The
FINANCIAL UPDATE
DAY & ENNIS, LLC
FEE-ONLY FINANCIAL PLANNING

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Court Ruling Hurts Brokers, But Is A Win For Fiduciaries

We're happy to report that the legal dispute between the Financial Planning Association and the Securities and Exchange Commission is over, and it's a victory for our firm and consumers. The U.S. Court of Appeals for the District of Columbia Circuit struck down a rule providing stockbrokers with an exemption from the Investment Advisers Act of 1940.

The FPA, the professional association for financial planners, won a huge victory on behalf of consumers and set straight a misguided effort by the SEC. The decision reaffirms an important distinction between stockbrokers, whose primary job is to sell investments, and financial advisors who provide broader services and serve as fiduciaries, legally bound to put your interests above their own.

Until late last century, most investors bought and sold securities through full-service brokerage firms whose brokers earned commissions on each transaction. Brokers, though they might steer customers to particular stocks or bonds, were exempt from the Investment Advisers Act because they were primarily in the business of selling securities, not giving advice. The brokers were required to recommend investments that were "suitable" for their customers but didn't have to register as investment advisors and act as fiduciaries.

Meanwhile, though, a growing number of financial planners and advisors began providing services to clients in a different way. To avoid the conflicts of interest that often arise when accepting commissions, these advisors instead charged fees for their advice. This approach, they said, aligned advisors' and clients' interests. These advisors operated as Registered Investment Advisors, or RIAs, and owed clients a fiduciary responsibility.

This alternative model proved popular with the public. In the 1990s, brokerage firms began offering their own "fee-based" programs. But that begged a question: were brokers who provided fee-based advice in fact still acting as brokers who were exempt from the Investment Adviser Act? Or should they be required to register as investment advisors? So the big securities firms asked the SEC for a new, broader exemption from the Act.

That's when the trouble started. In 1999, the SEC proposed a new exemption for the fee-based programs. After several years of public comment and revisions to what became known as the Merrill Lynch rule, the SEC in April 2005 adopted a final version. The new rule attempted to distinguish between brokers and advisors based on the services they provided. Those whose primary role was to recommend investments, even in a fee-based program, would be exempt from registering as investment advisors—because, essentially, they were doing what they'd always done. The fee-based accounts, the SEC said, were just a new version of the old full-service accounts. Now, as earlier, investors expected and received guidance from brokers; the only change was in how they paid for it.

The U.S. Court Of Appeals ruling is a victory for our firm and consumers

Other brokerage firm advisors, who had discretion over client assets and provided comprehensive financial planning

(Continued on page 4)

Continued Steady Growth

Day & Ennis, LLC continues to experience steady growth. We couldn't have done this without the support of you, our friends and clients.

Since our founding in 1998, we've focused on providing clients with carefully considered financial advice and investment management that is comprehensive, independent and conflict free. To that end, our services have been fee-only from the beginning. Our approach has been one of comprehensive financial planning, with continuous monitoring and periodic updates.

Our clients have responded to the results we've generated for them by recommending Day & Ennis, LLC to their friends, family and business associates. We're grateful for your consideration and your referrals.

As we grow, we will hire people to help us continue providing the highest level of professional and personal service. We have recently added Stephanie G. Davidson to our team. Stephanie is a CPA and graduate of Georgia College and State University. She worked for many years in the Accounting and Finance Department at Blue Bird Corporation. We are very excited about Stephanie joining our team. She will be working with us to prepare and update financial plans.

We want to thank all of you for your continued support.

John R. Day Bill Ennis

Key Questions For Those Nearing Retirement

Life may begin at 40, but the countdown to retirement starts at age 55. Now is the time to take stock of your savings, goals, and timetable for moving into a phase of life that may last 30 years. These questions can help you gauge how you're doing.

