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# Financial Planning on a Napkin





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**If you don't know where you  
are going , how will you know  
if you get there?**





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# If you want to travel YOUR plan, you must PLAN your travel....

- Goal Setting
- Cash Flow and Budgeting
- Estate Planning
- Income Tax Planning
- Risk & Insurance Analysis
- Investment Planning
- Retirement Planning



# Whose Financial Plan Is It?

- How many roads will get you to Chicago from Ft. Lauderdale?
- Some folks take the express lane.....others take the scenic route, windows down, enjoying the scenery
- **Our** job is to educate you and provide choices
- **Your** job is to choose - and live with the consequences
- It's not **Our** plan, it's **Your** plan



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## It's A Brand New Game

- Throughout 99% of history, the average life expectancy was fewer than 18 years
- Two thirds of all men and women who have lived beyond the age of 65, are alive today



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# Your Warranty Runs Out Long Before You Think!

## Average Life Expectancy

- 1776 - 35 years of age
- 1876 - 40 years of age
- 1989 - 75 years of age
- 1999 - 77 years of age



# Why Develop a Financial Game Plan?

- According to the United States Government, 95% of all people fail to reach age 65 independent of social security.
- To be in the 5% who succeed, you must:
  - **PLAN EARLY**
  - **PLAN EFFECTIVELY**



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# What are *Your* Personal Goals?

- Achieving financial independence?
- Beating taxes?
  - Income taxes?
  - Death taxes?
  - Inflation (the “invisible” tax)?
- Building an efficient, diversified portfolio?
- Providing children with a quality education?
- Protecting yourself from risks?



# Why Do Most People Fail to Achieve Their Goals?

- Failure to *establish* goals and philosophy
- Fear of losing money
- Lack of trust in using outside professionals
- Failure to take responsibility
- Personal wants & needs exceed available cash flow
- Lack of a burning desire
- Previous defeats experienced
- Lack of quality long term investment strategy



# Cash Flow and Budgeting

It's *our* job to find the money to fund your goals:

- Refinance Residence – lock in low rates
- Shop for insurance – property, health and life
- Invest in qualifying dividends - 15% tax rate
- Harvest tax losses – to offset capital gains
- Fund IRA's, 401(k)'s, SEP's, Simple's – to take advantage of “free money” from the government
- Maximize company retirement plan match – more free money from the boss
- Itemize every other year
- Pinch pennies - save dollars



# Estate Planning

- **Intestate – Do you really think the state knows best?**
- **Basic Will - I love you too!**
- **Revocable Trust – Make it easy on your relatives**
- **Living Will - You want me to read that whole thing first?**
- **Durable Power of Attorney - You must really trust me!**
- **Health Care Surrogate - Go ahead, pull the plug!**
- **Elder Care – Medicare, Medicaid, LTC – (If I knew I was going to live this long, I would have taken better care of myself or bought the extended warranty!)**
- **Gifting - CRUTs, CRATs, GRATs – Give it to your favorite charities, otherwise Uncle Sam will make the choice for you!**



# Risk & Insurance Analysis

- What is the purpose of insurance?  
Provide economic protection against losses due to chance events - Death, Illness or Accident
- Handling Risk – Your choices are: Avoidance, Reduction, Retention or Transfer (to ins. co.)
- Do you have Disability Insurance?
- Do you have an Umbrella policy?
- Are you under insured or over insured?
- Have you put your insurance out to bid? Make your agent do the work for you!
- Have you considered LTC insurance? Aren't you worth it?



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# Investment Planning





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# The Research Indicates.....

## Building Wealth Takes:

- Discipline
- Sacrifice
- Hard Work

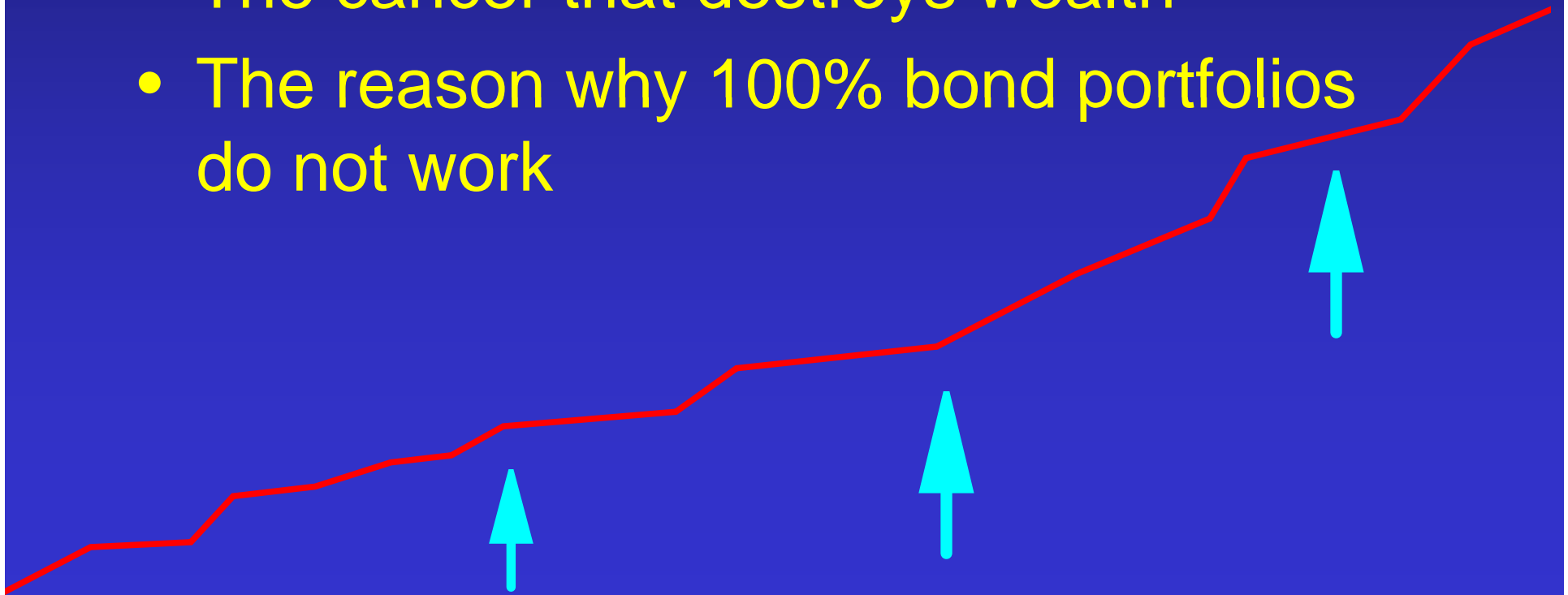


But above all .....

