

Financial Planning Considerations

SJC Mom's Club – April 12, 2013

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Pebble Valley Wealth Management

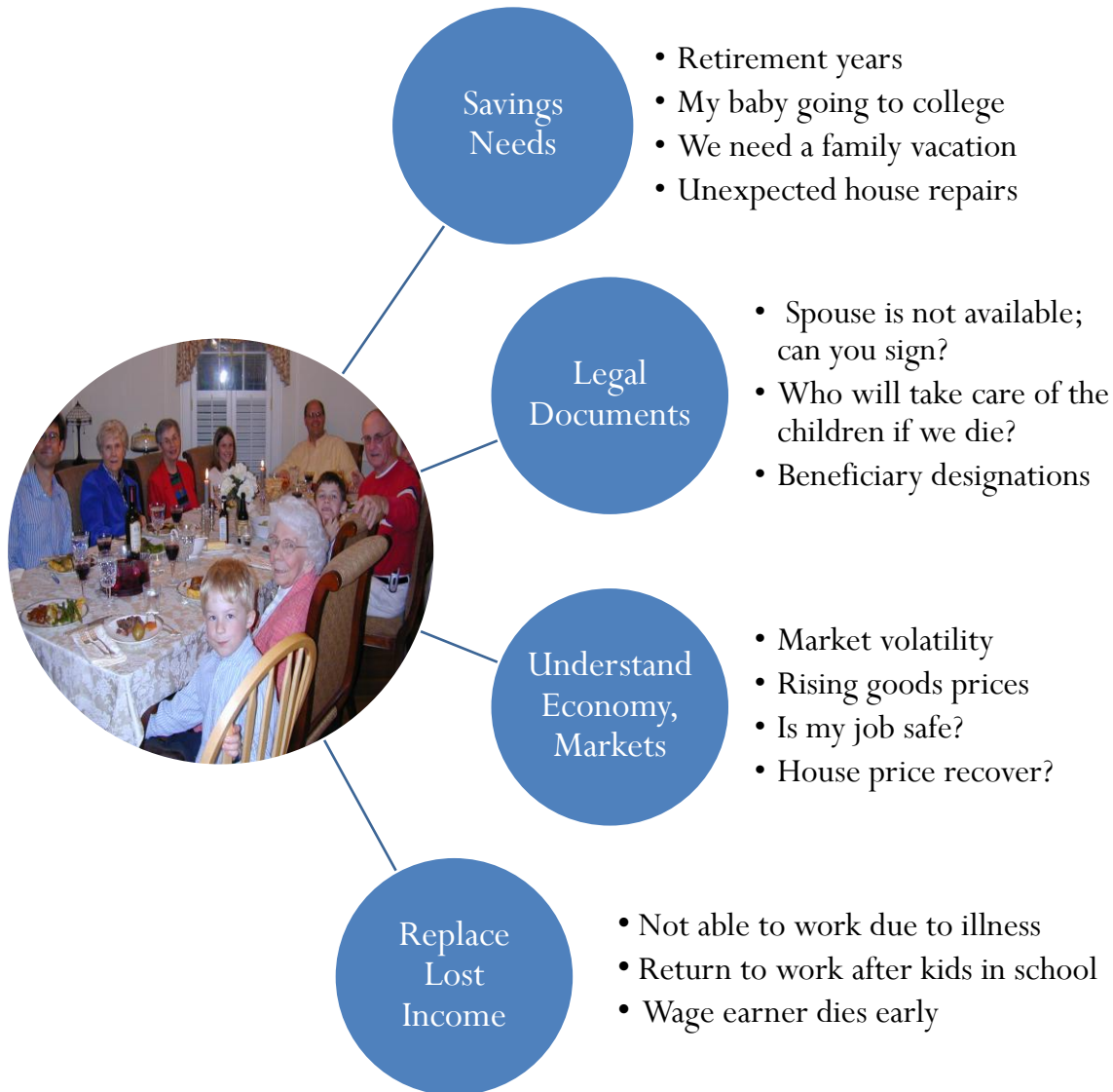
Topics discussed today

- Goal is security
- Components of a financial plan
- Needs and priorities vary by age, phase of life
- Drill into specifics of each component
- Appendix
 - State of economy and markets
 - Constructing a diversified portfolio

Goal is security

- Kids ask “why?” You should ask “how...?” and “what if...?”
- Save and invest to help pay for needs and wants
- Insure those things that would hurt financially
- Be aware of economy and markets
- Put your legacy wishes in writing

Family security requires action



Components of a financial plan

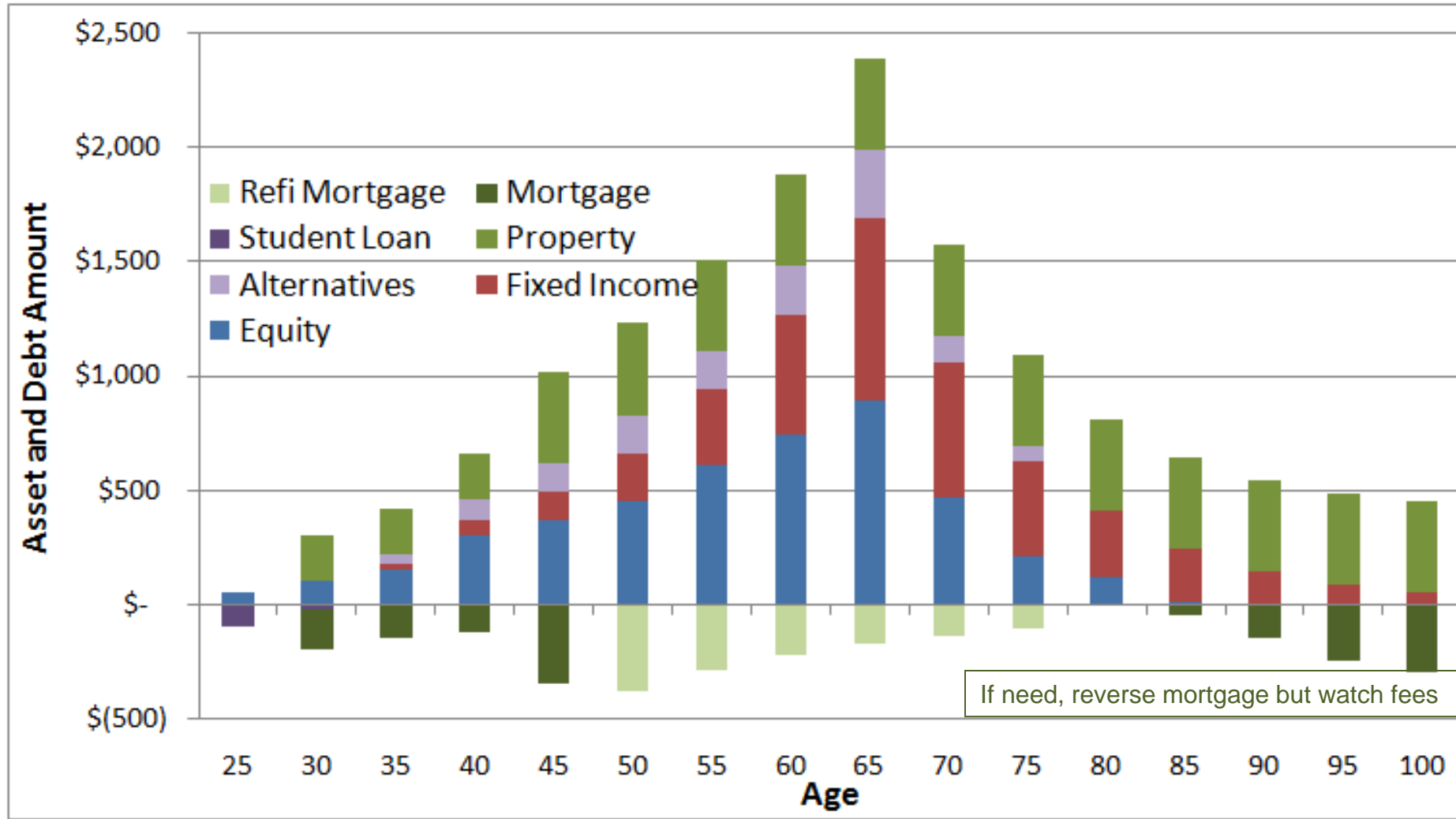
- Big picture of needs, wants and priorities
- Take steps to achieve goals and protect what have
- Competing goals and solutions must tie together
- Includes savings, investments, taxes, debt, employee benefits, insurance (private, social), legal documents
- End result is actionable road map for financial life

Components of a financial plan

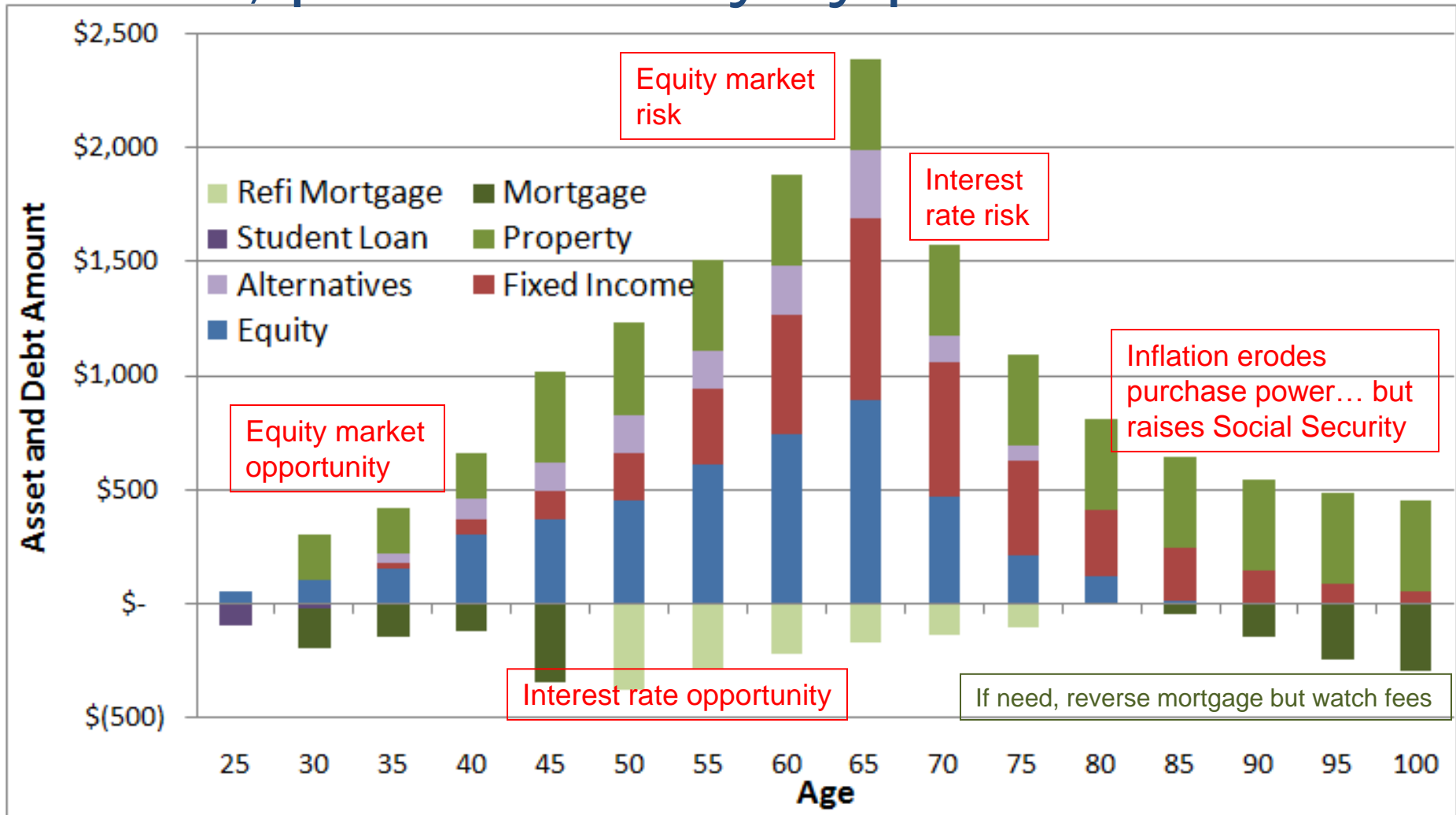


- Do it yourself
- Done by various experts separately but not an integrated picture
- ★ Fee-only fiduciary address all together
- Be careful - getting help in one area doesn't mean other areas considered
- Ask what fees being charged