When do you want to retire? This is a crucial variable. If you're planning to retire early—say, at age 55 instead of 65—you'll not only have to save more, sooner; you'll also need to have the money last an extra decade. On the other hand, if you expect to work well past normal retirement age, that reduces the burden on your nest egg. Another reason to keep working: While you normally can begin penalty-free withdrawals from an employer's qualified retirement plan at age 55, distributions from an IRA before age 59½ may result in a 10% penalty.

How is your money invested? Though there are no guarantees, a portfolio with most holdings in stocks holds the potential to grow more quickly than one emphasizing bonds or cash. But at this point, you won't have much time to recover from market losses and may need to reduce your allocation to equities. That, in turn, could affect when you'll have sufficient savings to leave the work force.

What will you get from Social Security? Government payments may make up only a small percentage of your retirement income, but this variable, too, needs to be part of your retirement calculations. How much you receive depends on several factors, including when you were born and when you apply for benefits. Payments could start as early as age 62, but if you begin then, your checks will be smaller. Wait a couple more years (if you were born between 1943 and 1954, full retirement age is 66), and your checks will be larger.We can prepare a breakeven analysis to determining if this is right for you.

How's your contingency planning? An unexpected job loss or serious illness could hurt your retirement plans, draining savings just when you need to be putting away as much as possible. If you have a cash cushion you can draw on in emergencies, it could stem the damage—but if you don't, build your reserves now. And you may want to invest in long-term care insurance.

How much will you need during retirement? Though rules of thumb suggest you'll need 70% to 80% of your current income to live comfortably after you leave the work force, the amount you should set aside depends on several factors, including the age when you expect to retire, your anticipated housing costs and other living expenses, and how healthy you are. To be effective, your retirement plan needs to take into account many interrelated variables. We can help you evaluate many possible scenarios, and if you're in danger of falling short of your goals, we can work with you to get on track before it's too late. ●

Lifecycle Funds May Pose A Hidden Danger

Wouldn't it be nice to set your retirement plan on automatic pilot? Just adjust the timer button to the year you expect to retire — "2023 please" — and go about your business until that golden day arrives and the checks start pouring in.

That's the promise of lifecycle funds, also called target date funds. And while these funds are probably beneficial to younger workers who don't want to think too much about their investment portfolio, there are dangers lurking behind the promise of "no-effort" returns.

Lifecycle funds have exploded in popularity in recent years, and investors may now choose from among nearly 300, compared with about two dozen in 2000. These funds promise to take care of bothersome details for you such as asset allocation, diversification, and rebalancing. They invest in a combination of mutual funds, stocks, and bonds, and the mix is automatically adjusted over the years to reflect how close the investor is to retiring. The funds start out with an aggressive asset mix and slowly become more conservative over time.

For most investors these funds likely will not be your best choice, especially if you have achieved a high net worth. That's because one size does not fit all when it comes to gifting assets to children, funding a college education, buying insurance, setting up trusts, and planning your estate.

If your goals include a second home in the mountains, a late-life doctorate degree, and continued part-time consulting work, a lifecycle fund is not going to take those factors into account. Such individual needs are best addressed with individual advice.

Financial Planning Association offers some factors to consider:

- **How much money will you need to retire?** Sure, a lifecycle fund promises investment growth, but just how much growth do you need? What

Dealing With Market Risk Right After Retirement

The greatest retirement plan in the world is not complete if it doesn't take into account the possibility of bad timing.

The technical term for it is "sequence risk," and it's a major threat to your financial well being in retirement. Sequence risk refers to the chance that the economy may take a bad tumble just when you leave the workplace. Such unfortunate timing can wreck your rate of return over the long term.

Consider Joe and Jane, a fictional couple setting up a retirement plan when he is 49 and she is 51. Joe earns $85,000 a year and Jane makes $55,000. She wants to retire in 2016 and he wants to retire in 2023.

The couple, who lives in Virginia, has a 13-year-old daughter planning to attend college. Their nest egg totals $341,500 and includes Joe's 401(k) plan with $255,000, Jane's Roth IRA with $68,000, and a 529 savings plan with $18,500 for their daughter's college education. They are contributing the maximum to Joe's 401(k) plan, $15,500 a year.

