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A consuming passion

Public spends with gusto despite economic storm clouds

By **Aldo Svaldi**
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Sunday, August 26, 2001 - Corporate America has slashed spending, cut workers and written off bad investments.

TIPS FOR TOUGH TIMES

Financial strategies recommended in a difficult economy - such as paying down debt, building a cash reserve and diversifying investments broadly - make sense anytime. Below are some pointers from financial planners:

* Find out how much debt you really have and how long it will take to pay it down. Remember that once-manageable debt can turn crushing in a downturn. Reduce it, don't add to it.

* About four out of 10 households live paycheck to paycheck. Try to understand why you spend more than you earn. Are you servicing too much debt? Are you using money to project success? Build an emergency cash fund. Three months is a minimum and at least six months or more should be salted away if a job loss is remotely possible.

American consumers, in contrast, continue to buy and borrow like it's 1999.

Do consumers, who have prevented a recession so far, have a better grasp of the nation's economy?

"Consumers are on a financial acid trip," said Suze Orman, personal finance editor at CNBC and a best-selling author, on a recent trip to Denver. "They are continuing to buy homes they can't afford. They are continuing to spend money as if nothing happened. What are they thinking?"

All people need to do is look at their retirement plan balances, which are declining, she said, or consider for a moment that they might be the next person laid off. The Labor Department counted 712,000 layoffs in the first half of the year alone - up 40 percent from last year.

"We are in a seriously difficult period," she said.

Despite the many layoffs, consumer confidence remains at historically high levels. Consumers in July were more optimistic than in February, according to The Conference Board, seeming to ignore signs of a

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* Considering attending classes to further your education or improve your career skills. Have a plan in place if a pink slip comes your way.

* Use the tax rebate as an opportunity to establish new habits. Pay off debt, add to savings or throw it into your IRA. Resist the urge to spend it.

* Continue to put money into your retirement plans. Now is not the time to stop.

* Those near or just into retirement should avoid selling off depreciated stock holdings to pay living expenses. Retirement funds that get diminished early may never recover.

* Don't allow the fear of admitting a mistake prevent action. Lucent Technologies Inc., at \$7 a share, may take years to reach \$77 again. Cut loose the technology losers, capture the tax writeoffs, and invest where the prospects are brighter.

* Lower interest rates are driving down the return on money market funds, CDs and savings accounts. Consider buying individual bonds to boost return.

* Homeowners thinking about selling may want to move sooner rather than later in case the residential market has peaked. Take extra caution with real estate investments.

Source: *Financial*

deteriorating economy. Their spending has decreased only slightly.

"I don't understand why there is so much confidence, why people are spending like they are," said Jim Elder, a registered investment adviser with Prestige Financial Advisors Inc. in Arvada.

Nearly four in 10 Americans spend more than they make because of easy credit, according to a July survey from the fraternal organization Lutheran Brotherhood.

Up to 32 million U.S. households, primarily those in the lowest income brackets, spend on average \$8,000 more each year than they earn and are at serious risk of bankruptcy within the next three years, estimates LowerMyBills.com, a Los Angeles-based consumer Internet site.

The spending message comes from all directions, including the federal government. The Treasury Department is mailing out \$40 billion worth of rebate checks to taxpayers.

Rather than encouraging people to sock their rebate checks away, the message has been to spend it all and revive the economy.

But the burden is too heavy for consumers to carry, Orman said.

"You need to think about your own self," she said. "Don't buy the financial ticket that Bush is trying to sell and that merchants are taking advantage of."

Financial self-preservation

If consumers are willing to do what is necessary to put their financial houses in order again, the U.S. economy will be better off in the

planners, "*The Road to Wealth*," by Suze Orman

long run, financial planners said.

Near-term, a heavy drop in spending could push the economy, which grew at an anemic 0.7 percent in the second quarter, into a recession.

"Our society will always be a consuming society," conceded James Shambo, president of Lifetime Planning Concepts in Colorado Springs.

But too much consumption can endanger financial health.

Step one requires getting a grip on your financial situation, something that may have seemed unnecessary in better times, planners said. Many borrowers, for example, don't realize how much debt they have and what it is costing them.

