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A Quiet Revolution Has Altered Financial Planning

Goal-based planning is quietly changing the way Americans plan financially. While business coverage in the media focuses on hot stocks, corporate scandals, and movie box office numbers, this is a major story that can change your financial outlook. The difference between a goal-based financial plan and a traditional cash-flow-based plan is in the level of detail. Cash-flow plans are far more detailed and the details can get in the way.

With a cash-flow plan, based on your current income, spending habits, savings rate, tax bracket, and portfolio, software is used to make projections about your financial future over the next 10, 20, or 30 years, or even longer. Each investment—every bond, every stock—is subject to a forecast breaking down the dividends, interest, and capital appreciation it is expected to provide over the period. Each expense must similarly be projected, year by year, from your mortgage to what you spend on food. Gathering all these numbers poses a problem. Many people simply never do it. Their financial plan ends before it ever begins.

Apart from this human foible, a bigger problem with cash-flow based plans is that the projections rely on so many variables. Forecasting your rate of return on an individual security or what you will spend on gasoline during the next 30 years is too iffy. If your return forecast is off by a percentage point or two in either direction, your plan can be well off the mark. In other words, while intuitively you may believe that more data makes a financial plan more reliable, the opposite may actually be true. Limiting the variables may indeed provide a better view of the future.

That's the approach of goal-based planning. With a goal-based financial plan, you essentially admit that predicting your income and expenses with accuracy is too difficult. Instead of relying on projections of your income and expenses, goal-based plans focus on how much you are saving now and the return you expect to earn.

In contrast to traditional financial planning, which calculates how much you could save, given your current income, expenses, and taxes, goal-based planning starts with how much you are saving. Instead of estimating your retirement income by requiring you to forecast returns on individual securities and accounts over the next 10, 20, or 30 years, a goal-based plan estimates how much of a nest egg you'll accumulate by making a single assumption about the return on your total portfolio. Instead of requiring a budget forecast based on dozens of items, your expenses are estimated based on your major goals in life. The focus on your goals makes a plan more meaningful to most people.

Bob Curtis, the founder of Pie

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Rollercoaster Ride Anyone? No Thanks!!

At times, this stock market will give even the biggest iron-stomached rider a run for their money. The ups and downs of the market may leave you a bit queasy.

But, as this ride is for the most part, uncontrollable, you can't afford to take a blind eye to planning your retirement, education, or just LIFE! You need to take control.

This reminder came very close to home for us when Dave had his heart attack back in May. As he continues to recover, planning has allowed for him, his family, and us to sleep better knowing that our bases are covered. For you too, making sure that death or incapacitation does not put a financial burden on the ones around you will leave a legacy to be admired!

Most of the articles included in this newsletter center around planning for uncertainty. Enjoy the article discussing goal-based planning, an easier way to plan for the future. Also discussed is what NOT to forget to include in your will when planning for the distribution of assets after you're gone.

Life insurance can be a real savior! Read about eight things to look for when purchasing (or if you already own) insurance. Have you ever wondered if you can put more money away – and furthermore, defer taxes on that money? An article on how using a Defined Benefit plan may be the answer. Lastly, how about a test? Put your thinking caps on and have fun with our Investment News Junkie quiz.

Enjoy the rest of your summer!

Jim Joseph, CFP®
Client Relations Manager

Are You An Investment News Junkie?

It's called market noise, and you know better than to let it distract you from your long-term financial plan. But it never hurts to stay informed, so you bookmark your favorite market news sites, never skip the paper's money section, and tune in TV's financial pundits. Use this quiz to gauge how well you paid attention last year.