Joe also has a $30,000-a-year pension coming, and both plan to take Social Security benefits at age 66.

Their plan includes three goals:

- **Living expenses**. When Jane retires in 2016, the couple wants income of $65,000 (in current dollars) a year from their investments. After Joe retires in 2023 that goes up to $110,000. The plan then assumes Joe will die in 2041, when Jane's income needs will fall to $85,000. Inflation is factored in at 4.64% a year.
- **College.** Since their daughter plans to attend an in-state school, the couple will need $12,573 per year for four years (in current dollars; inflation at 6%).
- **Travel**. Joe and Jane want to have $4,000 (in current dollars) available after 2023 for a big trip. Inflation is factored in at 4.64%.

Assuming an average return on their investments of 9.6% over the life of the plan, Joe and Jane will be able to fund all three goals and still have $268,859 in current dollars (this would be $1.69 million in future dollars) left at the end of the plan.

However, that result assumes a smooth progression of market returns, especially in the early years. If the market plunges just as Joe retires, all bets are off. For instance, assume the couple's portfolio falls 30% the first year after Joe retires and 15% the next year. Even if in subsequent years their returns recover enough to achieve the 9.6% average rate, Joe and Jane will only have enough money for 79% of their living expenses and 35% of their college goal. They would have no money to travel, and no money left over.

The reason? They are starting out with far fewer assets, and so the return they earn builds on a much smaller base. Starting their withdrawals then compounds the problem.

Here's how to guard against this type of catastrophe:

Change the emphasis: Build asset allocation adjustments into your financial plan. As retirement approaches, a higher percentage of your portfolio dollars should go into less volatile financial vehicles, such as bonds and fixed securities, to mitigate the effects of a market plunge. While you need stocks to protect against inflation, the proportion of stock investments in your portfolio should decline as you get older.

Spread the risk: Diversify both stock and bond investments. Among your stock investments, you may choose a mix of domestic and international stocks and a mix of large-cap and small-cap stocks. In your bond investments, choose a mix of domestic and international corporate bonds, state and municipal bonds, and U.S. Treasury bonds, bills, and notes.

Keep a buffer: At a minimum we recommend 3 to 4 years worth of estimated withdrawals be invested in short to intermediate term fixed income securities.

Comprehensive plan: Develop a comprehensive plan that addresses cash flow, investment strategy, withdrawal strategy, estate planning, income tax planning and insurance and risk management. The plan will address the potential for swings in the market and develop a strategy to insure you meet your goals. The plan needs to be reviewed and updated yearly or anytime there is a major change in your situation. We can help! ●

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specific spending, income, or tax issues will affect your investment picture?

- **How good is the lifecycle fund your employer offers?** Just because your company is offering a target fund doesn't mean it fits your needs.
- **What happens if you change jobs?** If you roll over these assets into another tax-advantaged retirement plan at another company, how will that match up to the strategy in the previous plan?
- **How much are you paying in fees?** If someone else is making the decisions, even if they are triggered automatically, how much are you paying for that service? Lifecycle funds are sometimes based on a fund-of-funds structure that layers a fee on top of the fees incurred by the individual funds.
- **How are you using the fund?** These funds are designed to provide all of the diversification an investor needs in one place. However, many investors are buying lifecycle funds while also placing assets into several other investment vehicles, resulting in overlapping investments. ●

You should consider a fund's investment objectives, risks, and charges and expenses carefully before you invest. The fund's prospectus contains this and other information about the fund, and should be read carefully before investing. A copy of the prospectus of the fund you are interested in can be obtained by contacting the fund company or our office.

Funding A Friend's Business Venture

Sandy thinks her friend Danny has a great business idea—an exciting, almost revolutionary new service. Now he wants her to make a significant investment in the corporation he's starting in exchange for a 10% ownership stake.

