O A K S T R E E T A D V I S O R S

F I N A N C I A L C O U N S E L

FINANCIAL ANALYSIS

PREPARED FOR

Sample Fiscal Checkup

My Town, USA

GOALS

- Need help with selecting and allocating 401k plan investments
- Need to review life insurance needs
- Need to develop college savings plan

WHERE YOU ARE

Basics

Dick is 32 years old and works for Boeing earning $60,000 per year.

Jane is 31 years old and works with Medtronic earning $55,000 per year.

You hope to retire when Dick reaches 62 years of age and you want to generate $90,000 in retirement income.

401(k)'s

Dick has about $86,000 in his company's 401k plan. He is contributing 5% of his salary and his employer matching contribution equals 4% of his salary

Jane has about $80,000 is her company's 401k plan. She contributes 5% of her salary and her employer match equals 4% of her salary.

Investments

$25,000 in checking

Pension Plans

Dick expects to receive $25,200 per year from Social Security at normal retirement age.

Jane expects to receive $23,600 per year from Social Security at normal retirement age

Other

Baby Julie arrived on March 22 of last year. You want to be sure you have enough life insurance coverage to protect your growing family and begin setting aside money for Julie's future college expenses.

FINDINGS

- You should develop an asset allocation model and an investment strategy to drive your decision-making process and provide discipline to help you reach your financial goals.
- You are not saving enough to reach all your financial goals. To fund both Julie's college expenses and your retirement lifestyle you need to increase your savings rate by about $500 per month.
- You have about 30 years to work on improving your retirement outcome. A combination of regular savings and smart investment choices can help you fill the retirement income gap.
- To protect your family, you should purchase an additional $530,000 of term life coverage for Dick and an additional $465,000 of term life coverage for Jane.
- You should consider using the SC Future Scholar 529 plan as a savings vehicle for funding Julie's college savings. You can set up and fund accounts directly to avoid sales charges and fees. See more details inside.
- You should reallocate both Dick's and Jane's 401k investments. Maintaining a coherent investment strategy increases the chances of you reaching all your financial goals.
- You should review and update your financial plan at least annually. Things change. Measuring your progress and making adjustments along the way is the best strategy for reaching your long term financial goals.

Life Insurance Basics

Life insurance can be a confusing topic. There are many different flavors and choosing the right coverage for your needs and budget can be difficult. Throw in the fact that life insurance agents goal of collecting a commission check may be at odds with your goal of obtaining the best protection for the lowest price and you have a recipe for disaster.

Let's start by getting to know some of the basic flavors of life insurance available to you. While this is not a complete guide to all the life insurance options available nor does this explain all the nuances of each policy type, it is useful as a primer to get you started.

Term Life Insurance

Term insurance is the most basic and the least expensive type of life insurance policy available. Term insurance is pure protection. You give the insurance company a premium and the commit to paying your beneficiaries a death benefit if you die during the policy's term. Once the term has expired you no longer have life insurance protection and the insurance company no longer has an obligation to pay.

One-year non-renewable term insurance is the absolute cheapest type of policy you can buy, but that is rarely the type of policy you will need.

Usually you need protection for longer than a year, so insurance companies came up with multi year guaranteed renewable term policies to meet that need. You can often find 5 year to 20 year guaranteed renewable coverage that can be used to customize coverage for just about any situation. Because the policies cover multiple years and have guaranteed renewability, premiums are a bit higher. You can also add level premium guarantees to the coverage, so you know what your premiums will be for the entire term of the contract. Level premiums mean there is a bit more risk for the insurance company which gets passed along to you the consumer in the form of higher premiums.

Many young families can use term insurance to protect against premature death and until they have accumulated enough capital to no longer need as much protection. For instance, new parents might purchase enough coverage to protect against the loss of wages if one spouse dies and provide funds for childcare and education until their children graduate from college with a fifteen or twenty-year level premium term policy. After that term expires their need for insurance may well be much lower and they can follow it up with a ten-year level premium policy to provide protection until retirement when they will likely not need any life insurance coverage.

Whole Life Insurance

Whole life coverage as the name implies will last your entire life. The insurance company issues you a policy with a premium based on your age when the policy is issued. The premium you pay is calculated to cover the cost of term coverage for you, pay the agent, and have some money left over to go into a savings account inside the policy. Usually there is a stated interest rate that your excess premiums earn inside the insurance policy. As you continue to make premium payments, you gradually build up enough money inside the policy to either increase the policy's death benefit or to stop making premium payments altogether.

Whole life coverage is usually the most expensive flavor of life insurance you can buy. There was an old adage that said buy term and invest the savings yourself for a better long-term outcome but having worked with many clients who are terrible savers, I do recognize the place for whole life insurance policies in many family's insurance portfolio. Perhaps it is used as a foundation that you build term coverage on to meet all your needs for all your life.

Universal Insurance

Universal insurance works like whole life but rather than earning a guaranteed rate, the excess premiums are credited with an interest rate that floats with market rates. These policies were popular when interest rates were high. As interest rates came down over the past two decades many of these policies collapsed as the interest rate assumptions made when they were issued failed to materialize leaving the owners with much higher than anticipated premiums or reduced or even eliminated death benefits.

Variable Universal Life

Okay, take a universal insurance policy and make the savings account inside the policy a high priced mutual fund and what you end up with is variable universal life. If the mutual funds you own inside the policy earn enough net of fees, your premiums vanish or your death benefit increases. If you can find a variable universal policy with low expenses this is a good idea but determining all the fees being charges to your account can be very challenging.