1. Which currency did not gain ground against the dollar in 2006?

a. yen
b. euro
c. pound
d. Swiss franc

2. During 2006, the price of a barrel of light sweet crude oil peaked during what month:

a. January
b. May
c. July
d. November

3. In 2006, margin debt (funds borrowed against securities) reached $270.53 billion. When was the only other time margin debt exceeded $270 billion?

a. 1987
b. 2000
c. 2003
d. None of the above

4. A radio network, a casino, and a supermarket chain were in the top 10 for 2006 in which category?

a. initial public offerings
b. stock market gainers
c. private equity buyouts
d. all of the above

5. Incidents involving CNBC star Maria Bartiromo spelled trouble for:

a. former Citigroup executive Todd Thompson
b. Federal Reserve chair Ben Bernanke
c. both of the above
d. neither of the above

6. True or false: In 2006, the housing boom faltered, with a decline in both the number and median price of existing home sales.

7. Commercial real estate in 2006 saw a decrease in vacancy rates and a rise in the average per square foot cost for:

a. offices
b. retail space
c. industrial space
d. all of the above

8. Drawn by the promise of big returns, investors poured a net $92 billion into hedge funds during the first nine months of 2006. For the year, the Credit Suisse/Tremont Hedge Fund Index outperformed:

a. the Standard & Poor's 500 Stock Index
b. the Dow Jones World Index
c. the Lehman Brothers U.S. Aggregate Bond Index
d. all of the above.

9. In 2006, measured in U.S. dollar terms, how did international market regions fare (from best to worst)?

a. Latin America, Europe, Asia/Pacific
b. Asia/Pacific, Europe, Latin America
c. Europe, Asia/Pacific, Latin America
d. Latin America, Asia/Pacific, Europe

10. Art prices soared in 2006 as new investors and collectors flooded into the market. Which artist's work brought the highest price at auction?

a. Pablo Picasso
b. Willem de Kooning
c. Andy Warhol
d. Rembrandt

11. True or false: At year's end, bond investors, apparently worried about the long-term health of the economy, were paying higher prices for 2-year U.S. Treasuries than for 10-year Treasuries.

12. The best and worst performing U.S. market sectors, respectively, in 2006 (as tracked by Dow Jones Indexes) were:

a. telecommunications; retail
b. oil and natural gas; construction materials
c. media; chemicals
d. food and beverage; travel and leisure. ●

Answers:
1a; 2c; 3b; 4c; 5c; 6 true; 7d; 8c; 9a; 10b; 11 false; 12a.

A Defined Benefit Plan Lets You Sock Away Large Amounts If

Is your 401(k) not enough? With a Defined Benefit (DB) plan, you can sock away around $2 million for retirement over a relatively short period of time while deferring taxation. Plus, you can still contribute to a 401(k), SEP, or other personal retirement account. If you've gotten a late start on retirement saving, a DB plan could help you quickly catch up. But it won't have much effect unless you can afford to fund it generously—for yourself and your employees.

Unlike a Defined Contribution plan, such as a 401(k), which is built around what goes into it, a DB plan is based on what comes out during retirement. A fully funded plan could guarantee that you'll receive as much as $2 million, either in a lump sum or as annuitized payments. To make sure you get there, actuarial calculations determine how much you must contribute each year. The size of that annual contribution is influenced by many factors, including the number of employees participating, their age and salary, and performance of the plan's invest-ments. In good years for the market, your contribution may be smaller, while a weak market could require you to write a larger check.

A DB plan lets you receive an annual benefit equal to 100% of your company salary, up to $180,000 a year, until your benefit reaches the $2 million limit. With no limit on the annual contribution, a DB plan can be the ultimate catch-up tool for retirement for a small business owner with few employees and who is nearing retirement. Assuming you have the cash to make the maximum contributions allowed, you could accumulate $2 million in as little as a decade, depending on the return on plan investments. Meanwhile, you can continue to

What Else Should Be In Your Will?

When writing a will, most people focus on big assets—real estate, securities, and bank accounts. Often overlooked are smaller items, such as jewelry, paintings, and family heirlooms, as well as other instructions that have nothing to do with assets—whether you want to be buried or cremated, for example, or who should clean out your house after you're gone. This begs the question: Exactly what, beyond the obvious, should be in your will?

