StrategicPoint of View®

WHAT IS FINANCIAL PLANNING ANYWAY?

You may be surprised to find out, *it's all about you.* Financial planning is about your future and how you're going to get there. It's about sending your kids to college and retiring with a comfortable nest egg. It's about putting your money in the right places and maintaining a budget to suit your needs. It's about providing for your loved ones even after you're gone.

Besides being the star attraction, you're also the lead protagonist. Financial planning depends on you. How you reach your goals is entirely up to the way *you* manage *your* money. And to manage your money, you need a plan.

Getting Started

Take a Picture

The first step of a financial plan is to take a snapshot of what you have (your assets) and what you owe (your liabilities). This is called a *balance sheet;* it provides a snapshot of the current state of your financial health. Your balance sheet will tell you how much of your assets are liquid (in cash equivalents), in long term savings (retirement accounts), or in taxable investments. It shows your real estate, business holdings and personal property. On the debt side, the balance sheet divides your liabilities into the good kind (tied to income tax deductions) and the bad kind (credit cards and car loans). The end result is a picture of your net worth—the difference between your assets and your liabilities.

Go with the Cash Flow

Cash flow is a record of your monthly income and expenses, not some magic river of money. Your monthly income might include: salary, social security benefits, pensions, interest, dividends, capital gains, partnership interests, among others. Some examples of expenses are: rent or a mortgage payment, insurance premiums, payments to your credit card or auto loan and taxes. If you are creating a budget for the first time, you may want to include expenses like entertainment, groceries and clothing to give you a more specific picture of where your money goes each month.

Subtract all of your monthly expenses from your monthly income to determine your cash flow. A *positive* cash flow—extra money left over after you pay your bills each month—signals growth

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of assets. This might mean you could be saving more than you actually think you are. A *negative* cash flow—just enough or *not* enough money to pay your bills each month—signals overspending or a depletion of assets. If you have a negative cash flow, you probably want to examine your expenses more closely for opportunities that might allow you to manage your money more efficiently. Perhaps you can spend less on entertainment and more towards reducing your credit debt. For example, skip going out to dinner every week and send Visa an extra $50 instead.

So Many Ways to Save

You know that you have to start saving now in order to retire someday in reasonable comfort. You may also want to save for other events between now and then, such as new cars, vacations, your children's education, weddings and so on. With a little planning, you will be able to take these occasional, high-expense events in stride.

Prioritize Your Savings Plans

First, create an emergency fund. The general rule of thumb is that your emergency fund should equal three to six months' worth of non-discretionary living expenses. That includes your mortgage, groceries, utilities—literally *all* expenses that must be paid. Your emergency fund should be easily accessible, such as in a savings or money market account at your bank. The rate of return on this account doesn't matter. This is not money you're going to rely on for your retirement; it's for peace of mind and to keep your cash flowing smoothly. As an alternative, a home equity line of credit can provide liquidity. However, you pay interest on money withdrawn from your line of credit—so use this resource sparingly! Also, remember that this is an emergency fund. If you find yourself dipping into it regularly, you probably need to readjust something(s) in your monthly budget.

Maximize Your Retirement Savings

If your employer offers a 401(k), 403(b) or a SIMPLE plan in which they match a portion of your deferrals, *participate* to give yourself a head start. Be sure to contribute at least enough to get the full match (free money!). Even if your employer does not match, your pre-tax deferrals in a tax-deferred retirement plan are still your greatest method for building assets. Tax-deductible IRAs and Roth IRAs also fall into this category.

If you are self-employed, consider establishing a retirement plan. Whether you have 50 employees or you are a one-man-show, look into setting up a 401(k), Profit Sharing plan, SIMPLE plan or SEP. Your accountant or financial advisor should be able to steer you in the right direction.

The key to retirement planning is *the sooner, the better.* Think about when you want to retire, how much money you will need to live on when you are retired and how much you will need to save on a regular basis to meet your retirement goals.

For instance, if you want to retire in 20 years with $1 million, calculate how much you will need to invest on a regular basis over the next 20 years to reach that goal. Consider the amount you are investing and the rate of return you hope to earn. Be realistic; if you have a time horizon of 10 years or more, plan on an 8% return. Be sure to add an inflation factor to your retirement income need, so that you can maintain your desired lifestyle in retirement. Retirement calculators are available on many websites and as part of StrategicPoint's Financial Check-Up.

Save in an After-Tax Account

This is where you would put aside money for a wedding or your next big vacation, as well as for

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your own supplemental retirement savings. Unlike your emergency fund, a portion or all of this money can be invested, depending on your goals and risk tolerance.

Clearly, you may have several goals for the money in your taxable investment accounts, some long term and some short term. It is important to know what these goals are in order to determine the appropriate investment allocation. If your goal is to purchase a first, larger or second home in the next few years, savings for the down payment should be in CDs or a money market account. If your primary savings goal is to retire in 20 years, you could have a greater proportion of the account in the stock market, depending on your personal risk tolerance.