Needs, priorities vary by phase of life



Needs, priorities vary by phase of life

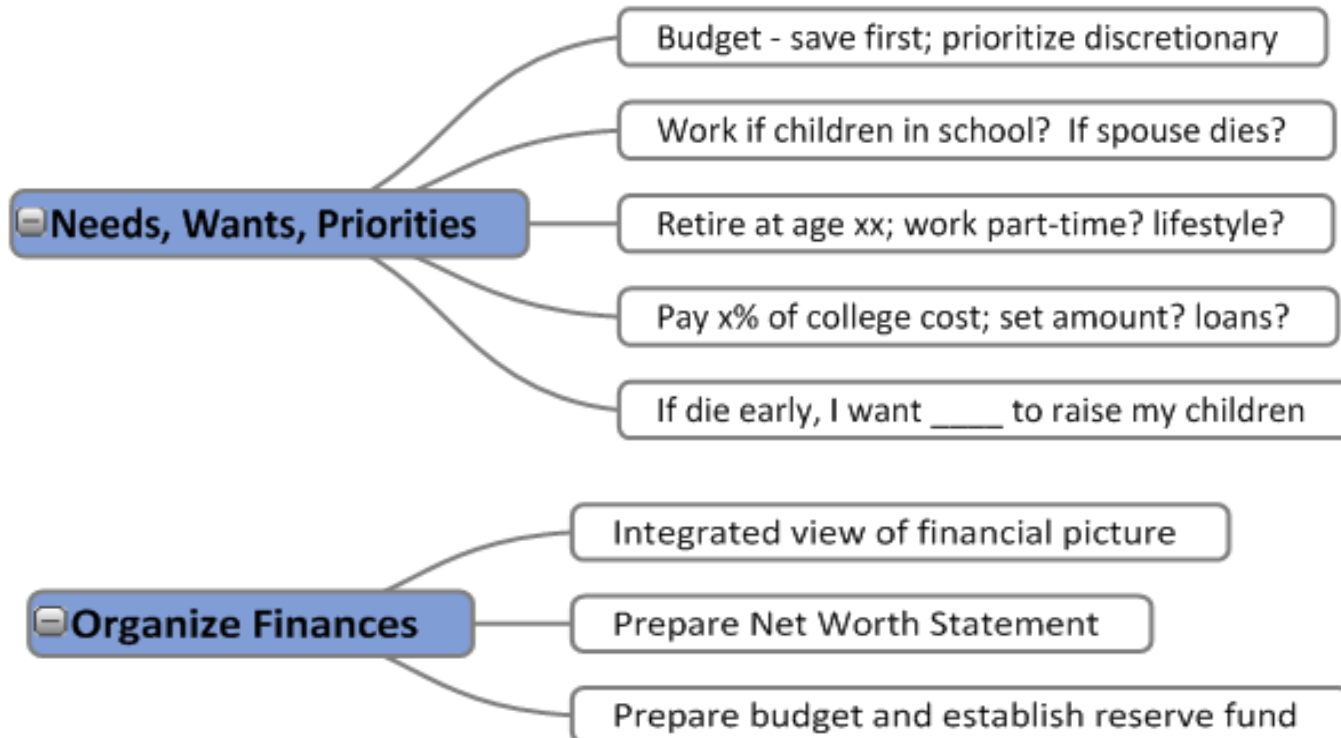


Insurance: <= Early death or disability=> <=Medical, Assisted Living, Longevity=>

Tax aware: <= vehicles defer taxes while grow=> <=but withdraw carefully=>

Drill into specifics – Goals, Organize



- Discuss and record unique situation and priorities
- Create balance sheet, budget, reserve fund




Key Document – Balance Sheet

- Net worth = assets – liabilities; tax status, ownership, debt levels

Assets

	Asset Name	Category	Type	Owner 	Amount
Taxable	Checking & Savings	Bank account	Checking	Multiple Owners	24,777
	Brokerage - Joint	Investment assets	Taxable	Harry Client Sally Client	228,370
Tax-free 	Sally's Roth IRA	Investment assets	Roth IRA	Sally Client	65,735
Tax-deferred	Harry's 401(k) Plan	Investment assets	401(k)	Harry Client	330,313
	Employer Defined Benefit Pensi...	Retirement assets	Defined benefit plan	Harry Client	67,420
	College Savings	Investment assets	529 Plan	Harry Client	68,434
	Sally's Traditional IRA	Investment assets	Traditional IRA	Sally Client	190,846
Non-investment	Primary Residence	Personal use	Primary residence	Multiple Owners	425,000
	Vehicles	Personal use	Automobile	Multiple Owners	31,000
Total					1,431,895

Liabilities

	Liability Name	Category	Owner	Amount	
Collateralized loans	Mortgage	Mortgage	Multiple Owners	 311,600	
	Home Equity	Home equity line of ...	Multiple Owners	12,100	
Total					323,700

Key Document – Budget

- Tool to find savings capacity and play good defense; it is not evil
- Helpful to show expense categories as % of total

<u>Inflow Category</u>	<u>Annual</u>
Gross Salary★	
Bonus	
Investment Income, Other	
Social Security	
Total Income	

<u>Outflow Category</u>	<u>Annual</u>
Savings★	
Mortgage, Taxes, Insurance	
Other Home Stuff	
Non-College Education Costs	
Phone, Internet, Cable	
Food - Home and Restaurant	
Clothing	
Health - Insurance + Co-Pays	
Life Insurance	
Vacations / Weekends	
Vehicles	
Other	
Income Taxes	
Total Expenses	

★ show Gross Salary, not "take-home" to see where all income goes (saving, insurance, taxes)

★ "pay yourself first" through aggressive savings

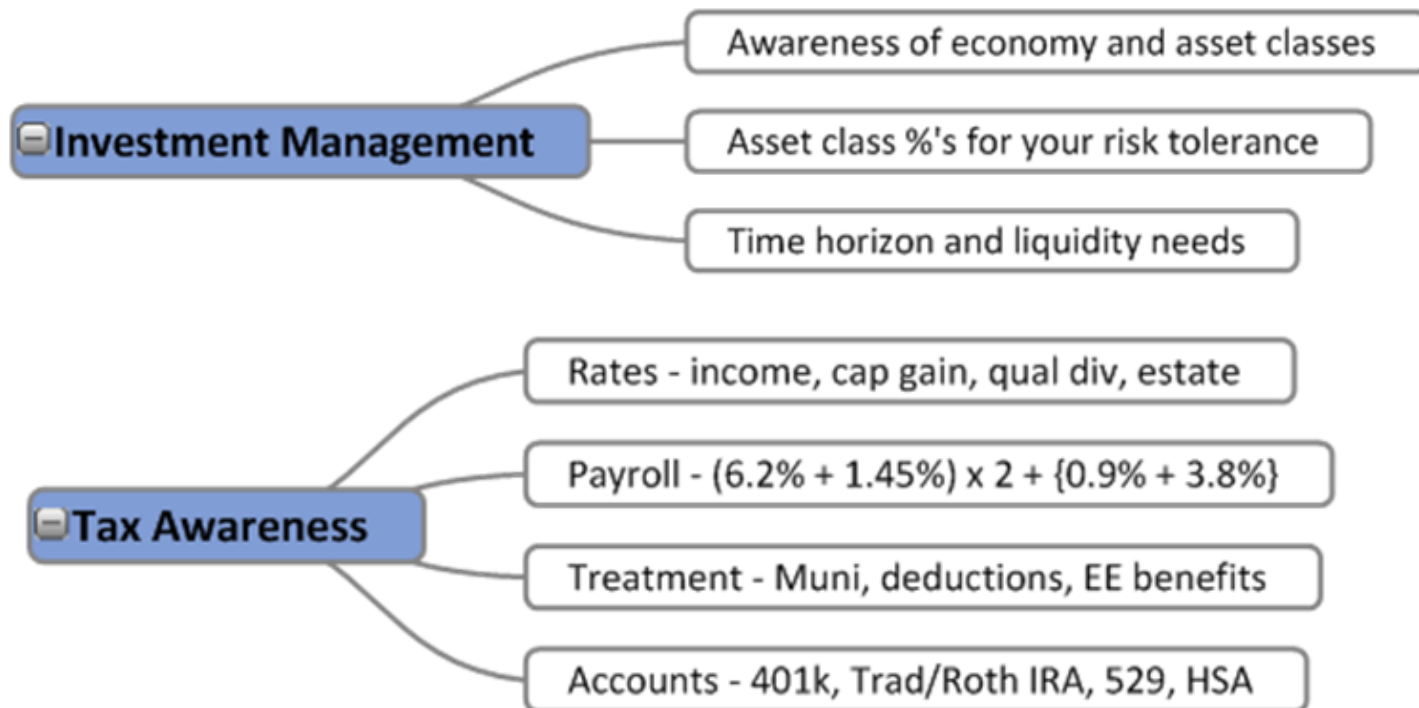
* track further detail where appropriate but don't drown yourself in detail

Specific Topic: Reserve Fund

- “How much money should I have in savings for a cushion?”
- Funds to cover unexpected expenses or if income stopped
- Rule of thumb is “3-6 months of living expenses”
 - Refine to “critical expenses + 50% discretionary”
- Liquid assets without market loss, taxes, withdrawal penalty
- Savings account and money market is safest choice
 - ultra-short bond funds riskier; tax-exempt if high tax bracket
- CD’s, government savings bonds may have early withdrawal penalty

Drill into specifics – Investments, Taxes

- Diversified portfolios to fund different needs and goals
- **Asset allocation, tax treatment, tax qualified accounts**

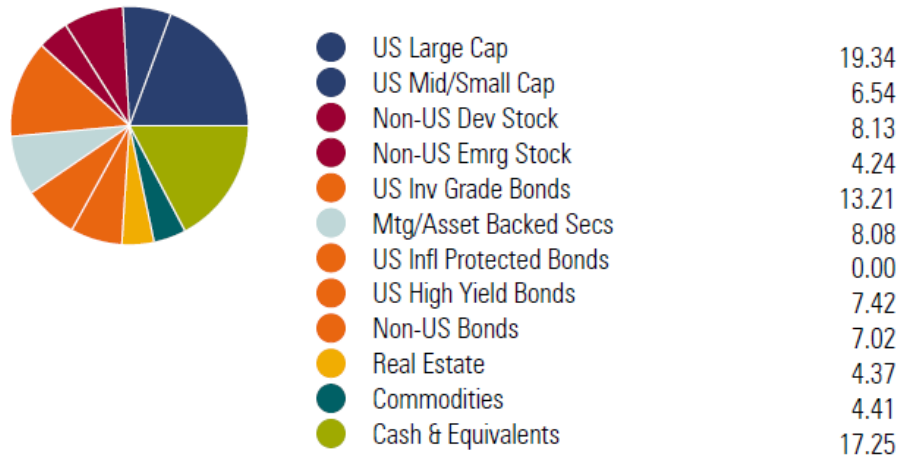


Key Report – Asset Allocation

- Combine all accounts backing a particular goal
- Know what % of total portfolio is in each asset classes

