financial *focus*

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"MOM AND DAD, CAN WE TALK ABOUT MONEY?"

by J. Marc Vorchheimer, CFP®, Spring Valley, NY

We often hear about how to educate our children about money. But we rarely hear about the flip side: talking to our parents about money. Many adult children of aging parents neglect this important topic—sometimes with disastrous results, both financially and emotionally.

You may face some challenges. For one, Mom and Dad are often used to advising you and your siblings. They may be uncomfortable to find themselves on the other side of the table, especially with a sensitive subject like money.

Parents may also feel embarrassed. If they have not handled their money effectively, they may prefer to keep the state of their financial affairs private, particularly if they feel they will be criticized by their offspring.

Denial can be another factor. Your parents may know they need to talk about their finances while they are alive and discuss the impact on the family after they pass on. However, they may feel distressed about facing their own mortality and not want to deal with it.

The closeness of the parent-child relationship also makes a difference. If there is more than one child, parents may feel awkward discussing their money issues with one for fear of leaving the others out of the process. Or they may have a closer relationship with one child and not want to discuss the topic with the whole family present. They may believe they do a much better job of handling their finances than their child does and therefore be reluctant to discuss their personal money issues with that child.

Sometimes it's just impossible to get parents to open up. But certain strategies can increase your chances of success.

State clearly that you understand their possible discomfort and explain you want to help.

Communicate from the outset that you care about them and their ability to continue to live full, active lives without worrying about money.

Don't preach or condescend.

Explain that you are not telling them what to do because you are smarter and know better than they do. Rather, you are making helpful suggestions based on the research you have done about your own finances.

Offer to talk one on one or as a group.

If your parents are anxious about dealing with multiple children, offer them alternatives. One sibling could talk to Mom and Dad, or you could do so as a group. Or perhaps your parents prefer to speak to each child individually and thus choose the information they share. Of course, this option could create animosity as well as confusion if each sibling hears different things. But in most cases, it is still better than none of the children knowing anything about Mom and Dad's money. Again, helping your parents feel at ease about sharing financial information with you and your siblings, perhaps for the very first time in their lives, is essential.

Assure confidentiality.

Emphasize that you and your siblings will keep any information your parents share with you completely confidential. Parents should feel their privacy will be maintained just like it was before they discussed the information with you.

Seek professional advice.

Your parents may be more comfortable having an objective third party involved in the conversation. At a minimum, your fee-only advisor can give you suggestions for discussing your parents' financial issues both peaceably and successfully.

If you wait for a crisis, everyone involved will be far more stressed, and Mom and Dad are likely to make hasty decisions that they (and you) may later regret.

By broaching the topic of personal finance now, you will ultimately reduce their anxiety and help them make better and more thoughtful decisions. ■ ■ ■

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REASONS PEOPLE FAIL AT INVESTING

by Linda Leitz, CFP®, EA, Colorado Springs, CO

Most of us have heard stories about someone who "made a killing in the market" or about people who "lost their shirts." And there are those who neither win nor lose big but who just never have much success building a secure financial future. Here are a few reasons why.

Procrastination

There's always a reason why they shouldn't invest now. Maybe they feel like they have too much credit card debt or they want to get their kids through school first, or pay off the mortgage, or get a better job. There are always going to be other things that need attention in our financial lives. If we wait too long, though, our future will catch up with us and we won't have the money we want.

Others are waiting for a better investment market. People will say the market is down too much or that it is too high to invest. When you invest regularly, you'll invest at some high points and some low points. It's more important that you do invest than when you invest.

No Clearly Defined Goals

Sadly, many people spend more time planning their annual vacation than they do their retirement. Do you know how much you want (and need) to save, how much you want your savings to grow, and how much you ultimately want to accumulate? Have you had a professional reality-test these goals? Clearly defined goals and the time horizon for accomplishing them help you determine how much investment risk is appropriate.

Fear of Risk

You can't avoid risk by not investing. Virtually everything we do involves some type of risk. Equity investments (individual stocks and mutual funds) do carry the risk that the principal invested will lose value. But even burying money in your backyard has risks (other than the obvious mess involved). Inflation averages 3% to 4% over most 20-year periods. So if you buried $100 in your backyard, it might buy only $97 of goodies a year later. Over 10, 20, or 30 years, that can make a real difference.

Lack of Diversification

Investments have different risks and advantages, so all your money shouldn't be in just one investment. Adequate diversification actually reduces the overall risk in your investment portfolio. Just like we use a variety of modes of transportation when we travel, different investments help us meet different goals. If you're going to travel 1,000 miles, you're more likely to take a plane or car than you are to walk or ride a bicycle. Similarly, don't put all your money in the stock market, or all in an insured savings account.

Keep in mind that diversification does not necessarily come through lots of different mutual funds. You must look at what that fund invests in and compare the funds in your portfolio to determine whether you are truly diversified.

