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**Fee-Only Financial Advisors**

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# Financial focus

*Summer Issue - 2015*

## Life Gets in the Way!

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As a fee-only financial advisor I get the opportunity to spend time really getting to know my clients, and I am very fortunate to have a great group of folks to work with. I am always amazed at what my clients can teach me through their life experiences.

Recently I met with a client who used to perform consulting work for the military. As we were discussing the importance of holistic financial planning she related it to this military mantra:

### "No Battle Plan Survives First Contact with the Enemy."

Wow, what a wonderful nugget of wisdom! This is not only true for the military's work, but it's also true for our financial planning experiences. In my opinion, the only difference is the word "enemy". While some folks would say the word "enemy" makes sense in this context (maybe their enemy is overspending), I feel the word "life" is appropriate to replace enemy.

Life is constantly on the move. We seem to be busier than our parents were. Life is pitching fastballs to us that we sometimes just can't hit.

So, what does all of this have to do with financial planning?

Financial planning is a process, not an event. Financial planning is constantly in flux and ever-changing. Always tweaking and making adjustments, we must keep our eye on the big picture and strive to stay objective. Adjusting and adapting to change is healthy. Again, as a fee-only advisor, objectivity is the cornerstone of my practice. This is one reason I feel almost everyone should work with an advisor, at least at some point. This is also why my wife and I have our own fee-only financial advisor. We want an unbiased opinion.

While creating a financial plan is a great first step, it's not the only step. We must implement the plan, monitor the plan, and then adjust the plan.

The military does a great job of planning for contingencies, but the enemy is also trying to step on those plans. When the military is faced with an unexpected situation it goes back to the drawing board and makes adjustments. The battle plan is always changing.

We, too, must adjust our financial plans. Whether it's an unexpected inheritance or a long term illness, we can be assured that we will all be faced with some sort of financial curve ball. If we simply give up, or try to move ahead with a plan that doesn't fit the situation, we may be in for a difficult financial ride.

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## In This Issue



## IRS Tips for Deducting Losses from a Disaster

1. Casualty loss. Damage done to your property due to a sudden, unexpected, or unusual event such as a natural disaster, fire, accident, theft, or vandalism may be deductible. You may not deduct losses from normal wear and tear or progressive deterioration.

2. When to deduct. As a general rule, you must deduct a casualty loss in the year it occurred. However, if you have a loss from a federally declared disaster area, you may have a choice of when to deduct the loss. If your property was insured, you must file a timely claim to deduct the loss.

3. $100 rule. The first $100 of each casualty loss cannot be deducted. In addition, the 10% rule reduces the deductible total of all losses by 10% of your adjusted gross income in that tax year.

Adapted from IRS Special Edition Tax Tip 2015-08

# Can Money Buy Happiness?

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Can money buy happiness? That has been the question ever since humans first devised money as a tool to facilitate transactions and measure wealth. In Happy Money: The Science of Happier Spending (Simon & Schuster, 2013, 197 pgs.), authors Elizabeth Dunn and Michael Norton approach this question from the perspective of behavioral researchers: Ms. Dunn is a professor of psychology at the University of British Columbia and Mr. Norton teaches marketing at Harvard Business School.

Their research has led them to five key principles that they believe enhance the happiness derived from spending money:
• Buy Experiences
• Make It a Treat
• Buy Time
• Pay Now, Consume Later
• Invest in Others

These principles seem to hold true around the world, at different levels of income: there's no denying that people in richer countries are generally happier than those in poorer countries, but shifting the focus on how you spend can maximize the level of happiness. For those of us fortunate enough to live in a wealthy country, increased happiness from our spending patterns might come with a bonus of enhanced gratitude for our good fortune.

## Buy Experiences
The pleasure burst from buying a luxury car fades quickly as ownership becomes routine. In contrast, novel experiences can be genuinely transformative. Those experiences can provide memories to return to again and again, proving more durable than material goods.

## Make It a Treat
Thanks to the power of adaptation, what we're regularly exposed to tends to be taken for granted. Choosing to restrict access to something desirable turns it into a treat and enhances the pleasure. Have a latte once a week instead of every day; pretend to be a tourist in your home town and see if there isn't a spark from seeing with fresh eyes.

## Buy Time
Time, like money, is a limited resource: money can be used effectively to create happier time, which generally means more time socializing with family and friends, and less time spent commuting, doing chores, and watching television.

## Pay Now, Consume Later
Yes, it's all about anticipation. Pleasure is enhanced by time spent looking forward to something perceived as positive, and this is particularly true when the something being looked forward to is an experience such as a vacation (see principle #1). A corollary is that consuming now and paying later (e.g., through the downward spiral of credit card debt) reduces happiness.

