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*Fee-Only Financial Advice*

## MAXIMIZING FINANCIAL AID FOR COLLEGE

*by Patricia A. Konetzny, CFP®, EA*

We all hope our children will earn an academic or athletic scholarship, but by the time they graduate from high school, most of us face the harsh reality of college tuition, along with room and board. Besides encouraging them to get a good summer job, it's too late for us to make big changes. Beyond just hoping for a full-ride scholarship, here are some additional strategies to help arrange college finances. Most of them need to be done before January of the year your child will start college.

Everyone applying to college (and annually thereafter) should complete the Free Application for Federal Student Aid (FAFSA) forms to determine eligibility for aid. Even if you plan to pay 100% of the cost, life often brings unexpected changes, such as job loss or unexpected medical bills. If the college has the FAFSA form you complete annually on file, it's much easier to explain any change to the school and request a review of your award package.

So where's the best place to start? No later than early December prior to graduation, spend a couple of hours on [www.collegeboard.com](http://www.collegeboard.com) familiarizing yourself with the FAFSA form and entering your

financial figures. It's all in the numbers, so the time you spend understanding how they flow will pay off. Parents' income and assets, the number of family members going to college, and the student's income and assets are what count the most.

There are two main formulas used to determine your Expected Family Contribution (EFC): The Federal Methodology (FAFSA) is used to calculate federal aid; the Institutional Methodology (CSS/PROFILE) is used by many (although not all) private colleges to calculate eligibility for institutional aid.

Look up the cost of the schools your child is considering. If the school costs \$8,000 per year and

your EFC is \$21,000, there's no point in trying to lower your EFC. You will be expected to pay everything. If you've decided to send her to an expensive private school for \$40,000, you have some work to do. Think of the day you file the forms as a photograph of what you'll look like to the college. It can be a totally informal photo or you can put on a nice shirt and comb your hair. Find out what percentage of need is met by the school. (Private schools often meet 70%-100%.) While need is often met with loans (which must be repaid), the award package may also include grants and scholarships (which provide "free" money).

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## REBALANCING YOUR INVESTMENT PORTFOLIO

by Stewart Farnell, Ph.D., CFP®

Every year the work of financial planning includes a review of your investment portfolio. We compare the actual percentage of each asset class in your portfolio (such as large cap domestic stock, international stock, money market funds) to your target percentage for that class. If you have too much invested in one asset class, we sell enough to bring it back to your target percentage. And if your investments in another asset class fall below your target, we buy enough to bring it back to your target. This is called “rebalancing.”

Rebalancing helps increase your portfolio return while it also reduces risk. A simple example of this is provided by author and investment manager Richard Ferri in his book **All About Index Funds** (McGraw Hill, 2002). Ferri asks us to consider a portfolio made up of only two funds, each making up half of the portfolio.

Fund AA gains 20% the first year and loses 10% the second year for an average annual total return over 2 years of 8%. (A 20% gain in the first year increases AA to 1.2 times what it was to begin with; likewise a 10% loss between the first and second years translates into a balance at the end of the second year that is only 90% of the balance at the end of the first year.) Using real numbers, it looks like this: the position in AA is worth \$1.00 at the start of Year 1 and is worth \$1.20 at the end of Year 1 (\$1.00 to \$1.20 is a 20% gain). So we start Year 2 with \$1.20, suffer a 10% loss (ouch!) and end Year 2 with \$1.08 (\$1.20 to \$1.08 is a 10% loss). Looking at both years together, Fund AA began at \$1.00 (beginning Year 1) and ended at \$1.08 (ending Year 2). So overall there is an 8% gain.

Our other Fund ZZ loses 10% in Year 1 and gains 20% in Year 2, again for an average return over the two years of 8%, but in this case the math is reversed. Starting from an initial value of \$1, a 10% loss in Year 1 means Fund ZZ ends the year at \$0.90. A 20% gain in Year 2 increases ZZ's value to \$1.08 (1.2x \$0.90).

If the portfolio is held for two years and not rebalanced during this time, the combined return of Funds AA and ZZ is 8%, since each fund grew by 8%.

However, if at the end of the first year the portfolio is rebalanced back to its target allocation of 50% in each fund, the return on the portfolio increases from 8% to 10.25%. At the end of Year 1 the portfolio has a 5% gain. (Fund AA gained 20% and constitutes half



of the portfolio, so the portfolio as a whole is up 10% due to AA; likewise fund ZZ lost 10%, so the portfolio as a whole lost 5% due to ZZ.) After subtracting the 5% loss from the 10% gain, our portfolio as a whole is up 5%.

Some of the gains from AA are sold (at a profit) and invested in ZZ, sufficient to bring the portfolio back

to its 50/50 mix. At the end of Year 2, the portfolio has another 5% gain. (This is the same calculation used above, except that this time it was AA that lost and ZZ that gained.) Over the two-year period, the portfolio has gained 10.25%. (At the end of Year 1 it is worth 1.05 times what it was worth to start with; at the end of year 2 it is worth 1.05 times what it was worth at the end of year 1, or 1.1025; compared to a beginning value of 1, this is a 10.25% gain). Not only has the return of the portfolio increased, but its risk has also been reduced. Because AA was trimmed back to its target 50% level after the first year, there was less in AA to be hit by its subsequent decline in year 2. Rebalancing helps keep the portfolio's risk from rising above its desired level.

Does it matter how often we rebalance the portfolio? Not really. A recent study published by Vanguard's Investment Counseling & Research group showed that annual rebalancing produces results similar to more frequent rebalancings. What matters is that the portfolio is rebalanced—regularly and systematically. ■ ■ ■



## MAXIMIZING FINANCIAL AID FOR COLLEGE (continued from page 1)

Gather all your information and get your taxes done as early as possible in January. If necessary, file the FAFSA with good estimates, making sure you don't overestimate income and taxes paid. When your tax returns are complete, file a corrected FAFSA with the final numbers. Loan and grant offers are passed out until they run out; those who file the FAFSA early have a better chance at aid.

