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## Time for a Holiday Checkup

By Kevin Adler, Editor, NAPFA

The holiday season can be a very busy time, as we enjoy special events and visits with family and friends. But it's also a time to reflect and take stock of our past year and what we want to accomplish in the years ahead.

This issue of *NAPFA Planning Perspectives* shares some ideas from NAPFA members about how a balanced approach to savings, investments, and money management can help us reach our goals. Rick Kahler, CFP®, ChFc, MSFP, begins with a perspective he has developed through his innovative work as a money counselor and financial advisor. He explains how money fitness contributes to “the best things in life.”

Next, Jonathan J. Robertson, CFP®, offers a process for defining and setting goals, which he observes are the first steps towards making those goals become a reality. For people who have retirement goals in mind, the next articles, by Walt Mozdzer, CFP®, and David L. Blain, CFA, will help them understand how to think about funding different “buckets” for retirement, and how those buckets contribute to retirement security.

In the final article in this issue, NAPFA member and newspaper columnist David John Marotta, AAMS, AIF, CFP®, uses an analogy of savings to fill a cistern. Marotta explains how combing through a tax return can help us understand where our money is going and how much we spend to maintain our lifestyle. With that knowledge, a plan for maintaining that lifestyle in retirement can be developed.

NAPFA wishes you a wonderful holiday season. Our members are always available to help you define and reach your personal goals.

## Jump-Start Your Retirement Plan Days Return in January

People in need of a quick check on their financial situations can take advantage of no-cost advice from the nation's leading financial advisors on two days in January. NAPFA and *Kiplinger's Personal Finance* magazine will conduct Jump-Start Your Retirement Plan Days on Thursday, January 12, and Tuesday, January 17. Both events will be held 9 a.m. to 6 p.m. Eastern Time.

“Jump-Start has been the most popular consumer education program that we have developed,” said Ellen Turf, NAPFA CEO. “Our members love to reach out to individuals and share their knowledge, and we have received wonderful feedback from many of the folks we've helped over the years.”

Please visit NAPFA's website, [www.napfa.org](http://www.napfa.org) and click Free Financial Advice (top right on home page).for more information.



## Best Things in Life

By Rick Kahler, CFP®, ChFc, MSFP, Kahler Financial Group (Rapid City, SD) [www.kahlerfinancial.com](http://www.kahlerfinancial.com)

**"The best things in life are free."  
"Money can't buy happiness."**

While both of these beliefs about money contain a great deal of truth, they certainly aren't the whole truth.

Often, I have clients do an exercise to uncover the things they value most in their lives. Typically, they list such things as family, friends, spirituality, health, and job satisfaction far ahead of wealth or possessions. Yet, in today's world, none of those all-important intangible values can be fully separated from money.

The holiday season is particularly a time when we reflect on what matters most to us, and it illustrates how our deepest desires are intimately connected with our financial situation and our relationship with wealth and money.



**Family and friends.** Certainly, spending time with people you care about doesn't require spending money directly. You can take your kids to the park or hang out in the back yard, or get together with friends for a walk or an evening at home. What these activities do require, though, is time: time that you don't have to spend working to pay your bills; time that isn't spoiled by worry about where the next rent payment is coming from and so on.

Sometimes, too, being committed to your family does require money. How many couples do you know who would like to have one spouse stay home to take care of young children? Yet how many of those families feel unable to do so because it's so hard to manage on one income?

**Spirituality.** For some people, spirituality may include



committing both time and money to an organized religion. For others, spirituality may mean making time and finding private space for an individual practice of prayer or meditation.

**Health.** You don't have to spend a lot of money in order to eat well and exercise. In fact, a healthful diet will probably save you money. Fitness doesn't require fancy equipment or even a gym membership, either. You can walk or do yoga at home.



However, money is an important factor in maintaining good health. You aren't taking care of your health if you can't afford to go to the dentist, or if you delay seeing the doctor about a possible problem because you have no health insurance. In addition, your health can certainly suffer if you live in constant anxiety and fear about money.

**Job satisfaction.** Much of the work I do is designed to help people discover what they really want in life, and then take the necessary action to achieve it. Creating a fulfilling career might require changing jobs, taking the risk of starting your own business, or going back to school. It's difficult to take any of those steps if you are just getting by from paycheck to paycheck and have no financial margin.



No, money in and of itself won't buy happiness. Poverty won't buy happiness, either.

Managing your money wisely can give you a foundation of security. Then you are much more capable of achieving your dreams and making time for the people and activities that matter to you. Then you are able to fully enjoy those "best things" in life that are free.

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# Planning

## The Power of Goal Setting

By Jonathan J. Robertson, CFP®

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**A** great starting point for achieving financial success is setting your goals. Where do you want to be in one year? Where do you want to be in five years? What do you want retirement to look like? What would your perfect day look like?