According to Mary Randolph, author of *The Executor's Guide: Settling a Loved One's Estate or Trust* (Nolo, 2006), "you can do pretty much whatever you want in your will." The question is, will what you want benefit your descendants—or only add to the confusion?

Many people writing wills indicate exactly who should receive specific big-ticket items—a car, a boat, the summer house—then stipulate that the rest of the estate be divided equally among all heirs. That's nice and simple, says Randolph, but it could spark family disputes. "Even in families in which everyone gets along fine, in times of stress, disagreements can bubble up," Randolph says.

Your goal should be to leave specific instructions without getting too complicated. Attaching conditions to a gift, for example, can be problematic. Suppose you'd like to provide your daughter with a financial reward only if she attends college—but what does "going to college" really mean? Does she have to attend full time, or can she take night classes? Does she have to enroll in a four-year university, or is a community college or unaccredited online program acceptable? And is there a specific time frame? What if she attends college in 50 years—does the estate have to reserve enough money to pay her then?

Randolph recommends you think about what material goods are particularly important to your family—your grandmother's china, a favorite painting, an 18th century armoire—and make specific bequests of those items. But those instructions don't necessarily have to be in your will. About half of U.S. states accept a "property memorandum"—a list, outside your will, of personal items you want to leave to certain people. If you choose this route, your will can simply indicate that you wish your personal effects to de divided according to the attached memorandum. This approach saves you the hassle of rewriting and re-notarizing your will if you acquire additional items you want to give away or change your mind about who gets what.

For the remainder of your personal effects, try to come up with a way for heirs to divide things up among themselves. For example, you might let each descendant pick one item and then another, until everything is accounted for. Or, you might assign everyone a certain number of points, which can be used to bid on individual items. "That way, your children can decide what's important to them," Randolph says. "John may want to spend his 100 points on furniture, while Mary prefers to spend hers on a snow globe."

You can also make specific instructions in your will—for example, that your son gets the job of cleaning out your house, or that you want to be cremated, not buried. But here you may find yourself in tricky legal territory.

First, you need to make such a request in language suggesting it is legally binding. "Saying, 'I want my son to clean out my house,' is not binding," says Randolph. "But saying, 'I appoint my son as executor and direct that he shall sort and divide my personal belongings as he sees fit' " is.

Next, consider when your will is likely to be read. If you want to be cremated, it's better to make that request in a final arrangements document or a similar form, because your will probably won't be reviewed until after the funeral.

Finally, realize that whether you make such requests in your will or another document, they may not have the weight of law. Most state laws don't say anything about how to make final instructions legally binding. Those that do require a form that must be witnessed and notarized—and even then, the instructions have to be followed only if they're reasonable. "You probably can't say you want to be buried in a Cadillac," says Randolph. "Your best bet is to write down what you want according to the laws of your state, and hope for the best." ●

You Can Overcome Some Obstacles

fund your own Defined Contribution plan, deferring taxation on another $45,000 in income each year.

The chief drawback to a DB plan is that if you have employees, you'll have to fund their retirement benefit, too. That may not be a huge burden if your workers are mostly young and earning low salaries. But if you're paying into the plan for well-paid employees nearing retirement age, the total contribution required could amount to a substantial drain. In general, any employee who is at least 21 and has worked for the company for a year or more must be covered by your plan.

Of course, making contributions for employees won't be an issue if yours is a one-person business. In fact, even those without a corporate structure may establish a DB plan.

DB plans offer estate planning advantages. If your plan is set up to continue payments to a surviving spouse after your death, the ongoing income won't be taxed as part of your estate, though your spouse will pay income tax on the payouts. In contrast, an inherited IRA or 401(k) could be subject to estate tax. ●

Eight Ways To Save On Life Insurance

The price you pay for life insurance largely depends on things you can't or don't want to change: your age, health, habits, and other lifestyle choices, such as smoking and skydiving. Still, there are ways to save when buying a policy.

