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Helping you achieve your financial goals

Welcome to the first edition of NAPFA's electronic newsletter, *NAPFA Planning Perspectives*. We are very pleased to have this opportunity to share with you some of the best financial planning ideas from our members. Our goal is to help individuals and families identify and achieve their financial and personal goals.

In this issue, you will see articles about comprehensive financial planning, retirement, and investments. In future issues, we will return to these topics, as well as insurance needs, saving for college, long-term care, taxes, estate planning and more.



NAPFA & Kiplinger's Offer Free Financial Advice in February & March

Later this month and several other times during the year, NAPFA and *Kiplinger's Personal Finance* magazine will co-sponsor free financial advice for individuals across the country through a unique program called Jump-Start Your Retirement Plan Days. This is a special chance to get free financial advice by telephone from the nation's premier financial advisors.

The first two Jump-Start days will be held from 9 a.m. until 6 p.m. EST on Friday, February 18 and Friday, March 4. When you call a toll-free number, 1-888-919-2345, NAPFA-Registered Financial Advisors nationwide will be standing by to answer your most pressing financial questions. Examples: *Am I saving enough to live the lifestyle I want in retirement? Is my money invested properly? What kind of*

IRA should I have? How should I be investing my 401(k)? What do I need to know about estate planning? Should I purchase a long-term care insurance policy? Are annuities a good investment? This service is free, and you will not be contacted with a follow-up sales solicitation.

The toll-free number to call during the Kiplinger Jump-Start Your Retirement Plan Days is 1-888-919-2345.



Building a Financial Future Takes Discipline and Time

By Gene Balliett,
NAPFA-Registered Financial Advisor
www.balliettf.com

Chances are you wouldn't be reading this publication if you weren't at least a little interested in improving your financial outlook. Give yourself a pat on the back. Not everyone thinks about the future, and fewer do anything about it.

To some degree, building a strong financial future is fairly simple: You can spend everything now, or you can save for the future. The more you put aside, the greater your wealth potential. With skill, a solid plan, and nothing more than an IRA (Individual Retirement Plan), a teenager could become a multi-millionaire by age 55 or so, and a couple of 40-year-olds could retire on \$2 million at 70 or so. The more you learn about personal finances, the more likely you are to become rich enough to live on the income flow from your investments.

High-quality information is available online to help you become a do-it-yourself financial advisor. As a do-it-yourself

financial adviser, your task is to conduct research, sort good information from bad, and decide what to do, and when.

Alternatively, you can work with a financial advisor. If you need financial advice, you should seek out the services of an appropriate, qualified advisor. If you prefer a *Fee-Only* financial advisor, you may obtain a free referral from NAPFA. Unlike *fee-based* financial planners, NAPFA members sell neither insurance nor investments.

Here are some services that you might need from your financial advisor.

- Defining your goals and wishes. Your advisor should act as a sounding board to help you define your goals, both personal and financial. Your advisor should be your fiduciary – that is, to act in your interest at all times.
- Improving your cash flow. Your advisor will help you
- figure out exactly where all your money is going, and suggest ways that you can improve your cash flow if that's needed to help you to reach your financial goals.
- Developing an investment strategy. Your advisor should develop an investment strategy that meets your unique needs—your risk tolerance, your long-term goals, your short-term needs. You might wish to manage your own portfolios after they have been created, or you can hire an advisor to keep track of it for you.
- Assessing your insurance needs. Your advisor can help you determine how much insurance you need (if any), and show you how to shop for it quickly and easily. You can ask your advisor for a referral to an objective insurance consultant.
- Protecting your wealth using legal and ethical instruments.

WHAT SERVICES DO

COMPREHENSIVE FINANCIAL PLANNERS PROVIDE?

Traditional comprehensive financial planning integrates six key areas of your financial life:

- Asset Management
- Tax Planning
- Distribution Planning
- Risk Management
- Debt Management
- Estate Planning



Comprehensive Financial Planning works within the interrelationships of an individual's or family's financial situation and life goals.

To find a comprehensive Fee-Only Financial Advisor near you, go to www.napfa.org.



Retirement Planning

Because NAPFA is supporting Kiplinger's Jump-Start Your Retirement Days in February and March, the following article from NAPFA member Kathleen Cotton, CFP[®], is especially timely and pertinent.

Ten Retirement Misconceptions

Submitted by Kathleen Cotton, CFP[®], NAPFA-Registered Financial Advisor
www.cottonfinancial.com

Planning for your financial future can be complicated, and unfortunately, the information available to you can be contradictory or unhelpful. Here is a list of 10 major misconceptions that individuals have about their retirement.

