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Fee-Only Financial Advice

THINK TWICE ABOUT INVESTING IN YOUR CHILD'S NAME *by Ken Robinson, JD, CFP®*

Financial advisors often meet with clients who have put money in their kids' or grandkids' names.

They may think this is a good idea, but they're not really clear why. They talk about "tax advantages," but can't really say what these advantages are.

At first glance, having investment accounts in your kids' names may seem like a good idea.

It would split the income between two taxpayers, possibly reducing the overall tax liability by keeping taxable income in lower tax brackets. But the "Kiddie Tax" applies the parents' highest tax rate to any investment income over a certain level (\$1,600 for 2004) for children under the age of 14. While that first \$1,600 is taxed at lower rates – the first \$800 isn't taxed at all, and the next \$800 is taxed at the child's rate – everything over \$1,600 is taxed as though it were in the parents' names. So the "tax advantage" is limited and can be difficult to manage.

In most cases, investing in the kids' names is a mistake. Putting money in a child's name is a one-way transaction. Funds must be held through a representative under the Uniform Gift (or Transfer) to Minors Act (UGMA or UTMA). The account custodian (often a parent) is responsible for using these funds solely for the benefit of the child named on the account.

So suppose you've put money in your son Paul's name. It can't be used for summer camp for your daughter Mary. Private school tuition for Paul is

probably OK. The cost of building an addition onto your home is not, even if the addition is used for Paul's bedroom. And while there's no definitive list of allowed expenses, there are certain expenses you should not expect to take from Paul's account. For instance, you can't use it for basic necessities like Paul's food and clothing.

Another significant problem has to do with college financial aid. Under one common formula, \$1,000 saved in your name translates to about \$56 that you'd be expected to pay toward next year's college tuition. But if that same \$1,000 is in Paul's name, he'll be expected to use \$350 for the upcoming school year.

Still, in my experience, the most compelling reason to keep the money in your own name is also the most straightforward. When Paul reaches a certain age – between 18 and 21 depending on the applicable state law – he's legally entitled to the money in the account. How many adults between the ages of 18 and 21 do you know who will make the wisest decisions about how to spend what

might seem, to them, like a huge sum of money? It doesn't matter that Grandpa wanted this legacy to be used for college expenses. Once Paul reaches the specified age, the money is his, and there is nothing you can do to stop him from spending it as he pleases.

It is often more advantageous for parents to leave the money in their own names. After all, they may need it for retirement. True, they may want the kids to have it for their education, but keeping it in the kids' name may reduce their chances for financial aid. And the kids can get loans for college, but no lender will give the parents a loan for retirement.

So unless you already have every penny you need for your own retirement, keep the funds in your name. If you end up with more than you need, you can always help your older, more responsible kids pay off their student loans – once they've shown that they can handle money responsibly as adults. ■ ■ ■



INSIDE THIS ISSUE

- 2 Dealing With Deprivation Anxiety
- 3 Five Key Strategies for Investment Success
- 4 Ask an Advisor



DEALING WITH DEPRIVATION ANXIETY - Part 1

by Bert Whitehead, MBA, JD and Charles "Chip" Simon, MS

Displaced emotions, misgivings, and misinformation can sometimes impede or threaten your progress toward financial goals. For example, those who spend more than they earn often use their overspending habit to deal with various emotional insecurities. Entrepreneurs, in contrast, frequently create personal financial strains for themselves by consistently funneling money back into their businesses which can translate into chronic personal liquidity shortages.

Given this, you might think that supersavers (those "prodigious accumulators" described by Stanley and Danko in their landmark book, *The Millionaire Next Door*) never have financial problems. They are the first to recoil from overspending and the least prone to squander wealth. Yet a pervasive problem for many avid savers is what we call deprivation anxiety. Deprivation anxiety is a "chronic emotional reaction based on an inchoate fear of becoming destitute." Informally, we call it the "bag lady" syndrome. It can cause intense emotional and interpersonal distress. Where does this obsessive fear of running out of money originate? It varies. We each have a money personality that develops from various life influences. For example, deprivation anxiety might take root from attitudes held over from the Great Depression, intense conservatism, guilt associated with family or religious values, attitudes engendered by specific occupations (e.g., farming), or even expressions of obsessive-compulsive disorder (OCD).

