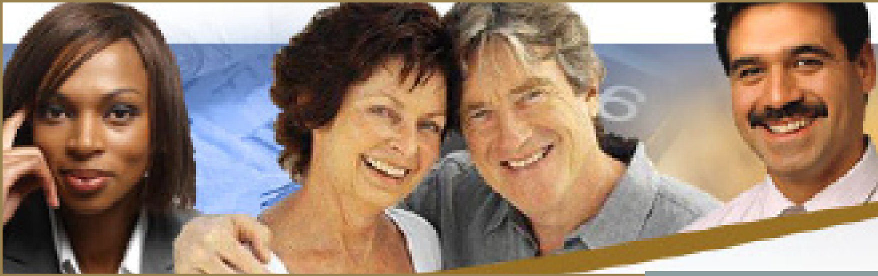

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NAPFA Planning Perspectives

NAPFA
The National Association of Personal Financial Advisors

The Power of Trust: Raising the Bar

By Kevin Adler, Editor, NAPFA

In the last few weeks, NAPFA has launched a new branding message, "The Power of Trust," that defines the organization's commitment to lead the financial planning profession forward.

Consumers have become wary about the conduct of financial advisors, due to the many scandals that have surfaced in the last several years. However, consumers' fears are interfering with their need to obtain financial advice just when they need it—when pensions are disappearing, investment returns are volatile, and the economic recovery is slow.

NAPFA
THE POWER OF TRUST

"People need to know whom they can trust. We are declaring that you can trust a NAPFA member," said Susan John, NAPFA National Chair. "Since our creation, we have promoted the Fee-Only model of service, in which advisors are not being compensated by sales commissions or hidden fees. That remains an important part of our message, but we realize that the issue has become larger. It's about trusting your advisor to have the skills and knowledge to handle the complexity of today's world, as well as the motivation to do what's right for you."

For more information about The Power of Trust, go to www.napfa.org.

Upcoming Webinars

NAPFA's next two free consumer webinars will cover debt and savings strategies and investing. These one-hour webinars provide the general public with basic information about how to take control of their financial futures.

On July 8, NAPFA member Cheryl Costa, CFP®, will speak about how to manage debt, save for major life goals, and differentiate between "good" debt and "bad" debt. On August 5, NAPFA member John Ritter, CFP®, CS, will explain how to develop an investment plan. Specifically, he will cover how an individual can best approach investing, based on risk tolerance, time horizon, income, and other factors. Both webinars will begin at noon, Central time.

To register for a webinar or to see videos of past sessions, go to www.napfa.org.

Retirees Need to Plan for Longer Life Expectancies

By Jerry A. Miccolis, CFP®, CFA®, MAAA   Brinton Eaton Wealth Advisors   (www.brintoneaton.com)

