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NAPFA *Planning Perspectives*

NAPFA
The National Association of Personal Financial Advisors

There's More to Money than Money

NAPFA-Registered Financial Advisor J. David Lewis, who contributed an article in this publication, often says, "There's more to money than money." This phrase reminds us that we have many emotional issues associated with earning, spending, saving, and investing.

There are times when our emotions deserve a great deal of our attention, and there are times when they should take a back seat to objective, practical concerns. This issue of *Planning Perspectives* explores both types of situations.

Our first article gives advice on sound investing, including the importance of ignoring the stock market's ups and downs. The message: Don't get emotional.

In our second and third articles, we explore how to think about your retirement, in both financial and non-financial terms. There's advice on projecting your income and assets, but also a reminder that you need to reflect on how you want to spend your time—as well as your money—in retirement.

In our final two articles, NAPFA members comment on how the presence of money can shape our lives, and the lives of our children. As the final article points out, having more money does not necessarily make us happier, and striving for it rarely does. Yes, there's more to money than money…and sometimes less, too.

Financial Advice on the Web

In the last few years, the amount of high-quality financial advice available to consumers on the Web has increased dramatically. NAPFA's Website (www.napfa.org), for example, contains worksheets that can help individuals select a financial advisor and guide their work with a chosen professional. NAPFA also offers more than 100 articles about specific financial topics.

Now, consumers seeking information about personal finance also can benefit from information provided through "podcasting" technology. Podcasts are audio or video programs distributed over the Internet; usually, they can be listened to directly on a PC, or downloaded to an iPod or other device.

One of the best podcasts about personal finance is www.30minutefinance.com. Developed by consultant Ben Lewis, the site offers 30-minute short Q&A's with leading experts in consumer financial issues.

NAPFA CEO Peggy Cabaniss recently was interviewed on www.30minutefinance.com, and she is one of numerous NAPFA members who will participate in upcoming months. Cabaniss spoke about what a comprehensive financial advisor does, what differentiates a true financial advisor from a stock broker, and other key issues.

Investments

Five Key Strategies for Investment Success

By William C. Cuthbertson, MBA, CFP®, NAPFA-Registered Financial Advisor
And member of the Alliance of Cambridge Advisors

One of the most common complaints heard by personal financial advisors meeting with new clients is, "My portfolio stinks!" Unfortunately, this is true for far too many investors. Poor performance can be due to poor asset allocation and diversification decisions, or misguided attempts at stock picking, market timing, and other speculative investing strategies. Ironically, most of these mistakes are made under the guise of informed investing.

Here are five key strategies to assist you in achieving your investment goals:

Start Early. Starting early is perhaps the most important rule for achieving investment success. It takes approximately 7 to 8 years to double your money in the market, assuming long-term average equity returns. If you can do this doubling at least 4 times, while saving and investing at least 10 percent of your annual gross income—and without prematurely dipping into your treasure trove—you will find yourself in pretty good shape after 30 years of investing. Because the last doubling cycle is generally the most valuable, those who wait to get started find they need to save 2x-4x as much to make up for starting late.

Go Long and Don't Look Back. Invest for the long term and don't try to time the market or succeed via stock-picking strategies. These are speculative activities. And, just like betting against the house, in the long run the odds are that you will lose.

Maintain asset allocation and diversification. When you consider that studies have found that the asset-allocation decision alone accounts for as much as 96 percent of a portfolio's eventual returns, determining what proportion of your money to invest in equity assets versus fixed-income assets is clearly one of the most important investment decisions you will make. This decision also will affect whether or not you will be able to sleep at night. If you choose an allocation that has more risk and volatility than you can tolerate, you are increasing the odds that you will end up selling out when you should be holding on. Additionally, failure to diversify into a number of asset categories can result in additional risk and missed opportunity.