The end of the year is a great time to sit down, think about the answers to these questions, and put your thoughts down on paper or on your computer. It's appropriate to set personal goals, as well as financial goals, too. Maybe you will realize that 10 years from now you would rather be in a different job that pays less money, but is more emotionally rewarding. Your personal goals may very well affect your financial goals.

Some tips for effective goal setting::

1. *Make sure your goals are as specific as possible.* You will be better able to visualize a precisely written goal than a generality. Think about the difference between "I want to be in better financial shape" and "I want to be out of credit card debt in one year." The second goal is more powerful because it allows you to visualize achieving the goal.
2. *Set priorities for your goals.* Before you start working to achieve your goals, you will want to know which goals are the most important. The priorities will show you where you should focus your energy and your time.
3. *Set a reasonable timeframe for achieving your goals.* A time horizon will help keep you motivated and help you create an

action plan to achieve the goal. By keeping it realistic, you will not grow discouraged along the way.

4. *Break your goals into manageable steps.* You need to have the appropriate level of difficulty associated with a goal. If your goals are too easy or too hard, you are likely to lose motivation. It might take you five years to achieve a specific goal, so you will want to have intermediate goals to keep you on track.
5. *Don't forget to celebrate your successes.*

Goal setting serves many purposes. The first step to taking a trip is figuring out the destination. Also, you will put your brain to work, thus engaging the unconscious part of your brain in finding solutions. You may very well reach your next step without having to think too hard about it.

If you want to learn more about goal setting, one good source is a free website devoted to self-improvement and personal development: [www.topachievement.com/articles.html](http://www.topachievement.com/articles.html).



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## Buckets of Money Should Be Tax-Diversified

By Walt Mozdzer, CFP®, Syverson Strege and Company (Des Moines, IA) [www.onlyworkforyou.com](http://www.onlyworkforyou.com)

When it comes to retirement savings, financial pundits often speak of the three-legged stool. The first leg is Social Security, the second leg is retirement savings, and the final leg is your pension, if you're one of the fortunate ones.

For our purpose here, let's focus on the second leg of the three-legged stool, since it's the only one you can manage. Your personal savings for retirement can take three basic forms: employer-based retirement plans, Roth IRAs, and taxable investment accounts. Each comes with pros and cons:

1. Employer based-retirement plans include profit sharing plans, 401k plans, and others. Many people believe they should stuff all their retirement money inside their 401k bucket because it reduces their taxable income. However, that decision might increase their taxes down the road. The way that 401k investments work is that all the money you withdraw in the future is taxed at regular tax rates in effect at the time you make your withdrawal. If tax rates are higher when you need the money, your income will be subject to higher taxes. A retiree could be held hostage to federal income tax policy that will be enacted in a decade or two or three.

2. Eligible taxpayers should consider saving some of their retirement money in a Roth IRA or a Roth 401k. The major benefit is that these

withdrawals will be tax-free. The downside is that the investor does not receive an upfront tax deduction, but getting years of tax-free growth may be a better bet.

3. Finally, investors should own mutual funds, stocks, bonds, etc., outside of company or government retirement programs. Those personally owned assets, when sold to provide income, are taxed only on their appreciation and at capital gains tax rates. The top capital gains tax rate is now 15 percent, as compared to 35 percent for the highest regular income tax rate. These deposits are made with after-tax money, so no tax break is received on contributions.

Keep in mind that the rules keep changing. Finding the right balance between immediate income tax savings and lower tax rates in retirement is a tricky tightrope and may require some professional help. The point is that by filling three buckets of money to draw from in your golden years, a retiree will be better equipped to manage the tax burden in the future.

Don't be fooled into thinking that Uncle Sam isn't tracking the enormous pool of retirement funds just waiting to be taxed, given the immense debts the federal government is facing. Unfortunately, the timing of increased tax rates just might coincide with your planned retirement.

## The New Three-Legged Stool

By David L. Blain, CFA, D. L. Blain & Co., LLC (New Bern, NC) [www.dlblain.com](http://www.dlblain.com)

Without traditional pensions and with Social Security unlikely to keep up with most people's retirement needs, it's time to remake the three-legged stool for retirement income. The improved three-legged stool might consist of approximately equal parts of paper assets, income-producing real estate, and ownership in an operating business.

As with most things, this is not really a new concept. It was originally presented in the Talmud as having one-third of one's assets in business (buying and selling things), one-third kept liquid (gold coins), and one-third in land (real estate). As with this ancient formula, each leg of the new stool will produce income and will react differently to various economic environments. Thus, by being diversified within each leg, a retiree can enjoy a sustainable and increasing stream of income.



# Taxes

## Understanding Your IRS Form 1040

By David John Marotta, AAMS, AIF, CFP®,  
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Soon it will be time to calculate and file your 2011 return. It's a chore that nobody enjoys. But this effort can yield valuable information that can help you get on track for a comfortable retirement, and there's no reason to waste the opportunity.

I suggest that after you file your tax return (whether you prepared it or you had hired a professional), you ask what to change in the future to keep more of your earnings and forfeit less to Uncle Sam.

