Castling Financial Planning, Ltd.

Helping You Secure Your Future ™

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Summer 2011 Newsletter:

Don't Panic!

We were going to lead off our Summer newsletter commenting on the season's above average heat. But the recent financial turmoil, coupled with our own delay in getting this edition published, changed that. We decided to add an update to our mid-year update of the Castling Defensive Portfolio and to calm fears and panic. Our advice has not changed. Every investor should be constantly ready for both bear and bull markets. We strongly recommend that the best way to do that is to adopt an asset allocation whose expected return, measured using a consistency based methodology, matches your required rate of return. Then, stay the course.

What is your required rate of return? This isn't a trivial calculation and we don't guess. We encourage do-it-yourselfers (DIY) to get educated and spend the necessary effort required. For everyone else, we offer our services.

While the S&P 500 index (including reinvested dividends), as measured by Vanguard's 500 Index Fund (VFINX) has returned -9.61% through August 19th, our Castling Defensive Portfolio stands at +1.23% YTD.

Please review our last article for more information. We give a mid-year report and also show how the components have individually contributed to create an investment portfolio that seeks a target return with much lower risk and cost, while maintaining a higher probability of success and requiring little maintenance.

When we started these newsletters, our objective was to provide articles of general interest that were not dependent on specific market events, months of the year or even seasons. It was really about imparting some of the knowledge we have learned over the years and sharing experiences gained while working with clients.

I truly enjoy connecting different branches of knowledge, like our background in quantitative methods and applying that to investments. Some years ago while learning the concepts of Project Management, I was able to relate the so-called “triple constraint” of time, cost and scope to real life financial planning. This led to the creation of a Castling Financial Planning, Ltd. metric that quickly shows you how well you're doing financially. We explain this in our lead story.

One of the often asked questions we hear from clients is whether and how they should prepay their mortgage. They are usually surprised with the answer we give, as compared to what they have heard from their previous advisor. We explain this process in an objective fashion, free of the conflicted advisor double talk that is so pervasive.

Have a comment, suggestion, criticism or just plain feedback? We would like to hear from you. Please contact us by email, post or telephone as shown below.

Castling Financial Planning, Ltd. was created as a unique, hourly, fee-only, non-product selling and non-AUM investment adviser and financial planning firm, that is still very affordable for middle America. We do not engage in conflicts of interest (and prove it), never set asset minimums and welcome all clients. Less than 1% of all financial advisors are both hourly and affordable for middle America.

Do you currently have an advisor who says he offers you "free" advice? We are so confident that we can save you money over your current advisor (based on your total costs), that if we can't demonstrate how during our initial meeting with you, we will offer to perform your financial planning services in 2011 without charge, completely pro-bono.

"Free" advice is worth exactly what you paid for it. How do you separate where the sales presentation ends and the analysis begins? Castling Financial Planning, Ltd. advises everyone to stop paying for the privilege of buying a financial product, such as through commissions and sales loads. We also disagree with the concept of paying asset management fees to a %AUM based advisor. Does he actually spend a great deal of time working on your finances? By definition, he has an obligation to provide "continuous and regular supervisory or management services" for your securities portfolio. Good luck finding a definition for "continuous", other than having this apply to the continuous fees YOU pay.

We believe financial planning services should be paid for in the same way as your accountant, dentist or lawyer. You pay each based on their time expended and for their professional expertise, not a percentage of some amount. This is partially why each is considered a true profession, while financial planning struggles along with endless conflicts of interest, scandals, questionable motives and some truly awful advice.

The "Triple Constraint of Life" and "What Have You Got to Show for it?"™

While studying project management some years ago, we learned the concept called the "triple constraint". This simply means that there is always a trade-off among the three basic resources of time, cost and scope. Enlarging the scope of any project meant more work needed to be done. That resulted in more cost and perhaps take more time. Trying to decrease total completion time by adding more workers would add to the project's cost and so on. The bottom line is that there is no "free lunch". A careful balancing act is necessary, to deliver a completed project on time and within budget, while still accomplishing its necessary objectives.

