The Financial Update

Day & Ennis, LLC
Fee-Only Financial Planning

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Why Plan For Retirement If You Don't Plan To Retire?

Forget all those warnings about not saving enough. Baby boomers' No. 1 retirement planning mistake is, well, planning to retire.

In his book *The New Retirementality*, Mitch Anthony calls retirement, "a short-sighted political machination and social manipulation, which is no longer relevant and is hopelessly out of touch with our times." Just because surveys show the vast majority of Americans can't wait to quit their jobs, Anthony argues, that doesn't mean they are mentally or emotionally prepared to quit working.

According to research from the AARP, it's just the opposite. A study conducted for the group by Roper Starch Worldwide shows more than 80% of today's pre-retirees plan to continue working long after their so-called retirement. Yes, some will be working because they need the money, but 75% of respondents say they will continue working because they want to.

So what about all those dire warnings that boomers aren't saving enough? "The big reason people haven't saved enough for retirement is they don't have a vision for what retirement means," says Anthony, president of Advisor Insights, a Rochester, Minnesota firm that trains financial advisors.

Anthony has spent years asking thousands of people about their retirement vision, and most answers mention two overriding themes—freedom and balance. People speak of the freedom to do what they want and a balance between work and leisure. Nobody reports they want to play golf and sip margaritas in Arizona for the next 30 years. That means any financial plan built around the golf-and-margarita thesis is immediately irrelevant, he says. "One of the great tragedies in America is having enough money to do absolutely nothing and doing exactly that," says Anthony.

Men and women over the age of 50 earn almost $2 trillion in annual income and own more than 70% of the financial assets in U.S. accounts, controlling more than $7 trillion in wealth, according to Ken Dychtwald, president of Age Wave Inc. and the author of several books on aging and trends among baby boomers.

So the risk is not that you won't have enough money. The real risk boomers face is that without a clear idea of what you want to do with those 30 years or so after you leave the traditional work force—years Dychtwald calls "the power years"—you are more likely to become depressed, get divorced, or die younger than your counterparts.

> *The "new retirement" means planning to work into your 60s and 70s*

"If you look at the underbelly of retirement, what the ads don't show is the number of people who die during the first year of retirement. People bored out of their skulls," Anthony says.

That's why so many retirees today are struggling—not financially but emotionally. Their planning was focused exclusively on the financial aspect of retirement. "Money is an issue," Anthony says. "But all money does is give you choices. The question is what you are

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Withdrawal Rates Affect Portfolio Allocation

When you're developing your personal financial strategy, your projected withdrawal rate is one of the most important factors to consider.

At Day & Ennis, LLC our comprehensive financial planning approach handles this by projecting your future cash flow, including portfolio withdrawal rates. The goal is to target your portfolio to provide an investment return at least 2% or 3% higher than the projected withdrawal rate. For example, we may target a withdrawal rate of 4% and an investment rate of return of 7% or 8% that lets us reinvest an average of 3% or 4% back into the portfolio each year.

We also like to insure that our clients have sufficient exposure to fixed income securities while they are withdrawing money from their portfolios. That way they don't have to sell equities at a discount when the stock market is weak.

If withdrawal rates are projected to be too high relative to expected rates of return, we work with clients to create a better withdrawal plan, particularly for discretionary expenses. As always, our efforts are centered around helping you grow your portfolio and enjoy a secure financial future.

John R Day   Bill Ennis

Bad Behavior Can Hurt Your Investments

Studies say that 15% of the time that we are absolutely, positively right about something, we're actually wrong. That's overconfidence, and it can be a financially dangerous behavior for investors.

Behavioral finance studies our irrational investment decisions. John Nofsinger, an expert in the field and author of Investment Madness: How Psychology Affects Your Investing and What to Do About It and Investment Blunders of the Rich and Famous, says our missteps fall into three categories.

Overconfidence. People exaggerate their ability to pick winners and their control over the market. Unable to admit mistakes, it is common to hang onto losing stocks or funds. "The overconfidence bias causes you to trade too much and take too much risk," says Nofsinger. "As a consequence, you pay too much in commissions and taxes, and you're susceptible to big losses."

Emotion. Fear and greed, rather than rational facts, rule many investment decisions. Worse, Nofsinger says, an "attachment bias" can make investors emotional about holdings. "You are emotionally attached to your family and friends, and so you focus on their good traits and deeds and discount their bad ones," he explains. "When you become emotionally attached to a stock, you may fail to recognize bad news about a company."