Clients with deprivation anxiety may exhibit an obsessive preoccupation with saving, spending, and investments. They may concern themselves ritualistically with account balances and fret over them constantly. In addition, there may be anxiety, sleeplessness, or an excessive need for validation from others that they are making the right financial decisions. Couples may bicker and blame each other for chronic shortages, even though they have plenty of money.

As financial professionals, we see these deprivation anxiety behaviors frequently. At worst, clients are miserable and frozen by their inability to spend. They have forgotten that the reason to save is to accumulate so they will have money to spend later on in life! As they approach financial independence,

they may experience deep-seated guilt about touching their hard-earned savings.

How can your financial advisor help if you suffer from deprivation anxiety? That depends on the type of advisor with whom you work. Commissioned 'financial advisors' are salespersons motivated to convince you to buy various products. Their agenda overemphasizes investment performance.

This approach to financial advising can be counterproductive, especially if you suffer from deprivation anxiety. If you are overly concerned with running out of money, the last thing you want is to risk losing money by investing activities! It can be difficult to have a satisfactory investment experience when there is a possibility of loss.

In contrast to product-oriented advisors, fee-only

Cambridge Advisors are in a unique position to help. We concentrate on education. We do not work on commission. Our approach creates a relationship that is better equipped to handle the day-to-day realities of deprivation anxiety. Your Cambridge Advisor can help you identify deprivation anxiety's symptoms. If they are evident, you will probably be relieved to hear, "Oh sure, I see that all the time. It's called deprivation anxiety." You will know you are not alone.

Your Cambridge Advisor can help create a financial environment that promotes emotional safety, financial security, and personal confidence. This system offers you much more than a performance-based investment portfolio. Instead, it's a comprehensive way for you to manage and be guided by your personal finances. It provides the tools, techniques, and feedback that are important to your financial success.

The Cambridge Cash Flow Management System has been developed, perfected, and used successfully for over 30 years. The system has three important features: (1) it aligns financial priorities with your emotional needs, (2) it is easily adaptable to every stage of your personal Financial Lifecycle, and (3) it involves an intimate interaction between you, your Cambridge Advisor, and your personal financial system. The Cambridge Cash Flow Management System reduces stress and anxiety while meeting your day-to-day financial needs. In our next article we will explore the details of the system. ■ ■ ■





FIVE KEY STRATEGIES FOR INVESTMENT SUCCESS!

by William C. Cuthbertson, MBA, CFP®

One of the most common complaints heard by personal financial advisors meeting with new clients is, "My portfolio stinks!" Unfortunately, this is true for far too many investors. Poor performance is routinely due to poor asset allocation and diversification decisions, as well as attempts at stock picking, market timing, and other speculative investing strategies — mostly under the guise of informed investing. Here are five key strategies to assist you in achieving your investment goals:

■ Strategy 1 – Start Early

Starting early is perhaps the most important rule for achieving investment success. On average, it takes approximately 7 to 8 years to double your money in the market (assuming long-term average equity returns). If you can do this doubling at least four times, while saving and investing at least ten percent of your annual gross income — and without prematurely dipping into your treasure trove — you will find yourself in pretty good shape after 30 years of investing. Because the last doubling cycle is generally the most valuable, those who wait to get started find they need to save two, three, or four times as much to make up for starting late.

■ Strategy 2 – Go Long and Don't Look Back

Invest for the long term and don't try to time the market or succeed via stock-picking strategies. These are speculative activities. And, just like betting against the house, in the long run the odds are that you will lose. Markets are volatile, and returns do fluctuate. Consequently, buying for the long term without looking back can be hard to do. Combine this with the constant drumbeat of the financial media encouraging you to engage in speculation as opposed to investing — and it gets pretty difficult to stick it out. With all these influences, it is no wonder the average investor usually sells too soon.

