A FULL FINANCIAL PLANNING PLATE: KIDS, PARENTS AND RETIREMENT

By Karen C. Altfest, Ph.D., CFP

A couple in the "sandwich generation"—between two other generations—faces financial concerns ranging from aging parents, children not yet in their teens, and their own financial support when they retire. Juggling these concerns means carefully defining goals: knowing what they'll need, when they'll need it and then setting priorities.

INVESTOR PROFILE

- Mr. and Mrs. Gilbert are a couple aged 46 (husband) and 44 (wife).
- They are both professionals with graduate degrees who are employed full-time.
- They are the parents of two children, aged 9 and 10.
- Although they are familiar with the details of their financial life, they feel that they make decisions as the need arises, but have never focused on the "big picture."
- They plan to work another 20 years and then retire in their mid-60s.

FINANCIAL GOALS

- Prepare for two children, now aged 9 and 10, to each attend four years of college.
- Assist aging parents financially, along with help from siblings, if it becomes necessary.
- Purchase a summer home.
- Retire comfortably in 20 years without a reduction in current lifestyle.

PLANNING ANALYSIS

Our Assumptions

For this plan we have assumed:

- An inflation rate of 3.5%,
- An investment return of 5%, and
- College costs inflating at 1% over inflation, for a total of 4.5%.

Our Procedures

This couple's inquiries involved many areas of financial planning as well as investments. Since my firm includes both investment managers and financial planners, we have addressed many areas of their financial life.

Because I spoke directly to the husband, I sometimes address my recommendations to him.

To: Todd and Janice Gilbert
Illinois, USA

Dear Mr. and Mrs. Gilbert:

You have begun thinking about retirement, which is 20 years away. There-

Karen Caplan Altfest, M.A., Ph.D., CFP, is vice president of L.J. Altfest & Co., Inc., [(212) 406-0850; www.altfest.com] a fee-only financial planning and investment management firm in New York City. She also teaches at the New School University in New York City, where she is director of the Financial Planning and Investments Program.

Karen Altfest is author of "Keeping Clients for Life," published by John Wiley & Sons in July 2001, and is co-author of "Lew Altfest Answers Almost All Your Questions About Money," published by McGraw-Hill.

FINANCIAL SUMMARY

Net Worth: Over $926,000

- The couple owns their own home, which they purchased about four years ago.
- Their portfolio is made up of personal and pension accounts, as well as individual and joint accounts.
- Total liquid assets (in equities and cash) are about $112,000.
- Total non-liquid assets, all in retirement funds, are about $477,000.
- Other assets, including home, automobiles, and personal property come to $555,000.
- Major liability is their mortgage.

Annual Income (2003): $144,000

Annual Expenses (2003): $132,531

- Deductible expenses occur in interest payments on the mortgage and contributions to the wife's qualified retirement plan.
- Includes non-discretionary expenses of $75,850.
- Also includes taxes (federal and state) of about $35,000.

Net Cash Flow (2003): $7,749

- Cash flow of $11,469 less retirement contributions of $3,720.

fore, you have time to make things happen. The good news is that you are on the right track to achieve most of your goals. To do so, however, you will have to make some adjustments in your spending and saving patterns.

ASSISTING YOUR PARENTS

Like many couples your age whom I meet in my practice, you are members of the "sandwich generation"—you are in between two other generations. Both of your parents are in their seventies, and you are concerned about them; your children are not yet in their teens and need your financial support for many years to come. At the same time, you are concerned about making appropriate plans for your own retirement. How to juggle all three of these goals concerns you.

I believe you can successfully work on many areas at once, as long as you carefully define your goals and mindfully tend each of them. Part of doing that means knowing what you'll need and when you'll need it, and then prioritizing the goals.

Planning for your parents is the vaguest of these three goals. You are not sure that you will need to help your parents, and you do have siblings who would help shoulder any financial burden should the need arise. You might have to reduce your own cost of living to support them, or you could use some of the cash in your emergency fund, which I recommend you establish at a bank or brokerage, with cash equal to three months' living expenses (as you are both wage earners) to take care of unexpected occurrences.

