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FINANCIAL CONCEPTS
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Get These Decisions Right

The sheer number of financial decisions required to manage our finances can seem overwhelming. However, there are six basic financial decisions that can determine the course of your financial life:

1. How you earn a living. Sure, we all want to enjoy our work. But within that parameter, why not choose a job that will pay more than another? Your income is going to drive all your other financial decisions, so investigate your options:

❍ Are you sure you're being paid a competitive wage with competitive benefits? Even if you aren't interested in changing jobs now, pay attention to what is going on in your field.

❍ Do you have an outside interest or hobby that can be turned into a paying job? This could be a good way to supplement your current salary, or it could turn into a part-time job or business after retirement.

❍ Can you get some additional training to help secure a promotion or qualify for another job? Read up on what jobs are expected to experience the highest growth rates and/or highest salaries over the next five years. If you don't enjoy your current job, you have even more incentive to implement these suggestions.

2. How you spend your income. The amount of money left over for saving is a direct result of your lifestyle choices, so learn to live within your means. To get a grip on spending, consider these tips:

❍ Analyze your spending for a month. In which categories do you spend more than you expected? Are you wasting money on

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Protecting Your Family's Security

One of your first financial goals should be to protect your family's financial security from major catastrophes. To do so, consider these four items:

❍ **A cash reserve for short-term emergencies, such as a temporary job loss, major home repair, or large medical bill.** A common rule of thumb states that your cash reserve should equal two to six months worth of living expenses. However, how much you'll need depends on your age, health, job outlook, and borrowing capacity. You may need a larger reserve if you expect to be laid off or lose your job, you are the sole wage earner in the family, or your income fluctuates. A smaller reserve may be needed if you have more than one source of family income or you can borrow quickly.

❍ **Adequate insurance in all major areas.** Your insurance needs will change over the years, so you may find yourself with too much or too little coverage. Thus, periodically review your life, disability, medical, and homeowners insurance. Don't overlook disability income insurance.

❍ **Umbrella liability insurance to protect against major lawsuits.** Umbrella policies are purchased in $1 million increments and kick in once limits of your homeowners and automobile policies are exceeded. In addition to the items covered by those policies, an umbrella policy typically covers damages from use of nonowned property in your possession and from lawsuits for libel, slander, defamation of character, and invasion of privacy.

❍ **A power of attorney.** A power of attorney gives an individual you designate the power to act on your behalf when you are incapacitated, allowing him/her to take over your finances and make investment decisions. ❍❍❍

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Get These Decisions

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impulse purchases? Give serious thought to your purchasing patterns, trying to find ways to reduce spending.

- ❍ One of your most significant spending decisions will be your home. Many people purchase the largest home they can afford. Purchasing a smaller home will reduce your mortgage payment as well as other costs associated with owning a home.
- ❍ Prepare a budget to guide your spending. Few people enjoy setting or sticking to a budget, but inefficient and wasted expenditures can be major impediments to accomplishing your financial goals. Start by setting a budget for a couple of months, tracking your expenses closely over that time. You can then fine-tune your budget for an annual period.

3. How much you save. You should be saving a minimum of 10% of your gross income. But don't just rely on that rule of thumb. Calculate how much you need to meet your financial goals and how much you should be saving on an annual basis. If you can't seem to save that much, go back to your spending analysis and cut your spending. First, look for ways to reduce your spending by lowering the cost of your purchases. Perhaps you can refinance your mortgage, find insurance for a lower premium, or use strategies to reduce taxes. At some point, however, you may need to cut your discretionary spending.

4. How you invest. The ultimate size of your portfolio is a function of two factors — how much you save and how much you earn on those savings. Even small differences in return can significantly impact your investment portfolio. Typically, investments with potentially higher rates of return have more volatility than investments with lower rates of return. While you don't want to take on excessive risk, you also don't want to leave all your savings in investments with little growth potential. Your portfolio should contain a diversified mix of investment categories.

5. How you manage debt. Before you take on debt, consider the effect it will have on your long-term goals. If you are already having trouble finding money to save, additional debt will make it even more difficult to save. To keep your debt in check, consider these tips:

- ❍ Mortgage debt is acceptable as long as you can easily afford the home.
- ❍ Be careful about taking equity out of your home in the form of a home-equity loan. You might want to set up a home-equity line of credit for emergency use, but then make sure it is only used for emergencies.
- ❍ Never purchase items on credit that decrease in value. If you can't pay cash, don't buy them.