Sandy is tempted. Why not help a friend see his vision to fruition, claim partial credit for launching the wave of the future, and potentially earn extremely handsome returns?

Though such opportunities may feel like the chance of a lifetime, there's plenty that can go wrong. If there's any rule of thumb for investing in a private venture as a minority owner, it's that you should do it only with money you can live without.

Consider Danny's corporation. With no market for its stock, Sandy's capital is likely to be tied up for five to 10 years. That's how long it may take to build a company that can go public or attract an acquirer. During the incubation period, Sandy must be prepared to rely solely on other assets to meet her financial commitments.

Then there's the failure scenario. Unlike stock in a deteriorating public company that can usually be sold for something on the way down, private shares' lack of marketability means the investor is strapped in for the full ride to zero.

There's also the matter of taxes. Owners of S corporations as well as partnerships and most limited liability companies pay income tax on their share of the business's earnings, even when those profits aren't distributed. While she's waiting to get her investment back, Sandy might have to spend more money on taxes.

Still another concern is share of ownership. Assume things go swimmingly and the company seeks to expand. Can Sandy remain a 10% owner? Depending on the laws of her state and the articles of incorporation, she and other shareholders may, or may not, be entitled to first crack at any new shares the corporation issues, in the same proportion as current ownership. (Partnership and LLC operating agreements, when properly drafted, indicate whether owners have the right to maintain their original percentage of ownership.) Without that promise, Sandy's interest could be diluted and her share of the profits compromised.

Not just money but also relationships may be at risk. If the venture bombs, will Sandy blame Danny? Will their friendship suffer? If it does, will she mind? Even with a successful venture, resentment can arise if some of those involved feel others are prospering more than their contribution merits.

For all of these reasons, investing in a friend or relative's business can present problems from the get-go. Sandy should obviously research the investment before diving in. But her friendship with Danny could hinder her ability to objectively analyze his business plan and his ability to execute it, and could make it awkward to quiz him about the plan's marketing or financial assumptions.

Dream deals do sometimes come along. But what often separates successful capitalists from dreamers is finding the right reason to say "yes" or "no." Before you make an investment in a friend or relative's company, talk to us. We can help you analyze the numbers and evaluate the opportunity. ●

Court Ruling Hurts Brokers

(Continued from page 1)

services, did have to register as advisors under the new rule, though they might also continue to serve other customers in their role as brokers, exempt from fiduciary responsibilities.

Complaining that all of this was confusing to consumers, the FPA sued the SEC. According to the FPA, investors didn't know what they were signing up for. They might reasonably assume that all advisors—including brokers in the fee-based programs and advisors in RIAs—operated under the same rules. But in fact, the FPA argued, there were big differences. RIAs had to disclose to their clients any conflicts of interest along with their qualifications and any disciplinary actions taken against them—and, most importantly, they were fiduciaries and therefore required by law to place a client's interests above their own. That's an important distinction. Brokers, in contrast, don't have ficuciary responsibilities, though they could call themselves financial planners or consultants and provide financial planning services.

In a two-to-one ruling in March, the appeals court sided with the FPA. Judge Judith Rogers wrote in the decision that the SEC had exceeded its authority by exempting brokerage firms from the Investment Advisers Act of 1940. That act, Rogers wrote, allowed exemptions only for brokers who don't get special compensation for giving advice, and asset-based fees qualified as special compensation. Rogers ruled that advisors in the fee-based programs would have to register as RIAs and could not give this type of advice as brokers.

The SEC has said it will not appeal the ruling, and now brokerage firms offering fee-based programs are scrambling to comply. In many cases, brokers are cramming for licensing exams that would qualify them to register as advisors and continue to serve their clients. But it will be some time before it's clear whether the FPA's hoped-for clarity will materialize.

You remain above the fray. You've chosen an approach to financial advice that has clearly defined rules and goals. We operate as fiduciaries as a matter of principle and of law. Your interests are always paramount. If you have questions, please give us a call. ●

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