Since the need for parental aid and a likely level of support are currently unknown, I suggest you keep it in mind, but not set up a separate fund at this time.

KIDS' EDUCATION

With education, you have a pretty clear idea of how much you'll need and when you'll need it: You wish to finance four years of college for each of your children, and you currently have about $38,000 saved for this purpose, which is invested in two mutual funds.

Using an estimate of $40,000 per year in today's dollars for four years of private college (less for public or state colleges), you would need $509,000 to send both children to college.

Since college is only eight years away for your first child, you will have to step up your contributions to your children's college funds. You might want to look into Illinois' 529 plan as a vehicle for saving. It is managed by Citigroup Asset Management. Since it's your state plan, contributions would be tax-deductible on your state tax return.

It is commonly said in the financial world that your children can borrow money to go to college, but no one will lend you money to retire. Therefore, when the time comes, you can also discuss selecting state colleges with your children to lower your costs, and look into scholarships and financial aid possibilities.

RETIREMENT PLANNING

This is your ultimate major goal: taking care of yourselves for decades of comfortable living.

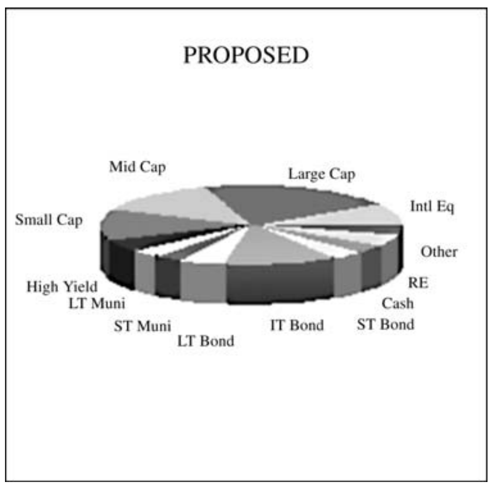
Currently, you are contributing only small amounts to your retirement plan at work. You should step these up on a regular basis, and max out your plans. Mrs. Gilbert currently contributes $3,700 when she could contribute $12,000 per year; you, Mr. Gilbert, are not eligible for a 401(k) plan, but you could be putting $3,000 a year into your own Roth IRA account. You should do so beginning now and continuing every year until retirement. Twenty years of contributions and tax deferrals can be a mighty powerful investment.

Furthermore, to make your retirement dreams come true, you should reduce your current expenses by $7,000 annually, adjusting that amount for inflation every year.

You will have to decide in which areas you can cut back without cramping your lifestyle. Many of my clients find they can cut back on discretionary items—such as vacations, hobbies, children's expenses, and

TABLE 1. CURRENT AND RECOMMENDED ALLOCATIONS

	Current (%)	Recommended (%)
CASH	**28.0**	**3.0**
BONDS		
Short-Term Bonds	0.0	4.0
Interm-Term Bonds	0.0	12.0
Long-Term Bonds	0.0	5.0
Short-Term Muni	0.0	3.0
Long-Term Muni	0.0	3.0
High-Yield Bonds	0.0	5.0
Total	**0.0**	**32.0**
STOCKS		
Small Cap	20.0	13.0
Mid Cap	1.0	13.0
Large Cap	48.0	21.0
International	3.0	10.0
Other (Mergers)	0.0	3.0
Total	**72.0**	**60.0**
REAL ESTATE	**0.0**	**5.0**
TOTAL PORTFOLIO	**100.0**	**100.0**



personal expenses—when looking for areas to change. That $7,000 per year will just about cover the additional contributions to your retirement plans discussed above.

TAXES

You have expressed a desire to save on income taxes. Contributing to a 529 plan and to your own retirement plans should help in this area. For example, if Mrs. Gilbert contributes the maximum to her 401(k) plan, your annual taxes will be reduced by about $2,600. In other words, Uncle Sam will help you meet your education and retirement goals.

