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FINANCIAL CONCEPTS

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Your Financial Road Map

Are you making progress toward your financial goals? Are your finances in order? Are you prepared for a financial emergency? If you're not sure, take time to thoroughly assess your finances so you have a road map for your financial life:

Assess Your Financial Situation

Evaluating where you currently stand financially will help you determine how much progress you are making toward your financial goals. There are several items to consider:

- **Your net worth** — Prepare a net worth statement, which basically lists your assets and liabilities, with the difference representing your net worth. Prepared at least annually, it can help you assess how much financial progress you are making. Ideally, your net worth should be growing by several percentage points over inflation.
- **Your spending** — Next, prepare a cash flow statement, detailing your income and expenditures for the past year. Are you happy with the way you spent your income? You may be surprised by the amount spent on nonessential items like dining out, entertainment, clothing, and vacations. This awareness may be enough to change your spending patterns. But more likely, you will need to prepare a budget to help guide your future spending.
- **Your debt** — Debt can be a serious impediment to achieving your financial goals. To assess how burdensome your debt is, divide your monthly debt payment, excluding your mortgage, by your monthly net income. This debt

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Deciding on a Mortgage Term

When considering mortgage options, most homeowners debate whether to obtain a 15-year or 30-year mortgage. However, lenders offer other terms, such as 10, 20, 25, or even 40 years. Even after obtaining a mortgage, you can typically lower the term by paying additional principal with your mortgage payment. So how do you go about deciding which is the best term for you? There are three basic factors you should consider:

- Since each term will have a different interest rate, you should review the rates for different mortgage terms. In general, shorter mortgage terms will have lower interest rates.
- Also consider the monthly mortgage payment, which will depend on your down payment, mortgage term, and interest rate. Longer mortgage terms have lower mortgage payments. Keep in mind, however, that your equity will build slower with longer-term mortgages. Monthly payments for 15-year loans are typically 15% to 25% higher than 30-year loans, but your interest costs are typically half, since your interest rate is lower and the mortgage is paid off much sooner.
- Your final consideration should be your financial plans. You want to select a mortgage term with a comfortable mortgage payment that will ensure you have money left over to save for other financial goals.

One option that gives you flexibility is to select a longer mortgage term, such as 30 years, and send additional principal in with your regular mortgage payment when you have the funds. Please call if you'd like to discuss your options in more detail. ❍❍❍

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Financial Road Map

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ratio should not exceed 10% to 15% of your net income, with many lenders viewing 20% as the maximum. If you are in the upper limits or are uncomfortable with your debt level, take active steps to reduce your debt or at least lower the interest rates on that debt.

Increase Your Savings

Calculate how much you are saving as a percentage of your income. Is it enough to fund your future financial goals? If not, go back to your spending analysis and look for ways to reduce expenditures. That may mean reassessing your lifestyle choices, since you need to live below your means to find money to save. Commit to saving more immediately and then take steps to make that commitment a reality.

Rebalance Your Investments

At least annually, thoroughly analyze your investment portfolio:

❍ Review each investment in your portfolio, ensuring that it is still appropriate for your situation.

❍ Calculate what percentage of your total portfolio each asset type represents, compare this allocation to your target allocation, and then decide if changes are needed.

❍ Compare the performance of each component of your portfolio to an appropriate benchmark to identify investments that may need to be changed or monitored more closely.

❍ Finally, calculate your overall rate of return and compare it to the return you estimated when setting up your investment program. If your actual return is less than your targeted return, you may need to increase the amount you are saving, invest in alternatives with higher return potential, or settle for less money in the future.

Prepare for Financial Emergencies

To make sure you and your family are protected in case of an emergency, set up:

❍ A reserve fund covering several months of living expenses. The exact amount you'll need depends on your age, health, job outlook, and borrowing capacity.

❍ Insurance to cover catastrophes. At a minimum, review your coverage for life, medical, homeowners, auto, disability income, and personal liability insurance. Over time, your insurance needs are likely to change, so you may find yourself with too much or too little insurance.

Review Your Estate Plan

The estate tax laws have been changing substantially over the past few years. Take a fresh look at your estate planning documents and review them every couple of years during this transition period. Even if the increases in exemption amounts mean that your estate won't be subject to estate taxes, there are still reasons to plan your estate. You probably still need a will to provide for the distribution of your estate and to name guardians for minor children. You should also consider a durable power of attorney, which designates someone to control your financial affairs if you become incapacitated, and a health care proxy, which delegates health care decisions to someone else when you are unable to make those decisions.