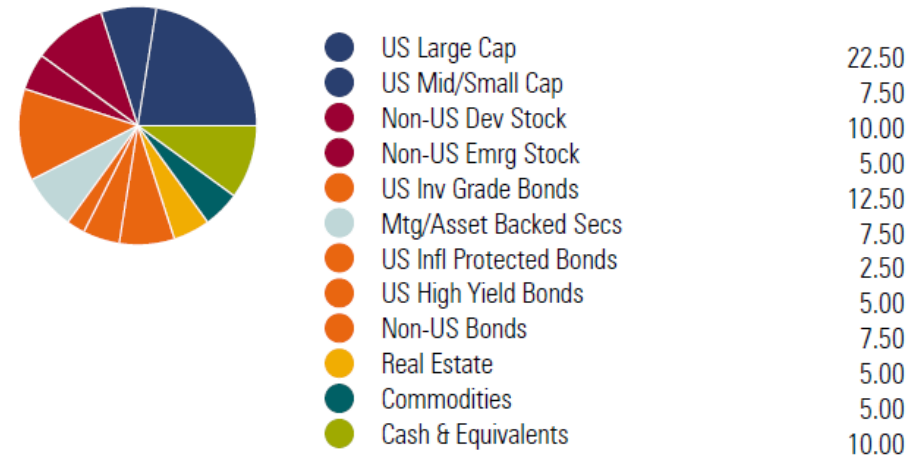
Vary by client's risk tolerance, time horizon

Portfolio Asset Allocation--Sample Moderate



Actual
Portfolio %

Target Asset Allocation--PVWM Moderate



Strategic
Target %

- Select investments from different asset classes to achieve target %
- Have +/- target to reflect market view

Specific Topic: Tax-deductible vs. -deferral vs. -free

401k / 403b / 457

Traditional IRA

Roth IRA

529 Plan

Health Savings Acct

Annuity

Cash Value Life Ins

	Tax-Deductible	Tax-Deferral	Tax-Free Withdrawal
401k / 403b / 457	X	X	
Traditional IRA	income limit	X	
Roth IRA		X	X
529 Plan	home state	X	for college
Health Savings Acct	X	X	for medical
Annuity		X	
Cash Value Life Ins		X	only DB

* tax-deductible has greater value if high marginal tax now vs. when withdraw

* tax-deferral switches capital gains > ordinary income for taxable withdrawals

Married Filing Jointly

Taxable Income >	but not >	Marginal Rate	Capital Gains
\$ -	\$ 17,850	10.0%	0.0%
\$ 17,850	\$ 72,500	15.0%	0.0%
\$ 72,500	\$ 146,400	25.0%	15.0%
\$ 146,400	\$ 223,050	28.0%	15.0%
\$ 223,050	\$ 398,350	33.0%	15.0%
\$ 398,350	\$ 450,000	35.0%	15.0%
\$ 450,000	\$ -	39.6%	20.0%

* If income > \$250k, extra 0.9% Medicare tax on income

* If income > \$250k, 3.8% Medicare tax on investment income

* If income > \$300k, deductions begin to be limited

Specific Topic: Tax-deductible and deferred growth

TAX DEDUCTIBLE EXAMPLE

Two People Save \$10,000

One has \$2,500/yr more for current expenses

Gross Income	\$ 100,000	\$ 100,000
Pre-Tax Saving*	\$ 10,000	\$ -
Taxable Income	\$ 90,000	\$ 100,000
Tax at 25%	\$ 22,500	\$ 25,000
Net Take Home	\$ 67,500	\$ 75,000
Post Tax Saving	\$ -	\$ 10,000
Left for Household	\$ 67,500	\$ 65,000

* Note: must pay taxes when withdraw years later

Wealth Growth in Taxable Account

Year	Balance	Gain	Taxes
0	\$ 10,000	\$ 800	\$ 106
1	\$ 10,694	\$ 856	\$ 113
2	\$ 11,437	\$ 915	\$ 121
3	\$ 12,231	\$ 978	\$ 129
4	\$ 13,081	\$ 1,046	\$ 138
5	\$ 13,989	\$ 1,119	\$ 148
18	\$ 33,482	\$ 2,679	\$ 354
19	\$ 35,807	\$ 2,865	\$ 378
20	\$ 38,294	after tax	

Same Growth in Tax Deferred Account

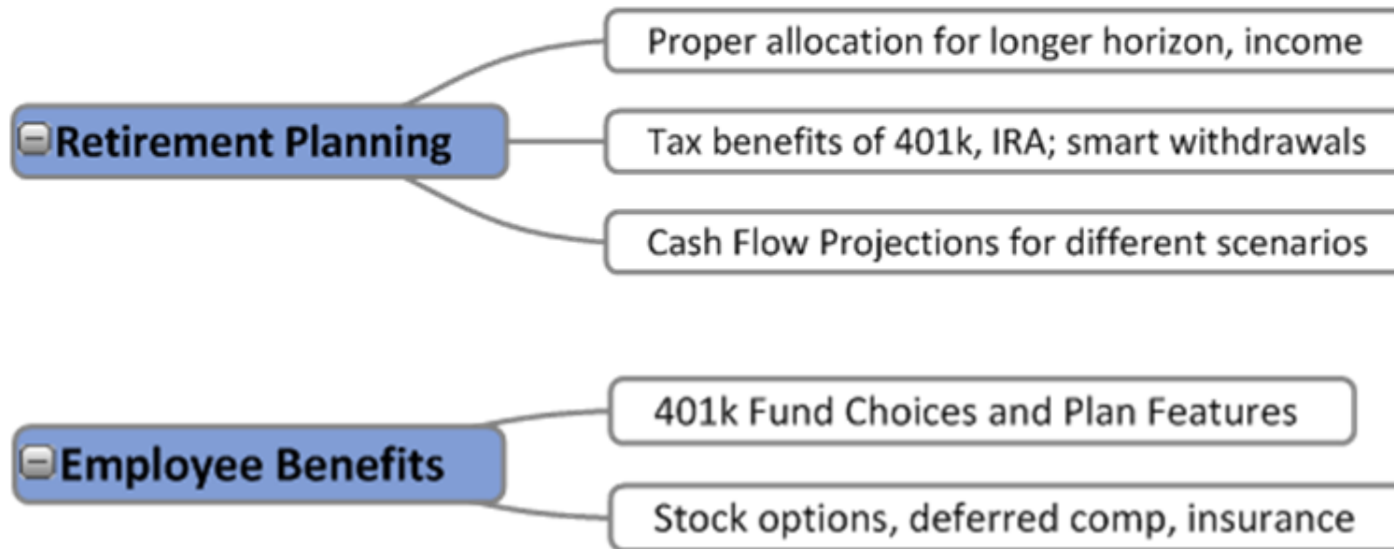
Year	Balance	Gain	Taxes
0	\$ 10,000	\$ 800	\$ -
1	\$ 10,800	\$ 864	\$ -
2	\$ 11,664	\$ 933	\$ -
3	\$ 12,597	\$ 1,008	\$ -
4	\$ 13,605	\$ 1,088	\$ -
5	\$ 14,693	\$ 1,175	\$ -
18	\$ 39,960	\$ 3,197	\$ -
19	\$ 43,157	\$ 3,453	\$ -
20	\$ 46,610		
	\$ 37,457	after tax if 25% rate	
	\$ 41,118	after tax if 15% rate	

Compare this number for 529s and HSA

* assume 8% annual return; 40% taxable at 33%

Drill into specifics – Retirement, Benefits

- Retirement years – saving, Social Security, pension
- How much to save, accounts to use, portfolio to invest
- What do with old 401k? Where save now? Benefits?



Specific Topic: Retirement Savings

- “I left the workforce. What should I do with my 401k/403b?”
- Allowed to keep but may forget to manage
- Allowed to do a direct rollover into an IRA account
 - Open an IRA account at brokerage or mutual fund
 - Request a direct transfer to IRA; assets continue to grow tax deferred
 - Greater investment choices and no 401k plan fees (high for small plans)
- If withdraw funds before age 59 ½, 10% penalty
 - Also pay taxes on amount withdrawn (assume all pre-tax)

Specific Topic: Retirement Savings

- “I used to save for retirement in my 401k. What can I do now?”
- If one spouse has earned income, contribute to spousal IRA
- \$5,500 for 2013; contribute \$5,000 for 2012 up to tax filing
- Can contribute to the same IRA used for 401k rollover
 - Non-deductible contributions on IRS form 8606 (check accountant)

	Contribution Limit	Income Limit for Deduction (covered)	Income Limit for Deduction (non-covered)	Income Limit to Contribute	> Age 50 Catch-Up
401k / 403b / 457	\$ 17,500	n/a	n/a	n/a	\$ 5,500
Traditional IRA	\$ 5,500	\$95k - \$115k	\$178k - \$188k	n/a	\$ 1,000
Roth IRA	\$ 5,500	n/a	n/a	\$178k - \$188k	\$ 1,000
Health Savings Acct	\$ 6,450	n/a	n/a	n/a	n/a
Roth Conversion	n/a	n/a	n/a	n/a	n/a

Specific Topic: Employee Benefits

- “Every fall go through employee benefits list. Anything good?”
 - Choose medical insurance option
 - consider own utilization in selecting deductible
 - Don't overlook Flexible Spending Account for pre-tax health costs
 - High deductible plans with Health Savings Account
 - Potential for lower total cost but utilization and choices must be managed
 - Look for group disability insurance coverage
 - If illness prevents from working, not able to save for retirement

Drill into specifics – College Savings

- How much to save, accounts to use, portfolio to invest
- **Asset allocation, tax treatment, tax qualified accounts**



Bright Start  College Savings

Today's a good day.

PLEASE PICK THE BEST OPTION FOR THIS YEAR'S TAX REFUND

		
<input type="checkbox"/> 1,000 GIANT FOAM HATS	<input checked="" type="checkbox"/> SAVING FOR YOUR CHILD'S FUTURE	<input checked="" type="checkbox"/> HOVERCRAFT

