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# financial focus

## Winter 2008-2009

### TIME TO ACT?

[Bert Whitehead, founder of the Alliance of Cambridge Advisors, recently posted an item on his blog discussing how clients of ACA members might respond to the remarkable events of yet another troublesome October in the investment world. This article is adapted from that blog post, which you can read in full at BertWhitehead.blogspot.com.—Ed.]

In October, more than 75 ACA members met to discuss the current economic turmoil and the appropriate actions clients could take. At that time, the Dow was down about 25% year-to-date, and the European markets were down more than 30%.

To put this in historical perspective, the Dow dropped 25% in one day in 1987. In the last recession, from 2000 to 2002, the market was off 45% at its bottom. A number of investors jumped out of the market in 2002 because they couldn't bear the thought of losing half their portfolio. They were hesitant to put money back in the market when it started to recover, worrying it would drop again. During 2003, the market soared over 30%, and by the time they got back in during 2004, they were never able to make up for their losses.

Times like these present both dangers and opportunities for investors. If you are laid off, in danger of losing your job, or your business is losing money, contact your advisor before taking any action. Otherwise, here are some ideas you might consider, depending on your stage in the ACA Life Cycle. [If you're not certain which stage describes your situation, ask

your ACA financial advisor, or see Chapter 7 of Bert's book, *Why Smart People Do Stupid Things with Money*.—Ed.]

**Foundation (typical ages, 20–30):** This is a great time to buy your starter home. If you shop for foreclosures and short sales, you could find a great value. But if more than 10% of the home sales in your area are foreclosures, they are driving the market price, so hold back, pay off your credit cards, and accumulate cash. Keep contributing to your 401(k) because you can borrow this money for a down payment if you have to.

**Early Accumulation (typical ages, 30–40):** Because by now your net worth should be one to three times your annual income, and you have a home, *save, save, save*. Hold off on home upgrades and renovations until you have built up a cash reserve of at least 20% of your mortgage balance. Split your 401(k) contributions 50-50 between cash/stable value funds and equity mutual funds.

**Rapid Accumulation (typical ages, 40–55):** Your net worth is now three to ten times your annual income, so invest aggressively in your equity mutual funds to bring them to at least 60% of your portfolio. This is a great time to buy stocks using dollar-cost averaging

(that is, buying every month). Doing this now will have you looking back in 10 years, amazed at how low the prices were.

**Financial Independence (typical ages, 55–70):** You are still working but may be supplementing your income with investment earnings. These are dangerous times for you. Make sure you don't deplete your investment portfolio! Either work more to increase your income or cut your living costs.

**Conservation (typical ages, 70–85):** You are probably now retired and should be confident about your future income, perhaps using the ACA bond ladder strategy. It is critical to make sure you continue to live within your means. Excess spending means your portfolio will be depleted too quickly. Keep to your spending plan to assure you will be able to replace the rungs you are using from your bond ladder when the economy turns around.

**Distribution (typical age, 85+):** Many clients in this stage are distributing their surplus. We suggest holding off on additional gifts



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# FINANCIAL STRATEGIES FOR EVERYDAY LIVING

## SEVEN FINANCIAL ISSUES FOR NEW PARENTS

by Avani Ramnani, CFP®, Jersey City, NJ

**A** positive result on a pregnancy test can bring up a multitude of emotions, both joys and anxieties. By the time they've begun to talk about names for their newborn, most parents-to-be are already thinking about their financial situation. Here are seven financial issues to consider when you are adding a child to your life:

### 1. Lifestyle Spending Plan

Many people struggle with making and sticking to a budget. I tell my clients not to do it! Yes, you need to live within your means and prepare for your future. But you don't need to know where you've spent every last cent. As long as you are saving enough for retirement and other goals (such as children's education) and paying off your credit cards every month, it doesn't matter how you spend the rest of your money. It does take some preparation and discipline, but most families find they can handle it.



### 2. Life Insurance

Ideally, ask an unbiased professional, not someone who sells insurance products, to analyze your need for life insurance. Very few people take the time to investigate life insurance properly, with the result that parents often buy too much insurance or get the wrong type.

### 3. Disability Insurance

Many advisors consider disability insurance more critical than life insurance. You are far more likely to lose income due to disability than you are to die before retirement. Disability insurance replaces a portion of your income if you can't work because of illness or injury. An unbiased advisor can help you understand any disability coverage you can get from your employer, and how much, if any, additional disability insurance you may need.

### 4. Saving for Retirement and Education

New parents commonly worry about saving for their child's college education. But retirement savings should take priority. Parents likely will be retired far longer than the kids are in

college. And parents can't borrow to fund their retirement, but the kids can usually take out loans or earn scholarships to fund their education.

### 5. Estate Planning

Who wants to think of dying when you are bringing a new life into the world? But even if parents don't have any significant financial estate, wills can be crucial because they are often used to designate guardians. If both parents were to die without wills, a court may lack guidance about who to appoint as guardians for any minor children. Consider backups for your guardians, in case the first designee is unable to take on the responsibility.