SUMMER HOME

You may be able to achieve your goal of owning a summer home by reducing your living expenses even further than the $7,000 recommended above. If you can cut an additional $6,500 from your annual expenses, you could purchase a $250,000 home in 2009 with a 30-year mortgage of $200,000. Or, in order to have lower monthly expenses, you can delay the purchase of a second home until your children are out of college, about seven years later. Since you have stated that you want this to be a "family home" you might opt for the earlier scenario. The choice is up to you.

INSURANCE

Mrs. Gilbert currently has disability insurance, but you do not. Since more people become disabled while working than die, and since you count on two incomes to support your current lifestyle, I suggest you look into the purchase of a disability policy. Your goal here should be to replace your income in the event that you are unable to perform your current job. Therefore, look for a policy that has an "own occupation" clause.

INVESTMENTS

Your portfolio seems to be an accumulation of investments over a period of time, without a well thought out plan. This is an area that could use considerable revamping. Think of it as spring-cleaning for your portfolio.

Table 1 shows your current allocation, as well as my

TABLE 2. RECOMMENDED SALES AND PURCHASES

Recommended Sales: $288,719

Small Cap	Amount	Account
Acorn	$37,000	Wife IRA
Acorn	50,000	Husband IRA
Avaya	105	Husband trading acct
Bethlehem Stock	1	Husband stock
Visteon Corp. Stock	305	Husband trading acct
Mid Cap		
Agere Systems A Stock	5	Husband trading acct
Agere Systems B Stock	120	Husband trading acct
PHBG Tech & Comm Fund	1,475	Husband IRA
Large Cap		
Burlington Resource	1,811	Husband stock
Credit Suisse Cap App	11,741	Joint account
Exelon Stock	5,597	Husband stock
Fidelity Puritan	19,240	Wife IRA
Fidelity Puritan	15,070	Husband IRA
Hancock Equity A Fund	3,157	Wife IRA
Hancock Equity B Fund	16,783	Wife IRA
Hancock Health A Fund	2,059	Wife IRA
Hancock Health B Fund	11,490	Wife IRA
Invesco Tech Class II Fund	114	Joint account
Janus Twenty Fund	6,123	Joint account
Lucent Technology Stock	386	Husband trading acct
Nicholas Fund	26,032	Husband IRA
Nicholas Fund	18,106	Wife IRA
Strong Growth 20 Fund	405	Husband IRA
Travelers Property A	82	Husband trading acct
Travelers Property B	248	Husband trading acct
Vanguard Index 500 Fd	34,151	Husband invest acct
Vanguard Windsor II Fd	5,000	Wife IRA
Vanguard Windsor II Fd	5,000	Husband IRA
International		
Acorn International Fund	4,030	Joint account
T. Rowe Price Int'l Stock Fd	8,889	Husband IRA
T. Rowe Price Euro Stock Fd	4,193	Husband invest acct
Harris Trading Account	1	Joint account
Total Sales	**$288,719**	

Recommended Purchases: $436,669

Discount Brokerage Joint Account

Pimco Municipal Long Class D $17,000

Wife IRA

Pimco Low Duration Class D $25,000

Invests in short- to intermediate-term higher-quality securities. Limiting maturities can also limit risk. It has a leading record of bond fund performance.

Pimco Real Return Class D $25,000

Invests in Treasury Inflation-Protection Securities, which are inflation-indexed bonds. These bonds can help reduce a portfolio's overall risk and are expected to perform well should inflation continue to increase.

Tweedy Browne American Value $15,000

Long time value managers run this value fund, which invests in mid- and large-cap companies that are undervalued.

Baron Small Cap $15,000

Manager Cliff Greenberg buys companies cheaply in three areas: growth, fallen angels, and special situations.

Longleaf Partners $15,000

Managers are value investors with an excellent long-term record.

Merger Fund $17,838

Adds diversification by investing in companies in which a merger has already been announced. It buys shares of takeover candidates at a discount to the announced buyout price, making a profit if the deal goes through.

