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THE FINANCIAL FORMULA

Giving You The Financial Information You Need

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Hello my readers - Fall is here! I hope you find these articles helpful. Please let me know if you have any questions - thank you!

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Homeowners are considering making improvements to their homes rather than trading up for a bigger, better model. What improvements will provide the biggest bang for your buck?

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The majority of Americans lack basic knowledge about the likelihood of a disability and are unprepared to cope with this type of life-altering event. Women across all age groups are at higher risk than men of becoming disabled at some point during their working lives.

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All too often, investors react to a sharp drop in prices by panic selling or digging in their heels despite deteriorating fundamentals. But more thoughtful investors see a correction or downturn as an opportunity to review the risks in their portfolios and make adjustments where necessary.

Should You Switch to a Shorter-Term Mortgage?

A growing number of homeowners are switching to shorter-term mortgages. Rates on 15-year mortgages are at all-time lows, and the differential between 15-year rates and 30-year rates is greater than ever.

The renovations that recoup the greatest percentage of their initial cost are those that residents are likely to use frequently or that enhance energy efficiency.

Remodeling Your Home: Is It Worth the Cost?

With home values nationwide still well below the historic average highs set prior to the housing collapse, homeowners are considering making improvements to their homes rather than trading up for a bigger, better model.

Remodeling magazine conducts an annual Cost vs. Value Report that presents the national midrange cost for a variety of renovation projects and the typical cost recouped at sale. Note that these numbers are national data and expenses may vary regionally.

Remodeling Cost Vs. Value 2011-2012[1]

Project	Midrange Cost	Resale Value	Percentage Recouped
Attic bedroom	$50,148	$36,346	72.5%
Basement remodel	$63,378	$42,338	66.8%
Bathroom addition	$40,096	$20,455	51.0%
Bathroom remodel	$16,552	$10,293	62.2%
Deck addition (composite materials)	$15,579	$9,780	62.8%
Deck addition (wood)	$10,350	$7,259	70.1%
Family room addition	$83,118	$50,004	60.2%
Home-office remodel	$27,963	$11,983	42.9%
Kitchen remodel (major)	$57,494	$37,785	65.7%
Kitchen remodel (minor)	$19,588	$14,120	72.1%
Master suite addition	$106,196	$62,874	59.2%
Siding replacement (vinyl)	$11,729	$8,155	69.5%
Sunroom addition	$74,310	$34,133	45.9%
Window replacement (vinyl)	$11,319	$7,692	68.0%
Window replacement (wood)	$12,229	$8,258	67.5%

Bigger Isn't Always Better

If you focus on an upscale project with high-end materials or a more budget-conscious approach, the initial cost of the job and the cost recouped at sale will vary accordingly. For example, the difference between a minor kitchen remodel and a major kitchen remodel lies primarily in the design and materials used to renovate a 200-square-foot kitchen. Variables include semi-custom cabinets vs. existing cabinet boxes with new doors and drawers and the presence of a 3-by-5-foot island in the major kitchen remodel.

Ironically, the data show that the minor kitchen remodel recoups a higher percentage of its cost than the major kitchen remodel. Spending your money wisely, vs. spending the largest amount of money, may be more worthwhile financially.

The renovations that recoup the greatest percentage of their initial cost are those that residents are likely to use frequently or that enhance energy efficiency. Bathrooms and kitchens, which typically are used daily, tend to be important to potential home buyers. Vinyl siding and window replacement can potentially enhance energy use.

Before embarking on a renovation project, consider whether you are likely to recoup a good portion of the cost over the long term. This approach may help to focus your thinking on long-term value.

[1] *Source: Remodeling, "2011-2012 Cost vs. Value Report" (www.remodeling.hw.net).*

Most Americans Unprepared for Disability

For millions of Americans, purchasing adequate disability income insurance is a potentially effective way of protecting against the financial hardship that could arise if illness or injury were to result in a long-term absence from work. Yet a new study found that the majority of Americans lack basic knowledge about the likelihood of a disability and are unprepared to handle such a life-changing event.[1]

The Social Security Administration estimates that one in four of today's 20-year-olds will become disabled at some point during their working years.

The Social Security Administration estimates that one in four of today's 20-year-olds will become disabled at some point during their working years. The study found that women across all age groups report a higher incidence of disability than their male counterparts, with arthritis and back/spine problems being the leading causes.

The financial impact of disability can be severe. A person with an annual income of $50,000 who works for 40 years is projected to make more than $2 million in future earnings. The loss of these earnings can be devastating for an individual or a family -- and for women, the financial consequences can be more severe. The study found that women are twice as likely as men (22% vs. 12%) to think their cash reserves would last less than a month. Single women have an even bleaker outlook.

According to the study, 61% of women and 46% of men have never researched disability insurance -- and fewer than 10% have purchased disability insurance plans. Even among individuals who work with a financial advisor, awareness and planning around the topic of disability is low. Fewer than half have consulted with advisors about what would happen if they or their spouse became disabled, and fewer women (37%) than men (52%) have had this discussion with an advisor.

Types of Insurance

For most people, there are two main forms of disability income insurance to consider: employer-sponsored policies and private insurance policies. Employer-sponsored policies (called "group" policies) are relatively inexpensive to purchase and generally remain in effect for as long as the individual continues to work for the company.