.....**SAVING Money**

# INFLATION

- The invisible tax
- The cancer that destroys wealth
- The reason why 100% bond portfolios do not work





# How inflation beats you

- Cash & equivalent assets
  - bonds
  - CD's
  - savings accounts
- You are merely a loaner



# How you can beat inflation

- Equity assets
  - Active
    - Businesses
    - Real estate
    - Farming
  - Passive
    - Stocks
- You are an owner



# Building a safe portfolio

- Articulate your needs and goals
- Understand investment principles and risk
- Select from the menu of investment vehicles - this is called “asset allocation”
- Build specifically tailored portfolio and modify as needed

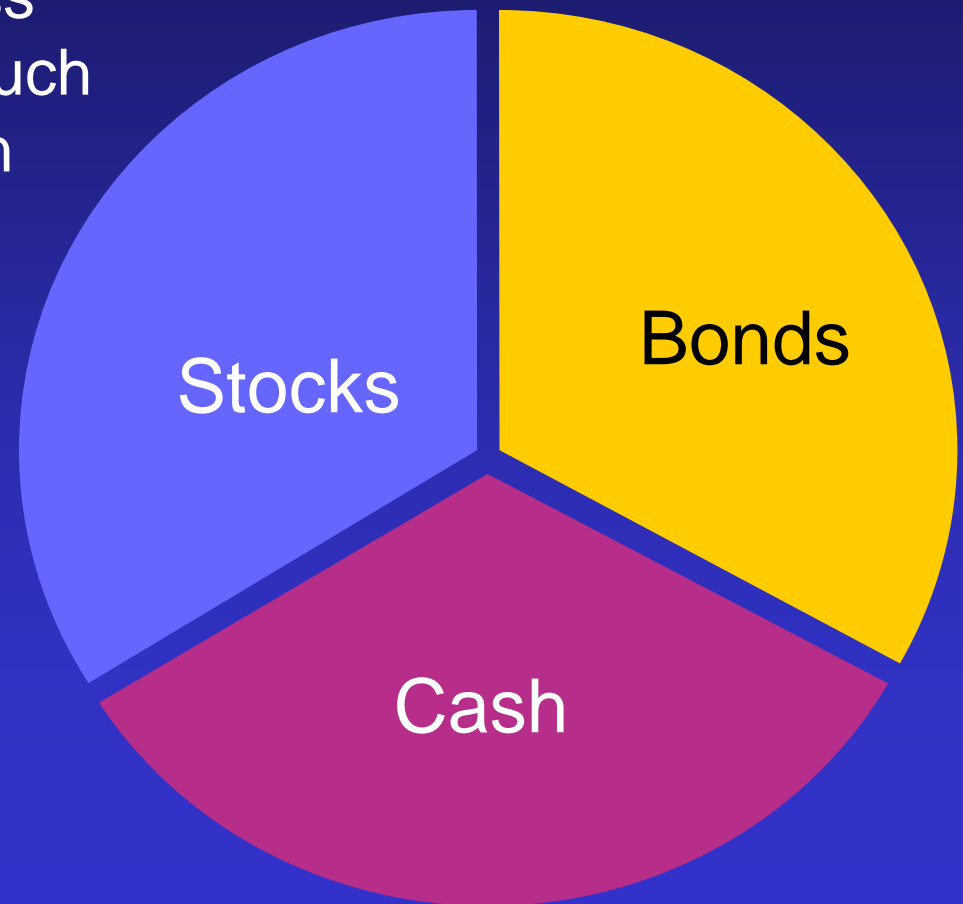


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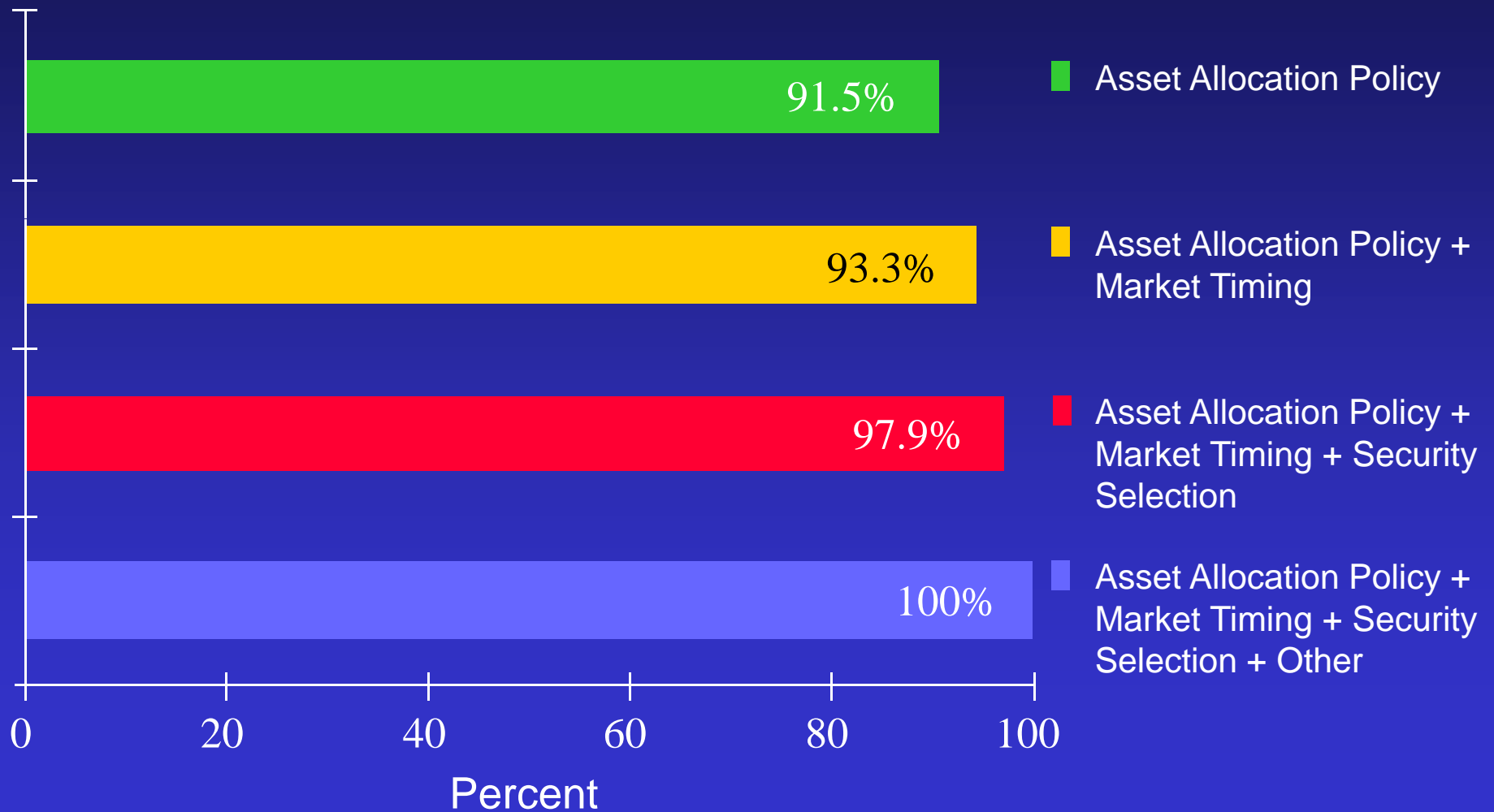
# What Is Asset Allocation?

Asset allocation is the process of combining asset classes such as stocks, bonds, and cash in a portfolio in order to meet your goals.



# Why Is Asset Allocation Important?

## Contributing Factors of Portfolio Performance

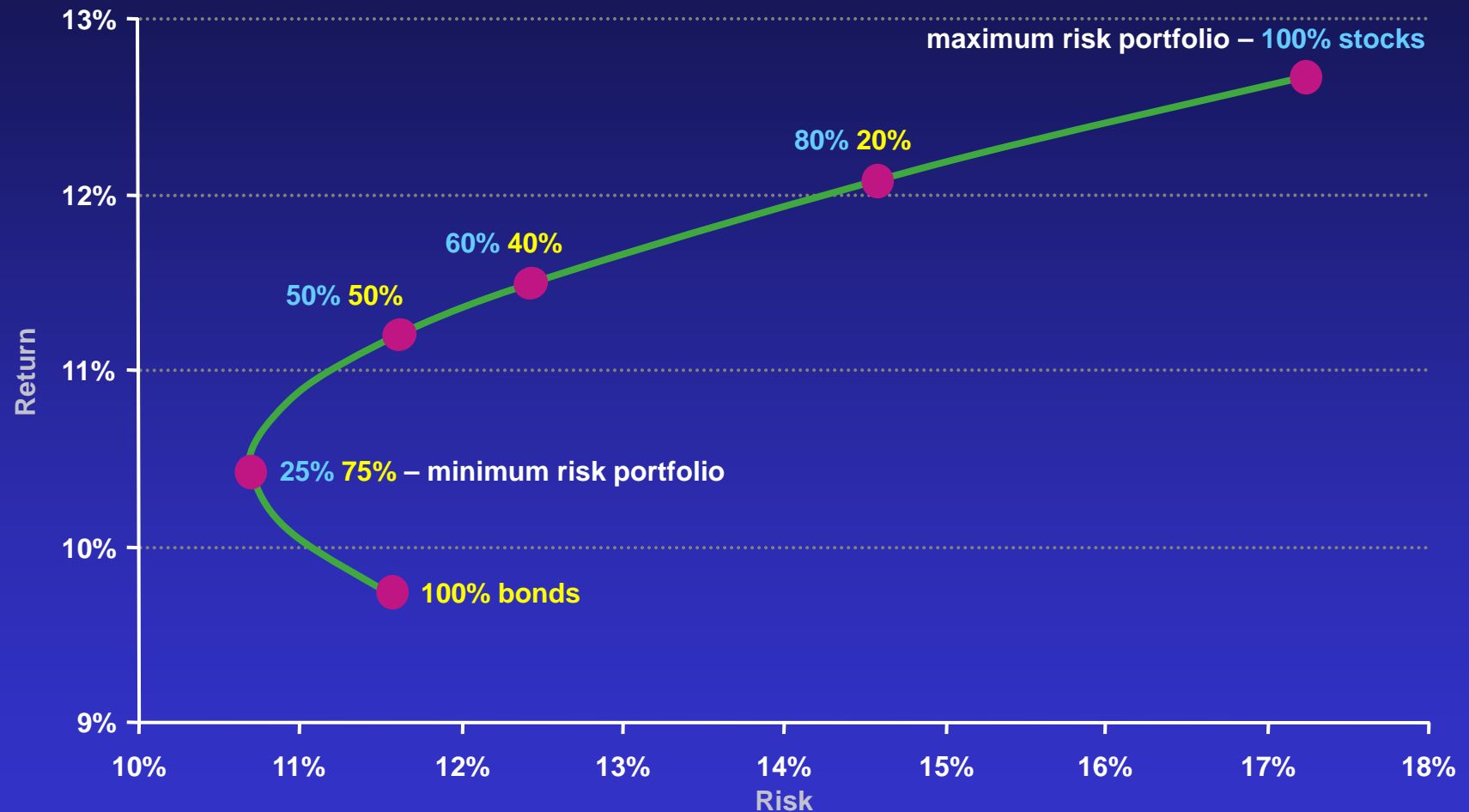


Source: Ibbotson

# Stocks and bonds: risk versus return

Adding some equities to the asset allocation actually **REDUCES** the risk!