1. **All retirees are alike, and when retired will spend 75% of what they did prior to retiring.** Retirees are not one homogenous group. An active 60-year-old does not have the same lifestyle as an 85-year-old in an assisted living facility. Younger retirees often spend more than they did pre-retirement, as they have more time to enjoy travel and entertainment than when they were working. You and your financial advisor should carefully discuss how you plan to spend your retirement years, and specifically plan differently for your younger, more active years than for your more mature years.

2. **The transition to retirement is easy.** Psychotherapists say that retiring can be an even more stressful life transition than our wedding day or the birth of our first child. Why? Fear of losing your identity, which is often tied to your job, and finding ways to meaningfully fill all your leisure time (50 extra hours a week, or 91,000 hours over a 10-year period).

3. **All retirees stop working when they retire.** Statistics indicate that 93% of individuals between ages 65 and 72 describe themselves as "retired," but one in four actually works at least part time. In fact, 1/3 of current retirees go back to work within one year after retiring, and 2/3 of these people take full-time jobs.

4. **Retirees are too old to exercise.** Studies indicate that even at 90 years old, retirees can recapture lost vigor with an exercise program.

5. **All retirees move south and into a smaller house when they retire.** Even in our highly mobile society, statistics show that most retirees choose to age in place: 90% of those who stop working continue to live within 10 miles of the home they occupied before they retired. And some who move south choose to return north a few years later. (Why? Does it make sense to move someplace where you don't know many people, just because it is warmer?) Also, many retirees don't buy smaller homes, but instead select homes with a different floor plan that suits their lifestyle.

6. **Retirees only have to worry about supporting themselves when they retire.** In fact, children often need financial help for decades as they integrate into the workforce. At the same time, elderly parents may need financial and emotional support in their later years.

7. **Retirees don't need long-term care insurance.** This is like saying if you don't plan for your death, it might never happen. Assisted living has become a mainstream part of later retirement years—and it's costly.

8. **Retirees should give away their assets now so that their heirs won't have to pay any estate taxes later.** This misconception makes advisors very nervous. Since we don't know how long anyone will live, determining how much to give away (and when) is extremely complicated. Everybody needs an estate plan, but it is more comfortable to err on the side of caution than to risk self-improvement just to save estate taxes.

9. **Retirees should invest only in income-producing assets.** Investing in bonds and certificates of deposit doesn't enable you to keep pace with the rising costs of living well. Many advisors suggest a mix of mutual funds and bonds, so that there is a predictable, but growing, income stream.

10. **Retirees don't need professional financial advice.** Some new retirees may decide to fill some of their free time by learning more about their investments. But that doesn't mean they don't need professional advice from time to time any more than you could say they no longer need medical checkups because they're spending more time exercising.

"The most selective credential is membership in the National Association of Personal Financial Advisors whose...members have agreed not to take commissions on the products they recommend."

-- Newsweek magazine,
April 2000



Investments

Don't Be Afraid of Rising Interest Rates

By Stan Richelson, NAPFA-Registered Financial Advisor, J.D., LL.M (In Taxation), and Hildy Richelson, Ph.D. stan.richelson@comcast.net

When interest rates threaten to go up, there is a hue and cry that a bond investor will take serious losses. This conclusion makes numerous assumptions about an investor's reasons for holding bonds, the types of bonds that are held, and other factors.

Depending on your strategy for using bonds in an investment portfolio, you might be in a wonderful position to benefit from rising interest rates. For example, if you are invested in bonds and interest rates go up from 4%/year to 6%/year over a period of time, you can increase cash flow by 50% by progressively selling some bonds and buying newer ones with higher interest rates. If you purchase safe bonds, that cash flow becomes a very secure, very attractive core of your financial future.

If you are concerned about the riskiness of equities, we suggest talking to your financial advisor about bonds. Ask your advisor about a "bond ladder," which is a series of bonds of different maturities (e.g., they come due over a period of time instead of all at the same time). A newly established ladder

might be anywhere from 5 to 20 years, and might have even or very uneven principal coming due in each year. There is generally a shorter end if you will either need invested capital or you believe that interest rates will rise in the near term.

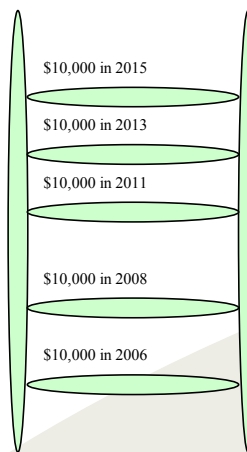
Here is how a bond ladder can be used to take advantage of rising interest rates: Each year a portion of the your bond ladder will come due, and the face value of the bonds will be repaid in cash. These funds can be re-invested in bonds at the then-higher rates.

Even if all of your funds are presently invested in a ladder, the bonds due in the next 1-3 years can be sold so that longer-term bonds can be bought. This will lock in the higher available interest rates. You may incur a small loss on the sale of those near-term bonds. The loss won't be substantial because the bonds coming due in less than three years are approaching face value. The higher rate on the longer-term bonds will quickly repay the initial loss.

