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A Road Map for Your Financial Future

Would you go on a vacation without planning it? Of course not, so why would you head for retirement without planning for it? Unfortunately, that's exactly what many people do. In early 2012, a survey sponsored by the Consumer Federation of America and the Certified Financial Planner Board of Standards found that:

- 34% of Americans say they can retire at age 65, down from 50% in 1997
- 48% of Americans with college-bound children are saving money for their education, compared to 56% 15 years ago
- About 50% have fallen behind on their retirement savings, compared to 38% in 1997

Not surprisingly, the study also found that less than one-third of all Americans — just 31% — have a plan for their financial future. That's the same number as in 1997.

What Is a Financial Road Map?

A road map for your financial future is about more than retirement. Done properly, it's a blueprint for using all of your financial resources and earning power to meet your financial needs, now and in the future, *in the most efficient way possible.*

What do we mean by the efficient use of money? We mean making sure that you cover all of your needs to the greatest extent possible, given how much money you have and, if there's any left over, maximizing your potential wealth while staying within your comfort zone for risk-taking. Planning for your financial future will help determine whether you are spending too much in one area of life to the neglect of another.

Creating a Financial Road Map

1. The first step is taking a snapshot of who you are. It's like a household census: how many in

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Calculating an Investment's Basis

Your capital gain or loss on the sale of an investment equals the proceeds from the sale less your basis (the cost of acquiring the investment). When you purchase an investment, your basis equals the price you paid plus any fees or commissions. While the calculation is fairly straightforward, other factors can affect your basis calculations:

- Reinvested dividends are added to your basis at full market value plus any fees or commissions.
- The basis of any investment received as a gift is the donor's original basis plus any gift tax paid by the donor. However, if you then sell the investment at a loss, your basis is equal to the lesser of the donor's basis or the investment's fair market value on the date of the gift.
- For inherited investments, the basis is the market value on the date you inherited the investment, typically the date of the donor's death.
- Your basis in stock that has been split is the same as your basis before the stock split. Your per-share basis, however, will now equal your total basis divided by the number of shares you own after the split.

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Road Map

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your immediate family and how many outside your immediate family do you want to provide for in some way, like parents or grandchildren.

2. The second step is to take a financial inventory: how much total income does your household bring in every year, what are your expenses including taxes, what is the value of all your assets, how much debt do you have, and what is your net worth (assets minus liabilities). Knowing your net worth is important, because it's the foundation for financing your entire life and a sign of how long you could cover your basic needs and lifestyle if you were never to receive another dollar of income.

3. The third step is to define all of your financial goals. For most people, this means:

- ✔ Creating a "rainy day" fund to pay for expenses in case you become too ill to work or lose your job
- ✔ Obtaining life insurance to cover your spouse's and children's needs in case you pass away prematurely
- ✔ Securing disability insurance coverage in case you can't work for an extended period of time because of an illness or injury
- ✔ Paying for your children's educations
- ✔ Financing your retirement lifestyle
- ✔ Minimizing your taxes, both income and estate
- ✔ Providing long-term care for you and/or your spouse
- ✔ Providing an inheritance for your heirs or a legacy to a charitable cause or institution

4. The fourth step is to develop a savings and investment plan to meet all of those goals. This is a multistep process. First, it's important to determine what kind of investor you are: are you comfortable with taking risk to obtain a high rate of return, or are you more conservative and willing to accept a lower rate of return for greater safety? How you score on a test of your "investor personality" will help determine an asset allocation strategy that balances risk and return while meeting your objectives. The final step is to select the types of accounts you'll need, fund them, and select the investments.

Completing a financial road map can make all the difference between having the future you want or settling for one you can afford. It's never too early to start planning. If you haven't completed a financial road map or feel like it's time to review the one you prepared years ago, please call. ❍❍❍

Dreams and Goals: What's the Difference?

It takes a lot of hard-nosed work to fulfill your dreams. We mean converting your dream into a plan to make your dreams come true. The first step is to recognize the difference between a dream and a goal. A dream is a vision that inspires you to work hard, smart, or both. As pleasant as the dream may be, however, it lacks specificity. Specifics are for goals and plans of action.