In the end life insurance is often a must for building a solid foundation for your family's financial plan. Life insurance is the one product that can create wealth where none existed before. Life insurance provides the cash your family will need to replace the earnings or human capital of a loved one. Life insurance is a valuable tool for providing protection for your family, but it is almost never a good tool for investing. If your agent talks about the investment properties of a life insurance product you should see this as a red flag and seek out a second opinion.

Future Scholar 529 College Savings Program

Paying for college can be a monumental task. Although inflation in higher education has moderated in recent years, the price of a four-year college education is still very high. To help parents meet this major expense, states have developed and offer 529 college saving plans with tax benefits that can at least ease the burden a bit. In South Carolina, the program goes by the name of Future Scholar. Like all 529 college savings plans, any US citizen can open an account regardless of income or family relationship and there can be multiple accounts for the same beneficiary so long as the combined contribution does not exceed $426,000.
The money from any 529 college savings plan can be used for tuition and fees, room and board, books, computers and other supplies required for attendance at an eligible institution. Eligible institutions include two and four-year colleges, graduate and professional programs, and certain vocation/technical schools.

Reasons to utilize a 529 college savings plan

No matter what your state of residence, there are some advantages to utilizing a 529 college savings plan that are common to all such plans.

Tax Free Growth

Your contributions grow tax free, and distributions used to pay expenses related to secondary education are tax free also. A common question is what happens if the money is withdrawn for reasons other than higher education? In that case you will pay taxes on any earnings and a 10% penalty on those earnings with your federal income tax return. However, keep in mind, you can change the beneficiaries of a 529 plan. So, if one child chooses not to go to college, you could name another child as the beneficiary and protect the tax benefits of the plan.

Estate Planning Tool

Although estate taxes no longer affect most Americans, a 529 plan can still be utilized to shift assets out of an estate for tax purposes. Using the gifting allowance, currently $14,000 per person per year, a couple could move up to $140,000 out of their estate by using the five-year contribution allowance common to all 529 college savings plans. If a contributor were to die before the five-year period has passed, some of the funds would be brought back into the decedent's estate.

A unique feature of all 529 plans is that, although the contributions are counted as a gift at the time they are made, the funds can still be reclaimed by the account owner at any time. This has some usefulness as a Medicaid planning tool for older donors.

Low Impact on Needs Based Financial Aid

Because the assets in a 529 plan are not in the student's name, they are considered as assets available for the family contribution versus assets that the student has. Colleges expect student to use up to 20% of any assets in their name each year to pay for college, but the family contribution is just 5.64% of their "unprotected" assets.

Portability

No matter which state's 529 plan you choose, the funds can be used to pay for college expenses at any college or university. Unlike prepaid tuition plans, with a 529 plan there is no in state requirement.

State Income Tax Advantages

For South Carolina residents, contributions to the Future Scholar 529 college savings plan could be deductible on their state income tax return. With most SC income taxed at a 5% or 7% rate, this could save you $50 to $70 per thousand dollars of taxable state income. If you itemize your federal income taxes, your net savings will be smaller because it results in a smaller federal deduction for state income tax payments.

The state income tax deduction is a valuable benefit. Even if you have not used the Future Scholar plan for your college saving vehicle, you can still use it as a pass-through account in the years when your student attends college and claim this tax benefit. This deduction for contributions to an account may be taken in any taxable year for contributions made during that year and up to April 15th of the succeeding year.

There is no requirement that the funds stay in the plan for any set period, so if your student is attending college in the fall you could still open and contribute to the plan, then immediately have the funds sent to the college or university, thereby capturing the tax savings and in effect getting a 5% to 7% discount on tuition, fees, and expenses. With the all-in cost of attending college approaching $20,000 annually that would translate into savings of up to $1,400 each year.

Dick’s 401k Allocations

Current

Fund	$ Allocation	%
American Century Int’l Bond	8,925	10
Franklin Small/Mid Cap Growth	20,000	23
Ishares Russell 2000	5,000	6
Vanguard 500 Index	20,000	23
Vanguard Balanced Index	10,000	12
Vanguard Global Equity	2,000	2
Vanguard Real Estate	150	0
Vanguard Target Retirement 2040	10,000	12
Vanguard Total Bond Market Index	8,925	10
Vanguard Total Intl Stock Index	1,000	1
Total	86,000	

Recommended

Fund	$ Allocation	%
Franklin Small/Mid Cap Growth	20,000	20
ishares Russell 2000	5,000	5
Vanguard 500 Index	20,000	30
Vanguard Total Bond Market Index	8,925	30
Vanguard Total Intl Stock Index	1,000	5
Cash/Interest Income	86,000	10
Total	86,000	

Jane’s 401k Recommendations

Current

Fund	$ Allocation	%
Medtronic Common	13.300	16
Vanguard Extended Market Index	500	0
Vanguard Institutional Index	14,300	17
Vanguard International Growth	500	0
Vanguard Primecap	500	0
Vanguard Target Retirement 2055	31,000	38
Vanguard Wellington	500	0
Vanguard Windsor	11,600	14
Vanguard Total Bond Market Index	7,800	10
Interest Income	2,000	2
Total	82,000	

Recommended

Fund	$ Allocation	%
Medtronic Common	8,200	10
Vanguard Extended Market Index	12,300	15
Vanguard International Growth	4,100	5
Vanguard Primecap	12,300	15
Vanguard Windsor	12,300	15
Vanguard Total Bond Market Index	12,300	35
Interest Income	4,100	5
Total	82,000	