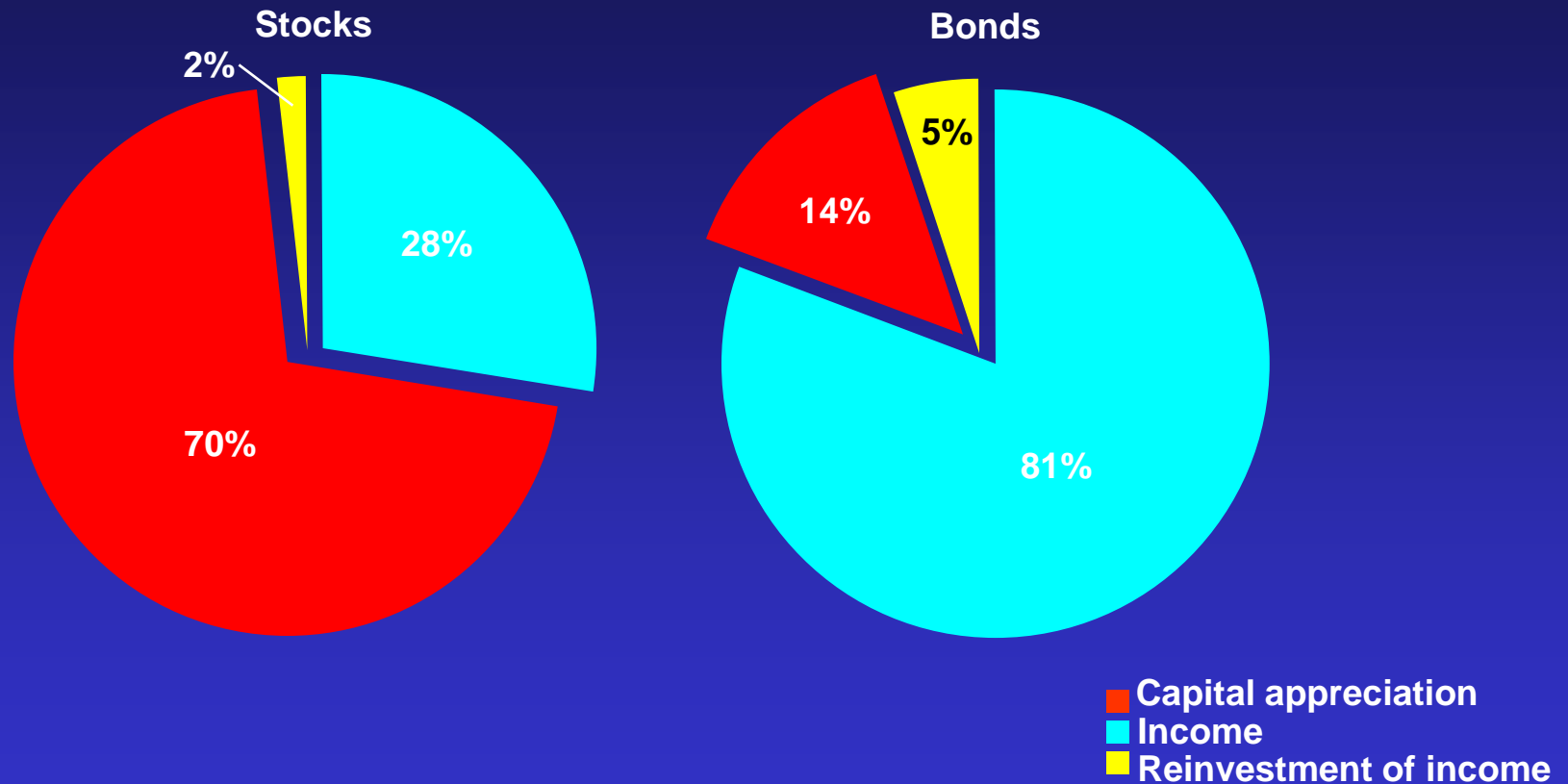
1970–2004



Risk is measured by standard deviation. Return is measured by arithmetic mean. Risk and return are based on annual data over the period 1970–2004. Portfolios presented are based on modern portfolio theory.

# Bonds produced greater income

1970–2003



Based on annual data over the period 1970–2003



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# Revisit the “Rule of 72’s”

A mathematical analogy that tells you how long it takes to double your money.  
Divide the number 72 by a constant rate of return to calculate the number of years  
until your money is doubled!

