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How Flexible Is Your Financial Plan?

Flexibility in a financial plan is a delicate balancing act: it is important to maintain enough flexibility that your financial plan can accommodate unexpected events that are out of your control. On the other hand, a sound financial plan needs to be firmly grounded by factors you can control.

Be Flexible: There Are Assumptions You'll Have to Make about Factors You Can't Control

When you develop a financial plan, you have to make certain assumptions, many of which are out of your control:

Taxes — The notoriously complicated U.S. tax code will affect your financial plan in a number of ways. For one, your effective tax rate will change as your income changes. Also, changes to the tax code itself can affect your financial plan, often dramatically. Fortunately, changes aren't typically made every year and, because Congress sets tax policy, most changes in the tax code are announced in advance of taking effect — allowing you time to plan for those changes.

Income — We all hope, of course, that our income will rise as we move forward in our careers. Typically, those kinds of income changes are predictable — maybe it's a 3% raise every year or a 10% raise every three years. More dramatic yet still predictable income changes can happen when one spouse voluntarily stops or starts working.

Health — Your health and your spouse's health is a significant factor in your financial plan for two reasons: first, because health is a big determinant of one's ability to earn income; second, because healthcare costs are often a large expense,

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Insurance Basics

It's not uncommon to purchase insurance in a haphazard manner. In the end, you haven't systematically evaluated your insurance needs, so you may find yourself overinsured in some areas and underinsured in others. To help prevent this from happening, consider these tips:

✔ **Review all your policies every couple of years.** You want to make sure you have adequate coverage in all major areas, while also evaluating whether revisions are needed due to changes in your personal circumstances. Review your homeowner's, life, health, auto, disability, and long-term care insurance periodically.

✔ **Purchase insurance wisely.** The primary purpose of insurance is to protect you from financially devastating losses, not from every minor loss you might incur. Thus, review all the riders and options in your policies, only retaining those important to you.

✔ **Avoid insurance you don't need.** Don't purchase insurance for minor items you can easily cover yourself, such as extended warranties on small household appliances. When reviewing your policies, make sure you're not paying for duplicate coverage. ❍❍❍

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How Flexible?

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especially for older people. As you age, it's important to think about changing your assumptions about your health. Maybe you reduce the income you expect because you won't be able to work such long hours anymore. Or you increase the healthcare-related expenses you plan for.

Life — Whether it's good or bad, expected or unexpected, events like the birth of a child, marriage or divorce, a spouse's death, or a relocation will impact your financial plan. Some you can plan for, some you can't; the point is to be aware that these kinds of events typically require a review of your financial plan.

Economy — For most of us, our financial plans are based on the assumption that our investments will earn a certain average return in the market. Those assumptions affect decisions we make about our plans; for example, the amount you need to save every month to retire at age 70 is larger or smaller the higher or lower your assumption about investment returns. The best way to make these assumptions is to base them on long-term historical returns in the relevant market indices.

That is not to say, of course, that these assumptions will always be correct; anyone with money invested in the stock market this year understands those assumptions can be turned on their heads in a few days. But given that we have to make assumptions, using historical returns is the best way to do it.

Be Grounded: Factors You Can Control to Keep Your Financial Plan on Track

It's critical to know the factors you can control and to stay on track in those areas.

Live within your means — When you keep your expenses (including savings and investments) less than your income, you give yourself more flexibility to accommodate unexpected changes that you can't control. If you have some breathing space in your budget every month, you can more easily accommodate, for example, a higher tax rate or economic downturn without having to alter your financial plan.

Have a rainy day fund — Have at least 3–6 months worth of living expenses in an easily accessible, liquid fund that you can draw upon in the event of an emergency or unexpected situation. This fund should be set aside from all other savings and investments and only used for true emergency expenses — like in the case of a job loss or illness. With an adequate rainy day fund, you can deal with unexpected events without having to dilute or erode your financial plan.

Revisit your plan regularly — The number one key to achieving your financial goals is to review and, if necessary, revise your financial plan regularly — at least once a year. That way you can make adjustments for all the factors out of your control that have changed, for better or worse. If you haven't revisited your financial plan in the last year, or if you need to develop one, please call. ❍❍❍

What to Do If Your Budget Isn't Working

If you find that you're not living within your budget every month, it's time to take a step back to understand why. The following questions can help you find the issues that may be wreaking havoc on your budget and figure out how to fix them.

Is Your Budget Realistic? If your budget is not realistic, then you are immediately setting yourself up for failure. If you are underestimating your expenses based on your current lifestyle, then you are repeatedly going to fail. Develop a realistic budget, including your fixed monthly costs as well as your discretionary spending to get a true understanding of your monthly spending.