Back in 2005, we thought of how to apply this concept to financial planning. I was taking financial planning classes at De Paul University, but this concept did not get introduced. It occurred to me that practically all people see a natural trade-off between "standard of living" and "quality of life". You can apply more effort to get ahead at your job, learn new skills, work part-time, etc. All of this may result in some monetary reward, which would then allow you to purchase more of the comforts of life, thereby raising your standard of living.

There is nothing inherently wrong with this. Millions have come to America to try and create a better life for themselves. Material possessions are certainly a big part of this. The downside comes into focus when the quest to keep up puts us on a treadmill that negatively impacts our "quality of life". We may sacrifice leisure time, vacations, simple pleasures, even time with our families, just so we can be successful in getting, keeping or growing our jobs and businesses.

What is the "correct" trade-off and how do we achieve it? Guess what? There is no one correct answer. Everyone must find the right balance. Financial planning is about identifying these trade-offs, quantifying them, coming up with alternative courses of action and then a set of recommendations. But any advice is based upon your ultimate goals.

Is that all there is to it? If I try to get to a higher standard of living, my quality of life may suffer. If I decline potentially lucrative jobs in other states to spend more time with my family, I feel better about myself, while my old car gets older, etc.

But something's missing. If any project consists of three constraints, then what about our personal lives? Just two? After giving this some thought, it became clear that one major aspect was missing, that deals with our overall financial well-being.

Simply displaying a high standard of living, while trying to maintain a high quality of life, could be possible for an unemployed person living off of a large credit line established before their unemployment. It is reasonable to assume that this life-style of borrowed wealth can only last for a period of time. At some point, the piper must be paid. A person in this predicament may well ask himself, "What do I have to show for it?". Long term financial security is not measured by current material possessions. In fact, beyond a certain point, material possessions simply eat away at long term financial well-being. Anyone doubting this statement should, after purchasing a brand new automobile, drive it back to the dealer the very next day and jokingly ask "So how much will you pay me to buy it back?".

For lack of a better description, we began to use this ("What have you got to show for it?") question to formulate the counter-balance to both standard of living and quality of life. We call these three: "Life's Triple Constraint". Change one variable and you impact one or both of the others. Guess which one is least important to most people, most of the time? Can there be any doubt that many people do not spend a good deal of time keeping track of what they have to show for life's efforts? They are simply too busy either enjoying the fruits of life's efforts or indeed expending the effort in the first place, in order to acquire those fruits.

So this thought experiment led to some calculations and finally, to creating a surprisingly simple process for measuring “What have you got to show for it?”.

If we want to effect change in something, we need to measure it first. Upon measuring it, we need a way to relate it to other similar things or people. We need some lines of demarcation that demonstrate significant differences. But we wanted to keep it simple. This led us to think of a pyramid with three sections.

At the bottom is a huge base comprising what we estimate to be about 80% of the American population. While this study has not been done over a large sample, we have not yet seen evidence to suggest these general percentages are way off. We call this the “Common” group. Most people fall into the Common group. There is nothing “wrong” with them.

The middle section is much smaller, perhaps comprising only about 15% of the population. We call them the “Aspiring” group. They must be doing something fundamentally different (and significant) with respect to their personal finances.

At the tip of the pyramid stands a very small cap, of approximately 5% of the population. We call them “Champions”. They have truly proven that they are doing something significant with their personal wealth. These are not necessarily only the richest people, although the group is at least somewhat wealthy. Those with very high incomes are not guaranteed a spot at the top, either.

At this point, you may be asking yourself how do I measure on this scale? The other purpose of this article is to show how this metric is computed, with only a modest amount of effort and tools you may have already used. It is also something we can calculate and interpret for you, if you wish.

It begins with your Net Worth statement. If you do your own financial planning, it should already be familiar to you. If you use an advisor, this may have already been done. If you would like us to show you how, please drop us a line. Now is the time to get it updated. When you know your current net worth, simply subtract out any inheritances or major gifts you have received. Your mother giving you $20 to get yourself a pizza is not a major gift. But getting a $10,000 wedding present in cash to put down on a new home certainly qualifies as being significant. You may remember inheritances received, since they do not happen very often, but if not, you should have kept the paperwork anyway.

