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Despite Media Fury, Few Pros Predict Recession

For months now, investors have been bombarded with so many reports of a recession ahead that the markets have seemed more than a little shell-shocked. But while the media have fixated on the gloomiest forecasts, most economists actually predict moderate economic expansion.

The Economic Cycle Research Institute (ECRI), made waves on September 30, 2011, when it announced that, according to its data, an economic downturn was nigh. "The most reliable forward-looking indicators are now collectively behaving as they did on the cusp of full-blown recessions, not 'soft landings,'" ECRI said. "The U.S. economy is indeed tipping into a new recession. And there's nothing that policy makers can do to head it off."

Three months later, ECRI stands by its prediction, and sooner or later it may come true. But in the meantime, investors may want to note three key points that say as much about how economic hype propagates in today's hyper-connected environment as they do about the underlying economy itself.

1. "Secret" methodologies are hard to trust.

ECRI economists made their reputation by calling the bottom of the 2007-2009 recession in March 2009—and again in 2010 for saying no "double-dip" recession was imminent. But they have been vague about exactly which "forward-looking indicators" are making them so nervous. Their methodology is proprietary, a secret to all except the firm's clients.

At the same time, the indicators the rest of the world has to work with give no clear signal of a recession ahead. Denver economist Fritz Meyer, a 35-year veteran of the industry, notes that according to the more established index of Leading Economic Indicators—published by the Conference Board for the past half-century—the economic environment seems to be improving. "The risk of economic downturn has receded, and the forward-looking economic data has actually picked up a little bit," Meyer says.

Meyer and other independent economists can check the Conference Board's work and judge the results for themselves, but ECRI's calculations remain a "black box" opaque to third-party verification.

2. Other economists see no recession on the horizon.

In contrast to whatever ECRI has seen, economic numbers from the Conference Board remain fairly strong. New factory orders from the Institute for Supply Management have actually improved during the past few months, for example, and vehicle sales, commercial lending, and non-manufacturing economic activity all picked up during the past quarter.

In fact, no significant economic gauges have turned downward. "Economists continue to believe that the U.S. economic expansion will continue at a relatively robust rate," Meyer says, citing a December Wall Street Journal survey revealing that, on

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Flexible Spending Accounts: Beware The Ides Of March

Do you still have money in your flexible spending account (FSA) from last year? Normally, you would have to forfeit any funds left over that weren't used for legitimate expenses by December 31. That cash is gone . . . forever.

However, if your company has authorized a "grace period," there may still be time to use your money. The tax law allows you to withdraw funds for 2½ months after the close of the year. That could give you until March 15 to empty your FSA from last year.

If your company offers FSAs for health care expenses, you can make pre-tax contributions to a fund in your name. Typically, contributions are made through regular payroll deductions. During the course of the year, you can withdraw money tax-free to pay for qualified expenses such as doctor visits and prescription drugs. Similarly, your company may provide an FSA that you can go to pay dependent care expenses.

Suppose you're in the 35% federal income tax bracket and you contributed $5,000 to a health care FSA in 2011. That would save you $1,750 (35% of $5,000) that would have been due if the money had been subject to income tax. And you could be eligible for additional savings on state taxes.

Just don't forget about the "use-it-or-lose it" rule, which companies must strictly enforce. Circle March 15th on your calendar as the absolute last day for tax-free withdrawals.

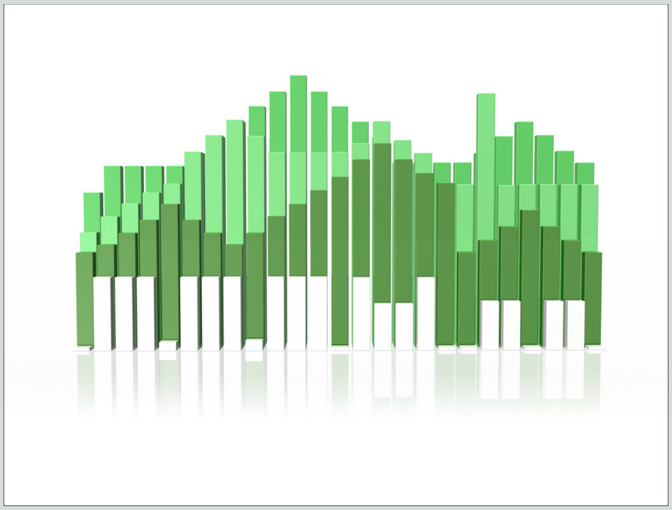
Demographics Heal Housing Markets

Five years after the housing sector imploded, economists finally see some support ahead for battered home prices—help that doesn't depend on Washington. The secret boils down to boom-and-bust demographics.