Did You Slash the Fun? If you cut out all the fun, you may be feeling deprived, which can lead to overspending. It's important to have a little fun each month, so set a dollar amount for entertainment.

Is Self-Control an Issue? For many people, self-control is the main reason their budget isn't working. It's all right to splurge once in a while, but if it's happening often, you need to find ways to live within your means. One strategy is to write down the financial goals you are trying to achieve and keep them next to your cash, debit, or credit cards. As you go to make purchases, look at your goals to decide if this purchase is worth it.

Is Budgeting Too Much Work? If you feel you don't have the time to track your expenses and evaluate your spending, your budget is not going to be helpful. There are many good budget apps you can use that will make this process simple and less time-consuming.

Do Your Financial Goals Seems Unattainable? If you feel like you're never going to meet your goals, you may find that you give up trying. While your goals may seem daunting, try setting up milestones along the way, so you can see the progress you are making. Take the time to celebrate those milestones to help you stick to your budget. ❍❍❍

How Much Do You Need to Save for College?

The ever-rising cost of college is common knowledge. Depending on the school a student chooses, the cost of tuition, room, and board for an undergraduate degree can easily exceed six figures. With costs so high, many parents are simply overwhelmed. Saving enough to cover all of a child's college education expenses may seem like an impossible goal. Many parents don't get started, or if they do save, they don't save enough.

If you want to help your children pay for their college costs, you need a clear savings strategy. Below are some simple guidelines for determining how much you really need to save.

Estimate How Much College Will Really Cost

According to data from the College Board, a year of tuition, room and board in the 2018-19 academic year costs $21,270 at a public institution and $48,510 at a private nonprofit institution. Assuming future increases of 3% annually, that means in 18 years, a year of college will cost more than $36,000 at a public school and roughly $82,000 at a private school.

Those estimates are staggering. Of course, it's possible college costs will level off or increases won't be quite so steep. But in any case, the young children of today will likely face much higher college costs than students do today.

Why does all this matter? Because you need to get a sense of what it might actually cost your child to attend college. If you have a baby who was born this year and hope to send him/her to a private four-year college, you'd need to save about $328,000 to cover all the costs.

Decide How Much You Want to Save

Once you have an idea of how much your children's college might cost, you can set realistic savings targets.

Say you want to be able to cover 80% of the cost at a four-year, private college for your child, with the expectation that your child will either obtain grants or scholarships or take out loans to pay the remaining portion. That means a savings goal of $262,000 at the end of 18 years. To hit that target, you'd need to set aside about $728 a month, assuming annual returns of 6%. If you want to cover 80% of the costs of a four-year education at a public college (estimated at $144,000), you'd need to save $115,000. To reach that goal, you'd need to save about $372 a month, assuming annual returns of 6%.

If your initial savings estimates are high, consider tweaking your goals. Meeting 80% of your child's estimated college costs may be unreachable, but 70% may be a more achievable goal.

Also, consider other sources you can tap to boost savings. Grandparents may be willing to make contributions. Monetary gifts your child receives for birthdays and other milestones can be added to a college fund. Finally, don't count out the possibility of financial aid.

Create a Plan

The estimates above are just that — estimates. Unfortunately, many parents have little idea how to get started saving.

Sticking funds in a low-interest savings account reduces risk, but means you'll have to save more. A 529 college savings plan, which offers tax advantages and access to investments, could be a better way to reach your goals.

To create your own college savings plan, you'll need to think carefully about your family and your situation. Please call if you'd like to discuss this topic in more detail. ❍❍❍

Bear Market Playbook

The New Yorker magazine recently ran an article with ideas on how to get through a lock down without losing your sanity. One suggestion is to watch Mary Tyler Moore as a reminder of when times were simpler. Gilligan's Island, however, is to be avoided because it may remind us of our forced isolation. In this piece, we are going to offer suggestions on how to get through a bear market without losing your mind, and hopefully your wealth. If the ideal were to happen, that this bear market is about over by the time you read this, keep it. Who knows when we will need it next?

When is a bear market over? The definition of a bear market is widely agreed upon; it is when stocks drop by 20% or more. Does that mean that when stocks go back up 20% or more, that the bear market is over? We don't think so. We think a bear market is over when you get your money back. Most people know exactly when that is.

We are not going to try to predict when that will be. Instead, we are going to make suggestions on how to proceed until that time, without too much stress, or worse, without potentially selling low and then buying higher. Maybe some of you have already done that. Don't feel bad, it happens to so many investors, and we believe more so in this bear market. One estimate showed $1 trillion coming out of the markets and into money market funds or bank accounts.[1]

Hersh Shefrin, a behavioral finance economist at Santa Clara University, agrees. "There's a psychological component: the pandemic wrecked people's illusion of control, triggering the amygdala, a part of the brain that's activated by fear, sending a rush of adrenaline that can create a high...then the body starts pumping cortisol if the threat continues — and that tends to diminish people's ability to engage in rational thought — creating panic."