Specific Topic: College Savings

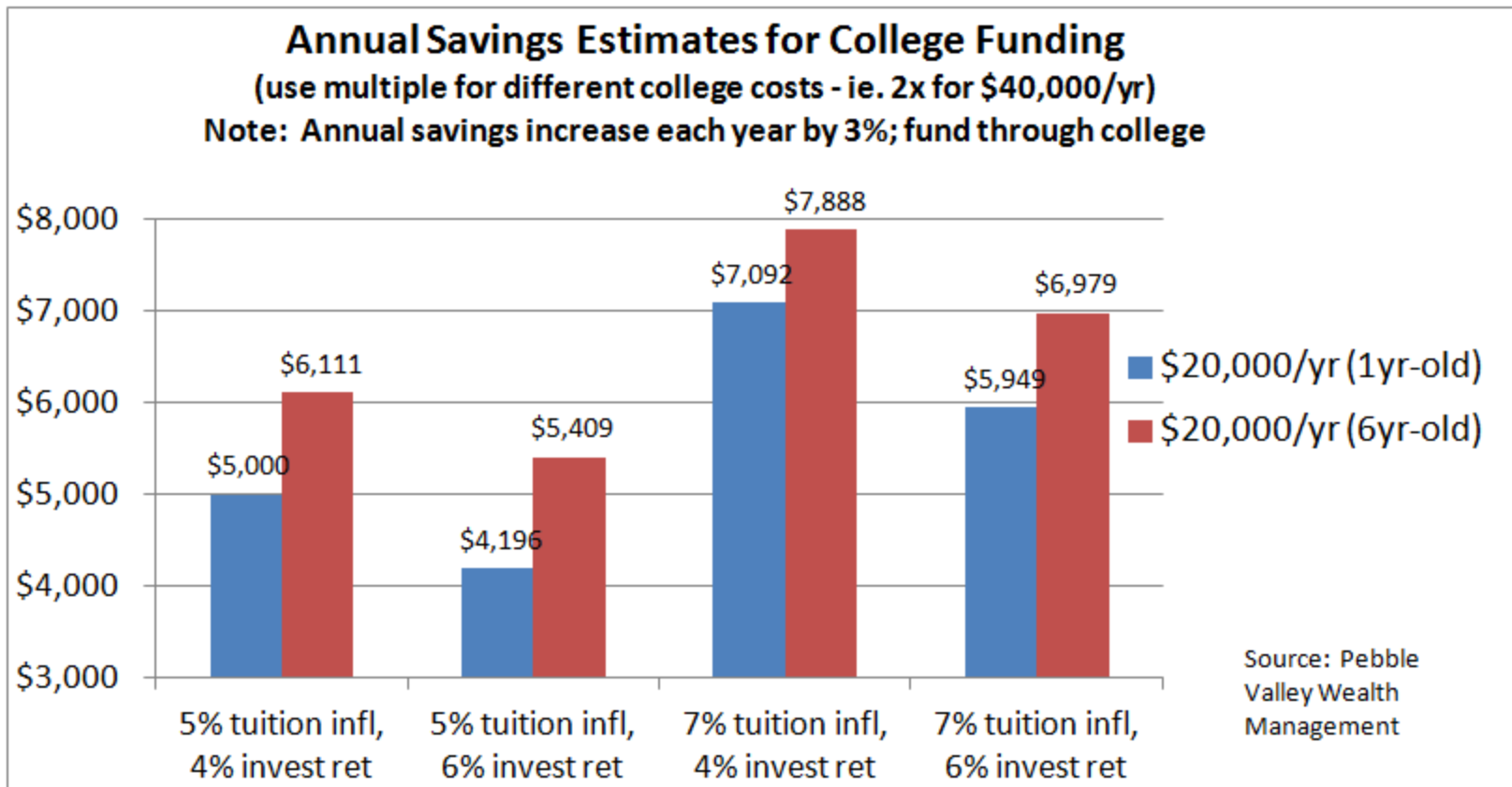
- “When do I start saving for college? What is the best way?”
- Make sure have reserve fund and saving for retirement first
- Consider tax advantaged vehicle like 529 Plan – Two Types
 - Pre-paid – buy future credits; IL credit risk, lower fixed return
 - Savings – education inflation, investment risk; potential higher return
- Savings used for accredited college in any state; not just IL
- Investment gains are federal and state tax deferred
- IL allows state tax deduction up to \$20,000/year/family
- Withdraw tax-free if used for qualified education expense

Specific Topic: College Savings (cont)

- “When do I start saving for college? What is the best way?”
- Can use any state’s plan but state tax deduction only for IL
- Illinois Bright Start - www.brightstartsavings.com
- Parent (or other adult) is owner of account; child is beneficiary
 - Assets in parents name, so count 5.6% for financial aid
 - Change beneficiary without penalty if plans change
- Be aware of shorter time horizon when choosing investments
- Investment choices either ‘age-based’ or asset class type
- See appendix for portfolio choices; WATCH RATE RISK

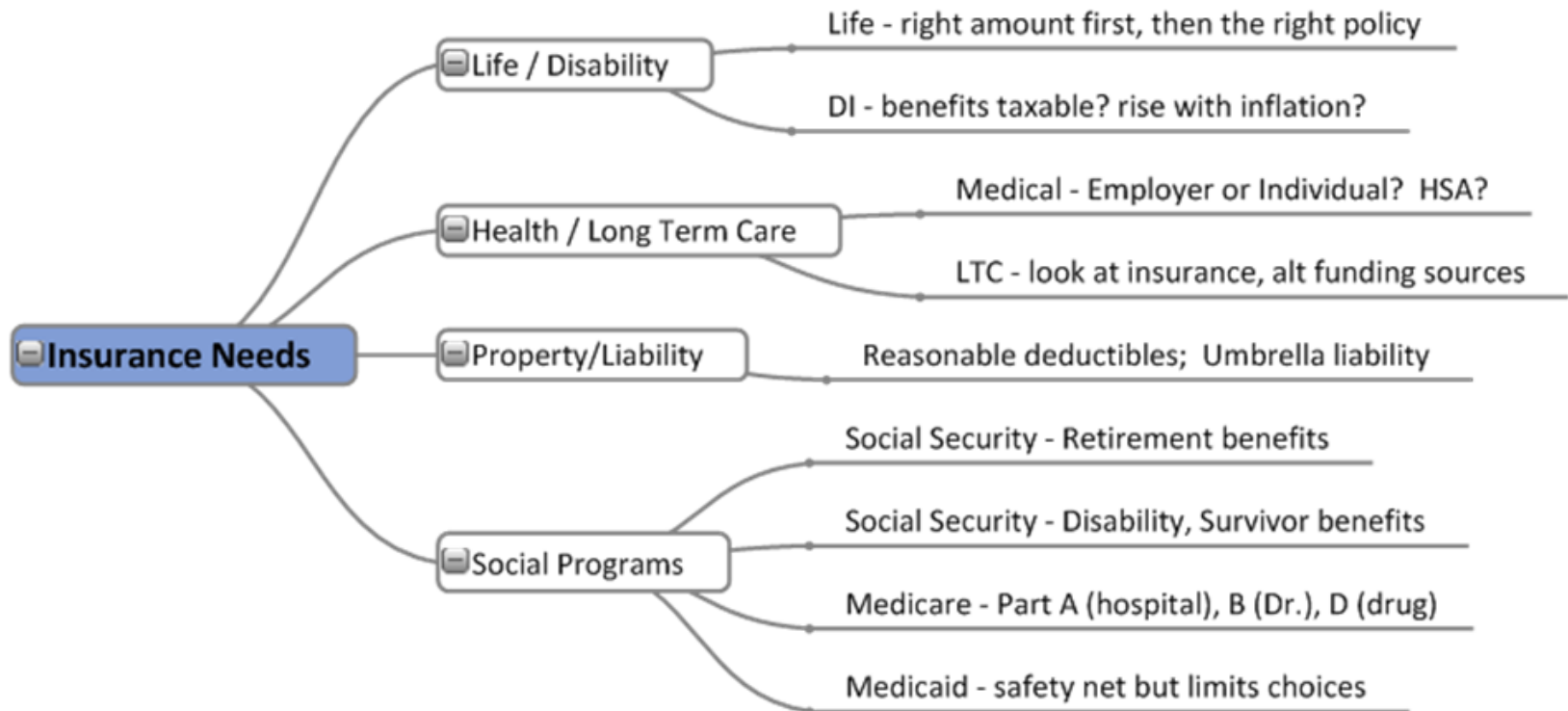
Specific Topic: College Savings Amount

- “How much do I need to save? Tuition inflation?”
- Determine dollar amount parent will pay
- “Net price calculator” on college sites; scholarship/aid may lower



Drill into specifics – Insurance

- Insure against unexpected events that hurt financially
- **Disability insurance; life insurance amount**



Specific Topic: Disability and Life Insurance

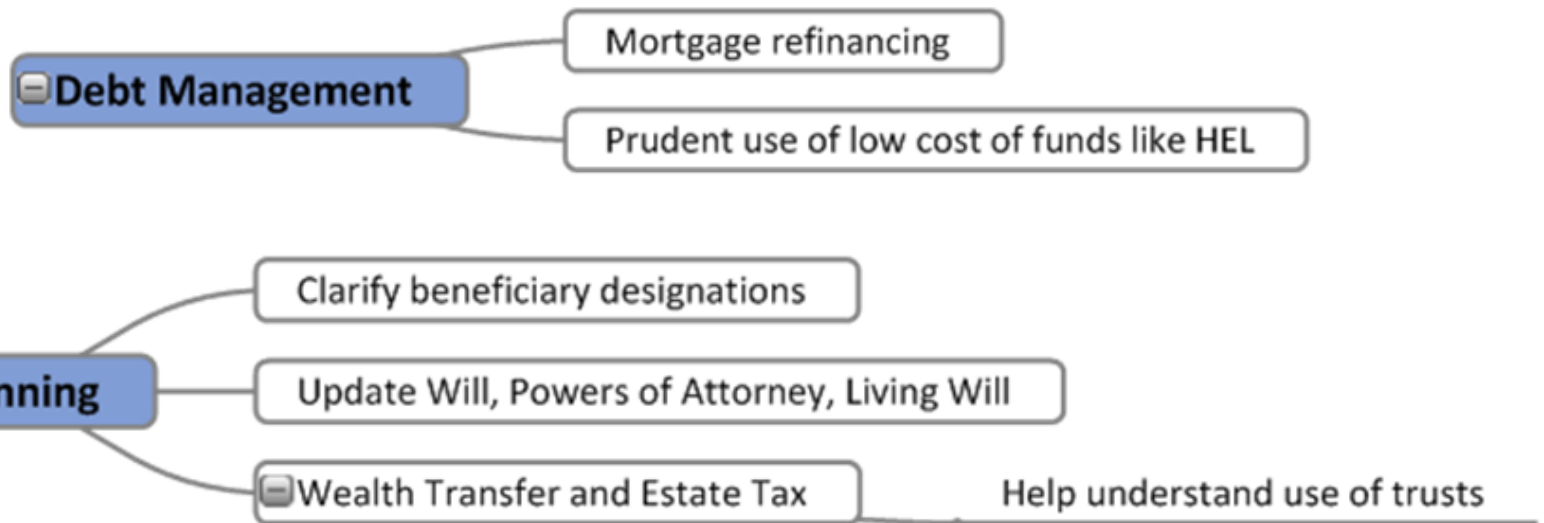
- “Should I have disability insurance?”
- Chance of disability > death; serious illness can erase income
- “Why is life insurance confusing?”
- Intended to replace lost net income if early death
- Important to have sufficient death benefit, then focus on type
- Term most affordable; pure insurance without savings (like car ins)
- DB amount varies by age, investment return, needs, spouse income

<u>if husband dies</u>	<u>Portfolio Return / Income Age 55-66</u>		
annual needs	<u>6.8% / \$0</u>	<u>5.8% / \$0</u>	<u>6.8% / \$60k</u>
150,000	1,450,000	1,990,000	1,140,000
175,000	2,000,000	2,650,000	1,700,000
200,000	2,575,000	3,325,000	2,261,000

Note annual needs drop to 80% after youngest turns 18
no mortgage; \$175k college fund established - need to add 3rd!

