financial focus

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'TIS A GIFT TO BE SIMPLE

by Claire Emory, CFP®, CFA, MBA   Arlington, VA

After 25 years of studying and working in finance-related fields, I've concluded that one of the greatest challenges in finance, as in many other areas of life, is to discover what we truly value. We get in trouble by complicating things and then overreacting at the scope of the resulting implosion.

Years ago, a former colleague with a modest income invested the bulk of his savings in a byzantine assortment of Tanzanian gold futures. When those investments subsequently tanked, he retreated to keeping any extra money he had in a checking account, afraid to make a move. Sometimes we get burned by being tempted into complexity we don't fully understand. Or the array of investing choices and their complexity can seem so paralyzing, we succumb to inaction.

A Morningstar study found that a lower expense ratio was the single factor most closely correlated with higher investment returns, more closely correlated than any sort of analytical filter. For people trying to build wealth for themselves and their families, it's clearly not worth devoting countless hours trying to figuring out who the standout market-beating active fund manager is going to be this year or next. Statistics show that over the course of a longer period of time, it's highly unlikely that any one manager will continue to beat the market return. Neither is it worthwhile to load up on a random collection of different actively managed funds. Chances are, there's considerable overlap among those funds, and you're adding complexity to your portfolio without increasing diversity.

As Jason Zweig recommended recently in the *Wall Street Journal*, "Above all, whenever there is a choice between simple and cheap on the one hand, and expensive and complex on the other, favor the former." It's important not to confuse *simple* with *simplistic*. The simple decision to invest in five or six low-cost mutual funds is backed by reams of data and loads of abstruse statistics. It's only possible to be simple (rather than simplistic) once the complexity has been understood and managed. As Pablo Picasso observed, "It took me four years to paint like Raphael but a lifetime to paint like a child." The more regression analyses I look at, the more I understand that saying.

Insurance is another area where simplicity can lead to lower costs and greater efficiency. In most cases, it makes sense to use life insurance in its pure term form to protect income as needed, for those who depend on it, and keep investments in their most efficient separate form. There's no advantage in mingling the two. With annuities, more bundling is also not necessarily to your advantage. For example, a combination of an S&P 500 index fund and laddered Treasury bonds can produce essentially the same risk-to-reward tradeoff as an equity-indexed fund, in a far less complicated, lower cost way. Don't become so paranoid that you're afraid to trust anything, but also don't discount the possibility that a product is being made complicated precisely so you can't easily figure out what it is, what purpose it serves, and why it's worth having (and worth the high commission that's probably being charged).

Evidence suggests that people who feel more in control of their lives are more likely to report feeling happy and more likely to be successful in their endeavors. Juggling a dozen credit cards and a bunch of stuff you have

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BIWEEKLY MORTGAGE PAYMENTS: SMART STRATEGY OR A SCAM?

by Bert Whitehead, MBA, JD Franklin, MI

Most homeowners receive offers to convert their monthly mortgages to biweekly payments. The advantage touted for this strategy is that the homeowner would save a heap of interest and reduce the time required to pay off the mortgage. Clients often ask us whether this is a good idea.

No, it is not. It is a scam.

The math does work: making half your monthly mortgage payment every two weeks does pay off your mortgage much faster and saves a substantial amount of interest. It may also be convenient because most people are paid biweekly.

But with biweekly payments, you actually end up paying an additional month's mortgage payment each year (26 payments divided by 2 = 13 months). And the biweekly mortgage's so-called advantage doesn't take into account what could have been earned if the extra payment had been invested. This is more than the mortgage interest saved.

Proponents of this dubious strategy compare biweekly mortgage payments against monthly mortgage payments. But the correct comparison is between the interest you could save with biweekly payments and the interest you could earn if you invest the extra month's payment every year.

Suppose a homeowner in a 33% federal tax bracket took out a 30-year, 4% fixed-rate mortgage five years ago. The homeowner is offered the chance to switch to biweekly payments, which would require a $500 set-up fee plus half a month's mortgage payment to start. (The interest rate remains the same.)

Instead of a payment of $763.86 monthly, the homeowner would pay $381.93 biweekly. This would enable the homeowner to pay off the mortgage in 21 years (instead of 25), saving $42,572 in interest expense. This is the pitch for biweekly payments.

To analyze this problem correctly, however, there are five factors to consider:

1. Normally (not always) the mortgage company charges a fee of about $500 to set up biweekly payments. This is ridiculous because most mortgages permit prepayments with no additional fee or penalty. If you were to invest this $500 fee at 6% for the 21-year mortgage period, it would grow to about $815.

2. The terms of the biweekly arrangement require the payments to be made at the beginning of the period, whereas typical mortgages are paid at month-end. This is like making an extra payment of principal on the mortgage balance. Instead, that extra payment could be invested. If the homeowner invested only one payment at 6% for 21 years, it would earn about $480 in interest.