If you'd like help evaluating your finances, please call. ❍❍❍

Distributing Personal Possessions

Organizing and planning an estate is not a simple process. After deciding who should receive major assets, you may need to use a variety of vehicles to distribute those assets, such as wills, gifts, and trusts. Dealing with major assets may be so time-consuming that you don't even think about your personal possessions, leaving distribution decisions up to your heirs. But disputes over personal possessions are more apt to cause conflict among heirs than disputes over money. Some items to consider include:

❍ **Take time to think about who should receive treasured personal possessions.** You might want to detail your wishes in a separate letter to your heirs to prevent disagreements. Indicate why you are distributing possessions in that manner.

❍ **Ask your heirs what possessions are important to them.** Otherwise, you may inadvertently give a treasured possession to one child without realizing its importance to another. Children may then try to read motives into your decisions.

❍ **Don't distribute assets based on arbitrary criteria.** You don't necessarily have to give your jewelry to your daughter or your tools to your son. Your son might want to pass on some of your jewelry to his wife or daughter. Likewise, don't give your most valued possessions to your oldest child without considering younger siblings.

❍ **Devise a method for heirs to distribute personal possessions.** You probably won't want to decide how every personal possession should be distributed. After you have determined how to distribute your most valued possessions, detail a method for heirs to distribute the rest of your possessions. It can be as simple as heirs taking turns selecting items or flipping a coin if more than one person is interested in an item. ❍❍❍

Buying a Second Home?

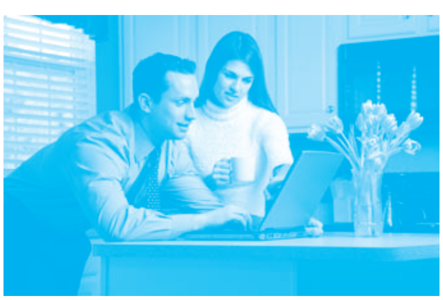
For many Americans, owning a vacation home is a long-held dream. If it's one of your dreams, consider these five factors before you decide to purchase.

1. Where will the mortgage money come from? Your first financial priority, after meeting your living expenses, should be to build up a rainy day savings of 3–6 months of living expenses and then to fully fund your retirement accounts. If you've met those goals, weigh your desire for a second home against other spending goals.

2. What is the true, total cost of second home ownership? The costs associated with owning a home go far beyond just the mortgage principal and interest payment. You'll also have to consider: mortgage closing costs, state and local property taxes, homeowners insurance, private mortgage insurance, homeowners association dues, maintenance, utilities, home security, and furnishings. At the same time, there can be substantial financial benefits to owning a second home.

3. How does the cost of owning a vacation home compare to the cost of renting a vacation property? Many people who buy a second home do so in a place that they visit frequently. It's important to consider how often you would actually use the vacation home. For many people, the total cost of owning a second home is much more than renting a home or staying in a hotel every visit.

4. Will you use the second home as a source of income? Since 1987, the average annual home price increase was 2.8%, just a hair above inflation. So as a pure investment, a second home probably doesn't make sense. However, if your plan is to use the home when you vacation or rent it as a source of income, it can make sense to buy.



If you plan to use your second home as a source of income by renting it out, the tax implications may be different than if the home were just a vacation home. Explore those implications with your tax advisor. Also, it's important to research the rental market in the area you're considering.

5. What are prices like in the market(s) you're considering? Trying to assess whether a home is undervalued or overvalued is difficult. But by researching price trends in the market(s) you're considering, you can get a sense of whether homes are under or over price trends. If they're over, now might not be the best time to buy; if prices are below trend, you might be able to get a good deal.

Please call if you'd like to discuss this topic in more detail. ❍❍❍

Bond Price Fluctuations

There are two primary factors that affect bond prices — interest rate changes and credit rating changes. Interest rate changes typically will cause a bond's value to fluctuate more than credit rating changes.

As interest rates rise, a bond's price adjusts down, while the bond's price will increase when rates decrease. Simply put, bond prices and interest rates move in opposite directions. Also, bonds with longer maturity dates are more vulnerable to interest rate changes, since the difference will impact the bond for a longer time.

Credit ratings also influence a bond's price. When a bond is issued, rating agencies assign a rating to give investors an indication of the bond's investment quality and relative risk of default. Typically, higher-rated bonds pay a lower interest rate than lower-rated bonds. After the bond is issued, the rating agencies continue to monitor it, making changes if warranted. A bond's price tends to decline when a rating is downgraded and increase when a rating is upgraded. However, these price changes are typically minor if the rating changes by only one notch. Certain downgrades are more significant, such as a downgrade that moves a bond from an investment-grade to a speculative rating, a downgrade of more than one notch, or a series of downgrades over a short time.