### 6. Liquidity

Having enough liquidity is key to a smooth financial plan. Plan for two sources of liquidity: ready cash for day-to-day expenses and funds for true emergencies such as extended unemployment. The amount you need may be more than you might think. The less secure your income, the more liquidity you need.

### 7. Benefits at Work

There may be benefits at work to help with child-related expenses. Many companies offer flexible spending accounts (FSAs) for medical and dependent care. Contributions to the FSA are not subject to federal income tax or employment taxes. For example, if taxpayers in the 25% tax bracket contribute \$1,000 to their company's FSA, they would save \$250, plus up to \$153 in Social Security and Medicare taxes. Money in the account is then available for qualifying medical or dependent care expenses.

The birth of a child can prompt us to think of the bigger picture and a long-term financial plan. Even if you think you are doing everything right, consider asking an independent professional to review your financial plan and help you make any needed adjustments. When you know you don't have to worry about money, you can concentrate on the joys you'll share as a family. ■ ■ ■

## TIME TO ACT?

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to children or charities for 6 to 12 months. You want to gift your surplus, but you don't know what that will be until this financial crisis ends.

The economic situation could worsen substantially, particularly if compounding events occur, such as terrorists setting off a war in the Middle East that interrupts the world oil supply, a severe California earthquake, or a global health plague. Of course, there is nothing we can do about these (very remote) possibilities.

It is more likely that your own situation will change due to a disability, layoff, divorce, or other life-changing event. If this is the case, reallocate your portfolio accordingly. A call to your advisor would be in order.

Finally, if you find yourself feeling anxious about the world financial situation, do yourself a favor and stop watching the news or listening to the radio. The media has been overemphasizing this problem, and in an election year politicians have been bellowing about it for votes. But most of *them* don't really know what to do about it.

Consider the differing approaches of people well known in the investment world. Warren Buffet is a calm, collected buyer in this market; television hosts are jumping up and down, telling people to "sell now!" Buffet is one of the richest men in the world; those TV hosts earn a living with their antics. Who would you rather emulate? ■ ■ ■



### TALKING WITH PARENTS ABOUT MONEY: WHAT HELP WILL THEY NEED?

by J. Marc Vorchheimer, CFP®, Spring Valley, NY

I wrote in this newsletter last summer about how to discuss your parents' finances with them. Perhaps you've already broached the subject with Mom and Dad and they're comfortable now talking about it.

As with your own financial plan, your parents' finances may need attention in a number of areas. Discuss your parents' financial situation with them as thoroughly as you can. If they aren't working yet with a trusted professional advisor to develop a comprehensive financial plan, suggest they do so. Perhaps a fee-only planner in their area can give them unbiased advice to address all their financial issues. Here are some important areas to cover.

#### Getting Organized

It's crucial to know where to find needed information. Learn where their bank and investment account statements are filed. Find out if they are receiving Social Security or other pension benefits and how these payments are deposited. Ask where they keep passwords to online accounts. Know the location of their legal documents, such as wills and healthcare documents (living wills and healthcare proxies).

Make sure one or more family members can have easy access to this information if needed. If they do not have a plan to give family members access to data, help them design one. Make it comprehensive enough that a family member can help wherever needed in an emergency.

#### Cash Flow

Sometimes the most critical financial issue to cover, and the toughest area to discuss without offending a parent, is cash flow. Of course, be nonjudgmental in your request for information. Explain you need to know if they're living within their means and that many people don't realize when they're spending more than they should. Emphasize that this request for information is for their benefit, so they have cash available for the rest of their lives.

Do they have a spending plan? Does it include unusual expenses? Find out if they are satisfied with their lifestyle. Some parents are unhappy with their self-imposed spending limits but want to bequeath as much as possible to family members or help out their children during their lifetime. Make sure your folks understand they need to take care of themselves first.

#### Investments

Take an inventory of their savings and investments. Find out if they understand and are comfortable with what they own. If they don't have a financial advisor, find one that all of you can trust. Ask the advisor for specific answers to concerns like these:

- Whether your parents are taking too much risk with their money
- If they are saving enough to last through retirement
- Approximately how long their money will last

#### Insurance/Asset Protection

Explain to your parents that insurance will help them protect what they have and avoid financial ruin. How comprehensive is their health insurance plan? Are they on a private plan or Medicare? Do they have a Medicare supplement?

Your parents may eventually need long-term care (LTC). Would they prefer to remain at their own home, move in with a child, or live in a skilled nursing facility? If they expect to move in with a child, which one—and is that child prepared to take them? Do they have LTC insurance, or will they pay these expenses out of pocket? They should consider LTC insurance while they are in good health and can qualify more easily.

Examine any life insurance policies. Are they adequate? Are they even necessary at this point in your parents' lives?

And of course, review their home, auto, and umbrella policies, especially to see if they have adequate liability coverage.