Once net worth minus inheritances and major gifts has been computed, this becomes the numerator of our metric.

For the denominator, we use the grand total of your lifetime gross earnings, unadjusted for inflation. It's time to finally put your annual Social Security statement to good use. While this annual statement may no longer be mailed to everyone as a cost savings measure, you can still request one by going to http://www.ssa.gov/.

We urge you to take the time to review your statement annually. This is your chance to catch errors in posted earnings that are used to calculate your future Social Security benefit. Please let us know if you need help with this.

Look at the section titled Medicare Earnings. This lists all recorded earnings and is not limited to the amount of earnings for which Social Security taxes were paid. Medicare taxes are paid on all wage and salary (W-2) income. Compute a total of all pretax gross income for both yourself and your spouse/partner, if you will be including his/her assets in the net worth calculation. This total is unadjusted for inflation, while net worth is naturally tallied in current dollars.

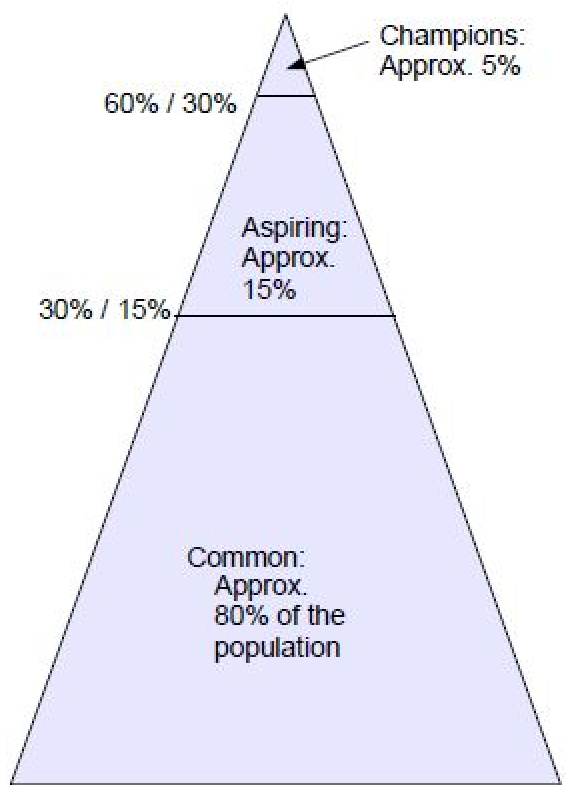
You may need to go back to your most recent Federal Income Tax Return to include last year's gross earnings, if not already included on the Social Security statement. It will also be necessary to look at the most recent pay stub(s) to get year-to-date gross earnings.

The resulting ratio (percentage) is what Castling Financial Planning, Ltd. calls:

"What Have You Got To Show for It?"™

= (Net Worth - Inheritances - Major Gifts Received) / Total Gross Earnings

Refer to the pyramid below. The outer values of 30% and 60% pertain to those who have been in the work force for a minimum of twenty years. The inner numbers are for those who have been working for at least ten, but less than twenty years. This metric does not apply to those who have not been in the workforce for at least ten years. After doing your own calculation, at first glance, are you pleasantly surprised, shocked and dismayed, or completely indifferent?



While we have not applied this on a large sample, the indications we are seeing are that about 80% of the population (and perhaps more), fall into the primary group that we label as "Common". There is nothing wrong with being in this group. Many people have various responsibilities, family sizes and personal circumstances that have influenced their financial lives. The bottom line is not to get bothered by a low ratio. <u>The point to understand is that if you assume your financial success has been significant, but your actual metric falls within this group, you definitely need a wake-up call</u>.