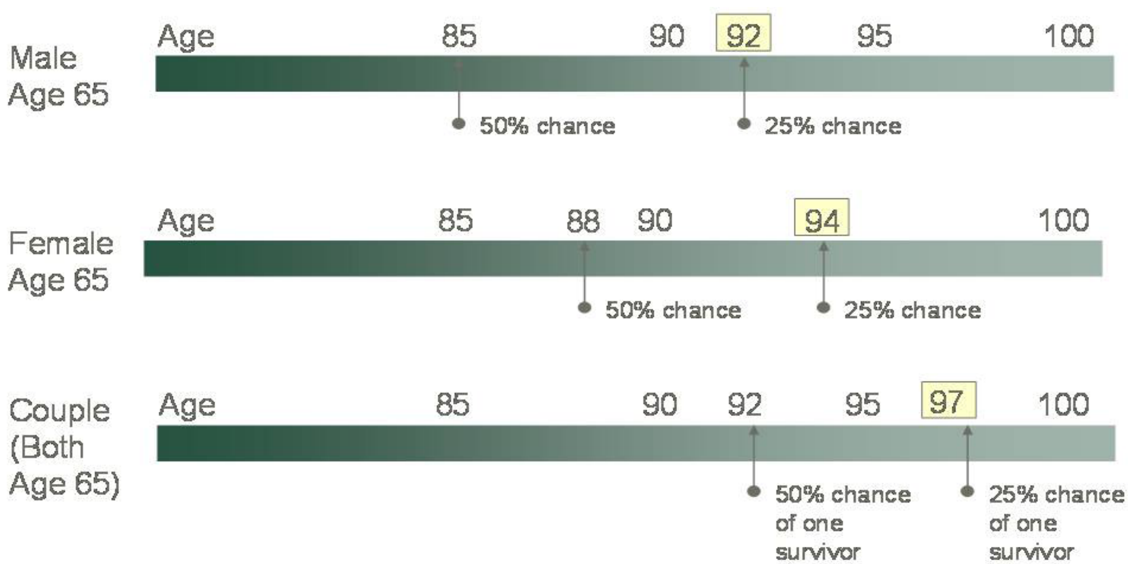
Many people have decided they've had enough of roller-coaster financial markets. At some point in the last couple of years, they have bailed out and placed their money in "safe" havens like bonds, cash, and CDs.

It's understandable—but for a great many people, this is precisely the wrong thing to do. Bonds and cash generally will not secure your financial future because they will not provide you with sufficient protection against inflation. For most people, the biggest threat to a comfortable retirement is inflation—not short-term market volatility.

All investors, regardless of age, should review their retirement planning with an actuarial life-expectancy table in mind. The latest actuarial tables from the Society of Actuaries (such as the one that formed the basis for the chart below) have some eye-openers. If you are a 65-year-old male, you have a 50-percent chance of living to 85 (and age 88 if you're a female) and a 25-percent chance of living to 92 (94 if female). A couple at 65 have a 50-percent chance that at least one spouse survives to age 92 and a 25-percent chance that one will survive to age 97. If you're already over age 65, you can expect to live to even more advanced ages.

Most people underestimate their life expectancies—and thus their investment horizons—by at least a decade. To achieve a retirement portfolio that will meet your needs through your expected lifespan without exposing you to too much risk, you need a portfolio of diverse investments that work together to both exploit and tame market volatility. This will produce a less-volatile, yet high-performing, portfolio over the long term.

A truly diversified portfolio should include stocks, real estate, commodities, timberland, agribusiness, managed futures, and absolute-return strategies, as well as bonds. You need to rebalance among these asset classes regularly. The portfolio also should have a degree of "safety net" protection, utilizing some creative products that have only recently come to market.



Source: Annuity 2000 Mortality Table; Society of Actuaries. Figures assume a person is in good health.

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How Safe Is Your Pension?

By Rob Williams, CFP® Baltimore-Washington Financial Advisors (www.bwfa.com)

We are well aware of how declining stock prices affect our investment portfolios. However, little attention has been paid to how the recession is affecting pension plans, even though most pensions hold risky investments, such as stocks and real estate, in their portfolios.

So, how safe is your pension? Let's look at each type of pension.

<u>Federal Government.</u> Federal pensions are safe. The two types of federal pensions (Civil Service Retirement System and Federal Employees Retirement System) pensions do not invest in the market. Instead, they pay monthly checks out of federal budget allocations, which are directly funded by taxpayers and government borrowing.

<u>State and Local</u>. The safety of state and local pensions is harder to determine because many of them hold risky investments, and their futures will depend on market performance and political decisions. Many of these pension plans have huge liabilities, in the form of benefits promised to current employees and retirees, in excess of money saved for those promises. Estimates in 2010 were that state and local governments' unfunded pension liability exceeded $700 billion. To cover this shortfall, states will have to raise taxes, cut current services, and/or reduce pension benefits.

