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# Monthly Market Monitor

## July 2009

## General Purposes of Life Insurance

Life insurance is a unique asset that can be used to solve some of life's perplexing financial problems.

### *Death Benefit Uses for Life Insurance*

- **Create an estate:** Where time or other circumstances have kept the estate owner from accumulating sufficient assets to care for his or her loved ones, life insurance can create an instant estate.
- **Pay death taxes and other estate settlement costs:** These costs can vary from a low of three to four percent to over 50 percent of the estate. Federal Estate Taxes are due nine months after death.
- **Fund a business transfer:** Business owners often agree to buy a deceased owner's share from his or her estate after death. Life insurance provides the ready cash to finance the transaction.
- **Pay off a home mortgage:** Many people would like to pass the family residence to their spouse or children free of any mortgage. Often a decreasing term policy is used, which decreases in face amount as the mortgage balance is paid down.
- **Protect a business from the loss of a key employee:** Key employees are difficult to attract and retain. Their untimely death may cause a severe financial strain on the business.



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- **Replace a charitable gift:** Gifts of appreciated assets to a charitable remainder trust can provide income and estate tax benefits. Life insurance can be used to replace the value of the donated assets. Proceeds from life insurance policies can also be paid directly to a charity.
- **Pay off loans:** Personal or business loans can be paid off with insurance proceeds.
- **Equalize inheritances:** When the family business passes to children who are active in it, life insurance can give an equal amount to the other children.
- **Accelerated death benefits:** Federal tax law allows a “terminally ill” individual to receive the death benefits of a life insurance policy on his or her life income tax free. Such “living benefits,” received prior to death, can allow a person to pay medical bills or other expenses and maintain his or her dignity by not dying destitute. If certain conditions are met, a “chronically ill” person may also receive accelerated death benefits free of federal income tax.<sup>1</sup>

Existing life insurance policies should be reviewed to verify that policy provisions allow for payment of such “accelerated death” benefits.

### *Other Uses for Life Insurance*

While life insurance products are primarily used for death benefit protection, they are also used for long-term accumulation goals.

- **College fund for children or grandchildren:** Cash value increases in a policy on a minor’s life (or the parent’s life) can be used to fund college expenses.
- **Supplement retirement funds:** Current insurance products provide competitive returns and are a prudent way of accumulating additional funds for retirement. Available cash values may also serve as an “emergency reserve,” if needed, or a source of loans, since life policies frequently include features permitting borrowing against these cash values<sup>2</sup>.

For a complimentary life insurance policy review, contact Linda Specht today at (209) 444-3354.

<sup>1</sup>The discussion here concerns federal income tax law; state or local tax law may vary.

<sup>2</sup> A policy loan or withdrawal will generally reduce cash values and death benefits. If a policy lapses or is surrendered with a loan outstanding, the loan will be treated as taxable income in the current year, to the extent of gain in the policy. Policies considered to be modified endowment contracts (MECs) are subject to special rules.



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Market Indices <sup>1</sup>	June Change	Year-to-Date (6/30/09)
S&P 500	0.0%	1.8%
MSCI EAFE	-0.8%	5.6%
Dow Jones Industrial Average	-0.6%	-3.8%
Russell 2000	1.3%	1.8%

## Too Far, Too Fast or a Pause That Refreshes?

With the major indexes gaining 35-40+% off their early March lows, the stock market appeared to catch its breath in June. Most analysts attribute the second quarter rebound to confidence that, thanks to government stimulus and Federal Reserve rescue programs, catastrophe was averted. Many economists now believe the economy could finally show growth by the fourth quarter. Signs of recovering consumer sentiment were also showing up, but late in the month many started to worry that the market had gotten too far ahead of solid economic evidence. Those hard numbers will be key to whether the rally continues or a market pull back, possibly to the old lows, is in the cards. Many analysts take heart in evidence of stability developing in the housing and auto sales data. Others believe this may be just a reaction to temporary cheap pricing to clear out inventory and is not sustainable with continually rising unemployment. The next important indicator will be second quarter earnings being released over the next month. Even without a clear improvement in consumer spending, the market could get a lift if, as some suspect, signs that corporate profits may experience a stronger-than-expected snapback in the second half of the year. Gains in business productivity and timely cost cutting in this downturn could lead to a faster rebound in profits, even with a generally slower forecasted recovery.

Profits are a major determinant of longer-term market direction. Another factor, interest rates, is not so encouraging. Longer-term interest rates spiked to almost 4.0% on 10-year US Treasury bonds in June from 3% in March based on sudden concerns over inflation. The biggest negative impact was seen on the emerging housing market recovery as the higher rates translated quickly into a spike in mortgage rates, threatening to end a mini-boom in mortgage refinancings. Most economists believe any sustainable economic recovery is still tied to the stabilization of the housing market and Fed programs to keep people in their homes and dry up the inventory of vacant homes are dependent on keeping mortgage rates low. While rates have receded somewhat in recent days, the growing argument over the potential level of inflation arising from the government stimulus programs will likely remain an important determinant for stock market performance in the coming months.

## Conflicting Views of Inflation and Higher Interest Rate Risk

The discussion over inflation boils down to two distinct arguments. The traditional definition of inflation is “too much money chasing too few goods”. This means that cheap money and easy borrowing terms create higher prices as consumers bid up prices on any variety of goods that are in limited supply. The eventual cure is to raise interest rates, making borrowing less attractive. This usually happens at full employment and in an overheated economy. By this definition, most economists would conclude that inflation has little chance for at least the next year, given the excess production capacity in the economy. The unemployment rate is high and expected to rise to over 10% in the next year. Factory utilization is running far below capacity. Moreover, instead of chasing new purchases, consumers are saving and paying down debt. Businesses, except for perhaps gas stations, are having a hard time raising prices. Banks are being careful to lend out the bailout money they received from the government and continue to cut customer credit card limits. Many economists worry that under this scenario the threat of *deflation* continues to be a bigger concern than inflation.

Other economic experts worry that the basic fundamentals of demand/supply inflation will be overcome by the unprecedented, and what they see as unrelenting borrowing and spending that the government continues to pursue to revive the economy. Interest rates will naturally rise to persuade lenders to continue buying. Compounding the problem is that a large amount of the government debt is being bought by overseas investors, particularly China. At some point foreign borrowers may have other uses for their money and cut back on their purchases, forcing the Treasury to offer even higher rates to attract buyers. This would have the same negative economic and market effects as raising rates to combat traditional inflation. A well-debated future problem for the Fed and the market is if, how, and when they will begin to pull out this immense amount of new money created by the stimulus efforts. The Fed has made it clear they are very aware of the inflation issue and will act to counteract it. Unfortunately, tools used to fight inflation can slow economic growth and many worry that investor's exaggerated fears of inflation could force the Fed to move too quickly during this still shaky recovery period.

1. Wall Street Journal, 7/1/09

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