The amount colleges expect you to contribute to your child's education (EFC) is based mostly on your income, but they also look at family assets. We'll discuss a few strategies for both.

### Strategies for Decreasing Income

- Thinking about taking a sabbatical or starting a business? Depending on your family's income, a \$40,000 income decrease can give you an \$11,000 reduction in your EFC. Remember, though, that lowering your family's income needs to start in the year **prior** to starting college (so the decrease is reflected in your first FAFSA and EFC calculations).
- Avoid capital gains and taking money out of your IRA to pay for college. Both are treated as income, the same as your salary. The same is true if you are cashing in savings bonds. If you must cash out, wait until the spring of your child's junior year when you won't be filing more aid forms (unless of course you have younger children right behind).

### Strategies for Reducing "Countable" Assets

- Pay off consumer debt such as credit cards and auto loans.

- Fund Roth IRAs. Contributing for both 2006 and 2007 Roths before completing your FAFSA forms will decrease your assets by \$16,000 (\$20,000 if both parents are at least 50). Roth assets can be withdrawn without penalty to pay college costs. In other words, you put money into a Roth where it won't count toward your EFC (any retirement account is "off the books" for EFC purposes) and then withdraw the money, penalty-free, to pay for college!
- Spend student assets in their name. Use UTMA (Uniform Transfer to Minors Act) accounts to purchase the computer or car they will need in college prior to filing the FAFSA.
- Don't overestimate the value of your home. Many people make the mistake of using the price they think they'll get if they sold the home. Instead, use a recent real estate assessment (or if that's not available, the Federal Housing Index Calculator at <http://www.finaid.org/calculators/federalhousing.phtml>) to get a conservative estimate of the current market value.

Want another way to maximize aid? Have more children go to college at the same time. That's what we did. Little did we know when they were small that having 3 children in college at the same time would be a benefit! And just think of all those lower grocery and water bills once they are living in the dorms! ■ ■ ■

## THE ULTIMATE PARENTING MAP TO MONEY SMART KIDS (continued from page 4)

For instance, college students should be similar to their peers in their workload, how much of the financial burden they bear, and how much of the financial burden their parents bear. If they are out of balance with their peers, resentment forms. For instance, if your child works 40 hours per week while attending college and his peers work 15-20 hours per week, it would be very discouraging, and he or she would miss out on

some of the other things that make for a well-rounded college experience.

**ACA: That is very intriguing. We'll have to watch for your next book. For those of you interested in Linda's current book, you can visit the website [www.brightleitz.com](http://www.brightleitz.com) and click on the link "Order Your Copy Here." Input "\$ACA\$" for the Promotional Discount Code, and shipping is free. Or you can find it at [www.amazon.com](http://www.amazon.com). ■ ■ ■**



## THE ULTIMATE PARENTING MAP TO MONEY SMART KIDS

Reviewed by Terry Gustafson, CFP®

I've just finished **The Ultimate Parenting Map to Money Smart Kids** written by fellow Cambridge member Linda Leitz. This excellent book discusses in detail how to educate your children about the world of finances. It is filled with useful, real-world examples and ideas, including anecdotes from the author's own trials and tribulations with her brood. Included in the book is an appendix with a handful of sample spreadsheets that readers may find helpful. It is obvious after reading the author's work that she has used and tested her ideas about money on her own children with great success and much introspection. I spent the lunch hour on a recent Sunday discussing the book over the phone with Linda. The following are excerpts from our conversation.



**ACA:** *Linda, what motivated you to write this book?*

Linda: The combination of being a financial planner and a deliberate, thought-provoking parent.

**ACA:** *You make multiple references in the book to your children and how they reacted to and learned from your teachings. It makes the reader take a more personal interest in the book and made me wonder how old they are now and how they have done with money matters since you wrote the book.*

Linda: My children are currently 13, 14, and 15 years of age so they are still in the process of learning. All 3 children have different goals and priorities and do not follow the path that you would guess. For example, the 13-year-old expressed a concern about lack of retirement savings the other day, and she is the "creative" one.

**ACA:** *So many advisors who think "left brained" people are the money-smart people may be oversimplifying things?*

Linda: Yes, too often we assume that people who are more creative will not be successful with money.

For example, my 15-year-old and I were discussing his aspirations to go to chef school, and I brought up the thought that—even though he has a great idea for a career—he will still have to know the business side of the restaurant industry. He immediately agreed and

surmised that maybe it would be best to obtain a business degree first and then go to chef school.

**ACA:** *I have two main theories regarding children and allowances. Your book addresses the first body of thought that children should have some household responsibilities to "earn" their allowance. The second theory is that they should receive their allowance as part of the family bounty, much like the whole family benefits from purchases of*

*food, movies, and furniture, for example, and that they should perform their share of the family chores without remuneration, similar to the way parents do household chores and maintenance, such as washing the car. What are your thoughts regarding the latter theory?*

Linda: I believe that there should be a balance between the work vs. entitlement theories of allowance and a concentration on the relative value of their spending and the trade-offs involved.

**ACA:** *Do you believe that children should also be tasked with putting some money in their college fund starting at a young age, or do you believe that the goal is too far out for them to comprehend?*

Linda: We have had discussions with them about college, but they are not actively saving on their own for college. While conducting research for my second book I had some discussions with a psychologist regarding a middle-ground, balanced approach.

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*The Ultimate Parenting Map to Money Smart Kids*