If you are concerned about the riskiness of equities, we suggest talking to your financial advisor about bonds.

How a Bond Ladder Works

Laddering bonds is an excellent way to minimize risk and obtain a steady return from investments. In the hypothetical bond ladder shown in this graphic, an investor has purchased \$50,000 worth of bonds. One-fifth of the bonds, or \$10,000, mature in each of five different years (2006, 2008, 2011, 2013, and 2015). When the first batch of bonds come due in 2006, the principal of \$10,000 is invested in new bonds that mature at a date beyond 2015. If interest rates have risen, the newly purchased bonds improve the average return of the portfolio. If rates have declined, the investor has locked-in the better rates through the bonds that were already purchased.





Investments

Using Exchange-Traded Funds

By David John Marotta, NAPFA Student Affiliate, and
George Marotta, NAPFA-Registered Financial Advisor
www.emarotta.com

There has been nothing new in finance in the last 50 years – except Exchange-Traded Funds, or ETFs.

ETFs are index funds that trade on a stock exchange, and they combine many of the best characteristics of stocks and mutual funds. Like a mutual fund, they represent a collection of stocks, but unlike a mutual fund, they trade throughout the day like a stock. This is similar to a closed-end mutual fund, but unlike a closed-end fund, ETFs do not have a limited number of shares and they trade very close to their underlying net asset value.

The first, and still one of the most popular is SPY, representing the Standard & Poor's 500 Index, which began trading in 1993. It is often called a "Spider," based on the acronym of its official name: S&P's Depository Receipts.

Advantages. One major advantage of ETFs is their very low cost of operation, frequently half the annual expense of an index mutual fund, and considerably less than a "managed" fund. For example, the annual expense ratio for a foreign equity fund averages 1.92%. This is the highest for any category of fund. An index mutual fund today averages 1.06%. But an ETF fund will range from .35 to .99 percent.

ETFs can be traded like stocks. They can be bought and sold any time during market hours. They can be bought on margin. They can be sold short. They can be bought on limit price orders. Some have options based on their price.

ETFs are also very tax efficient. They seek to minimize capital gains by exchanging those stocks that are being sold out of the index for those funds that are being added to the index. Because buying and selling in the fund is done by means of like-kind exchanges, it is not a taxable event.

Many mutual funds have \$2,500 minimum for purchases, but investors can buy a single share of an ETF. Mutual funds must hold cash for redemptions, but ETFs hold little or no cash and therefore match the performance of the index more closely. ETFs also have less paperwork than mutual funds, and do not charge 12b-1 advertising fees, as do many mutual funds.

Disadvantages. ETFs have a few minor disadvantages. Unlike open-ended mutual funds, ETFs cannot reinvest dividends. Dividends are paid out to owners of shares at the end of each quarter. This has a slightly adverse effect on performance and is called "dividend drag."

Also, ETFs are capitalization weighted, similar to the indexes on which they are based. This shows up particularly in sector ETFs where one company might loom very large in relation to the index, such as Amgen does in the Biotech ETF, and the stock Ericsson in the Sweden ETF.

Purchasing ETFs incurs a brokerage commission just as a stock does. For small amounts where the brokerage charges would be a significant percentage of the investment, it would be better to use a no-load, no-transaction-fee mutual fund.

"Financial planners who take a commission have a built-in conflict of interest...even with disclosure, my choice would be a fee-only planner."

**-- Jane Bryan Quinn,
financial advice columnist
and author**

For more information about ETFs

Assets invested in ETFs reached more than \$211 billion in January 2005, representing a rapid increase from \$117 billion in January 2004. Most ETFs trade on The American Stock Exchange, and new ETFs are regularly being created by the Exchange and other financial institutions.

Here are two good sources of information about ETFs:

www.ishares.com, which is operated by Barclay's Bank Global Investors, an international investment company that holds about half of the ETFs on the American Stock Exchange.

www.morningstar.com, which is operated by financial services information provider Morningstar.



Investments

Is This the Time to Increase Your Foreign Investments?

By Louis Kokernak, NAPFA-Registered Financial Advisor, CFP, CFA
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The fall of the dollar in currency exchange markets has caught the attention of investors. Unlike past declines in the US currency, this one is coupled with the ascendance of a real alternative to the dollar: the Euro. In actions likely to undermine the dollar's value on currency markets, 70% of central bank reserve managers said they had increased their exposure to the Euro over the past two years. Moreover, expansion of the European Union means that more productive capacity will be denominated or linked to the Euro.

Most Americans will pay for the vast majority of goods and services in dollars. We've thought little about the need for currency or investment diversification. Yet foreign investment does offer real benefits in terms of risk reduction.

Public companies headquartered overseas represent a growing fraction of the worldwide market capitalization. In another 30 years, the American stock market should comprise only one quarter of the worldwide stock market. We ignore foreign stocks at our peril.