We see that at and above the first cut-off point of approximately 30% / 15%, people appear to be doing something fundamentally different with their finances. These are not necessarily wealthier folks. We admit that making a good income helps. We have labeled this group as "Aspiring". They may constitute less than 15% of the population. Some have been more successful in investing. Others run small businesses that generate a good profit, yet they still pay themselves modestly, by comparison. Regardless of the specific reasons, people in this group have found a path to financial success that others in the group below have not.

An important point to keep in mind is that the cut-off points between each group are not meant to be rigid. A ratio of 29% for someone who has worked thirty years should not lead to instant depression. Obviously, someone who scores a 29% is doing significantly better than someone else who measures 19%. It's just that <u>escaping the Common group will not be all that common</u>. <u>It will require an analysis of what you have been doing, what you would like to accomplish and planning how to get there</u>.

Harder still is making it into the very tiny group at the top of the pyramid. We call this group the "Champions" because there is something statistically significant in the results that they have achieved. 5% or less of the population probably qualifies. These are not necessarily very wealthy people or only those with high incomes, although they may have significant wealth. The difference is that they tend to hang on to more of their earnings, perhaps by minimizing taxes and fees along the way. They may do well in investing or may own profitable businesses. They probably don't consider themselves to be misers, but many are indeed frugal. In short, Champions are really doing something different from the Aspiring and this accounts for their success. Compared to the general population (Common), well, there is no comparison.

While people can find true happiness and life's fulfillment at all levels up and down this pyramid, those at the upper levels have attained some financial security and resiliency that will serve them well. <u>They are better positioned to weather financial crises and economic downturns</u>.

If you tried to score yourself and the result was low in the Common group, you may think the entire exercise was a waste of time. Quite the contrary. We began by introducing the triple constraint, then standard of living and quality of life. It is possible to spend enough personal resources and credit lines, to achieve a desired level of both standard of living and quality of life.

But what would that prove? Our metric provides the necessary counterbalance to these two. Taking this measurement annually, after implementing some financial planning changes in your life, will allow you to measure your progress. Simply going from a 14% score to a 16% score after one year, may be a significant personal victory.

Since Castling Financial Planning, Ltd. does not sell products and is not an asset manager, we are in a better position to discuss with you and analyze the areas of your financial life that can both positively and negatively influence your situation. For example, budget, spending plan and and cash flow analysis are major obstacles for many people. Someone focused on selling you an insurance policy is probably not going to emphasize these areas.

The alternative is DIY (do it yourself). We are proponents of this approach. But if you don't spend the time, don't educate yourself, or are not interested or motivated, then you are only fooling someone. Guess who?

Haven't you worked hard for a very long time? And after all of this, what have you got to show for it? Good luck with the metric and let us know what you think.

How to Decide If, When and How to Prepay Your Mortgage

Should I marry this person? Should I take a job offer in another city? Should we buy this house? Should I trade in my car? Should I pay ahead on my mortgage?

We all are confronted with a multitude of questions and choices in our lives. Often times, real life provides no easy answers and there are a number of variables that need to be taken into consideration for almost every big decision we make. We believe that choice is a good thing. Continually having options is a cornerstone of financial planning. One path to resiliency is being able to encounter life's obstacles and steer around them, simply because different options are available.

One of the most often asked questions in financial planning is whether, when, how and to what extent, a person should pay ahead, also known as prepay, their mortgage. The act of prepaying one's mortgage does not relieve the borrower of the obligation to continue to make their monthly mortgage payment, in the required amount. It does represent a conscious attempt on the part of the borrower to reduce the outstanding principal on their loan, thus reducing their indebtedness. For a simple interest load that is fully amortized (reduced to zero over its lifespan), <u>the “rate of return” to the borrower for any prepaid amount applied to reduce principal, is the same as the interest rate on the loan</u>.

For example, given a 5% 30 year fixed rate loan, applying $100 a month extra towards the principal would effectively “earn” 5% for the borrower, pretax. How? No longer paying 5% interest on each $100 applied toward the principal balance is equivalent to earning 5% interest on that same $100.

