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financial $UCCESS

SPRING 2012

A Financial Plan: Your Financial Road Map

A 2009 survey by the Certified Financial Planner Board of Standards found that only slightly more than one-third (36%) of Americans have a formal financial plan.

What Is a Financial Plan?

A financial plan is a document that serves as a blueprint for addressing your money needs in the most efficient way possible for the rest of your life. It may include:

- ✔ A list of your household income and expenses — your personal income statement
- ✔ An inventory of your assets and debts — a household balance sheet — from which you calculate your net worth (assets minus liabilities)
- ✔ Your combined effective income tax rate, including federal, state, and local taxes
- ✔ An evaluation of your needs for life, disability, and long-term-care insurance
- ✔ Your vulnerability to estate taxes and recommendations on steps to minimize them
- ✔ Specific recommendations for satisfying such long-range goals as paying for college for your children and providing an income for your retirement, including: An amount to save and invest every year, and an investment strategy, based on assumptions about future rates of inflation and expected returns from various types of investments
- ✔ A tax-efficient strategy for leaving assets to the people or charities of your choice

Goals Versus Dreams

Every part of a financial plan is important, but the single most important component is your goals. It's a good bet that a number of the 64% of Americans without a

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SAVE THE DATE

October 15-16, 2012

Fifth Annual Financial Literacy Leadership Conference
Theme: *Financial Literacy, A Tool for Financial Success*
Hosted by:
Society for Financial Education and Professional Development, Inc.
"Enhancing Financial and Professional Growth…"

Where:
Washington Court Hotel
(Capitol Hill)
525 New Jersey Avenue, NW
Washington, DC 20001

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A Financial Plan

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financial plan don't actually have goals, because they may not understand the difference between a dream and a goal.

A dream is expressed something like this, "I want to retire early and have a comfortable lifestyle that includes playing golf and traveling." A goal sounds more like this, "I want to retire when I'm 60, be able to support a lifestyle that costs $125,000 a year in today's dollars, and maintain that lifestyle at least until the end of my current life expectancy."

While the dream sounds nice, the problem is that if you aren't specific, how would you even know whether you achieved it? How early is early? How comfortable is comfortable? And what must you do between now and then to fulfill the dream?

Goals are measurable targets that lend themselves to a series of precise action steps that make it possible to accomplish them. Defining a goal means you set specific numbers for:

- ✔ ***An amount:*** How much money you're going to need to spend every year for that purpose.
- ✔ ***When you'll need it:*** The first year you're going to have to come up with the money.
- ✔ ***How long you'll need it:*** Is it just four years for each of your children to attend college or for the rest of your life? If the latter, how many years is that likely to be?

A Living Document

Creating a sound financial plan takes a lot of time and effort. But the truth is that even after it's done, it's never really finished. That's because it's only as good as it faithfully documents your current situation: your age, health, assets, liabilities, how many dependents you have, and all those things that can and do change over time. ❍❍❍

How Should You Evaluate Your Investment Results?

Marked by two recessions, the last decade was one of the weakest for stock returns in a generation, with steep losses in three years and average annual returns in the major indexes of less than 3% — six points below their long-term rates of return. On the other hand, if you look only at the last two calendar years, at certain indexes, stocks, and gold, things look good. If you were in the right investments, you may well have outperformed the Dow Jones Industrials and the S&P 500.

All of this suggests at least four different ways of evaluating how well your portfolio has performed. These include:

- ✔ Focusing on only your short-term results.
- ✔ Looking at each of your positions in isolation from the others.
- ✔ Concentrating on how your results make you "feel."
- ✔ Comparing your returns to some index as a benchmark.

What's wrong with these? That's a question best answered by looking at the right way to assess your performance. The best way to tell how your investments are doing is a combination of two perspectives:

- ✔ Concentrate on the performance of all of your positions as one investment program, and
- ✔ Compare the value of your portfolio to how much your financial plan says you should have now.

A properly constructed financial plan defines how much money you need to have on hand when it's time to begin paying for a goal — whether it's paying for your child's college education, buying a first or second home, or retiring. In addition, the plan should include tables that define, year by year going forward, exact target amounts for the value of your portfolio.