## How long does it take to double your Money?

$$72 / 6\% = 12 \text{ Years}$$

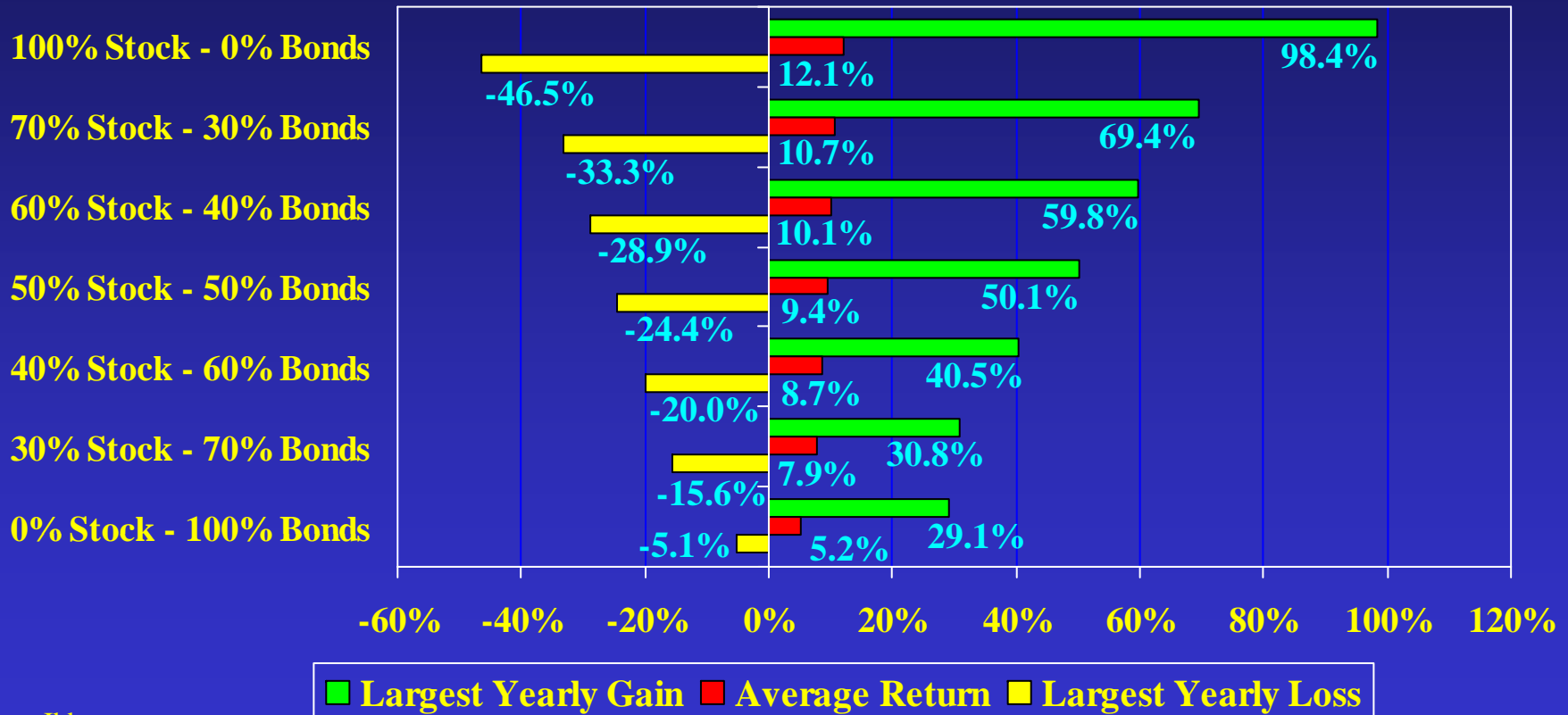
$$72 / 8\% = 9 \text{ Years}$$

$$72 / 10\% = 7.2 \text{ Years}$$



# Finding your Center: Risk Versus Reward

Where is Your comfort zone?



Source: Ibbotson

Each bar shows a range of annual total returns for each mix over the period 1926-1996 (70 years). Stocks: Large and Small Stocks. Bonds: Intermediate - Term Government Bonds. Past performance is no guarantee of future results. This chart illustrates the history of the stock market for the time period represented. It does not represent performance or allocations of portfolios managed by Chas. P. Smith & Associates, PA, CPA's

# S&P 500 32 year average 11.2%

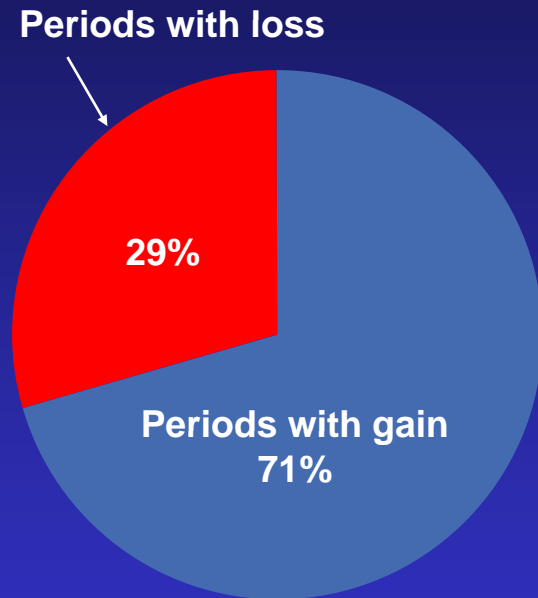
<u>Year</u>	<u>Return</u>	<u>Year</u>	<u>Return</u>
1973	-14.7	1989	31.5
1974	-26.5	1990	-3.1
1975	37.2	1991	30.5
1976	23.8	1992	7.6
1977	-7.2	1993	10.1
1978	6.6	1994	1.3
1979	18.4	1995	37.6
1980	32.4	1996	23.0
1981	-4.9	1997	33.4
1982	21.4	1998	28.6
1983	22.5	1999	21.0
1984	6.3	2000	-9.1
1985	32.1	2001	-11.9
1986	18.5	2002	-22.1
1987	5.2	2003	28.7
1988	16.8	2004	10.9

# Growth of \$100,000 from 1973 to 2004

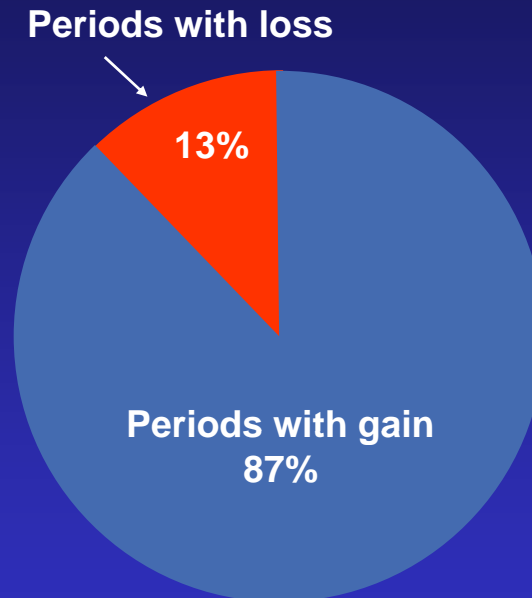
<u>Year</u>	<u>Balance</u>	<u>Year</u>	<u>Balance</u>
1973	85,340	1989	629,089
1974	62,751	1990	609,588
1975	86,094	1991	795,329
1976	106,618	1992	855,933
1977	98,963	1993	942,211
1978	105,455	1994	954,648
1979	124,901	1995	1,313,405
1980	165,394	1996	1,614,963
1981	157,273	1997	2,153,714
1982	190,945	1998	2,769,246
1983	233,927	1999	3,351,895
1984	248,595	2000	3,046,872
1985	328,543	2001	2,684,599
1986	389,224	2002	2,091,303
1987	409,581	2003	2,691,057
1988	478,431	2004	2,984,382