Many, if not most, financial advisors look with a disapproving eye on this action. Some consider it to be too simplistic, or that mortgage interest is deductible, therefore “good” to load up on, or may generally be engaged in conflicts of interest. In other words, <u>why should they advise on any action that goes contrary to their objectives of either pushing a financial product or pulling your assets under their management</u>?

In other words, don't expect them to recommend something that does not play along with their business model. We think that's advice everyone can live without.

Castling Financial Planning, Ltd. believes that this question, just like every other in financial planning, needs to be answered by pure analysis, completely free of conflicts of interest.

One of the most common arguments against mortgage prepayment is that the rate of return is low, compared to “other investments”. But this premise is faulty.

What if we said a Porsche 911 is a great car, but compared to “other station wagons”, it doesn't have much cargo space. The same faulty premise.

Principal applied toward a mortgage is not and never has been an investment. It is a form of forced savings. An academic may insist that everything is an investment, just like the previous example involves two types of automobiles.

I would scold this person for forgetting that every investment should be compared to another strictly on a risk adjusted basis. Within this framework, prepaying a mortgage is equivalent to savings products that involve negligible or no risk to principal.

“Got You!”, they reply. What if your home falls in value? Not relevant, we answer. Why? Because we would not advise anyone who is facing a short time horizon in their home, to prepay their mortgage.

The nature of mortgages is such that you must keep paying as long as you own the property, or refinance and then start paying the new loan, or eventually pay it off. The alternative is default, forced sale or foreclosure (we acknowledge that there are some “freeloaders” who have forestalled foreclosure for years, but we do not recommend this strategy).

There are really two distinct things to consider. The home as an asset and store of value, versus the mortgage as a liability. Have you made a decision to remain in the home indefinitely, perhaps irrespective of current market conditions and price trends? Is it because the home is still everything you wanted, located in the right school district, has a super garden, is close to shopping, etc.

Your primary residence is never your investment, since you derive “economic utility” from it. You live there. Everyone needs to live someplace and there are often non financial reasons for why we live where we live.

Our view is that real estate, whether for a primary residence or a rental property, should be viewed as a long term commitment. By that, we mean 10 years at least. We consider the advice given a few years ago to purchase property for low down payments or to “flip”, was highly irresponsible. Patient, long term buyers who made 20% down payments and borrowed no more than they could afford, may also have been impacted by the housing downturn. But they still achieve the same savings by prepaying mortgages on homes that they expect to live in, for a long time to come.

Our analysis really begins with understanding the client's financial goals and time horizon. We believe that combining paying off a mortgage, with retirement, is often a very solid choice. This allows you to minimize your “income footprint in retirement”, or the amount of income required to maintain a given standard of living. By comparison, a young couple with no investments, who can only think of paying off their mortgage, are making the mistake of not looking at long term compounded growth of assets, which will provide future funds for retirement.

Mortgage prepayment is a long term savings vehicle, similar to putting money in a cash value life insurance contract. While it is not a substitute for life insurance, the savings component can often be more lucrative and come at much less cost, as well as being completely transparent.

Another argument is that, since it is tax deductible, mortgage interest is “good” interest. Well, if I am in the 25% marginal income tax bracket and live in the State of Illinois (where mortgage interest is not deductible at the state level), a dollar spent on mortgage interest saves me 25 cents. Or does it? Since I only need to have a pulse in order to qualify for the standard deduction at the Federal level, <u>the value of mortgage interest only applies if I itemize deductions and only to the extent that the sum total of my itemized deductions exceeds the standard deduction</u>. For most people, this amount is not all that great.

While the alternative place for that $100 prepayment may be a savings account or Treasury bond, those vehicles will still produce fully taxable interest. The benefit of interest saved by prepaying needs to be computed after factoring in the lowered interest deduction and then comparing to the after tax interest earned from other low risk savings products. Or compare both on a purely pretax basis. But make sure you compare both either before or after tax, without mixing the two.