If you want to minimize the risk of price fluctuations, consider these tips:

- ❍ If you hold a bond to maturity, you'll receive the full principal value, so you won't be affected by any price fluctuations. Thus, consider purchasing bonds with maturity dates that match when you will need your principal.
- ❍ Consider investing in bonds with shorter-term maturities.
- ❍ Design your bond portfolio using a ladder, so you'll have bonds coming due every year or so. Since the bonds are held to maturity, changing interest rates won't result in a gain or loss from a sale. Bonds are maturing every year or two, so your principal is reinvested over a period of time instead of in one lump sum.
- ❍ Choose bonds that match your risk tolerance. Safer bonds, such as U.S. Treasury bonds or investment-grade corporate bonds, are less susceptible to credit rating risks. ❍❍❍

The Vital Importance of Disability Insurance

Without question, the death of the family breadwinner is devastating, but there's one condition that might be even more excruciating: a disability that renders you unable to work to support yourself and your family. Unfortunately, more people are financially protected against the former than they are against the latter.

One factor that contributes to the widespread lack of disability insurance coverage is the belief that Worker's Compensation insurance will cover most wage earners' needs if they can't report to work. But statistics show that belief is an illusion: only 5% of all disabling conditions are the result of workplace accidents. The rest are the result of illness and injury that have nothing to do with people's jobs.

In view of the financial threat that disability poses, it's vitally important that you understand the kinds of disability insurance available, how they work, and how and where you can get them.

Short-Term Disability Insurance

Depending on the policy, short-term disability insurance usually provides you with 50% to 70% of your work-related income, usually for between 10 to 26 weeks — although some policies will cover you longer. Generally, there's a waiting period of one to two weeks before benefit checks start if you're disabled by illness; if you're injured, coverage usually starts right away.

Short-term group disability insurance is frequently a part of the benefits packages at many companies. If you're self-employed or work for a company that doesn't offer this coverage, you can obtain a private policy from one of the many insurance companies in the market. Private policies are more expensive, but come with one advantage over an employer-provided policy: benefits from private policies are tax free, while those paid out by an employer-sponsored plan are subject to income taxes. Another advantage is portability: a private policy covers you no matter where you work.

Long-Term Disability Insurance

Like short-term disability, long-term policies usually pay 50% to 70% of your working income. The difference is that long-term coverage kicks in only after your short-term coverage ends. Depending on the policy, coverage can last for five years or until you reach the age of 65, when Social Security benefits begin. In addition, you're not required to make premium payments if you've been disabled for at least 90 days.

Another difference concerns whether you are able to work at another type of job. Some policies will pay you full benefits if you can't continue in the same profession but are able to work at another kind of job. These are called "own-occupation" policies and, as you might expect, are more expensive than policies that trim benefits if you can obtain limited employment in another occupation. In general, long-term policy benefits will stop if you're able to earn 80% or more of your predisability income.

Social Security Disability Insurance (SSDI)

The Social Security Administration provides free disability coverage; but for many people, it's a bad idea to count on it alone for disability income. For one thing, SSDI payments typically range between $500 and $2,000 a month. Second, the waiting period for SSDI benefits to begin is five months, during which time the Social Security Administration determines if you meet their definition of severely disabled. Using those criteria, 65% of all SSDI claim applications were denied last year.

Please call if you'd like to discuss this in more detail. ❍❍❍

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Did You Know?

The average decrease in American median wealth from 2007 to 2010 is 47% (Source: National Bureau of Economic Research, 2013).

The median share of household net worth represented by the principal residence for the richest 20% of U.S. households is 30%, while it represents 67% of net worth for the next 60% of U.S. households (Source: Desautels Faculty of Management at McGill University, 2013).

In the 1920s, the average age of Standard & Poor's companies was 67 years. In 2013, the average age was 15 years (Source: Yale University, 2013).

In 2012, the average amount spent by the average retiree household was $31,400, while the average working household spent $39,800 (Source: Center for Retirement Research at Boston College, 2013).

According to a study by Britain's Institute of Economic Affairs that covered individuals ages 50 to 70 years old, retirement adversely affects health. The study found that being retired led to a 39% reduction in the likelihood of describing one's health as "very good" or "excellent," a 41% increase in the probability of suffering from clinical depression, and a 63% increase in the probability of having at least one diagnosed physical condition (Source: Institute of Economic Affairs, May 2013). ❍❍❍