# Risk of stock market loss over time

1926–2004



79 one-year periods



75 five-year periods



65 fifteen-year periods



# The Stock Market (1973 to 2004)\*

Market is Up 69%

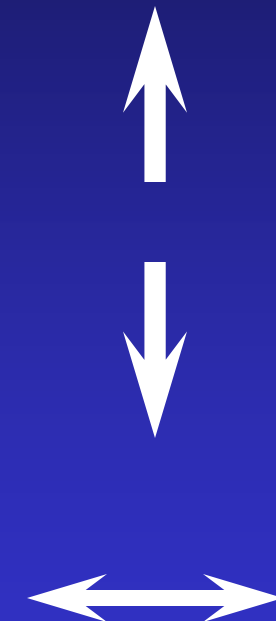
(22 out of 32 years)

Market is down 26%

(8 out of 32 years)

Market is Even 5%

(2 out of 32 years)



\* As measured by the S&P 500



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Ahhh, retirement



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# Will You Outlive Your Pile?





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# Are *your* current actions leading you toward *your* goals?

- Are you maximizing your contributions to your retirement plan?
- Are you living below your means?
- Are you living like the *Millionaire Next Door*? (Read this book by Thomas J Stanley Ph.D. & William D Danko, Ph.D.)



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# Retirement Realities

- Longer Life Expectancies
- More Ambitious Goals
- Changing Jobs More Frequently
- Retirement Funding Burden - Moving from Employer to Employer
- Who of Us Saves Enough?



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# Three Step Plan

- 1.... Estimate How Much You Need to Save
- 2.... Identify a Savings Goal for Retirement
- 3.... Develop Your Investment Strategy



# This is all you need to know!

- How many years before your invested money is needed?
- How much do you want to live on in retirement?
- How long do you expect to live?
- Add up financial assets and project the required future size of your “pile” (using an HP12C calculator) assuming a reasonable rate of return on your invested “pile.”
- **Multiply your future pile by 4% to 5%**



## Assumptions for John and Mary Doe

- \$100,000 current life style need
- 3% inflation
- \$200,000 future lifestyle
- Start: age 35
- Finish: age 60
- Live until age 94
- Save \$46,000 annually (profit sharing \$40K + IRA's \$6k)
- At a 10% return
- Future "Pile" required to build = \$3,500,000



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# Savings Plan Projection

John and Mary Doe

Year	Age	Annual Contribution	Cumulative Contribution	10% Annual	Cumulative Year End
2	36	\$46,000	\$92,000	\$9,660	\$106,260
4	38	46,000	184,000	21,349	234,835
6	40	46,000	276,000	35,492	390,410
8	42	46,000	368,000	52,605	578,656
10	44	46,000	460,000	73,312	806,434
12	46	46,000	552,000	98,368	1,082,045
14	48	46,000	644,000	128,685	1,415,534
16	50	46,000	736,000	165,369	1,819,056
18	52	46,000	828,000	209,756	2,307,318
20	54	46,000	920,000	263,465	2,898,115
22	56	46,000	1,012,000	328,453	3,612,979
24	58	46,000	1,104,000	407,088	4,477,965
25	59	46,000	1,150,000	452,396	4,976,361



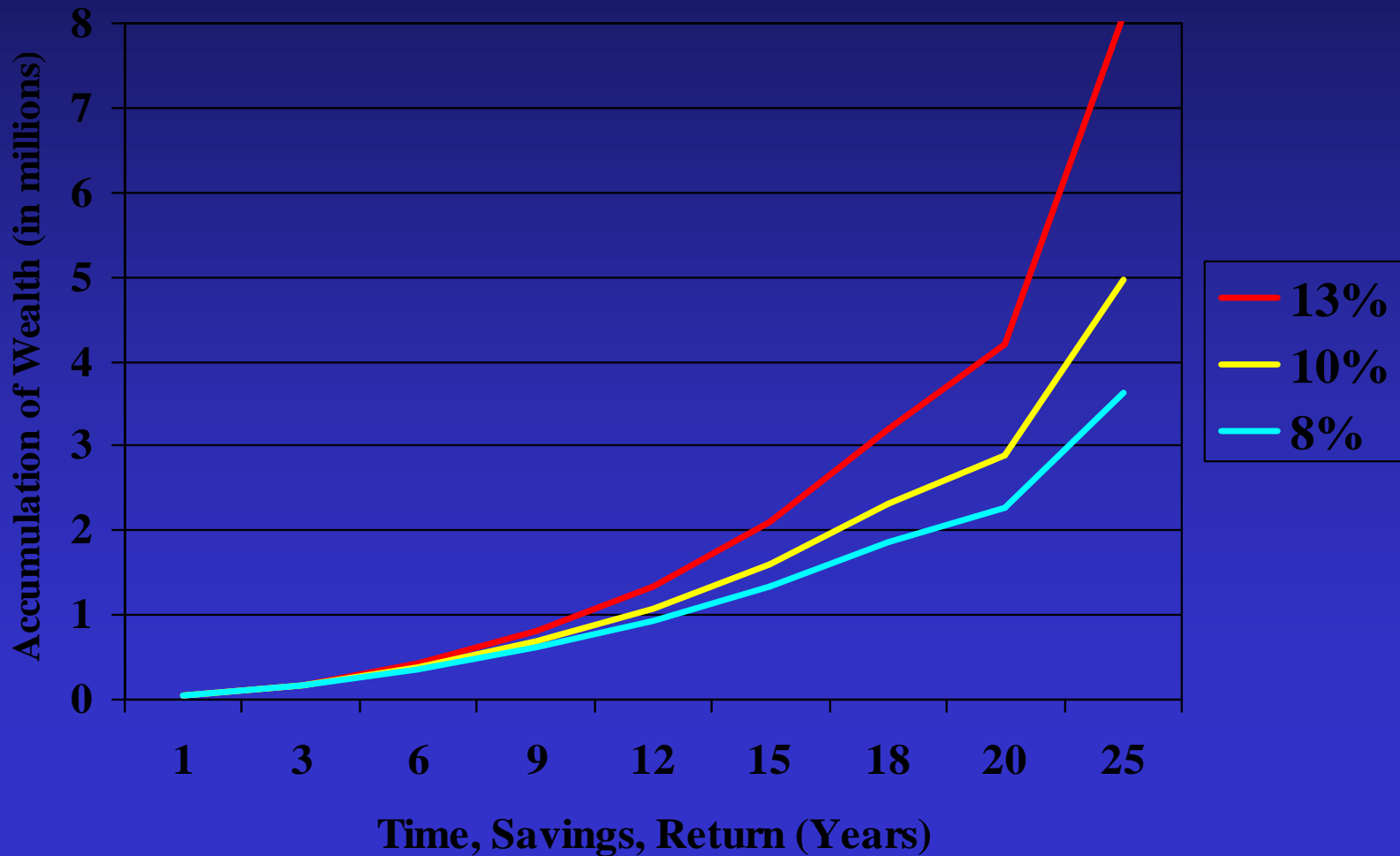
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## Wealth Accumulation at