## Invest in Others
Higher spending on, or on behalf of, other people is strongly correlated to a higher level of happiness throughout the world. The more we feel a connection to the subject of the spending, the more control we feel we have, and the more we believe our giving has an impact, the greater the increased happiness.

So, if happiness is one of your goals, keep these guidelines in mind when figuring out how to get the most bang for your buck. Or, if you find yourself with a sudden windfall, or even just a few extra dollars after you've paid the essentials, these five principles can help you increase your happiness by the way you choose to spend those bucks.

# Life Gets in the Way! continued

The key is to not give up and learn to deal with the ebb and flow of our personal finances. Don't quit! Go back to the drawing board and adjust the plan. This is one of the aspects of my practice that I really enjoy. I don't operate from a boiler-plate template. This approach keeps me on my toes, and I love it.

We can all take a lesson from the military's playbook and remember that whatever plan you have in place at this point will probably change in the near future. If we realize no plan is perfect and are willing to reevaluate, we will give ourselves the best chance for financial success by realizing it is a process – a long term process.

# Benefits of a Deep Freeze

Anthony Kure
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As we enjoy the warm temperatures, late sunsets, and lazy days of summer, the bitterly cold winter of 2014-15 seems just a bad dream. Despite these balmy days, I'd like to introduce you to another "deep freeze" you might find very beneficial. First, a little background information: We all hear news stories of data breaches and identity theft. If they seem more common of late, you'd be correct. The Identity Theft Resource Center estimates 86 million records were compromised in 2014 – an all-time high.

Opportunists and identity theft protection marketers must love the de facto free advertising they get with each of these stories splashed across the headlines. It seems we're inundated with these ads on the radio all-day every day. (Quick aside: As a rule of thumb, most financial products and services advertised on the radio are usually not in your best interest; they are sold not bought. I suspect identity theft protection services may fall into the former category.)

As good as those services might claim to be, I think there's a better approach to protecting your credit that is usually more cost effective, but does require some legwork. This is the "deep freeze" I'm advocating to protect your identity and it's called a "credit freeze". A credit freeze is a proactive locking down of your credit profile which prevents the opening of any new credit lines. To me, a proactive freeze seems more effective than the reactive notification to you of a credit breach, which is what most of the identity theft protection services provide.

In essence, the credit freeze works like this: You go out to each of the three main credit bureaus' websites and implement the freeze, which effectively prevents anyone from opening up new credit with your name, whether it's you (legitimately) or some identity thief (illegitimately). In my home state of Ohio it costs $5 per site to essentially lock down your credit and be issued a PIN number that you must never lose, nor disclose to anyone other than your spouse, assuming the trust factor there.

Then, when you want to open up a new credit card, mortgage, car loan, etc. you must first go online to each of these credit bureau sites and thaw your credit – again each for a $5 fee (in Ohio). This thaw allows a window of time for new credit applications to be processed before you freeze it again. It may seem like a pain, but for most people I work with, opening credit lines is maybe a once a year task (if that), as we always try to minimize consumer debt (auto loans, credit cards). Plus - how often do you apply for a mortgage or line of credit? Maybe five times over 20 years?

In addition to the hassle of the thaw and re-freeze there are, of course, cost considerations. So to implement the freeze initially, it's $15 total ($5 each for the three credit bureaus). To thaw let's say once a year, it's another $15 and then to re-freeze, it's another $15. So in total, we're looking at $45 in fees the first year and then $30 per year thereafter, assuming one thaw / refreeze per year. Compared to some of the identity protection services that cost $15 to $20 per month, you can easily see why the freeze is more cost effective. That said, these identity protection services offer several ancillary services which may or may not be of value to you. These services include change of address notification, $1 million of ID theft insurance, public record report, and other things listed on their websites.

So if you're really hell-bent on protecting things outside your credit, you may be interested in paying the $240 per year vs. the $30 per year (estimated) for the credit freeze - that's up to you.

Obviously, I won't make any guarantees about this or any other service when it comes to identity theft, but it seems to me that a proactive credit freeze, which does take more work, would be the preferred method to reduce chances of fraudulent credit applications, the thing I am most concerned about. Of course it won't stop fraudulent tax return filing or other nefarious acts, but at least the most common identity theft would be stopped in its tracks with a freeze. Coincidentally, I have never heard it advertised on the radio.

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# How Much House?