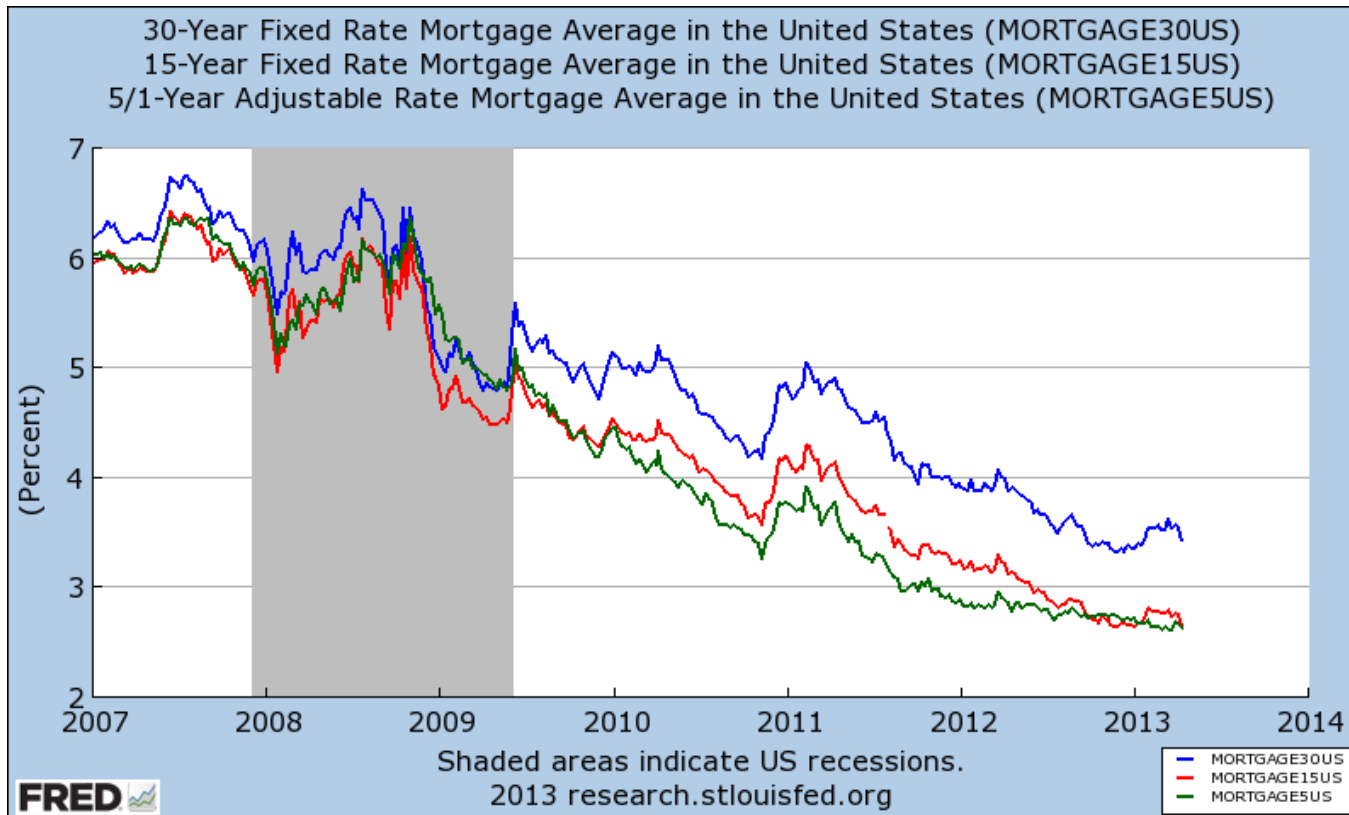
Drill into specifics – Debt, Estate Planning

- Two sides of a balance sheet; manage your debt
- Everyone should have ‘foundational’ legal documents
- Refinance, check beneficiaries, foundational documents



Specific Topic: Debt Management

- “Retirement? College? I need cash now! ... seen rates lately?”
- Pay off credit cards; ok to have good debt, especially at low rates
- If you haven't refinanced in awhile, LOOK AGAIN!



Current Mortgage	\$ 300,000
Current Rate	4.75%
Mthly Pmt	\$1,564.94
New Mortgage	\$ 300,000
Refinance Rate	3.75%
Mthly Pmt	\$1,389.35
Monthly Saving	\$175.60
Annual Saving	\$2,107.14

Specific Topic: Check Beneficiaries

- “Are beneficiary forms important? Doesn’t a will take care of that?”
- Beneficiary forms overrule a will
- Applies to IRAs, 401k/403bs, life insurance, other qualified plans
- Primary beneficiary typically the spouse; need to sign documents if not listed as primary
- Children can’t take ownership of assets
 - Check requirements of custodian
 - Some possibilities are using a trust for full flexibility or a custodial account for child (check with plan administrator or legal expert)

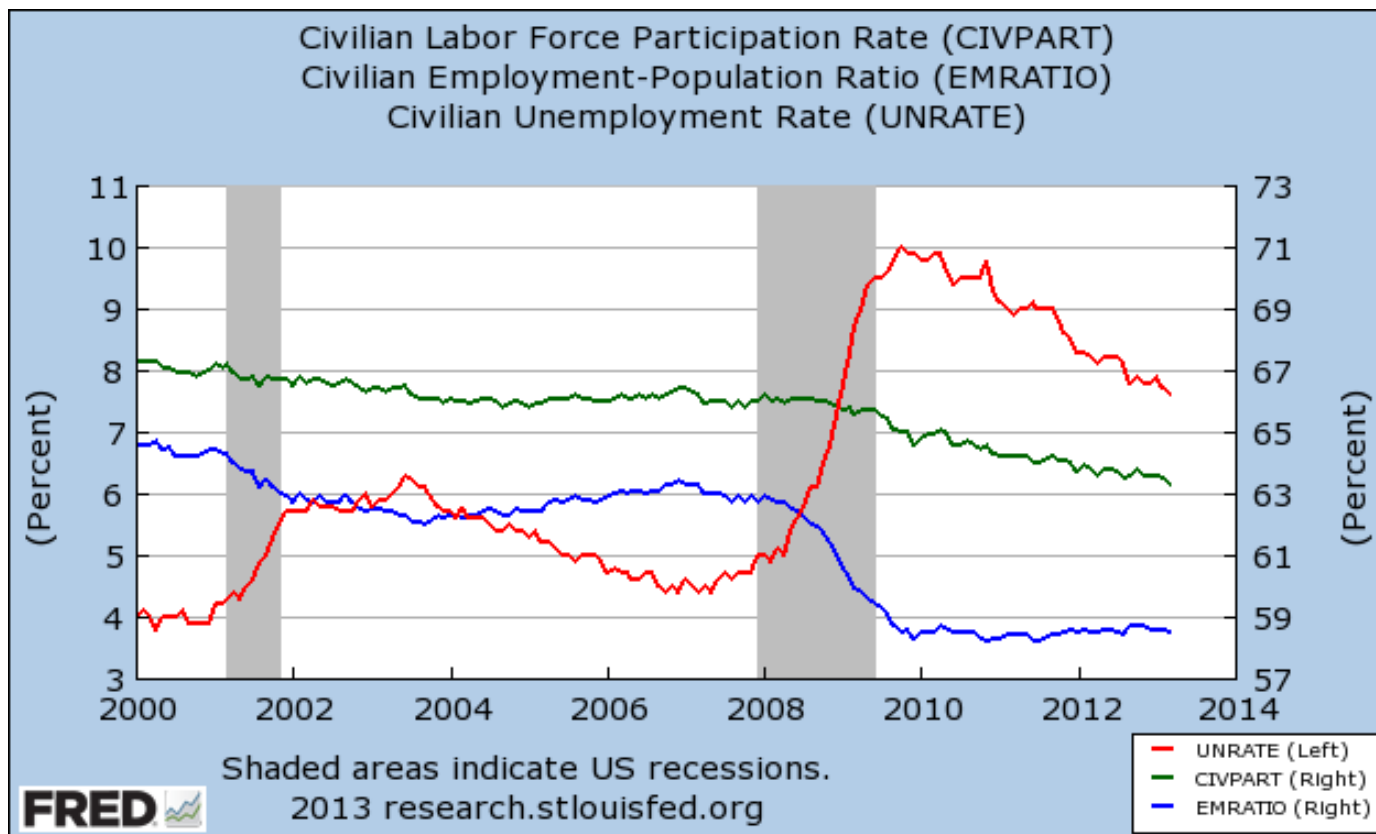
Specific Topic: Foundational documents

- “I’m below the estate tax limit. Do I still need these documents?”
- Everyone should have ‘foundational documents’
 - Will – identify guardian for children; allocate assets after beneficiary
 - Power of Attorney for Medical, Financial – make decisions if unable
 - Living Will – guidance on end-of-life measures
- Be aware of both federal and state exemption amounts
 - Federal estate tax exemption - \$5.25mm single / \$10.5mm couple
 - State estate varies by state - IL exemption \$4mm; no couple limit
- Estates include life insurance death benefit and house net equity
- Trusts provide flexibility to manage estate tax and asset direction

APPENDIX

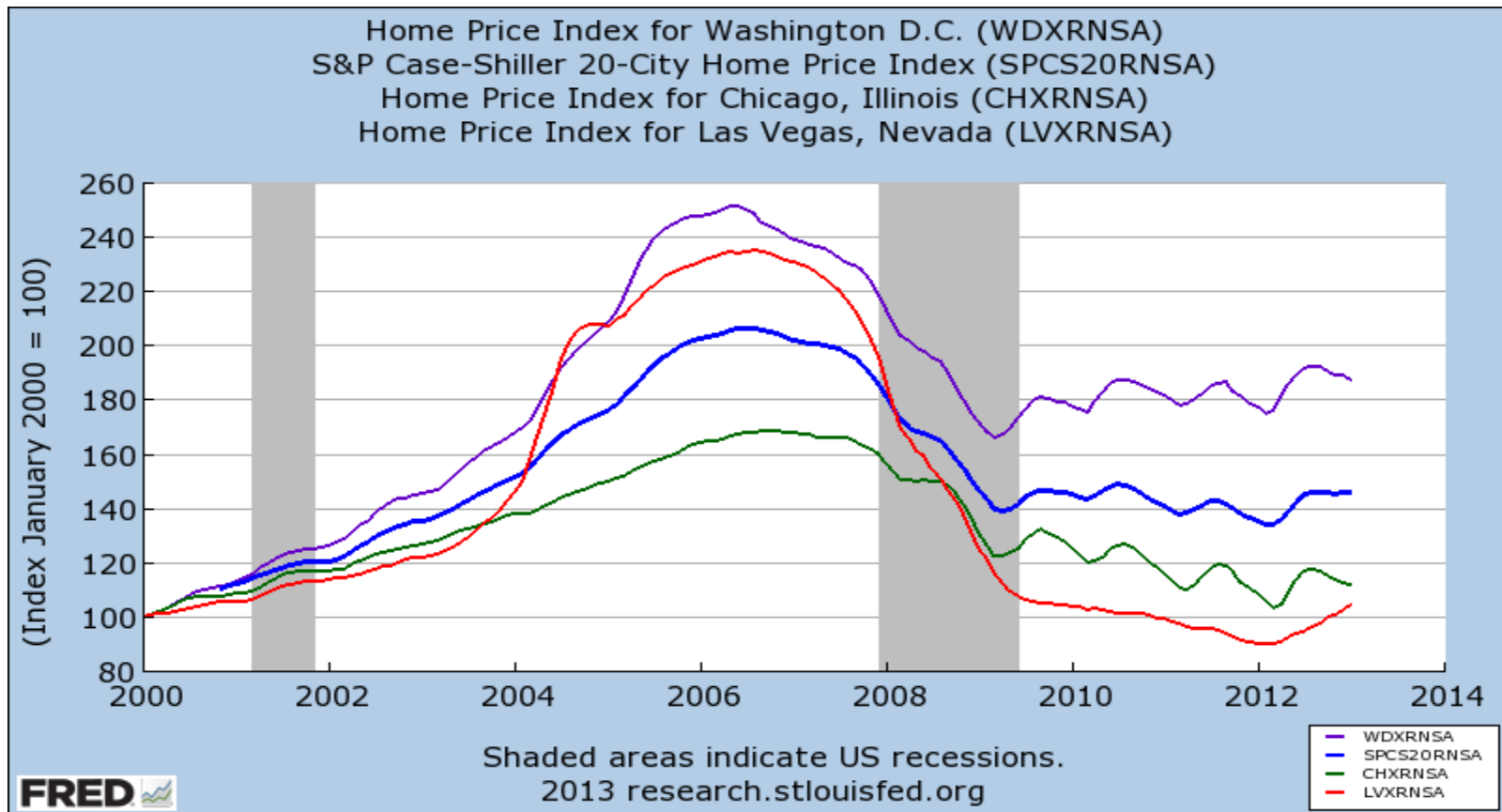
State of economy: Jobs

- Jobs market critical to put cash in pockets
- Unemployment rate down due to low participation