<u>Private</u>. Private pension plans are exposed to the recession and weak economic recovery in two ways. First, corporate pension funds typically hold a large portion of their investments in stocks and other volatile securities. Second, the security of private pensions depends on sponsoring companies fully funding their obligations. When companies are in financial trouble, they try to delay contributions to their pension plans. During this recession, many companies were unable to pay their obligations.

To protect employees and retirees from bankrupt private pensions, the federal government established the Pension Benefit Guarantee Corporation (PBGC), which insures annual pension benefits up to $54,000 per year. The PBGC's safety net is effective for pensions with moderate benefits, but employees with larger pensions are exposed to the health of the company plan. Also, the PBGC does not cover municipal and state retirement plans.

Some private pensions offer lump-sum payouts to participants, which enable them to convert the monthly checks they would receive for the rest of their lives into cash that they can invest. The lump sum might be available immediately, or it might come in a series of payouts over a few years.

Lump Sum or Pension?

Often, it's worth considering taking the cash and investing it in an IRA. Obviously, giving up the security of a monthly check in order to hold investments in risky markets does not make sense for many people. But there are cases where it really makes sense, including:

- Participants who have benefits that are greater than the amount insured by the PBGC. They are at risk of losing that part of their retirement benefit if their pension fails.
- Participants who are more interested in leaving an inheritance to their children. The returns on a long-term stock investment are likely to exceed a pension's returns.
- Participants who do not expect to live long lives. In order for a monthly check to be worth more than a lump sum, a retiree should anticipate receiving those checks for a long time.
- Participants who want to buy investments when the market is low and earn a higher return than their pension provides.

If you think a lump-sum payout makes sense for you, take the following steps. First, find out if your pension plan offers that option. Second, learn about the deadlines for making the decision, what your payout would be (and over what period of time), and other rules. Third, seek the advice of a financial planner who can review the option with you to assess whether it's the right decision.

A Really Big Decision

By Bill Keffer CFP®, MBA, CLU, ChFC, CDFA   Keefer Financial Planning (www.kefferfinancialplanning.com)

Often, advisors are asked by clients if it's better to buy a "personal pension" in the form of an annuity, or to manage their investment portfolio and to hope for the best. The following case illustrates the type of considerations that come into play in this decision.

The Millers are a fairly typical upper-middle class couple. They have worked hard and been good savers. Their children are educated and independent. Their house is paid for, and they have no other debts. The Millers have accumulated a nice nest egg, and they have reliable sources of retirement income that meet almost 80 percent of their annual income goal.

Case Facts

Clients: Pete and Cindy Miller
Ages: Pete, 66; Cindy, 62
Employment: Retiring this year
Assets: $525,000 (combined) in 401(k) accounts
$200,000 in regular investment account
$50,000 savings account
(not used in analysis)
Income: Social Security: $37,000 (combined)
Pensions: $29,000 (combined)
Gross income goal: $84,000 ($72,000 after tax)
Longevity: Both in exceptional health
Risk Tolerance: Moderate. Investments have been 61% stocks, 39% fixed
Goal: Maintain lifestyle and spending to age 100

At first glance, it looks like they are pretty well-set to have their money last until they both reach age 100. The historic return for their mix of investments (61-percent stocks, 39-percent bonds and cash) has been 8.85 percent. If that continues, their $725,000 in investments will generate roughly $64,000 in yearly returns, which is more than enough to make up the gap between their income goal and their income sources.

Still, the Millers face two problems. First, their pensions are not adjusted for inflation, so their income will not rise as quickly as their projected spending. Second, even if investment returns do average 8.85 percent in the future, the year-to-year returns will be volatile. Many advisors use "stress tests" to see how a portfolio holds up under varying conditions. In one scenario, the advisor might assume "bad timing," such as a market that takes a 10-percent dive in the first year of retirement, followed by a 14-percent drop in the second year (sounds pretty mild from the perspective of the last few years). For the remainder of retirement, the market returns to historic norms. However, the sharp initial drop has a lasting impact that causes the portfolio to be exhausted prior to the Millers' time horizon.