Be systematic. Practicing a systematic and consistent investment strategy will enhance your returns and give you a framework for investment decision making. Regular investing with an allocation plan can reduce the tendency to be influenced by your emotions during market downturns and bubbles. For example, close investigation of investor behavior reveals that many investors wait for the markets to rise before they buy. This is the exact opposite of what you want to do! Using proven methods for implementing and maintaining your strategy is a good way to prevent this from happening to you.

Know your weaknesses, and get help when you need it. Behavioral finance research shows we all have decision-making tendencies which gear us toward investment failure. We tend to be overconfident and unjustifiably optimistic. We are overly influenced by the media, and we also have a tendency to believe there is predictability in random events—such as the movement of stock prices from day to day. Because of these natural tendencies, it is important to have an investment plan that, as much as possible, reduces our biases. If you are unsure of how to achieve a successful investment experience on your own, get the assistance you need.

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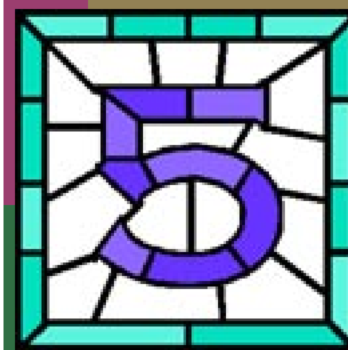

Start Early

Think Long-Term

Diversify Assets

Be Systematic

Get Help

Retirement Planning

The Decision Decade

By Helen Modly, CFP®, ChFC, NAPFA-Registered Financial Advisor
Sandra Atkins, CPA/PFS, NAPFA-Registered Financial Advisor

Most people spend more time planning their annual family vacation than they do on serious planning for their retirement. Making good use of the years in the Decision Decade (5 years before retirement and first 5 years of retirement) can help you to enjoy many years of financial freedom.

Five years before your expected retirement date, you need to conduct a thorough Retirement Readiness Assessment. This involves first identifying and quantifying three separate aspects of your financial life: your financial assets, your projected income in retirement, and your expected expenses in retirement.

- **Asset Inventory:** Prepare a complete inventory of your financial assets. Include investments, real estate, bank accounts, collectables, etc. With each asset, identify any related indebtedness, any embedded tax liabilities in the event you sell the asset, the annual cost to keep the asset (such as maintenance or insurance premiums), and the expected annual income or growth rate for each asset.

- **Projected Income:** Identify and quantify all expected sources of external income after you retire. Also identify how this income will be taxed. This may require obtaining pension projections from your employer, reviewing your Social Security estimate of benefits statement, and estimating future income from rental properties.

- **Expected Expenses:** Mentally picture yourself in your expected retirement setting and estimate the annual cost in after-tax dollars of maintaining your desired lifestyle in that setting. Resist the "rule of thumb" that you will spend less in retirement. Work out your own budget and be sure it realistically represents the lifestyle you plan to live.

If your projected income from external sources is sufficient to fund your expected expenses, then your retirement should be secure. Be sure to evaluate this in terms of a surviving spouse as well.

If you see a shortfall, you need to determine if your investments can generate the required income without depleting the assets too soon. This is the time to compare the various distribution options available from your retirement plans. Remember that, at age 60, you could easily be looking at three to four decades of income needs.

Designing a retirement income plan that will be sustainable over time is probably the most critical component to long-term success. Often, this requires a reallocation of your investment assets from an accumulation strategy to a preservation and income strategy.

Sometimes it involves re-evaluating your expenses in retirement. Some people choose a smaller house, and some choose a similar house but in a less expensive area of the country. Some people choose to supplement their retirement income with fulfilling part-time work.

In the early years of retirement, closely watch your actual income, expenses, and changes in net worth to confirm that your basic assumptions are valid. An income deficit that is identified in the first few years can usually be corrected with small adjustments. Waiting 10 years to discover that you are consuming your assets too quickly might require unwelcome changes.

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Failing to take advantage of the years immediately before retirement can be as costly as planning poorly in the Decision Decade. NAPFA member Stan Ehrlich notes that when children leave the nest, it's natural to indulge yourself. But if you indulge too long and at too high a rate, you might crimp your retirement lifestyle. Pre-retirement years should be spent accumulating savings, and those assets should be reallocated to reflect a need to spend some of those assets during retirement.