Another major argument is that once you prepay principal, the money is no longer available until you sell your home. This is not strictly true. A home equity line of credit (HELOC) is a great tool for a disciplined person intent on prepaying their mortgage. HELOCs can usually be obtained without any transaction cost. The borrower should shop for one which does not impose any annual maintenance fee or require that they draw money immediately. The HELOC can sit unused for years, but still be available. <u>This makes it suitable to act as a portion of an emergency fund, for a disciplined person</u>. By having funds available just by writing a check, instant liquidity is maintained. But by having these funds accessible only with a different check book (that can be locked away until a true emergency), some temptation is eliminated, as compared to drawing down your checking account (if that is the current location of your emergency fund). Of course, a HELOC's cost is its variable interest rate. But the impact is limited to the amount withdrawn and for the specific period of time until it is paid back.

For those of us who think that an emergency fund is to be used only in true emergencies and not where an expense should have been budgeted for (i.e. the aging roof should be a budgeted expense; the unexpected casualty loss is not), the HELOC is something to consider.

So how should we know when mortgage prepayment makes sense? Well, let's start by reviewing the current rate of inflation. Any mortgage prepayment can be started, stopped and restarted, as necessary. Historically, a negligible risk savings vehicle was capable of delivering 1% or 2% above the rate of inflation.

In early 2001, I pointed out to a Boston radio financial guru who pooh-poohed the idea of mortgage prepayment, that in an environment where many people had 6+% mortgages while the rate of inflation was about 3%, that a 3% real (inflation adjusted) rate of return on savings, was high by historical standards.

Refinancing to a lower rate mortgage may be a possibility, but the pay-back period (the length of time to recoup the amount spent on transaction costs of acquiring the new mortgage and repaying and terminating the old one) needs to be determined. Will you own the home long enough to benefit? For many, refinancing is difficult and costly. Prepayment may be an alternative.

By contrast, holding on to a low rate mortgage during times of higher inflation can be very wise. For example, we do not recommend prepaying a 4% mortgage, for example, when the inflation rate exceeds 5% and a 1 year bank CD is paying 5.5%.

To summarize, determine the current rate of growth in inflation (i.e. headline CPI is fine) and the best yield possible on a negligible risk savings product. Anything beyond a high quality short term bond fund is well past low risk. <u>Compare your mortgage's interest rate to current mortgage rates. If refinancing is not cost effective and savings products are not yielding positive returns after inflation, yet prepayments are, the decision should probably tilt toward prepayment</u>.

This assume that in the balance of life, other financial goals are being funded appropriately. As stated earlier, mortgage prepayment represents long term savings, not long term investing. Many people can and should fund multiple goals, based upon a careful analysis of their needs and time horizon. So the best answer will always depend on the circumstances of the client.

How should we prepay? Castling Financial Planning, Ltd. believes that the borrower who decides to prepay should automate their solution. Most every mortgage loan servicer now provides Web based access to the borrower's account. Both the monthly payment, as well as prepayment, can usually be automated through bank electronic funds transfer (EFT). This can probably give the borrower extra "float" time by extending the payment date to perhaps the 15th of the month, instead of the borrower trying to make sure their mailed in check arrives by the 1st of each month. At the same time, a prepayment can be set up. It will be usually drawn at the same time as the regular payment. The added advantage is that the prepayment is electronically separated from the regular payment, preventing the once common problem of additional payments being applied, but not just to principal, thus defeating the purpose. The automated payments and prepayments can usually be stopped and restarted with a minimal amount of effort.

We think that the "set it and forget it" approach is valuable, once the analysis is over and a decision has been made. In this way, you no longer need to remember to take these actions each month. Another criticism of prepayments has been that the amount of work involved would discourage people from adopting it. Some have even paid for this privilege or to have bi-weekly payments set up.

Our view is that these are unnecessary and costly. What we have described above should be available without paying any fees.