A home is the single biggest investment most people ever make. While there are solid emotional reasons for owning a home, there are also strong financial reasons. First, a house is your best protection against inflation. Inflation raises the value of your home, but with a fixed-rate mortgage your payments remain the same. Second, a house offers significant tax advantages because you deduct property taxes and mortgage interest from your taxable income. Finally, when a couple sells their house the first $500,000 of profit is tax-free ($250,000 for single tax payers).

To take full advantage of home ownership, it is critical that you buy the right size house. Buy too much house and the mortgage payments will crush you. Buy too little and you neglect a valuable investment opportunity.

### HOW MUCH HOME SHOULD YOU BUY?

Buy a home that costs 2–2½ times your annual income. If you make $80,000 a year, you should look at houses between $160,000 and $200,000. Don't let realtors talk you into buying too much house. These salespeople won't be around two years later when you can't make your mortgage payment.

Here are some general points about buying and improving a house. First, don't buy the best house on the block; buy a modest house and improve it to neighborhood standards. Second, watch your cash flow after you buy. According to Harvard's Joint Center for Housing Studies, the average new home buyer spends $9,000 in the first year for furnishings and home improvements (and it is easy to go over that). Also, don't forget increased maintenance costs. Even if your mortgage payment is comparable to the rent you used to pay, you will annually spend an additional 1½–2% of your home's value on maintenance you did not pay when renting. So if you buy a $200,000 home, you will spend $3,000 - $4,000 a year on ordinary home maintenance. Finally, be careful about renovations. While improving a modest home to neighborhood standards is a good investment, you won't recover the cost of putting a high-tech kitchen into a modest home. Recognize also that most renovations increase a home's value for only a few years. The $10,000 bathroom restyling you did ten years ago will not increase your home's value today.

### HOW MUCH SHOULD YOU PUT DOWN?

Your down payment should be 20% of the purchase price. If you buy a $160,000 home, you should put $32,000 down (giving you $32,000 equity [ownership] and a $128,000 mortgage). If you put down less, the bank will require that you buy private mortgage insurance (insurance you pay for to protect the bank's investment), plus you will not get the best mortgage rate.

### WHEN SHOULD YOU REMORTGAGE?

There are two times to think about refinancing. First, when interest rates fall and you can refinance at a lower rate with lower payments. Your ACP advisor can help you in this process.

The second time you should look to refinance is when you have too much equity (ownership) in your home. To have adequate inflation protection your mortgage should be 50%–80% of your home's value. If the mortgage on your $160,000 home is now $80,000, look to refinance at $128,000 again. (Remember you want to keep 20% equity.) Refinancing would allow you to pull $48,000 out of your home equity to use for long-term investing (not for a vacation!).

Pulling equity out of your house also increases your positive leverage. Positive leverage is when you borrow money to buy something that gains value over time. Say your $160,000 home appreciates at 4% annually (an historical average). That means its value increases $6,400 a year. If you have $80,000 equity in your home, then your investment return is 8% ($6,400 gain divided by $80,000 equity). If you refinanced pulling $48,000 out of your home and leaving yourself with $32,000 equity, your investment return is 20%, almost three times greater rate of return.

### WHEN SHOULD YOU BUY A BETTER HOME?

You originally bought a home that was 2–2½ times your annual income. When your income rises to where your home is worth 1–1¼ times your annual income, you should get a better home. In our example you earned $80,000 and bought a home for $160,000. If in ten years your income has jumped to $150,000, you should look for a new house costing between $300,000 and $375,000. It doesn't have to be a bigger house; it can be the same size but one better built in a better neighborhood with better schools.

## Five Fundamentals of Financial Fitness

**Thomas Jefferson in the Declaration of Independence refers to inalienable rights. I'm no scholar, but what I think he means by inalienable is that they are absolute. I see and use the Five Fundamentals of Financial Fitness as absolute financial truths.**

**It does not matter if you are single, a young couple, approaching retirement, or are in the conservation phase of your financial lifecycle. These five truths are ways to mark progress and to celebrate accomplishments, all while growing your net worth.**

1. **Pay Yourself First—Savings and Retirement**
2. **Have Sufficient Cash**
3. **Pay Off All Credit Cards and Consumer Debt**
4. **Own the Right-Sized Home**
5. **Invest in Your Career**

**ACP planners emphasize behaviors, not returns. We believe in comprehensive planning and that the market will take care of itself. Continuing our series of highlighting a Fundamental of Fiscal Fitness, in this issue Robert Reed tackles the fundamental of how important it is to buy the right size house.**

**-John Discepoli , CPA/PFS**