## \$46,000/year at different growth rates

Notice what little difference the rate of return makes in the 1<sup>st</sup>  
6-8 years of "saving" ?





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# Illustrations of Wealth Accumulation

Annual Investment: \$46,000

Time/Years	8%	10%	13%
1	\$49,680	\$50,600	\$51,980
3	161,281	167,486	177,091
6	364,449	390,410	432,614
9	620,382	687,122	801,308
12	942,784	1,082,045	1,333,296
15	1,348,917	1,607,688	2,100,900
18	1,860,528	2,307,318	3,208,473
20	2,273,454	2,898,115	4,207,616
25	3,631,903	4,976,361	8,089,105



## **But Why should I limit my “spending from the pile” to 5% - 6%?**

- If the stock market has returned 10-12% over time, why can't I withdraw that much?
- Does limiting withdrawals to 5% - 6% mean I never have to worry about running out of money?
- You mean I can stop worrying about my investments and focus on living my life?



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**Most people share a common retirement goal: maintain their standard of living and sleep well, free from worry about their future financial security.**

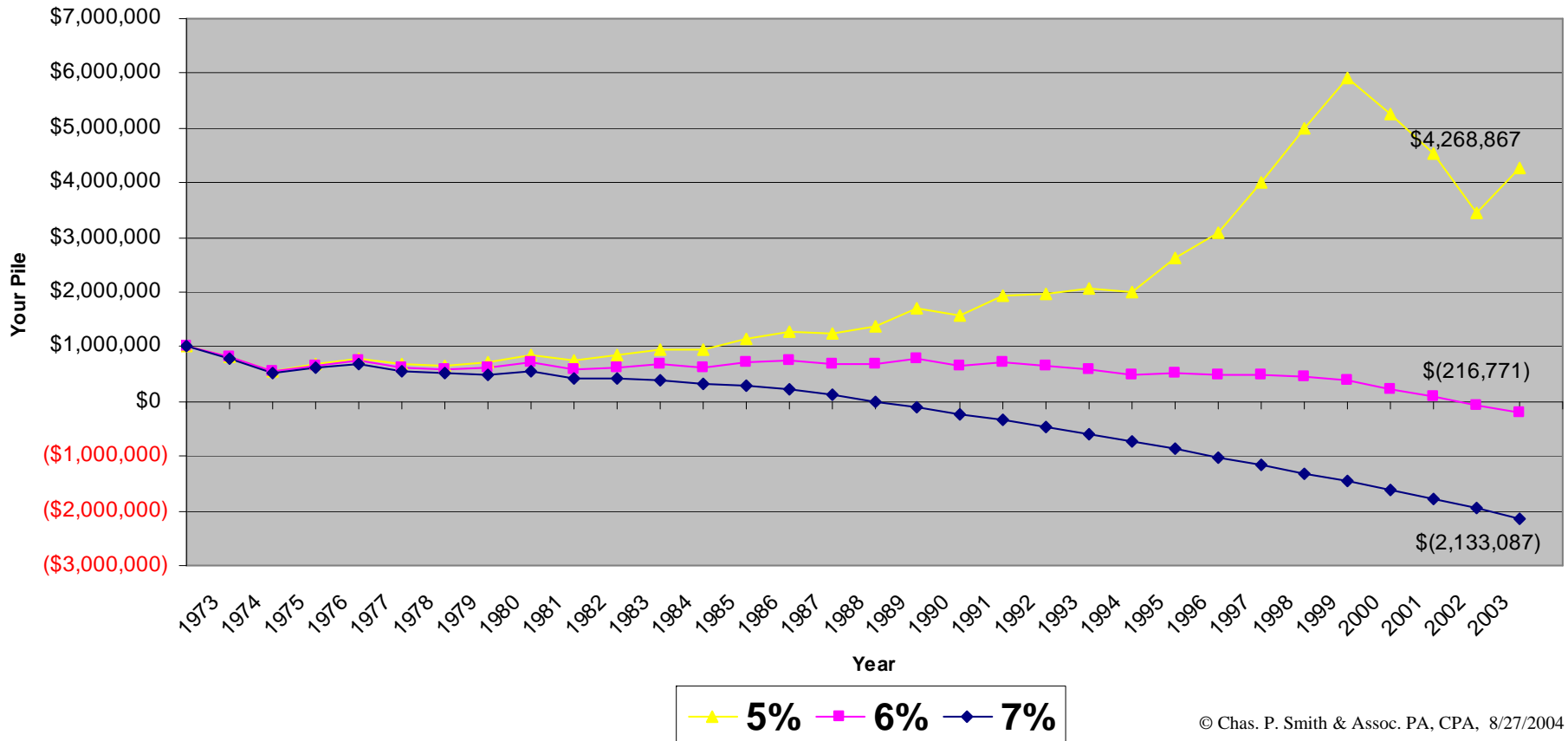
**Adopt a plan that will enable annual withdrawals to keep up with inflation, but minimize the risk of running out of money.**