6. How you prepare for financial emergencies. Making arrangements to handle financial emergencies will help prevent them from adversely affecting your financial goals. Make sure to have:

- ❍ An emergency fund covering several months of living expenses. Besides cash, that fund can include readily accessible investments or a line of credit.
- ❍ Insurance to cover catastrophes. At a minimum, review your coverage for life, medical, homeowners, auto, disability, and personal liability.
- ❍ A power of attorney so someone can step in and take over your finances if you become incapacitated.

Making the correct choices for these six basic financial decisions will help put you on the right financial course. If you'd like help with these decisions, please call. ❍❍❍

Considerations for Long-Term-Care Insurance

Should you buy insurance that will pay for your expenses if you ever need to live in an assisted living facility or nursing home? Unless you have substantial assets or relatives or friends ready and capable to take care of you when you can't, you should seriously consider buying a long-term care insurance policy. Here are some of the features that you should bear in mind when shopping:

Premiums are expensive and increase with age. Typical premiums range from $1,000 to $3,000 a year for people in their 50s and rise steeply from there. Since rates and eligibility for coverage also depend on your current health when you apply, it's better to apply before illnesses associated with aging catch up to you.

Coverages vary. Not all policies cover every health condition, service, or type of facility. Many rule out coverage for certain types of pre-existing conditions. Some policies offer only fixed coverage amounts, while others have built-in provisions for rising costs. Some will cover expenses for only two years while others may extend coverage for years or for life.

Focus on strong, experienced insurers. Credit rating agencies like Moody's and Standard & Poor's rate long-term care insurers on financial strength, and all things being equal, it makes sense to seek coverage from a strong company with at least 10 years of history. Be careful of firms with a recent history of frequent or steep increases in premiums.

Long-term care can be a tough subject to tackle, because it means considering the possibility that you will not be able to fully care for yourself in old age. Is it right for you? Please call if you'd like to discuss this in more detail. ❍❍❍

Your 401(k) Plan after Changing Jobs

Long gone are the days when most employees worked for the same employer their entire careers. That means millions of Americans have participated in more than one 401(k) or other type of qualified retirement plan. A good number of them maintain those 401(k) plans with their former employers. The alternative is to transfer accounts to your current employer's plan or to roll the funds over to an IRA.

There are practical considerations in favor of rolling over your plan assets into a single account:

❍ **It's harder to execute an asset allocation strategy across multiple accounts.** A key to getting the most out of your investments is a defined asset allocation strategy that matches your need for performance and your tolerance for risk. You achieve this by diversifying your portfolio across the basic asset classes and a number of sub-classes. When your portfolio is spread out over more than two accounts, it's more difficult to monitor your asset allocation strategy.

❍ **Plans can change providers.** Plan sponsors (employers) often change 401(k) plan providers as they try to maximize service and minimize administrative expenses. This usually means a change in the plan's fund choices, making it even harder to understand how you're invested. Also, if you don't make your choices in a timely manner, the new provider will typically automatically place your funds in a low-risk alternative.

❍ **Rebalancing is more difficult**. It's widely acknowledged that rebalancing your portfolio at least annually is a good portfolio management strategy. Rebalancing involves restoring your portfolio to its planned asset allocation proportions by selling off some of the investments that are performing well and reinvesting the proceeds in your underperforming investments. The more investments you have in more places, the more transactions you have to plan and execute.

❍ **With more than one account, it's harder to assess the performance of your investment choices.** With fewer investments in fewer places, it's easier to monitor their performance and identify how they're doing compared to the markets.

❍ **You may reduce your expenses**. Fees charged by 401(k) plan providers directly affect the returns your portfolio generates. Fees vary from one provider to another, so it pays to know what they charge. If former employers' plans charge more than your new one, you may be able to boost your portfolio return simply by consolidating your funds into the lower-fee plan.

There may also be very good reasons to maintain more than one retirement account. For example, rollover IRAs generally offer more investment choices and control than most 401(k) plans. Please call if you'd like to discuss this in more detail. ❍❍❍

Estate Planning for Unmarried Couples

While estate planning can be complex for married couples, it is even more complex for unmarried couples. Basically, this is due to the fact that unmarried couples do not benefit from two provisions:

❍ The unlimited marital deduction allows married couples to bequeath as much of their estate as they want to their spouse with no estate tax consequences. Unmarried couples can only shelter up to the estate tax exclusion amount from estate taxes. While that amount is currently very large, $5,120,000, it is only valid for 2012.

❍ Even if proper estate planning documents aren't in place, such as a will or trust, spouses still inherit at least a portion of each other's estate. Unmarried couples, on the other hand, must make special provisions to ensure they inherit assets.