#### Estate Planning and Healthcare Documents

A healthcare power of attorney and living wills make your parents' medical care wishes known and appoint someone to make medical decisions for them if they are incapacitated. These issues can be difficult for anyone. But once the documents are completed, they can help the family make the right medical choices. Many parents don't want to be a burden to their children, so explain to them this is one way they can reduce stress on the family during potentially difficult times.

They should also consider a separate durable power of attorney to appoint someone to handle their financial matters.

#### Final Wishes

Encourage your parents to prepare wills. A proper will is the best way to ensure their assets are distributed according to their wishes. Use an attorney qualified in the state where your folks live. Do-it-yourself kits don't always do the job.

Your parents may also want to consider an ethical will, to express personal messages to their loved ones. Ethical wills are best written in one's own words.

The conversation about finances with Mom and Dad can be a win-win process. Parents gain peace of mind knowing a loved one will be there to help them if it is ever needed. Children feel more confident that they will know enough to be able to help. It may be one of the greatest gifts a parent receives from a child—and vice versa. ■ ■ ■





## WHAT DO ALL THOSE LETTERS MEAN?

by Linda Leitz, CFP®, EA, Colorado Springs, CO

**W**e choose professionals to help us with many aspects of our lives. A competent attorney assists us when we need a will; a skilled auto mechanic repairs our brakes. With professional guidance, we can avoid costly mistakes and protect the interests of those we care about, including ourselves. Sometimes hiring a professional is more a matter of convenience. For example, I have someone else wash and iron my cotton dress shirts. It's not that I can't; I just don't want to take the time.

For help with financial planning and investing, many people seek professional guidance because they need the expertise or it's more convenient. Professional qualifications often play a big role in choosing that help. But all of those designations and initials can be confusing. Here is an overview of what some of those designations mean.



### CFP®

**CERTIFIED FINANCIAL PLANNER™ (CFP®)** professionals must complete coursework in the principles of financial planning, insurance, employee benefits, investments, income taxes, retirement, and estate planning and pass a 10-hour exam. They must also have 3 years of relevant work experience and subscribe to a code of ethics. A CFP® certificant may or may not hold licenses to sell investments or insurance.

### CFA

**Chartered Financial Analysts (CFAs)** have completed an extensive set of exams on ethical and professional standards, tools, and input for investment and portfolio valuation and management. They must meet professional experience requirements. CFAs usually work as institutional money managers or stock analysts.

### CLU/ChFC

The **Chartered Life Underwriter (CLU)** designation is held mostly by life insurance agents. They have completed a curriculum of 10 college-level courses, have at least 3 years of professional experience, and subscribe to a code of ethics. With three additional courses, they can earn the **Chartered Financial Consultant (ChFC)** designation.

### CPA and CPA/PFS

A **Certified Public Accountant (CPA)** has completed a college curriculum in accounting, has passed an extensive uniform exam, and has qualifying work experience. CPAs can also earn the **PFS (Personal Finance Specialist)** designation, granted to those who have substantiated experience in financial planning, received peer recommendations, and passed an additional exam.

### EA

**Enrolled Agents (EAs)** are taxation experts licensed by the federal government. They are authorized to appear before the IRS on the taxpayer's behalf. They must pass a 2-day exam on the taxation issues of individuals, partnerships, corporations, and estates and trusts. Their knowledge and experience about investments, like that of CPAs, varies.

### MBA

The **Master of Business Administration (MBA)** degree may cover a broad base of business issues or may have a special focus, such as marketing, finance, or healthcare administration. You may find comfort in working with a person having an MBA in finance, but you might want to think twice about taking financial advice from someone with an MBA in marketing.

### Registered Representative

**Registered Representatives** are also referred to as stockbrokers or investment representatives. They are generally licensed to sell securities, and although knowledgeable about certain types of investments, their experience and training regarding financial planning may be nonexistent.

### RIA

A **Registered Investment Advisor (RIA)** has registered with either the Securities and Exchange Commission (SEC) or a state regulatory authority as someone who charges for investment advice. The registration requires a disclosure of qualifications and business practices but does not impose any requirements for minimum training or experience. The SEC or state may examine RIAs (the review resembles a bank exam) to ensure they are complying with applicable laws and record-keeping requirements.

When choosing your financial professional, look for the qualifications that meet your needs. If you want help with financial planning and investing, find out about qualifications in both areas. Also, consider the impact of a professional's training and licensing on the specifics of your financial plan.

For instance, if your financial professional is licensed to sell insurance but not securities, you may find that your retirement plan, college fund, and other long-term goals are all funded solely with life insurance. If your professional is not licensed to sell insurance, maybe that's why he or she believes you don't need any. Fee-only advisors, who sell nothing but their professional advice, offer an objective view and can help you identify the financial products you truly need.

Your gut reaction can be an important guideline. Working with someone you trust is crucial, and all the credentials, degrees, and smooth talk in the world can't outweigh the need for honesty. ■ ■ ■