When you add up those uncertainties, the Millers have a surprisingly high chance that they will run out of money in retirement: 33 percent.

Testing Alternatives

Given those pressures, an advisor could analyze several strategies that the Millers could pursue:

1. Loading up on income-producing assets (bonds)
2. Purchasing a commercial annuity
3. Improving expense management

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Income-Producing Assets. The classic retirement portfolio used to consist primarily of bonds, with some allocation to large-company stocks that paid regular dividends. The theory was that the bonds offered relative safety of principal with predictable reliable income, enhanced with a sliver of growth potential from the stocks. To get additional secure income and to move away from volatile stocks, the Millers might shift their investment mix from 39 percent bonds to 72 percent. Unfortunately, this drops their expected annual return to 7.60 percent, which gets them further from their goal; in fact, the probability that their money will last drops below 40 percent. By replacing much of the equity in their accounts with fixed income, they have traded short-term market risk for long-term inflation and "longevity" risk.

Immediate Annuity. Alternatively, the Millers could purchase an immediate annuity, which would function like a pension. They would give up a portion of their assets in return for a guaranteed stream of payments. In its purest form, an annuity pays benefits for the life of the owner, no matter how long that person lives. But the funds used to buy the policy are lost to the clients' heirs.

Advisors know that annuities can be set up so that the payments continue after the death of the owner for the remainder of the surviving spouse's life. They can also be structured to provide a certain minimum number of payments, or even for a refund of a portion of the original premium. However, all of these bells and whistles "cost" the owner by reducing monthly benefits.

In the Millers' case, assume that they carved out $200,000 from Pete's 401(k) and purchased a no-load immediate annuity, with 100-percent survivor benefit for Cindy. The monthly benefit was $1,032. This annuity benefit, in combination with their Social Security and pension benefits, would make their total combined "safe" retirement income $79,000, or about 94 percent of their $84,000 goal.

Unfortunately, the projections show that adding this extra measure of guaranteed income actually reduces the probability of overall retirement "success" from 67 percent to 54 percent. This is because they have removed $200,000 from their investment assets, which would be growing each year, unlike the fixed payments from their pensions and annuity.

However, one should not conclude that an annuity is the wrong choice. If the Millers are highly risk-averse, that additional guaranteed income might be very attractive.

Cutting Spending. The third option, cutting spending, is always a good place to start, but it tends to be an unpopular strategy. If the Millers accepted a 5-percent spending cut, thus reducing their after-tax income to $68,000 per year, their expected results would improve dramatically. Their portfolio would not only be projected to last to age 100, but it would have an 81-percent chance of growing to over $3.4 million by that time. This assumes that their basic investment mix of 61-percent stocks/39-percent fixed income was unchanged.

Conclusion

There is truly no free lunch. Every scenario has its pros and cons. By shifting money to safer fixed-income investments, the Millers can raise their income but increase their exposure to inflation. By buying an immediate annuity with some of their money, they can "guarantee" some of their income, but they will reduce their legacy for their children and perhaps run out of money. By spending less today, they will have more for tomorrow.

A sound approach might be for the Millers to identify that portion of their living expenses that covers their essentials. If the Millers' guaranteed income sources are sufficient to cover those basics, plus inflation, they would probably be better off remaining in control of their investment assets as resources to fund the things they want but do not absolutely need. If not, they should consider annuitizing enough of the portfolio to clear that basic-needs hurdle. What's left would be the ultimate legacy for their children and grandchildren.

What About the Number?

By Anthony J. Ogorek, Ed.D., CFP® Ogorek Wealth Management, LLC (www.ogorek.com)

A major impediment to financial success, as well as to personal happiness, is loss aversion. In a nutshell, loss aversion is the strong preference we have to avoid losses, even at the expense of gains. Another way of putting it is that **we feel the pain of a loss much more intensely than we do the joy of a gain.**

There are many decisions that we make in life, often to our detriment, due to a subconscious aversion to risk. For example, some people will gravitate to public sector jobs because of the perception that they offer more security than a position in private industry. For them, the potential pain of a job loss, reduced pay, and possible relocation may outweigh the benefits of employment in the private sector.