A financial goal and plan of action to meet it sounds like this: I'm going to retire when I'm 65 years old in a lifestyle that costs $150,000 a year in today's dollars and maintain it, adjusted for inflation, for as long as I live. Of that amount, $120,000 is going to come from my personal savings, which means I need to save a total of $1.7 million. And that means I have to save $40,000 a year, and my savings has to earn 8% a year, pretax.

To summarize: a financial goal consists of 1) a date 2) by which time you need a specific amount of money 3) that lasts a specific amount of time. The action plan calls for: setting aside a specific amount of money, investing it to achieve a specific rate of return, and monitoring your progress and making the necessary course corrections to remain on target.

While planning for your financial future covers a number of topics and strategies, they revolve around two core goals: supporting a lifestyle and paying for education. Every other element of a financial road map — obtaining disability and life insurance, minimizing taxes, an investment plan, and planning the efficient distribution of your estate — is designed to support the two goals of lifestyle and education.

What good goal making comes down to is making fairly reliable projections of what your financial goals are going to cost in the future and when that future will arrive. The more expertise that's applied to goal formulation, the better the goals will be. After that, the creation of a road map to meet those goals takes even more judgment calls: what is the rate of inflation likely to be between now and when your goal needs to be met, what kind of funding will the plan require, what asset allocation strategy is going to achieve the best balance between the rate of return you need and the level of risk you're comfortable taking?

After all of that, the key to achieving your goals is adjusting to the unexpected. If the changes are significant enough, it may take you back to square one — restructuring your goals. Planning for your financial future isn't a one-time exercise. At its best, it's an iterative exercise that calls for steadiness of vision, calm reactions to new realities, market awareness, and flexibility. Please call if you'd like to discuss this in more detail. ❍❍❍

Make Pension Decisions Carefully

In the past, a retiree typically received a monthly pension check and Social Security benefits. Now, it's not uncommon for a retiree to have a pension plan, a couple of 401(k) plans, some individual retirement accounts (IRAs), personal savings, possibly some deferred compensation, and maybe an annuity. Deciding how to handle all those different income sources in the most advantageous manner is a daunting task. In many cases, decisions regarding pension plans are irrevocable, so proper choices are imperative. Before making those decisions, consider the following:

Prepare a list of all your retirement assets by type of plan. Indicate the expected monthly income as well as the earliest and latest date you can start taking benefits. Review the payment options available to see if some assets should be used before others. For instance, defined-benefit plans and deferred compensation plans generally require you to take benefits when you retire, whether you want the money or not. Other plans, such as 401(k)s and IRAs, allow you to start withdrawals between the ages of 59½ and 70½, providing flexibility regarding the amount withdrawn. Thus, if you can, it is typically advantageous to leave that money in the plan to grow tax deferred until a later date. You must begin taking minimum distributions from traditional IRAs (not Roth IRAs), 401(k) plans (unless you are still working), and other qualified plans when you reach age 70½.

Decide whether you want to take a lump-sum distribution or receive an annuity. This option is generally offered with 401(k) plans, profit sharing plans, and some defined-contribution plans. Your decision should be based on the income tax ramifications of the different options, your personal needs, and your financial ability to handle the money.

If you opt for an annuity, you must decide among various payment options, including life only, which pays you a certain amount until your death; joint and survivor, which will also pay a certain amount to your spouse after your death; and life and period certain, which pays a certain amount for your life or a specific time period, whichever is longer. Your payments are generally taxed as ordinary income when received.

You may like the comfort that comes with annuities, since you are assured of a monthly income without having to worry about investment decisions. However, annuity amounts are typically fixed, so inflation can seriously erode the purchasing power of this income over the years.

A lump-sum distribution gives you the opportunity to invest your retirement funds. Thus, you receive the rewards of smart investment decisions, but you can also suffer from poor decisions. Since you own the funds, proceeds can be left to your heirs after death.

The tax treatment of a lump-sum distribution depends on how you handle the distribution. The least favorable alternative is to include all the proceeds in your taxable income in the current year, subjecting the proceeds to your top tax rate and possibly the 10% tax penalty if you are under age 59½.

As an alternative, any portion of your account balance in a qualified plan can be rolled over into an IRA within 60 days. This rollover defers the tax on the distribution and allows it to grow tax deferred until withdrawn. Keep in mind that if you take possession of the funds, your employer must withhold 20% of the proceeds, even if you plan to roll over the entire balance. You can avoid this provision by having your employer directly transfer the distribution to your IRA. If you are between the ages of 59½ and 70½, you can access the funds as you need them, penalty free, paying ordinary income taxes only as you withdraw funds.