After the U.S. construction industry overbuilt during the decade that ended in mid-2006, new housing starts fell to their lowest levels on record during the years that followed. Meanwhile, the American population kept growing at roughly its long-term average rate of 3 million people a year. Eventually, there have begun to be too few new homes for new families, says Denver-based economist Fritz Meyer, and demand for housing is now increasing far faster than supply.

If 3 million Americans reach maturity each year, as Meyer estimates, they may need 1.5 million new houses and apartments to own or rent. However, when the construction sector pulled back in 2007, it eliminated millions of jobs and hundreds of thousands of development projects. That retreat has translated into an annual shortfall of 675,000 homes, or 3.3 million in total.

Demographic pressures aside, there hasn't yet been much improvement in the highest-profile gauge of housing market health, the national Case-Shiller Home Price Index. But the combination of growing demand and the lowest rate of supply in decades is a pretty good sign for the future.



It took until 2011 before the population finally absorbed the overflow of homes built between 1998 and 2006. That leaves the housing market tighter now than it has been in ages. And, according to Meyer, we haven't seen anything yet. The "echo boom" of 129 million Americans born between 1977 and 2009 is still coming into its own and will eventually need even more houses than its Baby Boom parents required.

"What's startling is that this generation has already surpassed the Baby Boom in size," Meyer says. "The most highly touted demographic event in all world history is ultimately going to be dwarfed."

Those born at the midpoint of the more recent population boom—1993—just turned 18 last year. During the next few years, they'll start their adult lives and look for a place to live—and to judge by what happened to the Baby Boomers, that will result in enormous demand for housing. The midpoint of the Baby Boom generation turned 18 in 1981, and during the next five years, the number of housing starts nearly doubled to keep up with demand.

If history is any guide, it might take a few more years before the Case-Shiller index finally starts to budge off its lows and home prices recover some of the 30% they've shed since the 2006 peak. But gathering demographic forces, Fritz Meyer says, mean that sooner or later a new housing boom will follow the current bust. ●

Is It Finally Time To Refinance?

During the past few years, mortgage interest rates have continued to flirt with historic lows, and Freddie Mac (the government-sponsored Federal Home Loan Mortgage Corporation) announced that during the week ending October 6, 2011, the average rate for a 30-year loan dropped to 3.94%, the lowest rate ever according to the National Bureau of Economic Research. Meanwhile, the average rate for 15-year fixed mortgages dipped to 3.26%—also a record low.

It appears that loans at rates hovering around the 4% mark, or even lower, should be available for at least the short term. So that begs the question: If you haven't refinanced your mortgage yet, why not? The answer is that there's more to refinancing than just low interest rates.

Deciding whether to refinance is all about finding your break-even point—the time when you'll actually begin to save money after taking into account all relevant factors, including tax ramifications, the fees you pay to refinance, and the difference in monthly mortgage payments. If you'll hit the break-even mark during the time you expect to be in your home, refinancing probably makes sense.

How do you determine the break-even point? Online calculators are plentiful, but some may leave out crucial factors. To make sure you're taking everything into account, do your own arithmetic using these five steps.

1. Add up the refinancing expenses. This may include fees for attorneys, loan application and origination, home appraisal and inspection, deed recording, title insurance, credit reports, and any "points" you pay to obtain a favorable rate.

2. Find your monthly savings amount. Simply subtract your current monthly payment from the amount you'll owe if you refinance.

3. Calculate the tax cost of

Pinpoint Four Top Trends In Section 529

Faith in Section 529 plans had waned in recent years as investors felt the pinch of the 2008 stock market decline. But now these tax-favored college savings vehicles are picking up steam again. Not only have investors regained confidence, but there have also been several positive changes to the state-sponsored accounts. According to Savingforcollege.com, a leading independent resource for information about 529s, four significant trends have emerged.

1. Fees and expenses have come down. Increased competition among rival plans has resulted in lower fees for participants. Savingforcollege.com's semi-annual "529 Fee Study" shows the total 10-year cost of a $10,000 investment in plans' least expensive options dropping from an average of $862 in August 2007 to $570 in August 2011 (or 8.62% to 5.70%). Those figures include underlying mutual fund expenses in addition to fees for program managers and account maintenance.

"Fees and expenses started dropping back in 2003, but it has only been since 2007, when OppenheimerFunds took over in Illinois, that we've seen a real 'race to the bottom' among the larger 529 plans," says Joe Hurley, founder of Savingforcollege.com. "Some in the 529 industry are saying fees in the lowest-cost plans have gone about as low as they can possibly go, and I tend to agree with that. Fees are likely to drop still further now only if states begin subsidizing program operations."

2. Risk management has become a priority. In the aftermath of the stock market downturn in 2008, the investment managers of many state plans sought to add new investment options—including bank certificates of deposit (CDs) and savings accounts—that provide greater security to investors. Managers are also tweaking age-based investment options so that they'll hold up better in future stock market declines.