Buy the type of insurance you need. Though there are dozens of variations, life insurance basically comes in two flavors: term or permanent. With a term policy, you pay an annual premium and, assuming you die during the term of the policy, the insurer guarantees it will pay your beneficiaries the face amount of the policy upon your death. A permanent policy does the same thing, but premiums are higher, because you build up cash value that you can borrow against or withdraw if you cancel the policy. The right type of insurance for you depends on several factors, including your age, family situation, and financial goals. Often a term policy can save you money.

Don't be loyal to one company. You may receive free or discounted life insurance through a current or former employer. But you'll probably need to supplement that coverage, and buying additional insurance from that insurer may not get you the best deal. Keep in mind, though, that you'll likely have to qualify medically for a policy you buy on the open market, which may not be required if you buy through an employer.

Negotiate. Smoke one cigar a month? You'll probably be lumped into the same category as someone who smokes two packs of cigarettes a day. And a dangerous activity, such as skydiving, that you tried just once could also ratchet up your premium, even if you have no intention of doing it again. Your premium may be negotiable, if you write to the insurer explaining why you think you should qualify for a better rate.

Find a specialist if you have health problems. Some insurers specialize in covering people with heart disease, cancer, or diabetes. These companies employ underwriters trained to differentiate, for example, between people with high blood pressure who take their medication regularly and those whose hypertension is uncontrolled.

Buy in bulk. If you're planning to buy $950,000 of coverage, a $1,000,000 policy may actually cost less. Insurance is priced in multiples of $250,000, and an insurer may charge disproportionately more for an in-between amount.

Avoid hidden fees. Before you sign up for any convenience, find out how much it costs. For example, some insurers charge for deducting monthly payments automatically from your checking account.

Choose riders carefully. An insurer may pad your policy with extras called riders. For example, the accidental-death rider, more commonly known as double indemnity, pays twice the normal death benefit if you perish in an accident. But the chance of that happening is quite small and may not be worth the extra cost. Be sure you understand what riders you are buying.

Review. It's wise to review your policies every two or three years, especially permanent policies, to see if they can be leveraged or exchanged into a new lower-cost policy. ●

A Quiet Revolution

(Continued from page 1)

Technology, which makes goal-based planning software for financial professionals, cites the example of John and Ann, a couple who are both 59 years old and want to retire within four or five years. Whereas a traditional approach to planning might determine that the couple needs a retirement income of $124,000 a year to afford everything they want and that the couple's savings can fund only about three-quarters of that amount, goal-based planning separates out John and Ann's goals and lists them in order of importance. It determines, for example, that they need $72,000 a year to fund their basic living expenses. It estimates that they may be able to afford additional goals—$20,000 a year for travel until age 78; $10,000 annual gifts to their children for 10 years; a new $30,000 luxury car every four years; a $20,000 second car every six years; and additional outlays for dining, entertainment, and other niceties.

Those goals aren't all of equal importance to Ann and John. Obviously, meeting basic living expenses is a must; next, in order of importance, come the luxury car, travel, the second car, the children's gifts, and extra living expenses. It turns out John and Ann can retire at age 63 and expect to fund almost all of their goals, though they'll likely have to pinch pennies on entertainment.

Approaching financial planning this way has several advantages. For one thing, it's hopeful. Instead of simply saying you will fall short of your goals and run out of money during retirement, the goal-based approach tells you what you can afford. It allows you to choose which goals are most important to you and design strategies to improve your situation. For example, retiring two years later might allow you to fund all of your goals, and switching to a riskier portfolio could be worth considering as well.

Creating a goal-based plan with fewer data inputs makes planning easier. Plans can easily be updated, making them more likely to be reviewed every year. Instead of the 75-page reports spawned by cash-flow-based plans, which often end up collecting dust, you receive a succinct report showing your progress toward meeting your goals annually. Our firm uses goal-based planning because we believe it serves you better. To find out more, please don't hesitate to call us. ●