Many people believe a dollar saved on their taxes is not worth the same as a dollar of their salary or a dollar of gain in the stock market. They are correct. A dollar saved on your taxes is actually worth more. Think about it: a dollar saved is all yours, but a dollar of salary or capital gains still has to be taxed before you can spend your share.

Intelligent tax planning and analysis is a neglected component of comprehensive wealth management. Think of tax management like filling cisterns with water.

First ensure you are filling those that leak the least. Plugging some of the leaks will allow you to preserve your store of fresh water. And if you are going to be drinking from those cisterns in retirement, you must know that as much as possible of the water you are storing is truly yours.

You can use your completed tax return to estimate how much water you drink every year. In other words, how much do you need to maintain your standard of living? If your standard of living is low, you need less money to secure your retirement. But I've seen families whose lifestyles require \$200,000 a year that have only saved \$1.2 million by the time they retire. With that high a lifestyle, they will run out of money in the seventh year.

By knowing your annual standard of living, you can calculate how many cisterns you need to fill by any given age. Here's how to measure your standard of living using your tax return:

- ▶ **Method A.** Compute the income that is not reinvested. Add up all of your sources of income on Form 1040: line 7, Wages, salaries, tips, etc.; line 12, Business income; line 16a, Pensions and annuities; and line 20a, Social Security benefits. The sum is your total income.
- ▶ **Method B.** Start with line 22, Total income, and then subtract line 8a, Taxable interest, and line 9b, Ordinary dividends. Assume these are part of your investment portfolio and therefore are reinvested and not spent. Finally, a portion of your Social Security is not taxed as part of your total income. Therefore add back in your untaxed Social Security, the difference between lines 20a and 20b.

These two calculations should produce approximately the same number. If not, you have to judge if the difference is money you likely spent or put into savings. We are only trying to compute the income you likely spent.

Now that you have a number for income, subtract where your income went other than to support your lifestyle. There are four items to subtract to approximate your standard of living.

- ▶ Subtract line 60, Federal taxes. This is not part of your standard of living, and when doing retirement planning, all of your assets should be valued in after-tax dollars.
- ▶ Subtract Schedule A, line 5a, State taxes, for the same reason.

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# Taxes

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- ▶ Compute how much you added to your taxable savings over the year and subtract that number, too. In retirement you will not need to add more to your savings, so this is not part of your standard of living. If you have a brokerage account, this number often appears on your end-of-year statement as total net contributions to your portfolio account. You do not need to subtract traditional IRA and 401k contributions because the money was taken out before taxes and therefore did not appear as part of your total income on your tax return. You do have to subtract any contributions to your Roth IRA or 401k because these were counted as part of your taxable income.
- ▶ Subtract any unusually high amounts of charitable giving. If you are living off half your take-home pay and giving the other half to charity, your standard of living is only half of your income. In retirement you may still be as charitably inclined, but don't count it as part of your standard of living.

Your total income minus these four factors should approximate your standard of living. If you keep a budget, you can cross-check this number, bearing in mind that your budget might include taxes and charitable giving you need to subtract. Understanding the level of your standard of living is the single-most important cash flow number for retirement projections.

Your standard of living combined with a net worth statement helps you measure your progress toward retirement. First, compute

your after-tax net worth. Discount your pretax investment accounts by counting them at only 70 percent of their value. (Assume you will have to pay about 30 percent in state and federal taxes when you withdraw the money in retirement.) Add that to your taxable and Roth accounts to compute your after-tax net worth.

Take your after-tax net worth and divide it by your standard of living. The result shows you how many times your annual standard of living you have amassed in savings. If you are younger than 40, the number probably comes to less than five, which is adequate for now. By age 45, you should be worth about seven times your annual spending, and, presumably, you are still working and building your savings.

Studies have found that people who've retired at age 65 can only withdraw 4.36 percent of their portfolio to maintain their lifestyle. In other words, to keep the same standard of living, they need about 23 times what they have been spending annually to retire at age 65.

The key in your working years is to make progress toward that "magic" figure of 23 times your annual standard of living. The table below shows by what age you should have saved increasing multiples of your annual spending to be on track. If your net worth is higher, congratulations! You may be able to retire earlier than 65. Want to retire younger? Try lowering your standard of living. If you can live off 50 percent of your take-home pay, you don't have to save as much.

| Age | Annual Spending Saved | Age | Annual Spending Saved |
|-----|-----------------------|-----|-----------------------|
| 26  | 1                     | 53  | 11                    |
| 31  | 2                     | 54  | 12                    |
| 34  | 3                     | 55  | 13                    |
| 38  | 4                     | 57  | 14                    |
| 41  | 5                     | 58  | 15                    |
| 43  | 6                     | 59  | 16                    |
| 45  | 7                     | 60  | 17                    |
| 47  | 8                     | 61  | 18                    |
| 49  | 9                     | 62  | 19                    |
| 51  | 10                    | 63  | 20                    |