### **Tested Rules for Financial Success:**

- Design a payout percentage that's realistic for the long term, such as – 4% minimum and 6% maximum per year.
- Never make up for prior years' spending shortfalls
- Consider reducing your payout (if possible) during severe lean markets.
- Adjust payouts annually for inflation, but never more than 6% higher than the previous year.



## How Big Does Your Pile Need To Be? Withdrawal Rates - 5%, 6%, and 7% 100% Equities - S&P 500 1973-2003





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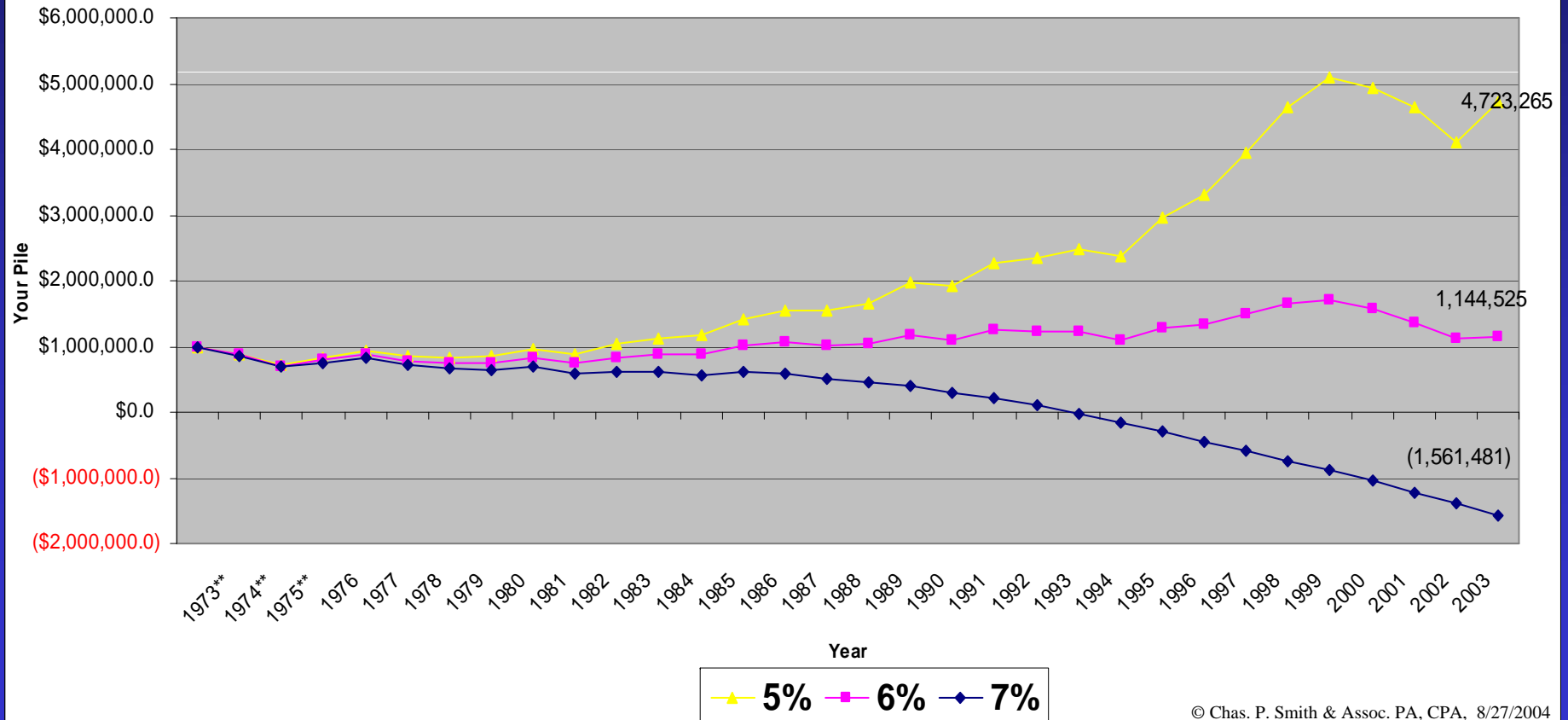
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## How Big Does Your Pile Need To Be?

Withdrawal Rates - 5%, 6%, and 7%

60% Equities / 40% Fixed Income

S&P 500 1973-2003; US Intermediate 1973-1975, LB Bond Agg 1976-2003





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# How to make your Money last a lifetime

- Invest a portion in equities
- Keep 1-2 years of household expenses in cash
- Adopt a Withdrawal Plan (spending limit) that works for all seasons
- Be willing to spend less in a prolonged down market
- Never, ever sell at the bottom
- **Don't spend more than 5-6% each year**



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- Fee for service financial consultants specializing in long-term wealth accumulation planning
- Guide people to :
  - gain financial independence
  - properly diversify their portfolio
  - maximize portfolio efficiency
  - avoid taxes on income, death, and inflation



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# Summary

- Have a plan
- Pay yourself first
- Protect yourself from inflation
- Diversify
- Quantify your personal risk/reward ratio
- Let compounding work for you
- Travel Your Plan