Non-US Equities. The costs of overseas investment remain high but are getting lower. Foreign companies and securities exchanges have been subject to regulation that is less transparent than their North American counterparts. However, foreign exchanges have adopted electronic trading systems that have reduced the cost of transacting shares. The venerable New York Stock Exchange (NYSE) may adopt fundamental restructuring to meet this foreign challenge. Indeed, a global, 24-hour stock exchange is on the horizon.

The most important innovations are occurring with the securities themselves. Exchange-Traded Funds (ETF) are available that offer access to foreign markets at reasonable cost. There is an ETF that invests solely in blue-chip companies in developed foreign markets at a cost of only 0.35% annually.

Non-US Bonds. Another important overseas investment opportunity are the bond markets. With American interest rates on the rise and the dollar falling, many investors believe that overseas bonds offer a good alternative to low-yielding US Treasury securities. These bonds are worth considering instead of the two most common fixed-income investments we typically see in low interest rate environments: cash or lower credit quality bonds. With cash, the returns are low; with low-quality bonds, the risk is high.

Currency Exposure. One strategic issue to consider is whether to assume currency exchange risk. As most bonds in developed overseas markets are denominated in foreign currencies, exchange rate movements are the major source of short-term volatility. Some bond funds hedge this currency exposure in the futures market.

The number of dollars held in overseas central banks has exploded in the past five years. Survey data indicates that foreign banks will not permit this trend to continue. Under these circumstances, it appears prudent to shift some currency exposure away from the dollar.

The question is how to do this. Two years ago, there were few alternatives short of trading directly in the foreign exchange markets. Since April 2004, PIMCO has offered an unhedged version of its foreign bond fund. Its performance has dominated its hedged counterpart as the dollar has fallen. Investors who are comfortable with currency diversification might welcome an investment vehicle with reasonable fees and exposure to foreign exchange rates—especially those that spend considerable time outside the US.

Benchmarks. There are some key benchmarks of foreign bond performance that investors should be familiar with. One is developing economies, such as Western Europe, Australia, and Japan. They have sovereign and corporate credit ratings similar to the United States. The JP Morgan Non-US Government Bond Index covers this market. Foreign bond funds will often use it as a benchmark.

Apart from the developed markets, there is another tier of countries generally characterized by high growth rates but less reliable political and economic infrastructure. The JP Morgan Emerging Market Bond Index covers about 30 countries and serves as a recognized benchmark. Mexico, Brazil, and Russia are major constituents of the index. Because of the small size of the member economies, the EMBI constitutes less than 3% of the market capitalization of the developed economy debt market.

As world economies grow, foreign investments will command more attention of the US investor. Fortunately, competition and innovation in domestic securities markets will offer easier ways for investors to take ownership and creditor positions abroad.

"The most important matter is how the planner is compensated. Hire the planner who has no financial stake in [your] investments."

-- Forbes magazine, May 2002

In Brief...

NAPFA FILES

How to Get Your Free Credit Report

By William L Eichenberger, NAPFA-Registered Financial Advisor, CFP
www.hpfinancialadvisors.com

The recently passed Fair Trade and Accurate Credit Transactions Act (FACT) requires that individuals be provided with a free credit report from each of the three major credit bureaus: Equifax, TransUnion, and Experian once each year. The implementation of FACT is being phased in this year over four regions of the United States. Thirteen Western states, including Washington, are in the first phase and became eligible for free reports in December 2004.

Due to a rapidly rising level of identity theft, consumers should check their reports annually. Knowing your credit score and how to improve it may be valuable if you plan to apply for credit in the near future.

I tested the online system and found it surprisingly easy to use. I say surprisingly because there have been news stories about the process being difficult and slow.

You can get your free credit report three ways. Online– www.annualcreditreport.com. By phone– 877-322-8228. By mail – Annual Credit Report Service, P.O. Box 105281, Atlanta, GA 30348-5281. All three bureaus will try to sell you additional products, including your credit score.

Meet...Ellen Turf



Ellen Turf is NAPFA's Chief Executive Officer and has been with the organization for nearly 20 years. Ellen has been instrumental in the growth of NAPFA to its current level of 1,200 members. She leads a capable and enthusiastic team in Arlington Heights, Illinois, who support the independent financial advisors who make up NAPFA's membership.

Ellen's motto is "Whatever it takes." She works tirelessly to expand NAPFA's membership and to improve services that NAPFA provides to its members. Ellen also leverages the talents within NAPFA to provide information for members of the public to improve their financial futures, including NAPFA's free call-in programs and extensive Web-based reference materials.

"It is a privilege to work for NAPFA," says Turf. "Our members truly are the 'best of the best.' The dedication and curiosity that they bring to their tasks seems endless. The client-first commitment that they have is amazing."

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