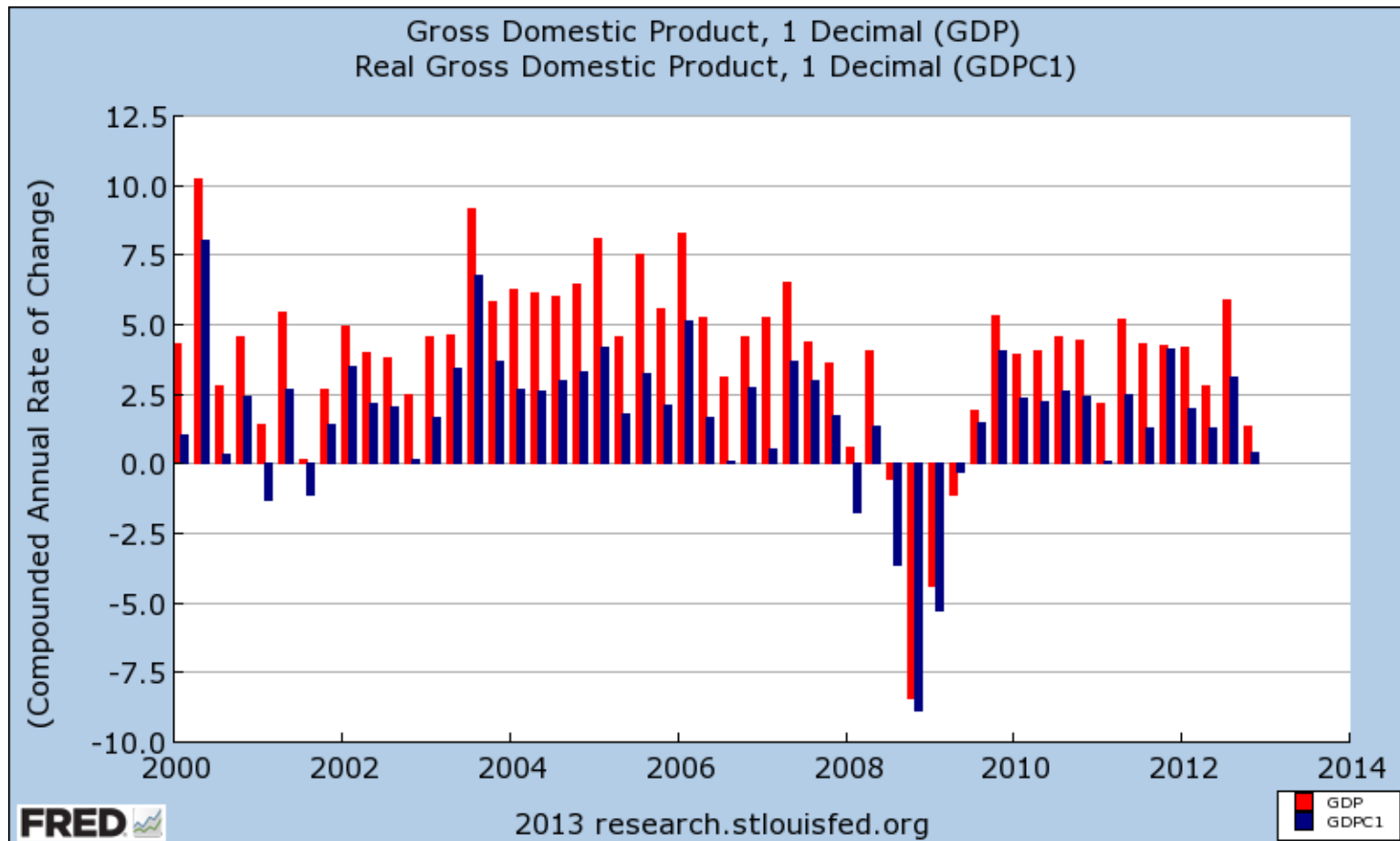
State of economy: Housing

- Market appears to have stabilized
- Likely not rise rapidly due to inventory of houses



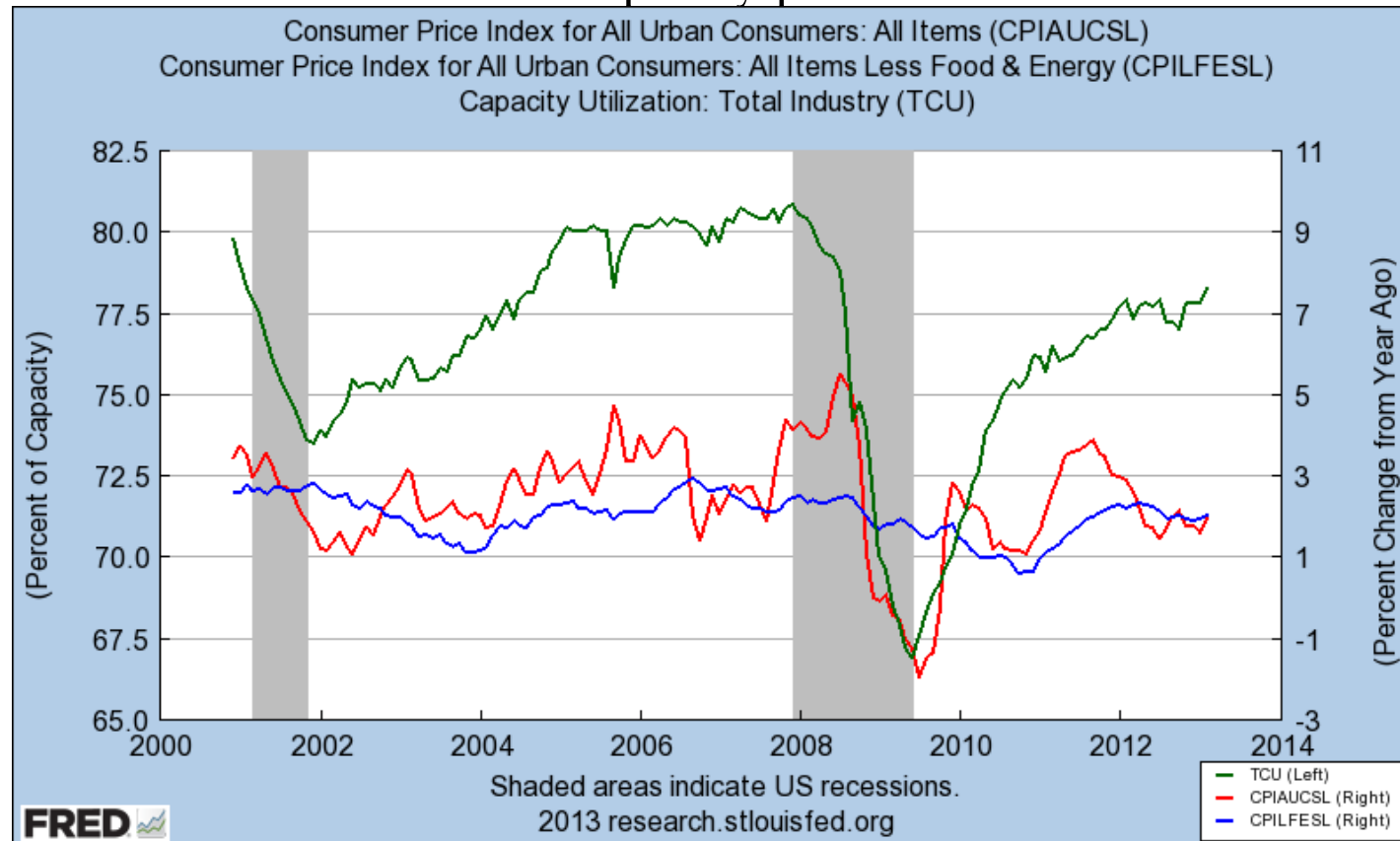
State of economy: GDP

- Annual growth of economic output remains sluggish
- Nominal (with) and Real (without) inflation



State of economy: Inflation

- Headline vs. core (excluding food, energy)
- Manufacturing capacity tighter but jobs market keeps wage inflation low
- Central bank accommodative policy poses risk



Federal Reserve Economic Forecast

Economic Projections of Federal Reserve Board Members and Federal Reserve Bank Presidents, March 2013

Advance release of table 1 of the Summary of Economic Projections to be released with the FOMC minutes

Percent

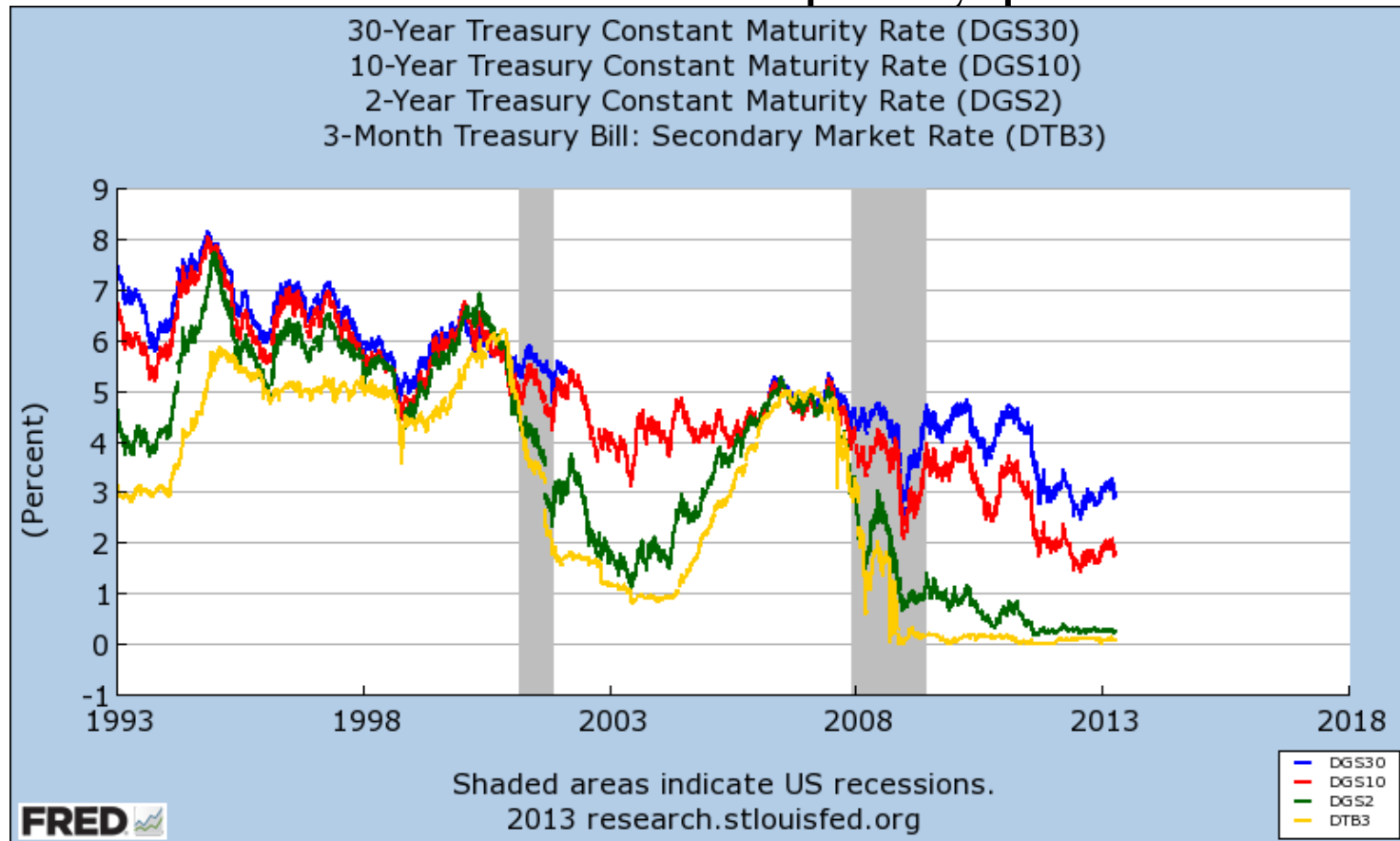
Variable	Central tendency ¹				Range ²			
	2013	2014	2015	Longer run	2013	2014	2015	Longer run
Change in real GDP	2.3 to 2.8	2.9 to 3.4	2.9 to 3.7	2.3 to 2.5	2.0 to 3.0	2.6 to 3.8	2.5 to 3.8	2.0 to 3.0
December projection	2.3 to 3.0	3.0 to 3.5	3.0 to 3.7	2.3 to 2.5	2.0 to 3.2	2.8 to 4.0	2.5 to 4.2	2.2 to 3.0
Unemployment rate	7.3 to 7.5	6.7 to 7.0	6.0 to 6.5	5.2 to 6.0	6.9 to 7.6	6.1 to 7.1	5.7 to 6.5	5.0 to 6.0
December projection	7.4 to 7.7	6.8 to 7.3	6.0 to 6.6	5.2 to 6.0	6.9 to 7.8	6.1 to 7.4	5.7 to 6.8	5.0 to 6.0
PCE inflation	1.3 to 1.7	1.5 to 2.0	1.7 to 2.0	2.0	1.3 to 2.0	1.4 to 2.1	1.6 to 2.6	2.0
December projection	1.3 to 2.0	1.5 to 2.0	1.7 to 2.0	2.0	1.3 to 2.0	1.4 to 2.2	1.5 to 2.2	2.0
Core PCE inflation ³	1.5 to 1.6	1.7 to 2.0	1.8 to 2.1		1.5 to 2.0	1.5 to 2.1	1.7 to 2.6	
December projection	1.6 to 1.9	1.6 to 2.0	1.8 to 2.0		1.5 to 2.0	1.5 to 2.0	1.7 to 2.2	