Private insurance policies are paid for by individuals and provide coverage when group policies don't apply or don't provide enough income. On the surface, a private policy is usually more expensive to purchase than a group policy. However, a private policy's potential to provide much greater benefits over time may make it a more prudent long-term choice.

For all practical purposes, if you need the income you earn at work, you probably also need disability income insurance. Among those who are most likely to need disability income insurance coverage are small-business owners, the self-employed, high-income professionals, and the primary breadwinners in a household. Your insurance professional can help you find out if you have enough coverage.

[1]*Source: State Farm Center for Women and Financial Services, "Women and the Risk of Disability," May 2012.*

Surviving Market Turbulence

Most stock market investors are looking for the same result: strong and steady gains of their investments. Dealing with a period of sustained falling stock prices is not easy. All too often, investors react to a sharp drop in prices by panic selling or digging in their heels despite deteriorating fundamentals. But more thoughtful investors see a correction or downturn as an opportunity to review the risks in their portfolios and make adjustments where necessary.

When confronted with any adverse market event -- whether it is a one-day blip, a more lengthy market correction (a decline of between 10% to 20%), or a prolonged bear market (a decline of more than 20%) -- take time to review your portfolio. Dealing with volatility can be difficult. Here are some suggestions to help you and your portfolio survive market turbulence.

- **Keep a long-term perspective.** The only certainty about the stock market is this: It will always experience ups and downs. That's why it's important to keep emotions in check and stay focused on your financial goals. A buy-and-hold strategy -- making an investment and then holding on to it despite short-term market moves -- can help. The opposite of buy-and-hold investing is market timing -- buying and selling investments based on what you think the market will do next. Market timing, as most investment professionals will tell you, is risky. If your predictions are wrong, you could invest when the market is on its way down or sell when it's on its way up. In other words, you risk locking in a loss or missing the market's best days.
- **Organize and review your financial records.** Crisis events highlight the importance of knowing where your assets are and maintaining organized financial records. Following the September 11, 2001, terrorist attacks, markets closed for several days and many records in the heart of New York City's financial district were destroyed. Yet the nation's financial systems were up and running in a matter of days, and your securities accounts were safe even when the stock exchanges were closed. While you cannot trade investments or access your assets during a market shutdown, securities firms maintain backup facilities and have contingency plans to help them service customers when trading resumes.
- **Talk with a professional.** A financial professional can help you separate emotionally driven decisions from those based on your goals, time horizon, and risk tolerance. Researchers in the field of behavioral finance have found that emotions often lead investors to read too much into recent events even though those events may not reflect long-term realities. With the aid of a financial professional, you can sort through these distinctions, and you'll likely find that if your investment strategy made sense before the crisis, it will still make sense afterward.

It's important to remember that periods of falling prices are a natural part of investing in the stock market. While some investors will use a variety of trading tools, including individual stock and stock index options, to hedge their portfolios against a sudden drop in the market, perhaps the best move you can make is reevaluating and limiting your overall risk position.

Should You Switch to a Shorter-Term Mortgage?

Perhaps most alluring for consumers is the prospect of paying off their mortgage sooner -- and saving thousands in interest payments in the process.

It wasn't that long ago that a 15-year mortgage was considered a fringe product, suitable for a relatively small number of buyers and homeowners looking to refinance. But no longer. In fact, according to Freddie Mac, almost one-third of all mortgages refinanced during the first quarter of 2012 replaced their 30-year mortgage with a shorter term loan.[1]

The trend toward shorter mortgage terms stems from several factors.

- **Debt reduction.** Many households are looking for ways to reduce their debt, especially in light of the drop in house prices, which has left nearly one-quarter of American homeowners under water with their mortgages.[2]
- **Low rates.** Rates on 15-year mortgages are at all-time lows, and the differential between 15-year rates and 30-year rates is greater than ever. According to Freddie Mac, the average rate for a 15-year mortgage, as of August 23, 2012, was 2.89%, compared with 3.66% for the average 30-year mortgage. That's a 77-basis-point difference. Historically, this spread has been much smaller, averaging 48 basis points for the 20 years ended December 31, 2011, and as low as 31 basis points as recently as 2007.[3]
- **Earlier payoffs.** Perhaps most alluring for consumers is the prospect of paying off their mortgage sooner -- and saving thousands in interest payments in the process. For example, on a 30-year, $100,000 mortgage at 4%, you would pay $71,870 in interest over the life of the loan, while a 15-year mortgage of the same amount and rate would cost you only $33,144 in interest -- a savings of more than $38,000.

The downside to 15-year mortgages, however, is that your monthly payment can be significantly higher because of the additional principal you are paying each month -- averaging twice what you would pay on a conventional 30-year mortgage. For many, the extra payment is simply not doable. But for those who can afford it, the long-term savings are significant.

Whether you go with a 15- or 30-year mortgage, remember to factor in points and closing costs. Also consider how long you expect to own the property. Your bank or mortgage representative can work with you to weigh different mortgage options and help you decide whether a 15-year mortgage is right for your situation.

[1]*Source: Freddie Mac, July 2012.*

[2]Source: CoreLogic, as of the first quarter of 2012.

[3]Source: Freddie Mac, *Primary Mortgage Market Survey*, August 23, 2012.