"Before 2008, FDIC-insured bank products were available through only five states: Arizona, Hawaii, Montana, Ohio, and Virginia," says Hurley. Now 16 states offer them (though Hawaii has dropped the FDIC-insured option in its 529 plan). Moreover, many 529s now let participants choose from among than one age-based investment option—letting extremely conservative investors, for example, select a track that shifts completely out of the stock market by the time a student graduates from high school, while more aggressive investors might choose to keep some money in stocks throughout the college years.

And a few states have gone still further. Rhode Island recently announced a new feature that adjusts for stock market volatility in the age-based investment option of its CollegeBoundfund plan by giving investment managers from AllianceBernstein limited discretion to reduce the allocation to stocks when market conditions become turbulent. In another variation, Utah now allows plan participants to create their own customized age-based tracks.

3. More plans are offering index funds. Mutual funds that passively track market benchmarks have been showing up in more and more Section 529 plans during recent years, largely because index funds tend to have lower expenses than funds that are actively managed. Most states use Vanguard index funds in plans they sell directly to investors, but other companies—including Fidelity, TIAA-CREF, and T. Rowe Price—are also finding their way onto lists of 529 options. And though advisor-sold 529 plans generally still use actively managed funds in their portfolios, one exception is Arkansas's iShares 529 Plan, which features an assortment of index-tracking exchange-traded funds (ETFs).

4. Multi-manager investment portfolios are becoming more common. Some states that use actively managed funds in their 529 plans have switched from placing investments with a single manager to employing multiple managers. Being able to choose from among several investment managers may help investors further diversify their investments and could lead to higher returns.

Fidelity recently added a multi-manager, age-based option in four states in which it manages 529 plans, TIAA-CREF is now using a multi-manager platform in Connecticut and Oregon—and plans to offer it in California—while OppenheimerFunds-managed plans in New Mexico and Texas have switched to multi-manager platforms. About half of the 529 plans sold by advisors are now multi-manager plans.

All of these changes have come in response to investor concerns about the safety and growth potential of Section 529 plans. Now, plan participants tend to have more investment choices and better options for protecting the value of their accounts. ●

refinancing by multiplying the monthly savings amount by your combined federal and state income tax rate. Generally, mortgage interest is deductible on your federal return, so if your interest costs drop, so will your deduction.

4. Subtract the tax cost from the monthly savings amount. That will give you your net monthly savings.

5. Divide the cost of refinancing by the net savings to find the number of months it will take to pay off the refinancing expenses. This is your break-even point.

For example, if your cost is $5,000 and your net savings is $1,000, it will take only five months to break even.

Unless you're planning an immediate move, refinancing makes sense. However, if your cost is $10,000 and your monthly savings is only $250, it will take 40 months—more than three years—for refinancing to pay off. That may be a tougher call. If you have questions about whether it's finally time to refinance, we can help you crunch the numbers and consider the impact of such a move on your overall financial situation. ●

Few Predict Recession

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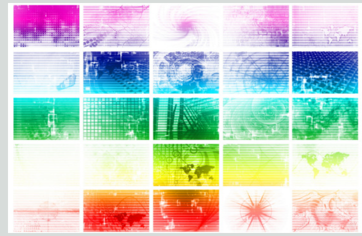
average, industry professionals suspected gross domestic product (GDP) growth would rise to nearly 3% in the fourth quarter.

That doesn't mean ECRI's secret recession recipe won't eventually be borne out. But in the meantime, publicly available numbers reflect the opposite of what is normally considered a recessionary environment.

3. Timing is everything. Timing the market is not.

Three months after ECRI's September recession prediction, it still weighed on investor sentiment, perhaps because ECRI had declined to provide a timeline for determining whether its call was right or wrong. In September, the group said the United States was on the "cusp" of a full-blown downturn, which would indicate some urgency. By mid-December, however, ECRI's time frame had softened to "sometime next year."



Recessions, like expansions, come and go, and there will inevitably be additional downturns, so ECRI was right on that front. But by moving the scope of its call further and further out, the forecasters have kept investors on edge, leading many to withdraw from investment markets to wait for brighter days ahead.

The problem, though, is that investing isn't something people do only when outside conditions make it convenient. It continues throughout the ups and downs of the economic cycle. And since September, the U.S. economy has shown every indication of continuing to expand, and financial markets, though volatile, have reflected that expansion.

The Standard & Poor's 500, a broad gauge of U.S. stock prices, climbed 8% between the time of ECRI's initial forecast and mid-December. An investor who fled to the sidelines to avoid that "full-blown recession" would have lost out on that appreciation, the equivalent of nearly a year of normal performance for large-cap shares. ●

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