■ Strategy 3 – Asset Allocate and Diversify

When you consider that the asset-allocation decision alone generally accounts for 96% of a portfolio's eventual returns, determining what proportion of your money to invest in equity assets versus fixed-income

assets is clearly one of the most important investment decisions you will make. This decision will also impact whether or not you will be able to sleep at night. If you choose an allocation that has more risk and volatility than you can tolerate, you are increasing the odds that you will end up selling out when you should be holding on. Additionally, failure to diversify into

a number of asset categories can result in additional risk and missed opportunity.

■ Strategy 4 – Be Systematic

Practicing a systematic and consistent investment strategy to grow and maintain your portfolio will enhance your returns and give you a framework for investment decision making. Regular investing with an allocation plan can reduce the tendency to be influenced by your emotions during market downturns and bubbles. Those emotions can undermine an otherwise successful, long-term strategy. Close investigation of investor behavior reveals that many investors wait for the markets to rise before they buy. This is the exact opposite of what you want to do! Using proven methods for

implementing and maintaining your strategy is a good way to prevent this from happening to you.

■ Strategy 5 – Know Your Weaknesses and Get Help When You Need It

Accept it: we are prone to undermine ourselves when it comes to investing our own money. Research in behavioral finance has shown we all have decision-making tendencies which gear us toward investment failure. We tend to be overconfident and unjustifiably optimistic. We are overly influenced by the media, and we also have a tendency to believe there is predictability in random events — such as the movement of stock prices from day to day.

Because of these natural tendencies, it is important to have an investment plan that, as much as possible, reduces our biases — a prime goal of these five key strategies. If you are unsure of how to achieve a successful investment experience on your own, get the assistance you need so you too can begin experiencing the returns you most certainly deserve! ■ ■ ■





ASK an Advisor

THE INSURANCE CLIMATE HAS CHANGED

by Karen F. Folk, CFP®

Q. A tree branch fell on the garage roof, and it will cost \$1,200 to remove the debris and repair the roof and gutters. Should I call my insurance agent? If my policy covers this, I will only have to pay the deductible of \$500.

A. The problem with making this small claim is that companies providing homeowners property coverage have recently begun to treat homeowners insurance in a manner similar to that of auto policies. If you have a number of even minor auto accidents within a short period, your auto policy premium increases, and the company may even refuse to renew your policy. In the past, small claims on homeowners policies didn't raise premiums or cause renewal problems. Now, if you make several small claims, or even inquire about whether something is covered by your homeowners policy, the company may decide not to renew your policy. If that happens and you have had two or three claims within a 3-5 year period, you will likely find it hard to get a replacement policy to protect your home. Or you may find another company willing to insure you but at a higher cost.



Q. What's the point of having homeowners insurance if the company penalizes me for making a claim or even inquiring about whether something is covered?

A. The point of all insurance is to protect you against risks that would either wipe you out financially (for example, liability to protect against lawsuits) or severely burden you financially (for example, replacing your house and contents after a fire). Buying insurance shifts those risks to the insurance company. The insurance company can afford to pay you for large claims because it spreads the risk among a large pool of policyholders,

most of whom do not have major disasters. By pooling all the premiums paid, the company has sufficient funds to pay the few policyholders who will have major claims. Now that companies have changed their treatment of small claims, you are better off just paying for small losses from your emergency funds and not inquiring about them or reporting them to the company. Reserve the use of your homeowners insurance for catastrophic events. The point of insurance is not to get back your annual premiums in small claims; those premiums buy the risk protection you need to avoid financial ruin or major setbacks.

Q. If I am not going to make any small claims, then can I save money on my premiums by raising my deductible?

A. Yes, Cambridge Advisors now recommend you increase your homeowners insurance deductible to \$2,500 or more. To protect your coverage for catastrophic events, you will pay the cost for these repairs or replacements yourself and not even inquire about coverage available under your policy. You are choosing to self-insure for the first \$2,500 of small damages, and you need to have a "repair/replacement" emergency fund adequate to cover those small events. You can also save on auto insurance premium costs by raising your auto deductibles to at least \$500 or even \$1,000. This is especially important for those with teenage drivers — just assume that you will be covering the cost of small fender-benders yourself. Of course, you will need to report to the police and your insurance company any accidents involving another vehicle or damage to property of others. Higher deductibles preserve your coverage for major collisions and decrease the likelihood of seeing your premiums rise since you won't be making small claims. ■ ■ ■