Simplification. Investors tend to see patterns in random events, such as stock price movements, and make investment decisions based on these false patterns. Also harmful, says Nofsinger, are the shortcuts people make to reduce complexity. "For example, we assume things sharing similar qualities are quite alike," he says. But this can lead to inaccurate conclusions. "You may put too much faith in familiar stocks," he says.

To steer clear of these tendencies, you need to understand the impact they can have on your decisions, and take the time to recognize and avoid them. Nofsinger proposes several strategies.

Know why you're investing. Most people have only vague notions of their investment goals—maybe, "I want a lot of money so I can travel abroad when I retire," or "I don't want to be poor when I retire." Says Nofsinger, "These do little to give you direction. Nor do they help you avoid psychological biases that inhibit good decision-making. So be specific." During annual portfolio reviews, examine your progress toward your specific goals.

Establish quantitative investment criteria. These can help you avoid basing decisions on emotion, rumor, or other psychological biases. Instead, your investments should measure up in terms of price-to-earnings ratios, sales growth, and other quantifiable benchmarks that are important to you.

Control your investing environment. "Limit activities that magnify your biases," suggests Nofsinger. That may mean avoiding Internet chat rooms and message boards, checking your investments just once a quarter, and relying on an objective professional financial advisor to keep you from behaving like a bad investor. ●

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

An Update On College Savings Plans

Section 529 college savings plans offer parents and grandparents the opportunity to save for college or prepay a child's tuition and fees—and now they're an even better deal. A 2006 law made the plans permanent—they had been scheduled to expire after 2010—and new rules improve the financial aid prospects of student beneficiaries of 529s.

There are two basic types of 529 plans. One lets you save for college by investing in a state-administered account. There may be several investment options with varying blends of risk and potential reward; when the account beneficiary heads to college, you withdraw money from the account to pay qualified educational expenses. A second type of 529 lets you prepay a child's future tuition at today's rates.

Prepaid 529s themselves come in two varieties: state-run traditional prepaid accounts, which cover tuition and fees only at state schools (though you can generally transfer the value of your contract to out-of-state or private colleges), and Independent 529 accounts, which can be used to pay tuition at hundreds of participating private schools. Both types of prepaid accounts let you purchase a tuition credit. Suppose you open a prepaid account for your newborn grandchild in 2007, and contribute $15,000, which is half of what tuition costs this year at the college your grandchild will eventually attend. When you use the credit, 18 years down the road, it will cover half a year's tuition, even though by then that may cost four times what it does today.

One major perk of both kinds of 529s is that they are usually exempt from federal income taxes, and in some states you can receive an income-tax deduction. Neither earnings on 529 investments nor withdrawals to pay college expenses are subject to capital gains or income tax. The same is true of prepaid plans.

Another 529 benefit is that the money you contribute reduces the size of your taxable estate. You and your spouse can both use your $12,000 annual gift tax exclusions to build the account, and 529's also offer the chance to lump five year's contributions in a single year. That means a married couple could jump-start a child's or grandchild's plan with $120,000. Moreover, you can do that for as many beneficiaries as you like.

If your student opts against going to a school covered by a prepaid plan or simply chooses not to go to college, you, as owner of the account, can change the beneficiary to someone else in the family. That should avoid the adverse tax consequences of simply taking back your money, which will cost you a 10% penalty, income tax on account earnings (though not on the principal contributed), and additional state taxes if you got a state tax deduction for your contribution. However, if the account beneficiary has died or is disabled or receives a scholarship, you can probably avoid the 10% penalty.

While a 529 savings account can be used at any accredited school, and the money covers tuition, room, board, books and supplies, there's no guarantee it won't lose money or fail to keep up with inflation in college costs. In contrast, a prepaid account guarantees a future tuition rate, but in addition to a limited list of participating schools—and a likely loss in value if you transfer your contract to an outside college—the money can go only to pay undergraduate tuition and fees.

You could combine the plans. Assume, for example, that private school tuition will increase 8% per year, the historical average according to the College Board. By allowing you to prepay tuition, a 529 prepaid account effectively guarantees that return, and could be treated as the cash or bonds portion of a college savings portfolio. A 529 savings account, invested mostly in stocks, could provide greater potential growth.

