to massive title problems where they would potentially have to pay off.

Let there be no doubt that this is shaping up to be another battle of the banks (and Wall Street) against Mainstreet America. Expect to see the banks paint this current problem as mere paperwork technicalities while they claim the real issue is deadbeat borrowers. In fact, relatively few people who can't afford their homes fight to keep it; most are beating back a bank motion to break a bankruptcy stay or believe they are the victim of servicing errors. They will also claim that unless the government caves into their demands and allows them to streamline foreclosures, the economy will fall back into the tank. To me this sounds like another ransom demand similar to the first TARP. And you can bet if this mortgage mess goes against them, they will be looking for another bailout. ■

This is shaping up to be another battle of the banks (and Wall Street) against Mainstreet America.



## "New Income Strategies for a Low Rate Environment" CONTINUED FROM PAGE 1

6 percent coupon bonds priced at \$120, remember that in six years investors will be paid back the original par value of \$100, after having received an annualized return of 2.5 percent.

Why would someone pay an inflated price for such a low rate? History tells us that market bubbles create behavior that rarely makes sense. In many ways this bubble resembles what happened in residential real estate in the past few years, or in tech stocks a decade ago. Home buyers and lenders found themselves consistently out of touch with the reality of how people were going to be able to pay back their mortgages without a decent level of income. Just a few years earlier, technology investors fell into a fantasyland where they persuaded themselves that

tech companies would be able to deliver ever increasing earnings to meet the dizzying growth in their stock prices.

Despite the losses that resulted from these decisions, it appears these same investors are now seeking safety in the bond market and creating a brand-new bubble. Eventually, bubbles burst, and the victim is the last one holding the bag.

The way to counteract these bubbles in the markets is to take a more dynamic approach to investing, to constantly monitor irrational market bubbles and take prudent action to resist their effects. Going along with the investing crowds is easy, and a trap that too many advisors fall into, but our job is to provide our clients with the highest returns given an acceptable amount of risk. The recent herd mentality to purchase bonds at any price has exposed investors to an unacceptable amount of inflation risk. Why would logical investors expose themselves to such risk for so little return? It makes no sense. Clearly, a day of reckoning is coming closer to hand.

As a result of this looming bubble, we have restructured how we generate income in our portfolios. Specifically, we've replaced these overpriced bonds with alternative income-generating securities, such as dividend-paying stocks and REITs, preferred stock and convertible bonds. Some of these securities are tied to tangible assets such as energy and real estate, some are adjusted as interest rates increase, and some are purely high-paying dividend stocks with potential for growth. But they all are currently paying at least double and sometimes triple the amounts one can earn from bonds in today's conditions.

Yes, there are inherent risks in all these investments, along with potentially more volatility. But when you consider the low returns bonds are offering, we feel that this well-diversified and monitored mix of income securities is a more prudent option for our clients. It certainly makes more sense than moving with the bond-buying herd - and waiting for the bottom to fall out. ■



### Who Receives the Inheritance? You May Be Surprised!

Many people may be surprised, if not shocked, to learn that an individual named as the beneficiary on a beneficiary form is entitled to the money regardless of what an individual's will, trust document, or divorce decree states.

In January, 2009 the U.S. Supreme Court unanimously ruled that beneficiary forms trump all other documents. In *Kennedy v. Plan Administrator for DuPont Savings and Investment Plan*, the Court ruled that an ex-spouse should receive the retirement plan benefit because she was named on the beneficiary form—even though she waived her right to any of her ex-husband's retirement plan benefits under the divorce decree. The Court ruled that the plan must pay the beneficiary named on the beneficiary form, even though there were contradictory signed agreements between husband and ex-spouse. The deceased intended to leave his retirement plan balance to his daughter, but he never updated the beneficiary form. The Supreme Court said that plan administrators have to look at the terms of the plan and pay the death distribution to the person named on the beneficiary form.

**The Lesson.** If your marital status has changed or you have made updates or any other changes to your will, divorce decree, or other documents, then make sure that your beneficiary forms carry out your wishes in accordance with your estate planning documents. It is not enough to just check your IRA or 401(k) beneficiary forms. Double-check all of your retirement plans, pension plans, life insurance policies, and annuities. ■

# FINANCIAL PLANNING *Outlook*

## Is Your Bank Safe?

By Craig Evans Carnick, CFP®



If you've been reading the headlines about banks these days, you're probably worried. Last year, 140 banks shut their doors; as of the beginning of September this year, the number of bank closings is already up to 125. That's compared with three bank closings in the more normal economic times of 2007. At last count (June 30 of this year), 829 other banks were on the Federal Deposit Insurance Corp.'s "Problem Bank List," meaning they have weak capital positions that could lead to failure.

But if you have substantial assets on deposit at a lending institution, you do have some protection against losing money in a failure, and a way to check how much. The FDIC provides government-backed insurance for your deposits, and the new financial reform bill permanently raised this amount to \$250,000 per depositor.

As it happens, you probably have more protection than you think. The FDIC has created a web calculator called EDIE (<https://www.fdic.gov/edie/calculator.html>), which lets you input the name of your lending institution, the value of your deposit, personal, business or trust accounts, and it will tell you how much of your money at that institution is insured. A quick run through

the site shows that if a husband and wife have a joint deposit account worth \$500,000, then the total amount is insured—\$250,000 each. Suppose one of them also has a business checking account as a sole proprietor? That, too, is insured up to \$250,000. A trust with beneficiaries is also protected, with the amount of coverage going up the more beneficiaries there are. A tutorial on the site gives the example of a \$1.2 million trust co-owned by a husband and wife who have three named beneficiaries (their children). The way the math works, the full amount is insured; each child counts for \$250,000 of FDIC insurance with the father and for the same amount with the mother.



Before you go to the web site, however, you might first want to check and make sure that your lending institution is a member of the FDIC. Most member banks have official FDIC signs prominently displayed at the teller windows, but you can also check online at the FDIC web site's "bank find" feature: [http://www2.fdic.gov/idasp/main\\_bankfind.asp](http://www2.fdic.gov/idasp/main_bankfind.asp).

And finally, understand that investment products sold by banks like stocks, bonds, mutual funds, annuities or other investments don't qualify for FDIC coverage. Only CDs, checking accounts and deposits are FDIC insured. ■

Be financially  
confident.®

**CARNICK  
& COMPANY**

PERSONAL FINANCIAL ADVISORS

675 Southpointe Court  
Colorado Springs, CO 80906

(719) 579-8000  
[www.Carnick.com](http://www.Carnick.com)



Pictured left to right:

Bill Moyer, CFA • Craig Evans Carnick, CFP® • Clarissa R. Hobson, CFP® • Kim Young • William Van Keulen, CFP®