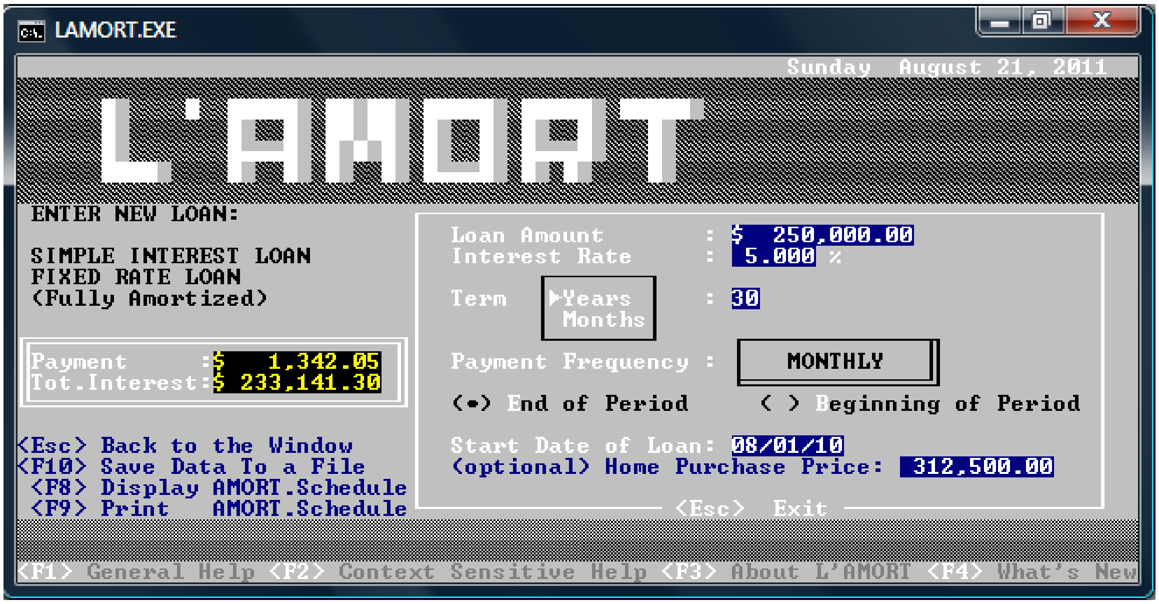
While irregular prepayments (different amounts paid at different times, with perhaps long gaps in between) can work, we think the added work in remembering to do these is not as worthwhile. Automate it and move on with your life!

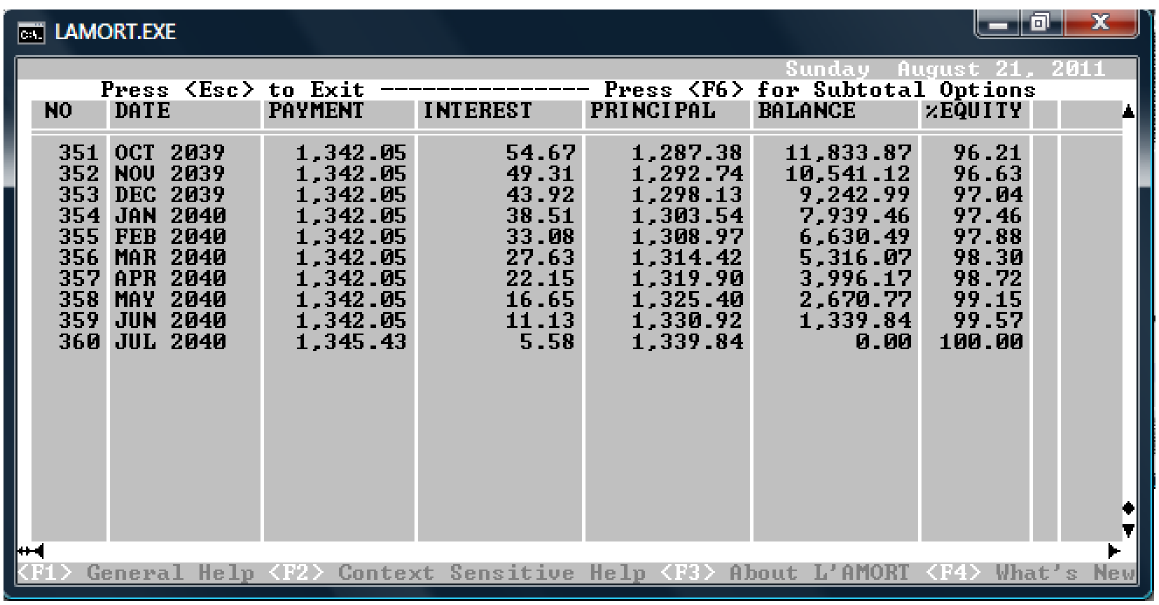
Finally, we close with a hypothetical example. Suppose a 45 year old couple was one year into a 30 year, 5% fixed rate mortgage with a starting loan amount of $250,000. The regular monthly payment is $1,342.05. They are both planning on retiring at age 67, in 22 years. Their goal is to have enough assets to support their lifestyle. They have decided to live in their present home indefinitely. Supporting their retirement goal is the strategy of owning this home free and clear of any mortgage by age 67. We are estimating current inflation at a little over 3% and keeping an eye on it for possible increases. But when we review other savings products, we see that the best we can come up with, is at or slightly above 1% APY (annual percentage yield). They currently have the amount of six months fixed and variable (after income tax) expenses, tucked away in an emergency fund and instantly available. There is no other urgent need for extra cash. They also invest in his and hers 401Ks, with amounts projected to grow to fund their retirements, starting at age 67 (in 2033). So there is no urgency to increase their level of (riskier) investments.