Retirement Planning

Planning for the Stages of Your Retirement

By Cheryl S. Hancock, CFP, NAPFA-Registered Financial Advisor

We all know the value of proper planning for a child's education, our retirement, and even our eventual death. However, most of us give little consideration to planning for the time period from the day we retire until our death, which I refer to as "retiree planning." There are numerous issues throughout this stage of life which will require your careful planning.

The first and most obvious stage of retirement is "active retirement." This typically includes increased travel, frequent trips to the country club, visiting the children/grandchildren, and possibly even starting a small business. You will need to consider your cash flow needs and adjust to the lack of a regular paycheck. For most people, this is typically where the planning for retirement stops.

The second stage of retirement may well be the most neglected one. This encompasses a more "passive retirement" in which trips abroad are replaced with trips to the supermarket or the doctor's office. Retirement likely becomes more localized, and the focus shifts to dealing with the everyday tasks at hand and the realization that they are suddenly harder to accomplish on your own.

The problem that occurs in the passive stage is that (typically) the increased need for assistance takes place over a long period of time and can be so subtle that it is difficult to notice that anything has changed. Because it can be so difficult to gauge the level of change taking place, it is important that while you are still in your active retirement phase, you honestly assess both your current condition as well as what triggers should prompt changes in your current situation.

Qualified planners can assist you in completing a thorough assessment of your current circumstances, including housing, overall health, and proximity to doctors, stores, and neighbors. Hand in hand with this assessment should be a list of measuring attributes which, when noticed, would trigger changes to your lifestyle or surroundings, and the list of desired outcomes resulting from each type of change.

Although the subject of lifestyle changes later in life is not easy to face, it is critical to properly prepare for this stage of life, just as you have prepared for all the other stages. Without proper planning, your spouse or children could be thrust into the uncomfortable situation of having to force a sudden lifestyle change that may be contrary to your desires. This results in strained relationships and in you being told how your life is going to change, as opposed to you being in control of your own decisions.

Once you have completed an honest assessment, conduct a family meeting and share it with those you love. This will enable them to see your commitment to the planning and allow you to elicit their cooperation in seeing these desires carried through to completion.

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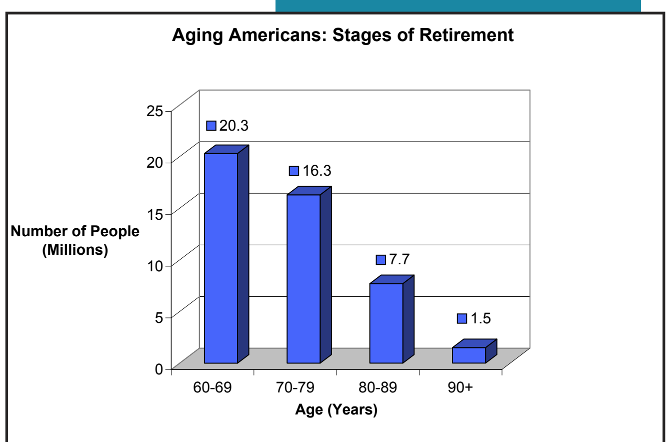
Aging Americans: Stages of Retirement



Souce: U.S. Census, 2002

Financial Planning

How Your Education Funding Decisions Give Your Kids a Real Education

By J. David Lewis, NAPFA-Registered Financial Advisor

Why are so many investment products advertised today with references to college expenses? Why do parents come to our firm, while paying for private secondary schools, eager to start education accounts? Why have I met two young couples with college savings for children and no children? The answer: There is more to money than money!

It comes down to goals, strategies, and tactics. I think most parents' goal is to raise children who become healthy, happy, and well-adjusted adults, capable of maintaining their lifestyles, and even building their own wealth. Some may choose different words, but these desires are fairly consistent for most parents.