3. Because paying half the monthly payment every two weeks is comparable to paying 13 monthly payments a year, the biweekly plan pays an extra $764 each year. If that were used instead to pay off the mortgage, it would grow to $30,548.

4. Because home mortgage interest is deductible, using biweekly payments to reduce that deductible interest by $42,572 over 21 years would increase federal income taxes by $12,024. Paying monthly preserves the tax savings. In addition, the taxes saved would earn $7,575 over the same 21 years.

5. In total, the regular monthly plan's $51,442 in tax savings and additional investment earnings is sufficient to pay off the balance of the original 30-year mortgage in full in 21 years and still have $18,262 in cash remaining.

For some, there are even more reasons to stick with monthly payments. If you could invest the amount of the extra mortgage payments in an IRA or other pension fund each year, you would be able to defer an additional $17,981 in income taxes. Also, mortgage providers generally charge a lower rate for shorter mortgages. So if you prefer to pay off your home in 25 years instead of 30, it would be wiser to arrange that at the outset, when applying for the mortgage, and take advantage of the lower rate.

Even if there was no option to pay a mortgage biweekly, I advise clients to keep a longer mortgage on their home because it is the best hedge against inflation. If inflation increases in the next 5 or 10 years back to 5% (or 10% as it did during the 1970s and 1980s), mortgage rates will soar to 9 to 14%. Interest rates on deposits will rise, too. You might be pleased to owe the bank a couple hundred thousand dollars at a 4% fixed rate when your money market account is paying 6% or more!

For their assistance with this article, special thanks to ACA colleague Chip Simon from Poughkeepsie, NY, technical consultant Al Hoefer, and copy editor Shari Cohen.

PUT YOUR GRATITUDE INTO ACTION

by Kathleen M. Rehl, Ph.D., CFP® Land O'Lakes, FL

When good things happen to us, we feel grateful. For example, we are thankful for our family, a comfortable home, caring friends, meaningful employment, good health, life in a free country, a pretty sunset, and much more. When we stop to count all our blessings, we would likely say we've received lots to be thankful for.

I believe feeling thankful is a crucial first step. But the next step is to be *actively* grateful rather than just *passively* grateful. For me, that means doing something to show my gratitude. So I give to others, just as I have received. My giving is an active response to all the good I have already received and will be given in the future.

Active gratitude might be writing a note of thanks to my neighbor who invited me for a cup of tea, or spending time with an ill friend. Opening my purse for worthy nonprofits is another way I can say "thank you" for the good in my life. It's simply healthy for me to give. Indeed, giving isn't mainly about the receiver who benefits from my gift. It's more about me as the giver. I give because expressing gratitude makes me feel good.

Charitable giving allows me to express gratitude in a very tangible way. I know these gifts make a difference in the lives of others. My late husband and I established the Rehl Family Scholarship Fund many years ago, following the tragic death of our daughter. Giving in this way helped our healing process. I've received heartwarming letters from our scholarship recipients. It really makes me feel good knowing I'm helping a student. Yes, I get a great emotional return on this financial philanthropic investment.

After my husband died, I added memorial gift money to our fund. When I pass on, another gift will be made from my estate to enable even more scholarships in the future.

You may also want to express gratitude by making charitable gifts both now and in your estate plan to organizations special to you. These may include religious groups, educational institutions, children's causes, health research, cultural arts associations, care and support groups, world hunger relief, homeless shelters, senior services, humanitarian causes, animal-related organizations, or others. Giving your volunteer time and talents is also a good way to express gratitude.

"Give thanks for a little and you will find a lot."
—Hausa proverb from Nigeria

This piece is adapted from Kathleen's book, *Moving Forward on Your Own: A Financial Guidebook for Widows*.

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to struggle to contend with isn't likely to help you feel in control of your life. What do you *really* need? What do you *really* want? Maybe it's the peace of mind of knowing you're saving enough for retirement, rather than the sexy midlife crisis Corvette (assuming of course that you can't afford to have both!). Use one or two credit cards, paid off every month, to manage cash flow, and accumulate points or miles if that's a goal. Sometimes inertia leads to unnecessary complexity. Bank accounts can start accumulating and multiplying long after they've served their purpose. If you have multiple accounts, ask yourself why, keeping in mind that basic per bank FDIC coverage is currently $250,000 or more.

Simplifying record keeping can also yield benefits. Using the HOMEFILE system, for example, can help weed out items such as unnecessary monthly bank account statements going back to the Reagan administration and guide you on what does need to be kept and where best to keep it. As for those stacks of those ancient statements, feel free to shred them. Many jurisdictions offer periodic free shredding sessions, typically limited to two bags or boxes per resident. Preparing your taxes is much easier if you have an orderly system for collecting receipts and storing monthly bills, either in paper form or online.