> *We feel the pain of a loss much more intensely than we do the joy of a gain.*

Another example of the power of loss aversion is that professional golfers will play more conservatively in order to avoid shooting a score above par. They are more interested in not giving up a shot than they are in taking more risk to score below par. This observation isn't just anecdotal, either. Researchers from Wharton Business School have found that the joy of scoring a birdie is outweighed by the fear of scoring a bogey.

What people fail to realize is that the fear of a loss may result in a self-fulfilling prophecy. In other words, the biggest loss may not be what we have lost in the past, but what we will lose in the future by passing up opportunity.

In the area of personal finance, we can examine loss aversion in the context of the bursting of the credit bubble in 2008 and the first quarter of 2009. The financial calamity exacted a maximum level of punishment on investors of all stripes, and it will take years for them to recover.

Where risk aversion rears its ugly head is in how so many investors continue to focus on what they have lost, rather than on what they still have. Despite an impressive recovery from the market's lows, it is not unusual for an advisor to be told, "I know that the market is coming back, but what is the number?"

In other words, investors want to know how much more they need to earn before they are back to where they were at the end of 2007 when the market was at its peak. In fact, there was nothing magical about where the world was back in 2007. Getting back to that number will not assure anyone that they will be able to maintain their current lifestyle or provide for their future needs. The concept that the world will be "right" when I recoup all of my losses can be destructive to an investor's future if it handicaps planning for the future.

While it is important to learn from the past, it is equally important to avoid being paralyzed by the past. What we do in the present, not the past, will have the greatest impact on our future.

Consumer Education

Four Steps to Manage Your Credit Cards

By Kimberly J. Howard, CFP®, CRPC® KJH Financial Services (www.KJHFinancialServices.com)

New credit card regulations went into effect last year that provide consumers with additional protections, but it's still important to still follow some basic practices.

1. Consider your needs vs. your wants. Think before you use the credit card to fulfill a "want."

2. Although credit cards are a convenient way to pay or to delay payments, paying in full each month is crucial. When you carry a balance—and especially if you miss a payment—the cost of the item will be inflated. A missed credit card payment could significantly raise your interest rate well above 20 percent. Plus, you'll face a late-payment fee of $25 to $40.

3. Consider your credit score. Late payments and non-payments will quickly damage your credit score. Although balance-transfer offers sound like a helpful and immediate solution, paying off debt is a much wiser choice than moving debt from credit card to credit card. Don't know where to start? Pay off the credit cards with the highest interest rates first.

4. Every time you apply for and open a new credit card, your credit score goes down, so resist the urge to accept the offers that arrive in your mailbox or you see online. Raise your credit score by having lower balances compared to your credit limit and maintaining a longer credit history.

NAPFA's consumer webinar series™

Debt and Saving
July 8, 2011
Noon to 1:00 pm CT

Instructor: Cheryl Costa, CFP®
NAPFA-Registered Financial Advisor
Past member of the NAPFA National Board of Directors

You hear all the time that there is good debt and bad debt. But which debt is good and which is bad? More importantly, how do you address those forms of debt while trying to save for those important life milestones like a child's education or retirement? This session will delve into how you can manage debt issues wisely while still being able to put money away for those things in life that are truly important.

Determining Your Investment Approach

August 5, 2011
Noon to 1:00 pm CT

Instructor: John Ritter, CFP®, CFS
NAPFA-Registered Financial Advisor
Member, NAPFA National Board of Directors

No two investors are alike, and how you approach your investments must be unique to you and your needs. This session will lay out how you can best approach investing based on your risk tolerance, time horizon, and other factors.

Visit our website www.napfa.org to register.

All NAPFA consumer webinars are FREE.