The *New* College Try

The cost of public and private education is rising faster than inflation. There are different ways to cover these costs—some, but not all, tied to savings. You can pay out of current income; utilize prepaid tuition plans; invest in state-sponsored savings plans (529 Plans) and Coverdell IRAs; apply for student loans, grants, and scholarships; or accumulate personal funds in advance through savings and investing. (See our separate report *Cramming for College* for more details.)

Whatever form of savings you choose, check with your CPA or your financial planner to see which kinds of accounts are right for you.

Risk Management Through Insurance

Life Insurance: When and What Kind?

Survivor income is the amount of money needed each month to replace the earnings of a deceased spouse or partner. This can come from investment income from existing assets, social security and pension income, retirement plan distributions or from life insurance proceeds. The latter is particularly helpful in paying off a mortgage or funding retirement or education goals, while maintaining current lifestyle choices.

Owning the right kind of life insurance is important. Level term insurance can offer an affordable choice of coverage for many people. Your goal should be to have insurance for as long as you need it, but not when you don't. With term insurance, you pay only for the time period desired. Most people find that by the time they reach retirement, they have sufficient resources to support their desired lifestyle.

Permanent insurance, a much more expensive alternative, should be reserved for special planning issues. Its savings component is expensive and not a cost-effective way to invest for retirement, college funding or other goals. There are times, however, when permanent insurance is attractive: when the insured would like to leave a legacy; when a special needs family member is involved; and when a spouse has chosen to take a single-life pension payout and needs insurance to protect the surviving spouse or partner.

Who Needs Disability Income?

Disability income is the amount of money you would need to live on if you were unable to work because of an illness or injury. Ultimately, you would want to maintain your lifestyle and complete your financial goals even if you could no longer work. This often requires that disability payments cover 70% of your after-tax current income, keeping in mind that health care coverage and retirement savings may also play important roles in the disability period. Insurance companies limit the total amount of coverage available in order to discourage misuse of claims.

Policies are based on varying definitions of disability and length of benefit. For example, the most liberal

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definition of disability is "own occupation," which means that the insured can no longer perform his/her own job and therefore requires disability income.

The least liberal definition, "any occupation," means that the insured must be incapable of performing *any* job before coverage will be provided. The "any occupation" definition is found on social security disability policies.

Many employer sponsored policies limit the amount of coverage to 60% of your salary, with additional caps placed on the total monthly amount received. Employer-sponsored policies offer more restrictive benefits but are usually less expensive than individual policies. If you are single, consider disability coverage seriously. If you are married and both of you work, you might only need disability coverage for one of you, if your family could maintain its lifestyle on one paycheck. Start by asking your employer about disability plans they might offer. Make sure you understand the different policy definitions and restrictions. If employer-sponsored insurance is not enough, look into supplemental individual policies.

A Little LTC

Long Term Care (LTC) Insurance provides coverage for individuals with chronic illnesses or disabilities who need custodial care on an on-going basis. The insurance increases your control over an uncertain future and provides peace of mind for your family. You protect your assets and, at the same time, pass along the risk of financial loss to an insurance company.

Good LTC insurance policies cover the cost of a nursing home, assisted living, home-based and community care—including home health aides, chore services, relief for daily care-givers and adult day care centers. Nationally, the 2007 annual cost of nursing home care is $74,806, according to the *Genworth Financial 2007 Cost of Care Survey.* And the cost is rising, on average, over 5 percent a year. It is possible that long term care expenses could eat away a substantial portion of your assets if you do not have coverage. *Medicaid does cover nursing home care but only if you qualify as a "needy" family.* This requires spending down your life savings before you can apply. (Please note: the Deficit Reduction Act 2005 all but eliminated the ability of individuals to gift away their assets in order to be able to qualify for Medicaid.)

Most hesitancy over purchasing long term care insurance revolves around costs and complexity. However, it is important to remember that it takes many years of paying premiums to cover the daily cost of at-home-care or a nursing home for only one year.

Long term care insurance policies are complicated and do require an understanding of the various benefit options before purchasing. And, since not all long term care insurance companies are equal in terms of reliability and claims processing, selecting an insurance company with strong financials and a solid servicing track record is a critical part of the process. That is why it is very important to work with a knowledgeable, dependable insurance producer who can present your options in understandable terms and work with you to find a product that best fits your potential long term care needs.

Planning Your Estate

Most likely, you don't want to leave your financial affairs in a big mess for your loved ones to sort through when you're gone. It's a good idea to organize your estate. You want to ensure that your assets are passed on to your desired beneficiaries, while keeping the tax bill to a minimum.

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Estate taxes are based on the value of the estate you leave when you die. Currently, federal estate tax laws allow you to leave as much as you want to your spouse and up to $2 million to others (in 2009 the exclusion amount will rise to $3.5 million, only to disappear in 2010 and reappear in 2011 at the reduced amount of $1,000,000). When completing estate planning now, keep in mind that Congress will likely modify the rules and limits in 2009.