The reason for doing this is that your future doesn't depend on how well any single stock you own performs or whether your portfolio is doing better or worse than any particular stock index. Invariably, if your portfolio is properly constructed — which means it's properly diversified — it's always going to be underperforming some stock or index somewhere.

If you're the kind of person who just has to try to beat an index or enjoys bragging about some hot stock you purchased, do this: make sure that given how much you can save and how much money you tucked away, you're on target for accumulating more than you need to meet your goals, then take some of the excess and play with it.

On the other hand, if your portfolio is currently behind your targets to meet your goals, you have some reengineering to consider. You may need to adjust your investment strategy to achieve potentially higher long-term returns, save more, postpone the date of your goal, or lower your expectations for the future.

It's this kind of organic perspective that is the most useful for assessing your investment results. And that means that you should have a solid financial plan in place before you start investing. If you don't have a financial plan or you have one but you're behind schedule for meeting your goals, the best thing you can do is call to discuss this further. ❍❍❍

Major Estate Tax Law Changes Ahead

On December 31, 2012, the provisions of the law that took much of the sting out of estate taxation are due to expire. It was the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, or TRA 2010, signed into law on December 17, 2010, that ushered in the lightest levies against inherited assets in more than 75 years. Among other things, it raised the estate tax threshold to $5 million per person ($5.12 million in 2012), and lowered the estate tax rate to 35%.

The rate hadn't been that low since 1931 when the top rate was 20%. It rose to 45% in 1932 and soared to 77% from 1941 through 1976, before decreasing to 55% in 1984 where it remained through 2001. Changes in the 2000s gradually brought that rate down to 35%.

With the expiration of TRA 2010 set for the end of 2012, estate taxation will revert to what it was in 2001: taxes begin on estates of just $1 million (still twice that for married couples), and the tax rate moves back up to 55%. To illustrate the impact: the taxes due on a joint estate of $5 million will rise from nothing this year to $2.75 million in 2013.

What's more, when TRA 2010 expires, it will also become more difficult to reduce your estate by gifting. In sync with the lowering of the threshold for estate taxation, the lifetime gift tax exemption will be cut from $5.12 million per person ($10.24 million for couples) to just $1 million ($2 million for couples).

If you're among the Americans who would be affected by the reset of estate tax laws in 2013 (if you have an estate worth more than $1 million and/or would consider gifts of more than $1 million), then there are steps you can take today to take advantage of the current favorable estate tax laws. Those steps include:

Accelerate your gifting. Even if you had previously used your full lifetime gift exemption (which was $1 million), through 2012 you can make additional gifts up to the limited-time-only lifetime limit of $5.12 million. Work with a professional advisor to ensure that you balance minimizing estate tax consequences with leaving enough liquidity in your estate to provide for your own needs.

Move more assets into trusts. Sheltered trusts can be an effective way to protect your assets from estate taxes. It always makes sense to ensure that you have maximized your use of trusts to minimize your estate tax burden, but with stiffer tax laws likely in the future, no is a critical time to do so.

While it's possible that Congress could pass new laws before the end of 2012 that make the estate tax code more benign, with federal spending cuts in the neighborhood of $1 trillion on the table along with proposals to increase taxes on the wealthy, it appears that an extension of estate tax relief is a long shot in the near term.

Smart changes in your gifting strategy and your estate plan depend on knowing, in part, how the market has changed the value of your assets and how those changes affect your entire financial picture. Please call if you'd like to discuss your estate plan in more detail. ❍❍❍

Factors Impacting Your Asset Allocation

While you probably won't make frequent changes to your asset allocation strategy, changes in your personal situation may necessitate periodic alterations. That will typically occur when personal changes alter the major factors affecting your asset allocation — your risk tolerance, return needs, and investment time horizon.

Risk tolerance — Your risk tolerance is likely to change, either as you become more familiar with investing or as you age. Familiarity with investing typically makes you more risk tolerant, while aging may make you more or less risk averse. Both conservative and aggressive investors are likely to hold changing views of risk tolerance over their life. However, adjust your asset allocation when your risk tolerance shifts, so you don't become uncomfortable with the risk in your portfolio.