One of my goals for 2013 is to simplify my life both at home and at work, freeing myself to focus on what really matters to me the most. I hope you, too, will find a way to simplify your life, take control of your finances, and find yourself, as the Shakers so aptly put it, in the place "just right."

Page 1 "Image courtesy of Sheelamohan / FreeDigitalPhotos.net"

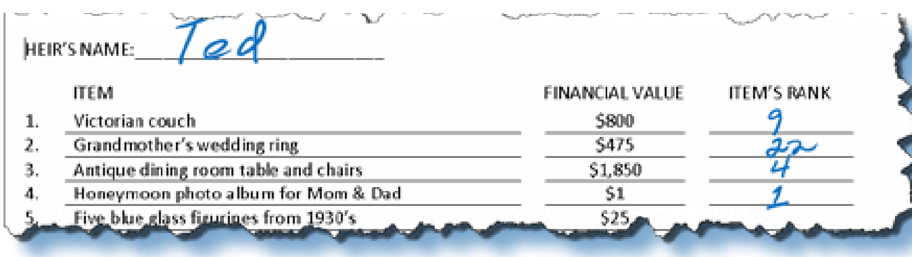
HOW TO DIVIDE PERSONAL PROPERTY FAIRLY AMONG FAMILY WHEN A LOVED ONE PASSES

by Howard Cadwell, CFP®, AIF ®   Hampton, NH

In estate planning meetings, I always ask clients if they know a family that has experienced conflict over *who gets what* when a parent dies, even if it's just personal property. In every case, they know such a family. Sometimes it's already happened to them or they're worried it will.

Dividing up personal property from an estate can cause family friction way out of proportion to the dollars involved. Without an organized plan for distribution that seems fair, much can go wrong:

- Children may ask for bequests, or gifts before death, to pick up favored items. This can cause distrust among siblings because the transaction may recall competition they experienced as kids for gifts and attention.
- The process of property distribution can put the executor in a difficult position with other family members if he or she acts as the tie breaker.
- If there are a series of negotiated side agreements among the siblings on specific items, there may be concerns that the sum total of the transactions was unfair.
- Heirs who are politely generous or hesitant when other heirs want the same item may quietly harbor regrets and resentments.



HEIR'S NAME: Ted

	ITEM	FINANCIAL VALUE	ITEM'S RANK
1.	Victorian couch	$800	9
2.	Grandmother's wedding ring	$475	22
3.	Antique dining room table and chairs	$1,850	4
4.	Honeymoon photo album for Mom & Dad	$1	1
5.	Five blue glass figurines from 1930's	$25	

Here is one method that *will* work. It's not complicated, although it works best if agreed on while parents are still alive. Even if everyone doesn't get everything they each want, they will have to agree the process is *fair*.

1. Make a list of the items with enough value to become a line item on an estate appraisal or with significant sentimental value (photo albums, etc.). All heirs review the list and can add any items they wish. Get the appraisal done, and put the value next to the item.

2. Give each family member the list, and ask them to *rank-order* their preferred items. If there are 57 items, they start with number 1 and go down to number 57, a unique ranking for each item. (They can leave unwanted items without a ranking.) The ranking should accurately reflect how much they want each item based on whatever criteria they choose.

3. Whoever ranks an item higher, gets it. Ties can go to a flip of a coin or other fair method. If someone else really wanted the same item, but put it further down their list, well, they just didn't want it quite as badly and got other, more desired things instead.

4. Total the value of items distributed to each family member. Some heirs may have received a larger or smaller share of the financial value of the listed items. If there is an equal-shares bequest in the will, or just a family concern with financial equity, they can settle up to equal shares by offsets on other property received in the estate (e.g., cash, investments, or proceeds of the sale of other property). Be sure the terms of the will are consistent with this plan.

You may create a variation on this approach that will work better for your own family. However, here are the key elements that make the approach fair:

- The executor agrees on this plan with the aging parents in advance. If possible the whole family is brought into the plan, so independent discussions with Mom or Dad or gifting of individual items prior to death are discouraged. Also, parents may assume they know what their children really want, and they're often wrong. *It is usually best to avoid most or all specific bequests in the will.*
- The family members are *all* negotiating together for *all* the items, simultaneously, averting the distrust that could come from perceived side negotiations or decisions by the executor.
- Each family member is applying the values that matter to them individually—monetary, sentimental, or aesthetic—in ranking their list. However they assign value, the comparative rank-ordering fairly shows who wanted each item the *most.*
- Each family member is not pressured into being either too assertive or too diffident with other family members who have a competing interest in the same item because the negotiation is with a piece of paper, not with other individuals. Everyone puts down their *real* wants when they rank-order the list.

Putting this approach into place requires a little foresight by the parents or by the person nominated to be executor. The hardest part may be initiating the conversation. This method could also be used when an elderly parent is downsizing or moving to an elder care facility.