Lack of Attention to Investment Costs

Ignoring your investment expenses can cost you a bundle, especially when investing in mutual funds. There may be onetime fees and there are always ongoing fees. The most common onetime fee is the load or commission paid to the person who sold you the fund. These might be charged when you purchase the fund (front-end load) or when you sell the fund (back-end load). Ongoing expenses are reported as the fund's expense ratio and brokerage costs. Costs included in the expense ratio include management costs, administrative costs, and 12b-1 fees (the costs to distribute and advertise the fund—that's right, you pay for those commercials). Expense ratios can be as high as 2% to 3%, which can seriously undermine the return on your investment.

Taxes

Investments always have tax consequences. The income you receive from your investments (interest and dividends), making money and losing money on your investments, and the type of investment you hold in what type of account (tax advantaged or not tax advantaged) all have tax consequences. And when tax laws change, the tax consequences of your investments change. Smart planning can reduce the impact of taxes on your investment portfolio. Unfortunately, most investors either pay taxes unnecessarily because they don't plan at all or they let taxes disproportionately drive every investment decision they make.

Negative Outlook

Anyone who has accomplished a goal has experienced victory and defeat as part of the process. The real winners are the ones who build on the successes and learn from the disappointments. All successful investors have had some unsuccessful investments and even some frustrating years.

Don't let past mistakes or fear of future ones keep you from building a secure financial future. With the professional advice you need to invest intelligently, you can steer clear of common mistakes and be an investing success story. ■ ■ ■

IDEAS FOR RAISING MONEY-SMART KIDS:
ALLOWANCES AND TEACHING KIDS HOW TO WORK, SAVE, AND INVEST

by Elizabeth A. Barrett, MA, CFP®, Plantation, FL

What do our kids learn when we wear $30 shoes and they wear $140 shoes? They're certainly not learning to make thrifty choices. Kids today have more money to spend and develop financial styles younger than earlier generations did. Yet they are ignorant about money and money management. Parents often pay for extras that kids want in their lives, and then at age 18, without any prior training, we expect them miraculously to manage their own money.

Why an Allowance?

Allowances help children discipline themselves to save, set financial goals, learn how to make purchases with cash, and practice delaying gratification. An allowance makes children aware of the limit of available funds ("No, we can't have everything we want"). It also teaches them logic and math skills.

We all learn about money, at least in part, by making mistakes. Doesn't it make sense to let your children make some of their financial mistakes while the cost is minimal?

When to Start

Children as young as toddlers know the shiny stuff has power and buys things. They also know that if they beg long enough, they can usually get what they want. It's not too early for them to learn they can't get everything they crave.

Allowance Guidelines

- Try to avoid questioning purchasing decisions other than asking a few questions. We all learn best through mistakes, and it's better that those mistakes be made now.
- Determine how much money you are already giving your child. Remember to include what you buy for them that they might buy for themselves with a larger allowance. If you aren't giving your child an allowance, in essence you are managing their money for them.
- Make a list of what they are expected to buy with their allowance (birthday gifts for friends, movies, clothes beyond the basics, eating out with friends, etc.). Then follow the list faithfully. It's essential to be consistent.
- Let them negotiate raises. What a great opportunity to learn this before they're in front of a cheap and growling boss! Make sure they tell you how they will spend the increased amount.

How Much Allowance?

Surveys give these weekly amounts as guidelines:

Age 3–8	$3–5
Age 9–13	$5–10
Age 14–16	$14–18
Age 17	$30
Age 18	$40

Remember, the idea is not to give 18-year-olds an additional $40 a week but to use the $40 a week you are already spending on them and let the kids manage it.

How Often?

Start with a weekly allowance and then increase the interval to every 2 weeks or once a month (similar to a paycheck). Pay on time, each time (like a paycheck).

If children wish to borrow, charge them interest. They must realize they are spending tomorrow's dollars today, which will prevent them from saving. You could put an IOU note on the savings jar until the note is paid off. What if your child misses a payment or doesn't pay off the loan? Repossess the item! Wouldn't you much rather be the one to repossess your 10-year-old's skateboard than to have the bank take his house when he's 30?

Should You Tie the Allowance to Chores?

Most experts recommend that allowances not be contingent on doing chores or on good behavior (such as $5 for an A and $3 for a B). Punishing children by taking away money they're owed or giving them extra money because they've been "good" sends children unhealthy signals.

When they do a good job with their chores, praise them. When they don't do their chores, take away some privileges. They must realize that all family members have chores. Everyone on the team must take part for the home to run efficiently.

But it's OK to pay for extra chores. The message is that they can work harder for the things that they want (like those $140 shoes). Remember that feeling of working hard for something and then really appreciating it?

How Can I Teach My Kids About Money?

Several games are available that teach children about investing, the stock market, and business principles. There are also "money camps" for kids where they are taught about investing through competitions and team challenges. Some mutual funds (e.g., Stein Roe Young Investor) gear their investor packets toward children and can be a good first fund to help pique a child's interest.