"You don't have the courage to tell your friends you can't go out to dinner with them because you have \$8,000 in credit card debt," Orman said. "If you go out to eat with them, you are sick to your stomach because you know when the waiter comes back to collect the bill, they have a good chance of saying 'credit denied.'"

Orman, who recently released a financial planning guide called "*The Road to Wealth*," has a strict standard for defining too much credit card debt.

"If you can't pay off your credit card bill in full at the end of the month, you are already in credit card trouble," she said.

She also discourages people who haven't seriously reformed their spending habits from rolling unsecured debt into a home equity line or mortgage refinancing.

The typical pattern is for borrowers to run up the credit cards again while greatly increasing the risk for foreclosure and even homelessness, she said.

Besides trying to lighten their debt burden, Shambo recommends workers look seriously at their job security. Those working for weak companies in weak industries should prepare for the worst, he said.

"Are you a long-term employee with a lot of tenure or the new kid on the block who is likely the first to be chopped?" he said.

Employees don't need to passively wait for the ax to

fall: They should continue their education and improve their skills, Shambo said. Changes in the tax code make saving money for educational expenses easier, he said.

Financial planners recommend people at risk of having their jobs eliminated save at least six months worth of expenses instead of the typical three months.

The cushion reduces the need to borrow and allows people to hold out for the best job offer rather than being forced to jump at the first thing that comes along.

Should the economy slip into a recession, expect stocks, which remain richly valued in relation to rapidly falling earnings, to take another hit, experts said.

The Nasdaq index, which fell 39 percent last year and is down 24 percent this year, could revisit the low of 1,638 that it hit April 2 before eventually dropping to the 1,200 range under a recessionary scenario, predicted Paul Dickey, a financial consultant with A.G. Edwards & Sons in Denver. His opinion isn't widely shared.

Such a decline would shock investors who believe the market bottom came in April and who have continued to hold battered technology stocks in the hope that a rebound is around the corner.

What people don't realize is that a stock that has fallen from \$100 to \$1 is at a much greater risk of falling to \$0, Shambo said.

Worth more as write-off

"A lot of people can barely stand this," Elder said. "They are saying, 'Wake me up when this is over.'"

Stocks that have fallen so precipitously - a group that includes big technology names as Lucent and Cisco - are in many cases worth more as a tax write-off than an investment, Elder said. It may be better to take what money is left and put it to work where it can earn a decent return, he said.

Investors who won't need to touch their investments for several years should look at any further declines in the market as a buying opportunity, financial planners said. Younger workers should continue to fund their retirement plans as much as possible, they

said.

Elder and others recommend putting small amounts of new money into the market on a regular basis - a buying method called dollar-cost averaging.

Orman said those who have envisioned the worst-case scenario are not caught off guard when it happens and can act rather than react. Preparation is key, she said.

"The idea is not to panic - that is first and foremost," agreed Thomas Zanecchia, a CPA with Wealth Management Consultants in Denver. "As long as you don't panic, you will do well over the long term."

Retirees who have just left the workforce need to be especially careful with investment decisions, Shambo said. If they sell stock holdings during a down market early in retirement, retirees risk not having enough money to last them.

Shambo recommends retirees or those approaching retirement keep at least five years' worth of living expenses out of more volatile stock investments. Other planners recommend two or three years' worth.

Planners advise some caution about buying real estate for investment purposes if it's not for a primary residence.

Low interest rates make home buying more attractive, but there is a good chance that home prices could weaken with the overall economy if consumer confidence cracks.

Sellers shouldn't put off a sale too much longer if they want to move, planners said.

Retrenching coming?

Evidence is mounting that Americans, realizing the economy is worse than previously thought, are pulling back.

Consumers increased their spending by only 2.2 percent in July, slipping below 3 percent for the first time since 1996. Consumer credit, which was growing at a 10.5 percent pace in the first quarter, contracted 1.2 percent in June.

Still, households continue to hold \$1.59 trillion in credit. That doesn't include real estate loans.

"There is a nervousness out there," said Janet duClook, a portfolio manager with Wells Fargo Private Client Services in Denver. "When is it going to all end and when are we going to see a recovery?"

Difficult times, if nothing else, can force people to re-evaluate their relationship with money. How did they get in such a tight spot, or how did they avoid it?

"You need to be powerful over who you are and stop defining yourself by the things you have," Orman said.

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