Determine how to withdraw money from your plans. After going through this analysis, you can decide when to start taking distributions. These decisions will take into account your life expectancy, your tax situation, your current income needs, the expected inflation rate, and your expected rate of return on retirement assets. The calculations can quickly become very complex if you need to evaluate several different plans under several different payment scenarios. Since the calculations are so important for your retirement, please call if you'd like help with these decisions. ❍❍❍

Rebalancing Your Portfolio

There is a relatively underused and simple technique to raise your long-term portfolio performance and reduce your risk at the same time. It's called "rebalancing," and it's something every investor can and should do.

Let's start with the basics. First, to rebalance, you need to have more than one investment in your portfolio (so you can hold investments in different asset classes, like stocks, bonds, and cash). Second, you need to determine the right mix of those investments for your objectives.

The opportunity for rebalancing arises when the market performance of your investments changes their value and, as a result, their weighting in your portfolio.

The purpose of rebalancing is to restore an investor's portfolio to the structure that fits his/her objectives. Here's how you do it: you sell off a portion of any asset class that has increased beyond its target percentage and reinvest the sale proceeds in more asset classes that have shrunk below their target percentage. The calculation is simple: multiply the new market value of your portfolio by your target mix percentages and compare them to the values in your account.

Aside from maintaining the level of investment risk that's right for you, rebalancing has two additional benefits. First, it forces you to lock in your gains, which many investors fail to do. Second, rebalancing can add as much as one-half percent or more to your long-term investment returns. That may not sound like much, but over 20 years, it could mean thousands of dollars more in your pocket.

A good rule of thumb for rebalancing is once a year. But, depending on market performance, it could be more or less often than that. The best advice is to check your portfolio several times a year and rebalance whenever there have been significant changes in the weighting of its constituent parts.

This is just an overview of rebalancing. It can apply not only to asset classes, but to subasset classes as well. There's also the question of which particular stocks or bonds you sell or buy. Finally, there's always the chance that changes in your portfolio may coincide with changes in your objectives — you may actually need to be taking more or less risk than in the past. Please call if you'd like to discuss this in more detail. ❍❍❍

Do You Need a Prenuptial Agreement?

In the past, prenuptial agreements were common only with very wealthy individuals. But times have changed. People get married later in life after accumulating substantial assets or obtaining postgraduate degrees that will help them earn more in their careers. Second marriages are also more common. Thus, it is now more common for couples to sign prenuptial agreements.

A prenuptial agreement details what will happen in the event of divorce or the death of either party. Keep these points in mind:

✔ **It is important to discuss all financial information.** You and your future spouse should detail all assets, debts, and income, so you can plan appropriately for their distribution.

✔ **Consider other topics to include.** You can also include things like who will be responsible for caring for children, how children will be raised, and other lifestyle issues.

✔ **Sign the prenuptial agreement in advance of your wedding day.** To ensure a spouse doesn't later claim that the agreement was signed under duress, consider signing the agreement at least two or three months before your wedding. ❍❍❍

Financial Thoughts

Approximately 35% of federal spending goes to entitlements such as Social Security and Medicare. If the Medicare eligibility age were raised today from 65 to 67, approximately $125 billion would be saved by 2021 (Source: *Money*, September 2012).

Approximately 4.8% of U.S. gross domestic product is spent on the military, compared to 2.6% in Britain, 2% in China, and 1% in Japan (Source: *Money*, September 2012).

Almost 16% of high-net-worth investors say they buy and sell investments more than they should. The average investor's annual returns trail the market by 1.5%, while active investors trail the market by 6.5% (Source: *SmartMoney*, September 2012).

Only 1% of American children save their allowance, totaling $780 per year on average (Source: *Time*, September 2012).

The percentage of people eligible to sign up for Social Security who choose to start collecting benefits dropped to 26.9% in 2011, the lowest level it has been in 35 years. That's down from 30.8% in 2009. Waiting to take Social Security benefits can boost the benefit by roughly 8% for each year delayed between ages 62 and 70 (Source: *Money*, August 2012). ❍❍❍