You can also suggest guidelines on how your children use their allowances once they've received them. Because children aren't taxed on their allowances, a simple rule could be that they spend a third, save a third, and give a third to others, such as donating to a charity or spending it on a friend's birthday gift. ■ ■ ■

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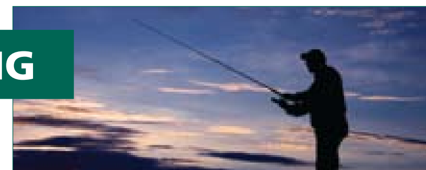


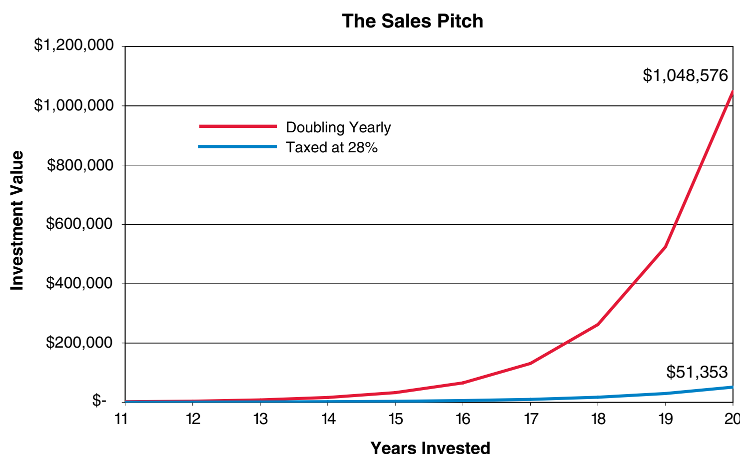
SELLING INVESTMENT RETURNS

by Kenneth F. Robinson, JD, CFP®, Cleveland, OH

A financial planning colleague recently told me how he introduces himself. When asked what he does for a living, he answers, "I protect people from the financial services industry."

I know what he means. I recently heard a brokerage representative deliver a sales presentation for a variable annuity he promoted for its tax deferral. Then he made a startling statement about taxes. One dollar, he said, doubled every year for 20 years, would grow to $1,048,576. But taxed at 28%, it will grow to only $51,353.

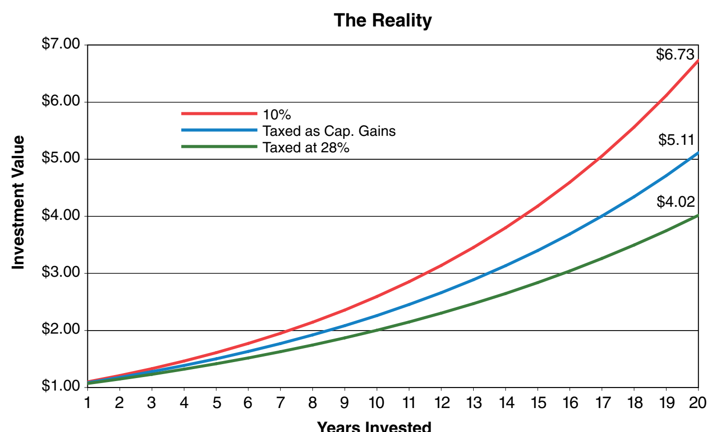
I ran the numbers myself. One dollar doubled yearly for 20 years does indeed grow to $1,048,576. Taxed at 28%, it does indeed shrink to $51,353, a loss of 95% of the value.



But an investor who buys and holds—typically a more effective way to invest—will benefit from long-term capital gain (LTCG) tax rates, which top out at 15% in most cases. So the investment would be worth $220,513 after 20 years, not $51,353.

Sure, that's still a startling drop from more than $1 million. But you only get $1 million if you double your money every year and you owe no taxes on the accumulation.

Doubling your money means an annual 100% rate of return. The financial markets don't provide investments where you can count on a 100% return every year. A more realistic 10% return on equities (I use 9% when making retirement projections for my clients) shows that over 20 years, $1 will grow to—*drum roll, please*—$6.73. At 15% LTCG tax rates, it drops to $5.11. Taxed even at 28%, it's reduced only to $4.02, a loss of 40% of the value.



You could multiply those numbers by 10,000 and still have quite a compelling picture: starting with a $10,000 investment, $67,300 after 20 years looks a lot better than $40,200 (or even $51,100). So why did this salesperson exaggerate by describing a scenario with grossly unrealistic rates of return and emphasizing a high tax rate?

He may not even realize the problem. I wonder if his sales trainers have told him "how to sell" and are hoping he won't notice the outlandish assumptions built into the examples they're telling him to give. At the least, it grossly misrepresents what investors should expect.

Investing and finance are no place to get excited or greedy. Financial decisions should be made rationally, based on the real world. When the financial services industry tries to sell you something, the more exclamation points they use, the more tightly you should keep a grip on your wallet. If a salesperson tries to appeal to feelings of greed or fear, what they say should be viewed skeptically—even with suspicion.

I'm not saying all investment salespeople are dishonest. But don't ignore your common sense. It's like the old adage says: if something looks too good to be true—like doubling your money every year or a promise of huge tax savings from the investment—it probably is too good to be true. ■ ■ ■