Wife 401(k)

One Group Investors Growth and Income $15,000
One Group Conservative Growth I $20,000
Putnam Small Cap Value Fund Y $15,000
One Group Mid Cap Value Fund I $16,547
One Group Income Bond Fund I $40,000

Your selection is limited to investments offered in your plan. We have selected those we feel fit your risk profile and overall portfolio best.

Husband's IRA

Loomis Sayles Bond $31,000

Invests at least 65% of assets in investment-grade debt securities and convertibles; balance may be invested in securities rated below BBB.

Northeast Investors $11,000

A high-yield bond fund that invests in lower-quality bonds providing higher cash income in expectation that some companies will default.

Royce Opportunity $15,000

Manager B. Zaino focuses on a limited number of companies. His approach is less correlated with equity markets because he selects stocks that are less popular but whose businesses he thinks will turn around in 12–18 months.

Longleaf International $30,000

Has a solid record of purchasing out-of-favor companies.

Tweedy Browne Global Value $30,000

Managers invest in companies that sell at extremely cheap price multiples, focusing on small- and mid-cap sectors.

Cohen & Steers Realty $31,284

The managers, Martin Cohen and Robert Steers, seek maximum total return while keeping volatility low and diversifying across real estate sectors. Investments include shopping centers, office complexes, health care real estate, and apartment buildings.

Husband Discount Brokerage Investment Account

Northeast Investors $20,000
T. Rowe Price Mid-Cap Growth $15,000
Vanguard Limited Term Tax-Ex $17,000

recommended allocation.

Currently, you have 72% of your $588,724 in investable assets in equities and 28% in cash (this includes cash in both taxable and retirement accounts). You have no bonds. Moreover, your equities are invested mainly in two areas: large-capitalization companies (48% of your portfolio) and small-capitalization companies (20% of your portfolio).

In my view, this heavy concentration in just a few areas gives you a more aggressive portfolio than you indicated you are comfortable with. You think of yourselves as "moderate" investors, and originally discussed a 50/50 asset allocation, but then decided you would be comfortable with a portfolio that provided an asset allocation of 65% equities and 35% cash and bonds.

I believe even within these categories, you need to be further diversified. Therefore, with your preferences and goals in mind, I recommend the asset allocation presented in Table 1.

This reallocation will give you the level of risk you said you were comfortable with and the diversification you currently lack.

In this reallocation process, you should also consolidate some of your 15 accounts wherever possible. This should be easy since you have several IRAs that could be combined. That would leave you with only eight accounts and would be easier for you to manage. You should open an account with a discount brokerage that would allow you to purchase no-load mutual funds for a modest transaction cost, consolidate your accounts in one place and serve as an efficient back office for your buying and selling.

You have many holdings with very small amounts, ranging from less than $5 to $386. I suggest you sell those small amounts. In other cases, I suggest you sell to lighten up on a position, or to allow you to purchase another asset. The recommended sales are presented in Table 2.

My recommended purchases, which total $436,669, are also presented in Table 2. Money for these purchases will come from the $288,719 you will now have from my recommended sales. In addition, reducing your cash allocation from 28% to 3% will provide you with an additional $147,950 to invest.

One final reminder: Don't forget to rebalance your accounts at least once a year.

RED FLAG: ESTATE PLANNING

Neither of you currently has a will. I see this as a huge red flag.

Since your children are still young, and you are concerned with their well being, I feel certain you would want to have a say in who would raise them in the event of a family tragedy. You might also wish to dispense of your personal property in a particular way, for example, giving a treasured piece of jewelry to someone special. And you might wish to set up a trust fund for your children's care and education.

I strongly suggest you speak to a qualified attorney about this right away. You will need to determine your executors, beneficiaries, trustees, and guardians and then draw up your wills. Also, speak to your attorney about health care proxies, durable powers of attorney, and other documents to protect yourselves and your family.

Sincerely,
Karen Altfest