With this unlimited marital deduction, there is generally no tax due at the time of the first death; regular estate tax rules apply when the second spouse dies. Usually, any estate taxes that are due are paid by the estate itself. In fact, you can specify in your will that you want your estate to pick up the tax tab. However, your heirs might have to pay inheritance taxes on the property you leave to them. The best way to keep your estate nice and tidy is to establish the following:

- Wills
- Health Care Proxies
- Living Wills
- Power of Attorney
- Trusts (in some cases)

Where There's a *Will...*

If you want to make sure that your children split your $150,000 summer home, put it in your will. If you want to guarantee that your nephew gets your antique spoon collection, which is priced at $20,000, put it in your will. A will is crucial to ensuring that your loved ones get what you want them to get. Without a will, your estate could be left for state courts to divvy up.

Certain assets — retirement plans, IRAs, annuities, and life insurance, for example, will not pass by will. They are subject to other legal terms and go to named beneficiaries.

Depending on your situation, preparing a will can be a simple task. You just need to know what you own — real estate, investments, personal items, etc. — and to whom you want to leave these assets. If you have young children, name a guardian to take care of them, and someone to manage any property they inherit. Most importantly, you need to sign and acknowledge your will in front of witnesses. If your situation is more complex, you may want to seek the help of a lawyer or financial advisor.

What about Trust?

A trust is a fiduciary relationship that allows you to transfer your assets to a trustee if you become incapable of managing your affairs. Trusts are intended to avoid probate. Probate court is the supervised method through which your debts and estate are settled after your death. This process can be expensive and time-consuming. Though a portion of your estate often must go through probate, a trust can keep many of your assets out of probate.

When establishing a trust, you have to identify all of your assets and declare them a part of the trust. Contrary to popular belief, a living trust doesn't necessarily eliminate estate taxes. There are other kinds of trusts that can reduce the estate-tax impact. Speak with your lawyer or financial advisor to find out more.

The Proxies

As with a trust, you can name the person whom you want responsible for your affairs by establishing durable power of attorney, a living will, and a health care proxy. These legal documents let you name someone to make decisions on your behalf to certain degrees. *Durable power of attorney* names someone to act as the manager of your financial affairs. A *living will* directs doctors and hospitals regarding

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the use of life sustaining medical treatment when death appears imminent. A *health care proxy* appoints someone to make medical decisions on your behalf, if you are incapable of doing so. These measures might be unpleasant to think about, but establishing them now will save confusion and valuable time later—if you should ever need them.

Everybody's Favorite Subject: Taxes

One of the most important considerations in any financial plan is the projection and impact of income taxes. The majority of tax planning opportunities lie within the federal income tax framework. Federal income tax liability is based on gross income minus adjustments, deductions, and exemptions.

The myriad of rules makes it imperative that you stay abreast of tax law changes—be it new retirement plan provisions and limits, estate planning exclusions, education credits/deductions, business depreciation rules or other regulations. A competent Certified Public Accountant can help you navigate the complexity of filing your taxes.

A Few Words About Investing

Remember that stuff about cash flow? Well, if you ended up with a negative cash flow, you probably shouldn't be involved in the stock markets. The first rule of investing is to *understand risk*. Evaluate your risk tolerance and only buy investments that fit within your risk tolerance limits. Assess how much risk you can stand by asking yourself what you would do in various situations. For example, if you have a $100,000 portfolio and it suddenly lost $10,000, how would you feel? What if it lost $20,000, $30,000 or even $50,000? If losing $10,000 means you can't retire when you want to, then your risk tolerance is on the low side. Be honest with yourself; if you are serious about protecting your portfolio, it is paramount that you buy assets that match your risk tolerance.

The second rule of investing is to *diversify, diversify, diversify*. Find the right mix of stocks, funds and bonds for your situation. Talk to an advisor about the best asset combination for your situation. Diversify across sectors and within sectors. Watch out for mutual fund overlap; some stocks are commonly interrelated by product line. You may have more exposure to a certain company or sector than you think. Also, be sure to review and reallocate regularly. And make sure your investments are performing as they should be.

Most importantly, don't try to time the markets. Gambling is for the casinos. Define your goals and stay on top of your investments. If you don't have the time or patience to follow your money carefully, hire an advisor to do it for you. There are many considerations that go into an effective financial plan. It is imperative to review your options and make adjustments as changes in your life occur. Also, laws, deadlines and contribution limits change constantly, so make sure your planning is up-to-date and you are maximizing your opportunities. It's a lot to keep up with; you may want to hire someone who can do it all for you.

If you are interested in hiring a financial advisor, choose carefully. Look for someone who will take the time to understand your situation, needs and objectives and can explain your options clearly. Ideally, look for a Registered Investment Advisor (RIA) who works on a fee-for-service model, rather than on commission. A fee-based advisor will be less focused on selling products and more intent on serving your best interests. Be aware; arm yourself with the questions that can help you decipher an ethical, qualified advisor

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from someone who may not be interested in your well-being. Ask to see the Form ADV. This is a legal document that ensures you are working with a licensed RIA.

To learn more questions you should ask when interviewing financial advisors, order your copy of the report *Ten Critical Questions You Must Ask Before Hiring a Financial Advisor*. Call 1-800-597-5974 to order your complimentary copy today.

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