To protect each other's interests, unmarried couples should properly plan their estate.

Consider these tips:

❍ **Prepare a will.** At a minimum, unmarried couples need wills to outline who should receive their estate. You may also want to consider a durable power of attorney and a health care proxy.

❍ **Review beneficiary designations.** Assets with named beneficiaries will automatically go to the named beneficiary, so they should reflect your wishes.

❍ **Make sure assets are properly titled.** Owning an asset as joint tenants with rights of survivorship means the asset will automatically go to the co-owner after your death.

❍ **Take a look at life insurance amounts.** If you are leaving a large estate to a significant other, that person may have to pay significant estate taxes, since the unlimited marital deduction does not apply. Thus, you may want to review life insurance amounts and adjust them upward to help deal with estate taxes. ❍❍❍

Tips for Your Asset Allocation

Unfortunately, there is no one asset allocation plan that is suitable for all investors. You need to evaluate your risk tolerance, time horizon for investing, and return needs to determine how you should allocate your portfolio. To help you with those decisions, consider these points:

- ❍ The theory behind asset allocation is that different investment categories are affected differently by economic events and market factors. Some asset classes move in opposite directions while others move in the same direction at different speeds. By owning different types of assets, it is hoped that when one asset suffers a major decline, other assets will be increasing in value.
- ❍ Investments with higher return potentially generally have higher risk and more volatility in year-to-year returns. While most investors want higher returns, they may be uncomfortable assuming higher risk levels. Asset allocation allows you to combine more volatile investments with less volatile ones. This combination can help reduce the overall risk in your investment portfolio.
- ❍ Not only should you diversify across broad investment categories, such as stocks, bonds, and cash, you should also diversify within those categories. For instance, within the stock category, consider large capitalization stocks, small capitalization stocks, value stocks, growth stocks, and international stocks. Bonds could include long-term bonds, intermediate-term bonds, high-quality bonds, lower-quality bonds, Treasury securities, municipal bonds, and international bonds.
- ❍ Assessing your risk tolerance is one of the most important, yet most subjective, parts of determining your asset allocation.
- ❍ Your portfolio can become more aggressive as your time horizon lengthens, since you have more time to overcome downturns in investments. Those with a time horizon of less than five years should not be invested in stocks. Look at cash and bonds for those short-term needs. Individuals with time horizons over five years should consider stocks because of their growth potential.
- ❍ Make sure you have reasonable return expectations for various investment categories. Basing your investment program on return estimates that are too high could cause you to increase your portfolio's risk in an attempt to obtain higher returns.
- ❍ In general, consider a more conservative allocation if you are older, have short-term needs for your money, have low earnings, have a low risk tolerance, or are uncomfortable with investing. A more aggressive allocation may be warranted if you have higher earnings, are younger, do not need your money for many years, or are an experienced investor.
- ❍ Time diversification is also important. By staying in the market through different market cycles, you reduce the risk of receiving a lower return than expected, especially with investments that fluctuate significantly over the short term.
- ❍ Rebalance your portfolio at least annually. Over time, your actual asset allocation will stray from your desired allocation due to varying rates of return on your different investments. Changes may be needed to bring your allocation back in line.
- ❍ Be patient. The results of an investment program are best evaluated over a period of years, not days, weeks, or months.

Please call if you'd like help with your asset allocation strategy. ❍❍❍

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Did You Know?

Approximately 42% of American workers reported living paycheck to paycheck, with women more likely to do so than men. But despite these financial challenges, respondents indicated they would not give up the following expenses: Internet connection (56%), driving (46%), mobile phones (42%), and cable television (27%) (Source: Career Builder, 2011).

Based on an analysis of retirement decision trends between 1992 and 2008, a 10% rise in the S&P 500 increased the odds of retirement by 25%. Preretirees with a retired spouse were two-and-a-half times more likely to retire in any given year compared with those without a retired spouse (Source: Prudential, 2011).

To cover living expenses, 50% of unemployed or underemployed individuals tapped their savings, 32% used credit cards, and 22% took withdrawals from retirement accounts. Among those who were unemployed for one year or longer, 39% took a withdrawal from a retirement account, compared with 20% for those who had been unemployed or underemployed for less than one year (Source: Transamerica Center for Retirement Studies, 2011).

When preretirees were asked to rate six factors that could impact when they would retire, the factors mentioned most frequently were the cost of health care (72%), inflation (62%), and energy prices (60%) (Source: Gallup, 2011). ❍❍❍