A final consideration when funding a 529 plan, particularly if it will benefit a grandchild who might qualify for financial assistance, is how 529 account funds are handled in the federal financial aid formula. Recent rule changes mean prepaid plans are now treated the same as savings plans; both are considered parental assets. As a result, just 5.6% of the account balance is factored in each year to determine how much a family can afford to pay. And now money in custodial plans converted to 529s also counts as parental assets—instead of belonging to the student and being tapped at a far higher rate. ●

Section 529 plans are not suitable for all investors, and this article is not a recommendation to purchase or sell one of these securities, which can be made by prospectus only. Section 529 plans are not guaranteed and you can lose money. Some Section 529 plans offer state tax benefits depending on your state of residence - check on available state tax benefits before investing.

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. ●

Helping Out Adult Children Financially

A recent University of Michigan study revealed something you may already know from personal experience. These days, one in three young adults rely on parents for financial help.

According to the survey, 34% of those age 18 to 34 are getting assistance. In some cases, Mom and Dad make a one-time gift, financing a vacation or the down payment on a house or car. In other instances, parents provide monthly checks to cover expenses such as rent and groceries.

Though you may be surprised to find your financial obligation to your children extending well beyond age 18, there is an upside. Playing a financial role in your child's life gives you the opportunity to teach valuable lessons about financial responsibility. Your guidance, as much as your dollars, can help ensure your children's future financial health.

What's the most instructive way to dole out the cash? One option is to have Junior send you certain bills you agree to pay. You'll see how he's spending his money, and you may be able to suggest strategies for cutting his phone bill, say. But this can undermine your child's sense of independence and discourage him from taking responsibility for himself—a failing that may become more crucial as he acquires a family and larger financial burdens.

Playing a financial role in your child's life gives you the opportunity to teach them a valuable lesson

Another possibility is to transfer a lump sum into your child's bank account. This could be pegged to a particular need, or you could step in whenever cash runs low. This implies less ongoing dependence than the bill-paying route. It also encourages careful budgeting to make the money last—or at least demonstrates what happens without careful budgeting.

But probably the best approach is to provide monthly, salary-like payments gauged to fill the gap between the child's income and expenses. This mirrors the way your son or daughter receives money in the real world, via paychecks. You're just providing a supplemental salary, helping meet ongoing financial obligations for rent and utilities, car payments, and other expenses. This can also help your son or daughter get used to the ebb and flow of earning money and paying bills.

To avoid the awkwardness of handing over a check each month, you could set up an automatic funds transfer to your child's account. Like a direct-deposit paycheck, the money will be part of your son or daughter's normal income. Of course, this can be habit forming, and you may want to strike a deal to reduce your support proportionately when the child gets a raise. ●

Why Plan For Retirement ?

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going to choose."

That is something you need to answer long before you start crunching numbers and trying to figure out how much you need to save. Only then can you begin pulling together a "financial life plan" that incorporates strategies to occupy your mind, time, and energies during retirement. And you can decide how you define success once your financial goals are met.

Anthony argues that no financial or investment decision should be made without considering how it will affect our lives. By the same token, though, no life decision should be made without understanding its impact on our financial situation. When both elements are fully integrated into a comprehensive plan, chances are the word "retirement" will be erased, replaced by a broader concept of a life transition that for most of us will include some kind of work.

To plan for your successful transition, you need to throw away outmoded financial models, including the infamous "three-legged stool"—having Social Security, your pension and your personal savings support you. Instead, Anthony suggests four cornerstones:

1. Your history (including your history with money)
2. Your principles and values toward life and money
3. Your present life transitions
4. Your hopes and your goals

With that foundation in place, you can begin constructing an income-for-life model built on an adaptation of psychologist Abraham Maslow's "hierarchy of needs." Anthony calls it "Maslow Meets Retirement."

- **Survival income.** How much money do you need to make ends meet?
- **Safety income.** Money to meet unexpected expenses
- **Freedom income.** Money that pays for the things that bring enjoyment and fulfillment to your life
- **Gift income.** Money for the people and causes you care about
- **Dream income.** At the top of the pyramid is money for everything you've dreamed of doing, being, and having.

From there, you can engage in a financial process that incorporates each element of your life plan. "Once you reach balance in your life, you don't have to retire from anything," Anthony says. ●

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