NOTE: Projections of change in real gross domestic product (GDP) and projections for both measures of inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The December projections were made in conjunction with the meeting of the Federal Open Market Committee on December 11–12, 2012.

1. The central tendency excludes the three highest and three lowest projections for each variable in each year.
2. The range for a variable in a given year includes all participants' projections, from lowest to highest, for that variable in that year.
3. Longer-run projections for core PCE inflation are not collected.

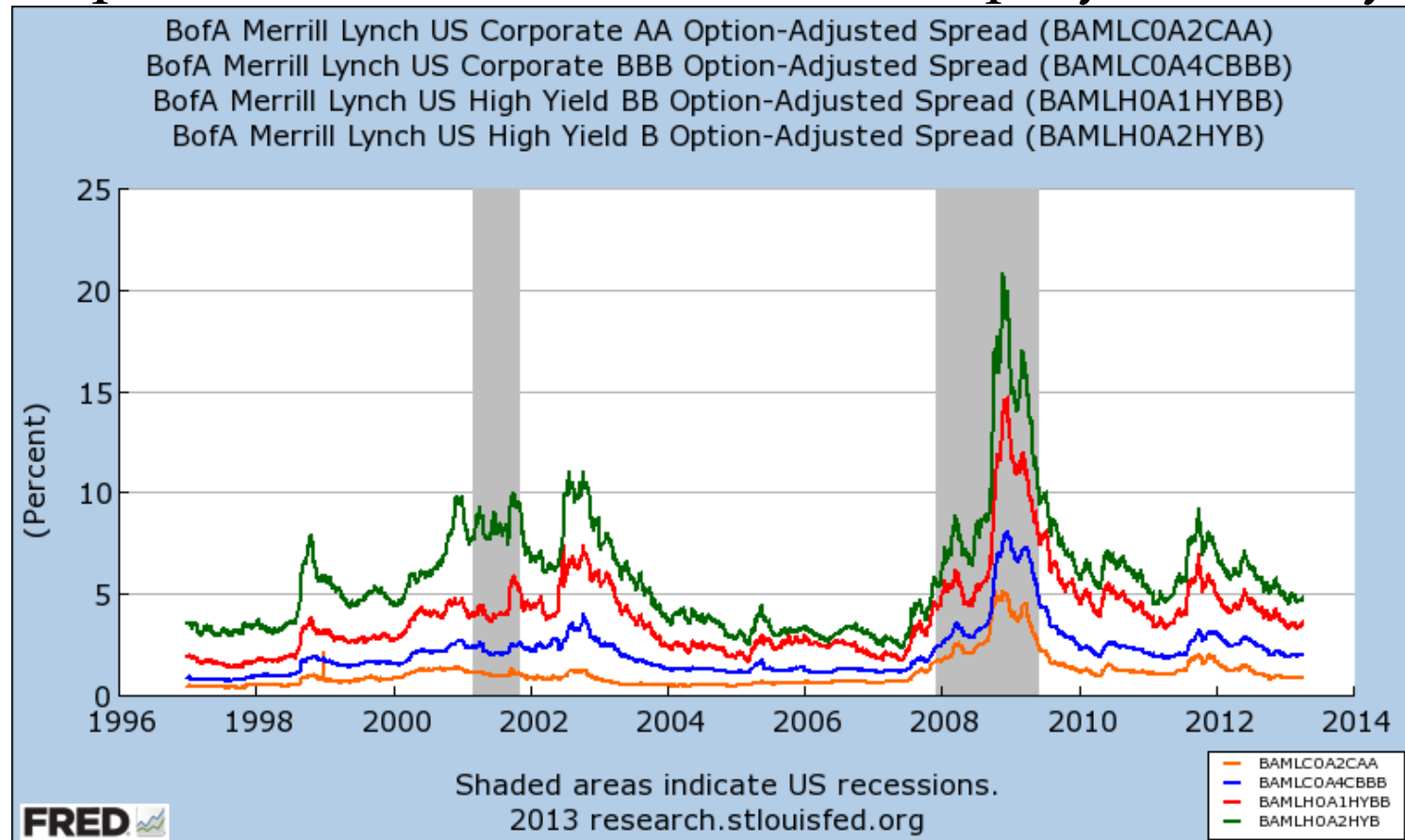
State of markets: Treasury Rates

- Fed controls short-end; market controls long-end
- Central bank accommodative policy poses risk



State of markets: Credit Spreads

- Extra yield above treasury rate
- Compensation for chance of bankruptcy, volatility



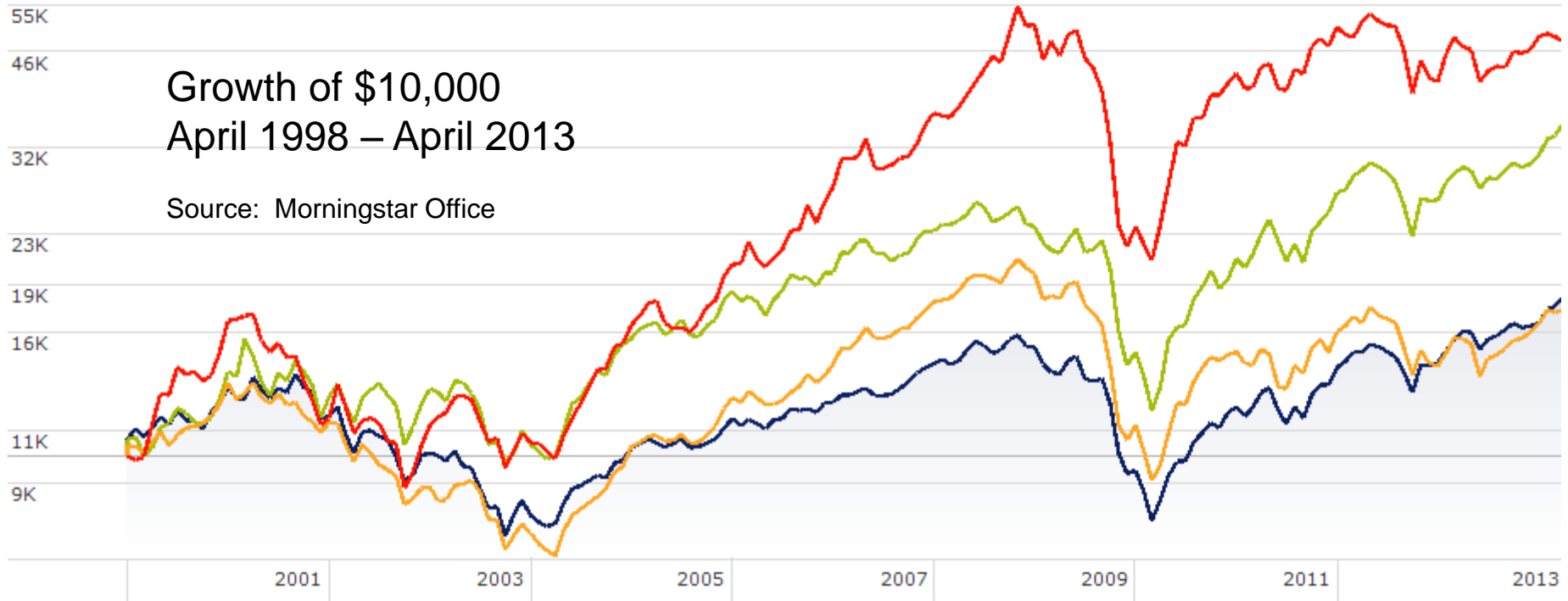
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State of markets: Equities

- Both US and International
- Refined – large vs. small; developed vs. emerging

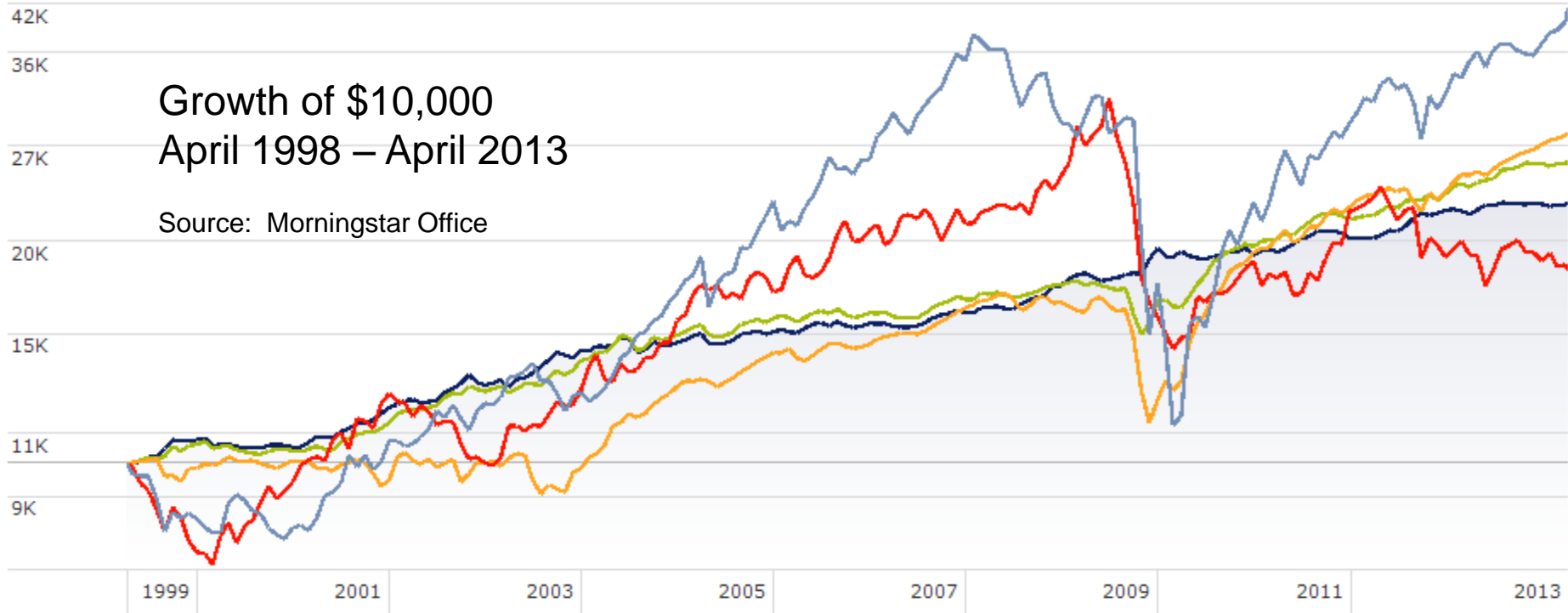
Growth of \$10,000
April 1998 – April 2013