There are many strategies for reaching those goals. The examples we give our children are an influential factor in whether we and our children will reach the goals. If we can afford a more expensive car, but don't buy it, that teaches a lesson that almost any child will understand at a young age.

Children also understand and mimic our actions if our family has financial stresses. The emphasis we place on religious participation, education, travel, or hobbies act similarly on our children. To a large extent, our actions teach children our values for the things important to us.

Formal education is another important strategy. As a high school student, I knew only two kids who attended private school, but it's much more common today. My son took that route, a Montessori school. I wanted to give him something special.

Funding education is a tactic—a way to implement a strategy—that's often used to sell financial instruments. A 529 Plan is a tax program, available in every state, designed to encourage saving for education. The incentive is tax-free earnings. In a 529 Plan, the donor does not receive an income tax deduction for contributions (although significant assets can be moved from estate tax calculations). But the asset can be used for education without paying taxes on the earnings. Educational IRAs have similar provisions, but without provisions for large contributions.

While tax-free educational programs are attractive, it takes significant principal, low investment costs, good performance, and time to realize the benefits. Parents must be disciplined with contributions and investments. For many families, desirable purchases must be foregone in order to make contributions to the plans.

But the great thing is that your kids should capture more from your example than just the tax savings. Consider making these plans a noticeable part of your financial tactics, and make sure your kids know it, too: Your actions will speak louder than your words.

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We really want to teach our kids to use their college savings activities as part of their training, the way an athlete uses exercise equipment to prepare for the challenges of her sport.

Financial Planning

Money Can't Buy Happiness…Or Can It?

By Stacy Francis, NAPFA-Registered Financial Advisor

You've heard it ad infinitum, "Money can't buy happiness." Now there's scientific data to give the old saw new teeth. University of Southern California economist Richard Easterlin surveyed 1,500 people over nearly three decades to see what gets high marks on their "Happy-o-meter." His results revealed that time with family and good health are the stuff of happiness.

Money? Did this play a role in happiness? The study found that wealth doesn't necessarily lead to joy and contentment. In fact, the magic number that equals satisfaction is far lower than you would expect. It's $40,000 a year. Once enough is earned to meet basic needs, money in relation to happiness is a very personal equation.

Oprah magazine says so. And so does Harvard psychologist Daniel Gilbert, who studies such things. In fact, the rule is well established in research: The first $40,000 makes a big difference in one's level of happiness. After that, the impact is much smaller. The difference between someone making $40,000 per year and someone making $15,000 is far greater than the difference between $100,000 and $1 million.

So technically, most of you should be happy. And if you're working for the next big raise, forget it. You're better off working on teaching yourself how to look at your money with a different eye.

The sad truth is that Americans are as rich as we were in 1957, but only half as happy. As Dr. David G. Myers, an authority on the psychology of happiness, wrote in, Does Economic Growth Improve Human Morale?, "Never has a culture experienced such physical comfort combined with such psychological misery. Never have we felt so free, or had our prisons so overstuffed. Never have we been so sophisticated about pleasure, or so likely to suffer broken relationships."

Despite air conditioning, TiVo, organic wine, and high-speed Internet access, we're not as happy as our parents and grandparents.

But what about the Donald Trumps of the world? Surveys reveal that even lottery winners and the super rich soon adapt to their affluence and are little if any happier than the average Joe. Moreover, those who strive most for wealth tend, ironically, to live with a lower overall well-being than those focused on intimacy and relationships.

"By far the greatest predictor of happiness in the literature is intimate relationships," Sonja Lyubomirsky, a researcher at the University of California-Riverside, told a *Chicago Tribune* reporter. "It's definitely not money."

In the end, happiness is about wanting and managing what you already have, spending time with friends and family, as well as taking care of yourself.

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Percentage of American households earning more than $35,000 per year (2002 data): 58%

Percentage of American households earning more than $100,000 per year (2002): 14.1%

Source: U.S. Census