Return needs — Your need to emphasize income or growth is likely to change over your life. Young investors typically want to emphasize growth, while retirees may want to emphasize income.

Investment time horizon — With a short time horizon, your liquidity needs may require avoiding more volatile investments, such as stocks. With a longer time horizon, you can wait out any fluctuations in volatile investments. Typically, young investors have longer time horizons than older investors, so they can invest more aggressively. However, young investors may need to allocate at least part of their portfolio to conservative investments if they are investing for short-term needs, such as for a down payment on a home or to pay for a child's education. ❍❍❍

Should You Serve as a Guardian?

When asked to serve as the guardian of someone's minor children in the event of his/her death, it is usually meant as a compliment that the person trusts you to serve in this important role. While you may fear that you'll hurt your relationship with that person by saying no, don't accept this role without giving it serious thought. Consider the following:

✔ **Are your lifestyles compatible?** Go over all details involved in raising the children. Will the children move in with you? If so, will that mean relocating them far from their current home? It is difficult to lose parents, but it becomes even more traumatic when the children must relocate away from friends and school. What are the parents preferences regarding education, religion, lifestyle, and other factors? How well does your family get along with their children? Consider the impact on your children, including the fact that you will probably have less time available for them. Combining families is never easy, and you should consider all factors before agreeing to serve as guardian.

✔ **How much financial support will be available?** This involves more than making sure money is available for college and other expenses directly attributable to the children, such as clothing, medical expenses, and entertainment. Additional children in your house will increase many of your bills, including food, utilities, transportation costs, etc. Your house may now be too small, requiring an addition to your current home or moving to a larger home.

✔ **Are you comfortable taking on responsibility for the children's finances?** Just because you agree to take physical custody of the children does not mean you have to handle their finances. You may feel more comfortable with another person involved to review how the children's money is spent.

✔ **Has a contingent guardian been named?** Find out if a contingent guardian has been named in case you cannot serve. However, don't use this as an excuse to say yes when you really want to decline. It is better to indicate that you do not want to take on this responsibility now, so another guardian can be chosen and has the opportunity to go over all these details. Also, if your situation changes in the future, inform the parents immediately. ❍❍❍

Sharing an Inheritance

Married individuals who receive a large inheritance face a tough decision — should you share the inheritance with your spouse or hold the assets separately? Legally, you aren't required to share the inheritance. Even if all other marital assets are owned jointly, you might want to consider keeping an inheritance separate for these reasons:

✔ Should you get divorced, you probably wouldn't have to split a separately held inheritance with your spouse.

✔ When you die, you control who receives the inheritance. If the inheritance is owned jointly, it goes to your spouse. If your spouse remarries, there is a chance the inheritance will ultimately go to a second spouse or children from a second marriage. You can get around that result through the use of a trust, but it may be simpler to just keep the assets separate.

Rather than remaining evasive, discuss the inheritance and your concerns openly with your spouse. Even if you decide to keep the inheritance separate, that doesn't mean you can't share some of the assets for common goals. ❍❍❍

Financial Thoughts

In 2010, 57% of companies used auto-enrollment for 401(k) plans, compared to 24% in 2006 (Source: Center for Retirement Research, 2011).

Approximately 6.7% of Americans live in deep poverty, meaning they are at 50% or less of the official poverty level, earning less than $5,570 as an individual or $11,157 as a family of four (Source: Associated Press, 2011).

In a recent survey of workers in the United States, 39% plan to retire after age 70 or not at all, and 54% plan to continue working after retirement. Of those who plan on working after retirement, 34% plan to do so because they can't afford to retire, 19% want to stay involved, 18% want the income, 16% enjoy what they do, and 9% need the health benefits. In the same survey, 66% of respondents did not have a backup plan for income if they were forced to stop working (Source: Transamerica Center for Retirement Studies, 2011).

Approximately 52% of employers are having difficulty filling critical positions because they cannot find workers with the needed skills (Source: Manpower Group, 2011). ❍❍❍