Source: Morningstar Office



State of markets: Bonds, Alternatives

- Different bond types – treasury, corporate, high yield
- Alternatives include REITs, Commodity, Real Assets



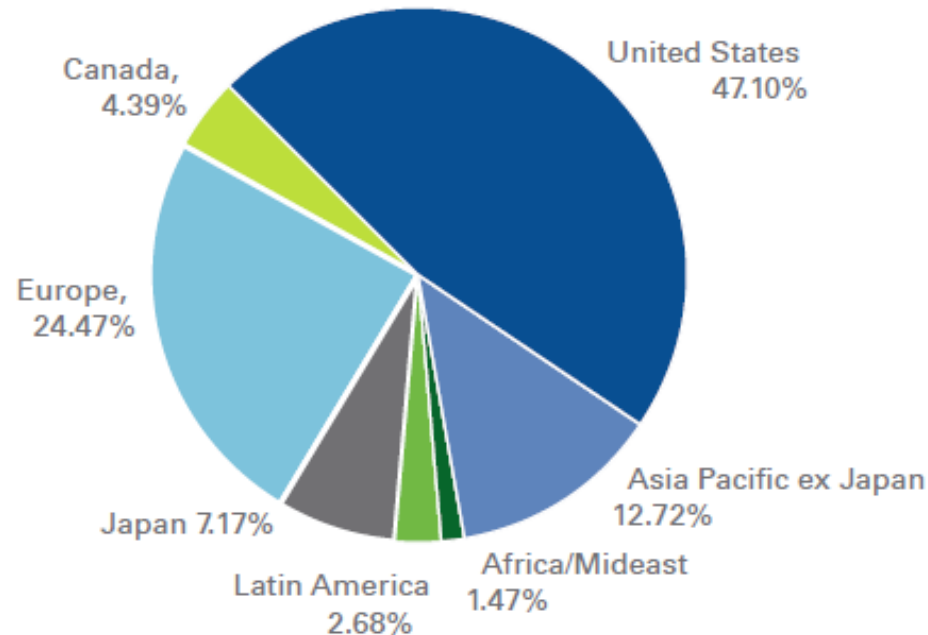
Construct a diversified portfolio

- Allocation
 - Go beyond 'equity, bond, cash' to include international, sectors, alternatives
- Holdings
 - Go beyond individual stocks, bonds, mutual funds to include Exchange-traded-funds (ETFs), Treasury Inflation Protected Securities (TIPS), REITs, options
 - NOTE: mutual funds and ETFs are portfolios of individual stocks or bonds or other underlying
- ETFs made many asset classes, strategies accessible but must know what is in the ETF and how it works

Construct portfolio – Global Equity

- International equities make up large portion of total

FIGURE 1: WORLD EQUITY MARKET CAPITALIZATION



Source: FactSet, based on MSCI All Country World Index, as of 9/30/2012.

Construct portfolio – Global Bonds

FIGURE 2: GLOBAL BONDS BY COUNTRY

COUNTRY	MARKET VALUE (%)	MARKET VALUE (USD)
United States	35.79	15,426,593,454
Japan	20.27	8,738,216,228
United Kingdom	6.34	2,730,974,300
France	5.89	2,538,750,601
Germany	5.88	2,535,131,586
Italy	3.72	1,604,788,900
Canada	3.46	1,491,474,006
Spain	2.54	1,094,338,892
Other	16.08	6,939,650,649

Source: Barclays, as of 9/30/2012.

Based on Barclays Global Aggregate Index.

FIGURE 5: BARCLAYS US AGGREGATE INDEX

SECTOR	MARKET VALUE (%)	MARKET VALUE (USD)
Treasury	36.08	6,067,597,618
Securitized	32.25	5,423,457,398
Corporate	21.12	3,551,384,419
Government-Related	10.54	1,772,796,902

Source: Barclays, as of 9/30/2012.

Construct Portfolio– Historic Returns, Risk

- Modern Portfolio Theory as framework to determine target %

Asset Class Annualized Total Returns as of 3/31/2013

Asset Class	Index Description	YTD ⁽¹⁾ Total Return	1 Yr Total Retur	3 Yr Total Return	5 Yr Total Return	10 Yr Total Return	15 Yr Total Return	10 Yr Std Dev	10 Yr Sharpe Ratio
Equity-US Large Cap	DJ Wilshire US Large Cap	10.83	14.06	12.86	6.04	8.95	4.51	14.83	0.54
Equity-US Small Cap	DJ Wilshire US Small Cap	12.86	18.00	14.97	10.26	13.36	7.57	20.22	0.64
Equity-Int'l Developed	MSCI Europe, Asia, Far East	5.13	11.25	5.00	-0.89	9.69	3.77	18.37	0.51
Equity-Int'l Emerging	MSCI Emerging Markets	-1.62	1.96	3.27	1.09	17.05		24.08	0.71
Bonds-US Treasury Short	Bonds-US Treasury 5 Yr	0.18	2.97	5.65	5.02	4.69	5.62	4.54	0.65
Bonds-US Treasury Long	Bonds-US Treasury 30 Yr	-3.07	7.48	13.53	8.11	7.08	7.12	15.14	0.41
Bonds-US Inflation Protected	BarCap TIPS	-0.36	5.68	8.57	5.89	6.32	7.27	6.56	0.71
Bonds-US MBS	BarCap Mtg-Backed Securities	-0.05	1.97	4.17	5.15	4.98	5.71	2.63	1.19
Bonds-US Inv Grade Credit	BarCap Inv Grade Corp	-0.11	7.47	8.12	7.88	6.05	6.48	6.24	0.69
Bonds-US High Yield Credit	BarCap High Yield Corp	2.89	13.13	11.24	11.65	10.12	7.06	10.54	0.80
Bonds-Int'l Bond (Curr Hdg)	BarCap Gbl Agg exUS (CurrHdg)	1.06	5.77	4.36	4.64	4.40	5.22	2.45	1.05
Commodity	DJ UBS Commodity	-1.13	-3.03	1.42	-7.11	3.67	4.22	18.20	0.20
Real Estate-US	DJ Wilshire REIT	7.04	13.19	16.94	6.07	12.10	9.59	26.65	0.51
Cash	BarCap 1-3 Month Treasury	0.02	0.09	0.10	0.30	1.67	2.49	0.75	-0.09
Inflation	BLS CPI ⁽²⁾	0.71	1.98	2.31	1.82	2.40	2.45	1.25	0.52

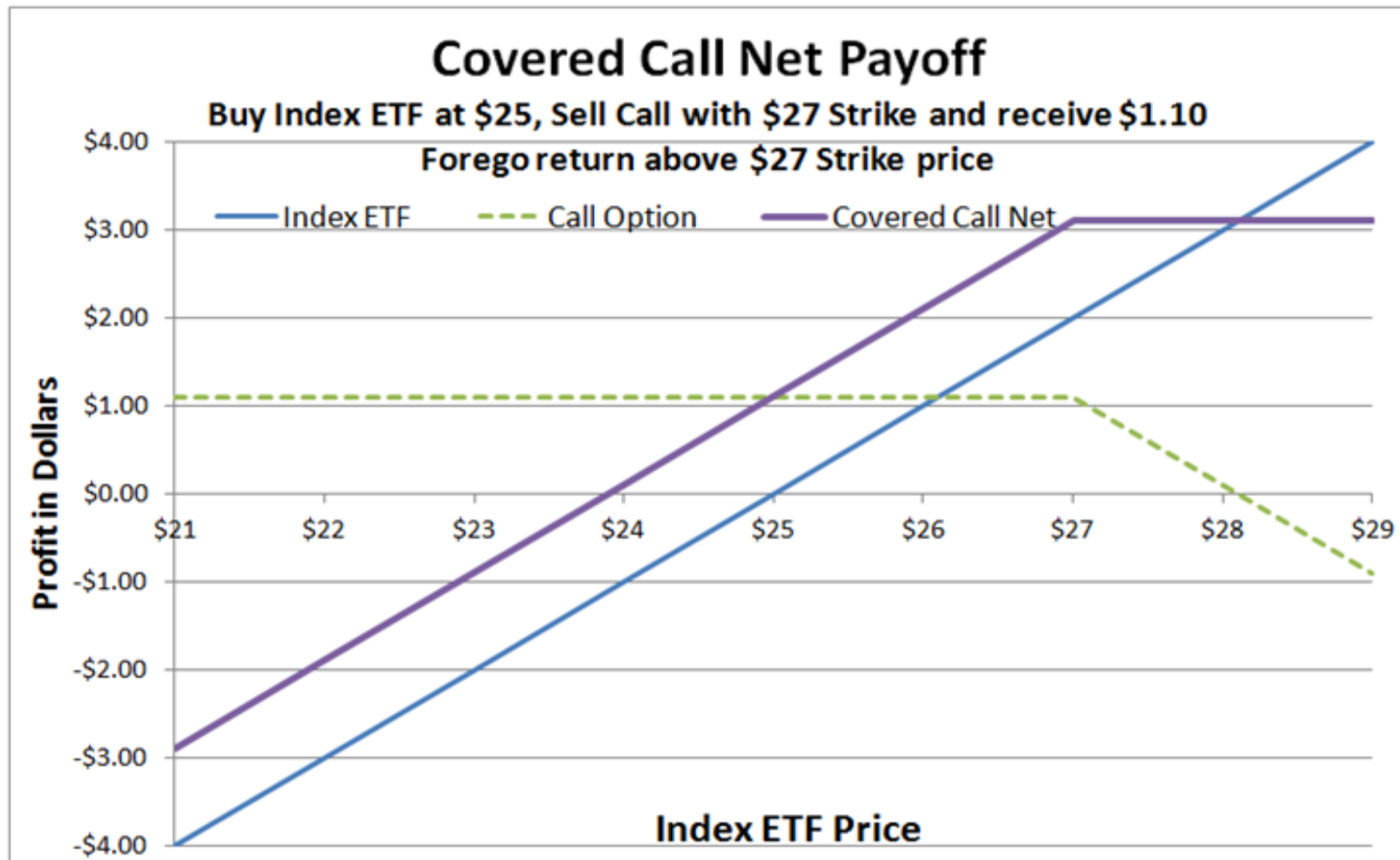
Note: (1) Returns are not annualized; (2) as of 2/28/2013

Source: Morningstar Office

Sharpe Ratio = (Return over Risk-Free) / (Std Dev of Return over Risk-Free); risk-adjusted reward per unit risk; high is good but note return

Construct Portfolio– Options

- Options used to modify risk profile (only if client comfortable)



Contact Information

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