This bear market has elements in play that make it different from 2008. And anyone who is a new investor in the last 11 years has never experienced a bear market. Besides the obvious Coronavirus Pandemic, there are election year anxieties, high-frequency trading, no-cost trading that causes less inhibition to selling, and there are index funds that can drag down an entire sector.

The media does not help, nor do the prognosticators who get the media's attention. We have long held that the media favors the prognosticators that are selling fear. Goldman Sachs received a lot of coverage when they predicted that GDP would fall 24% in the second quarter. The New York Times quoted an expert who predicted a level of poverty that "would exceed the peak of the Great Recession." The governor of California received a lot of press when he predicted that 25.5 million Californians would be infected by the coronavirus, hospitals would be overrun, and that desperate patients could die without ventilators.

The print media have nothing on the broadcast media. On March 2, CBS News predicted that the coronavirus might infect up to 70% of the world's population. On March 23, the low point of the market (we hope), CNN contributed to the panic with a story comparing this "plague" to author Sylvia Browne's book "End of Days."

What chance do buy-and-hold investors have of not letting fear affect their investment decisions when the media is predicting the end of days?

We try to help prevent clients from acting on panic but it is not our decision to hold or sell. One successful advisor we know says that he tells clients he will try to stop them the first time they want to panic and sell, but not the second. We try to be more helpful than that, doing as much as we can to remind clients about long-term goals.

Our experience is that clients who sell after a significant drop in the market generally can impair their ability to achieve those long-term goals. Investors are human beings, and the desire to sell is driven by emotion and fear. Listening to the news, or perhaps even friends, can trigger this fear, which leads to the natural desire to stop that feeling. Selling eliminates the fear of losing your life savings. But even if the market drops further, most likely you won't invest because there will be even more bad news at that point…that's what drove the market down more. Only the lack of bad news will make you feel like it is OK to invest again. But once the bad news is gone, stocks prices will have likely already increased…the market is relentlessly forward-looking. If at that point you buy, you just sold low and bought higher. And if you don't buy then? That's a tough situation.

We have been through the 2008 – 2009 bear market with many of our clients. It was very difficult. That bear market bottomed on March 6, 2009. Not only did we not know that was the bottom, but we can tell you that we did not even suspect it was the bottom. Stocks had been going down for 16 months, slowly at first, and then suddenly in the fall of 2008. Things had stabilized at the end of 2008 only to start badly in 2009, dropping another 20% to 666 on March 6 — the devil's low.[2] It felt like the financial world might just come apart. In that bear market, everyone we talked out of selling we helped. Might we face a situation where selling after an already significant loss makes sense? Yes, but we have never experienced this, and our country has not seen a bear market like that since the Great Depression. This is why we think the odds are quite high that selling sparked by a panic, at low prices, is going to be a bad idea.

We suggest you think of the stocks as businesses. Profits are paid out as dividends. Profits tend to grow over time, and so do dividends. Focusing on these dividends makes it easier to forget about the current price of stocks. Some companies are called dividend aristocrats. These are companies that have historically raised their dividends for 25 years or more. According to Investopedia, there are currently 57 of them. We like the following members of that club: 3M, AbbVie, Abbott Labs, Air Products, Becton Dickinson, Caterpillar, Chevron, Coca Cola, Colgate, Emerson, Genuine Parts, Illinois Tool Works, Johnson & Johnson, Leggett & Platt, McDonald's, Pepsi, Procter & Gamble, Target, United Technologies and Walmart.

There is a newsletter called Dividend Growth Investor. We want to quote from one of the contributors, Joe Ferris, from the March 27 blog. "I will get right to the point. What am I doing with the portfolio that I have nurtured for the past 25 years? I am not changing my current approach; I am waiting this out. Bear markets last for about a year or so on average, and have occurred 32 times in the last century. While they are happening, they feel absolutely awful. We check the news and the sky is falling and everything seems to be negative, at times confirming what we think our fears are. However, the skies will ultimately clear, investor panic ends, and the path resumes for further economic growth and continued innovation."

We hope in the near future that we will all be celebrating the end of the Pandemic of 2020, along with the bear market that went with it. As it was with Gilligan, the skipper, the millionaire and his wife, the movie star, the professor and Mary Ann, we went without restaurants, motor cars, not a single luxury. We hope this bear market ends like that series. After 98 episodes, the series was cancelled unexpectedly at the last minute. It just went away. We hope the virus just goes away. In the meantime, we are open and here to answer your concerns.

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[1]Barry Knapp, Ironsides Macroeconomics, LLC
[2]FactSet

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