So we see that the current return offered by prepaying their mortgage with a small, but steady amount, is greater than the risk adjusted alternatives. This idea fits within their stated goal of moving ahead on their loan by seven years. Our couple, having redone their budget, can devote no more than $250 per month to prepayments.

Of course, they must still continue to pay their mortgage in full each month and also continue to contribute the same amount to their retirement accounts.

Here is how our ***L'Amort*** software displays the regular payment information. The purchase price of the home was $312,500 and they made a 20% down payment of $62,500, leaving a loan amount of $250,000. We see that continuing just the regular payment for the remaining 29 years would result in a grand total of $233,141.30 in interest being paid. They would be free of mortgage payments after July, 2040, if they make NO prepayments.




LAMORT.EXE

Sunday August 21, 2011

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NO	DATE	PAYMENT	INTEREST	PRINCIPAL	BALANCE	%EQUITY
351	OCT 2039	1,342.05	54.67	1,287.38	11,833.87	96.21
352	NOV 2039	1,342.05	49.31	1,292.74	10,541.12	96.63
353	DEC 2039	1,342.05	43.92	1,298.13	9,242.99	97.04
354	JAN 2040	1,342.05	38.51	1,303.54	7,939.46	97.46
355	FEB 2040	1,342.05	33.08	1,308.97	6,630.49	97.88
356	MAR 2040	1,342.05	27.63	1,314.42	5,316.07	98.30
357	APR 2040	1,342.05	22.15	1,319.90	3,996.17	98.72
358	MAY 2040	1,342.05	16.65	1,325.40	2,670.77	99.15
359	JUN 2040	1,342.05	11.13	1,330.92	1,339.84	99.57
360	JUL 2040	1,345.43	5.58	1,339.84	0.00	100.00

<F1> General Help <F2> Context Sensitive Help <F3> About L'AMORT <F4> What's New

There are multiple software programs and Websites that can help provide answers along the lines that we are demonstrating. Be sure to use one that allows you to enter prepayments and record them, thus dynamically affecting the amortization schedule. Be sure to save the results and print them out for later review and comparison. Determine the date and payment number for which your remaining principal balance goes to zero. Compare this to your projected retirement date.

This is where the iterative, trial and error, approach works well. You have a limited amount of available funds and an optimistic forecast of when you would like to have the mortgage paid off. By working the numbers and dates, you can arrive at what is the most optimal decision, given your unique goals and constraints. Even if you can not achieve exactly what you wish, it is important to begin now. In future years, you may be able to slightly increase the amount of the prepayment and catch up with your original target.

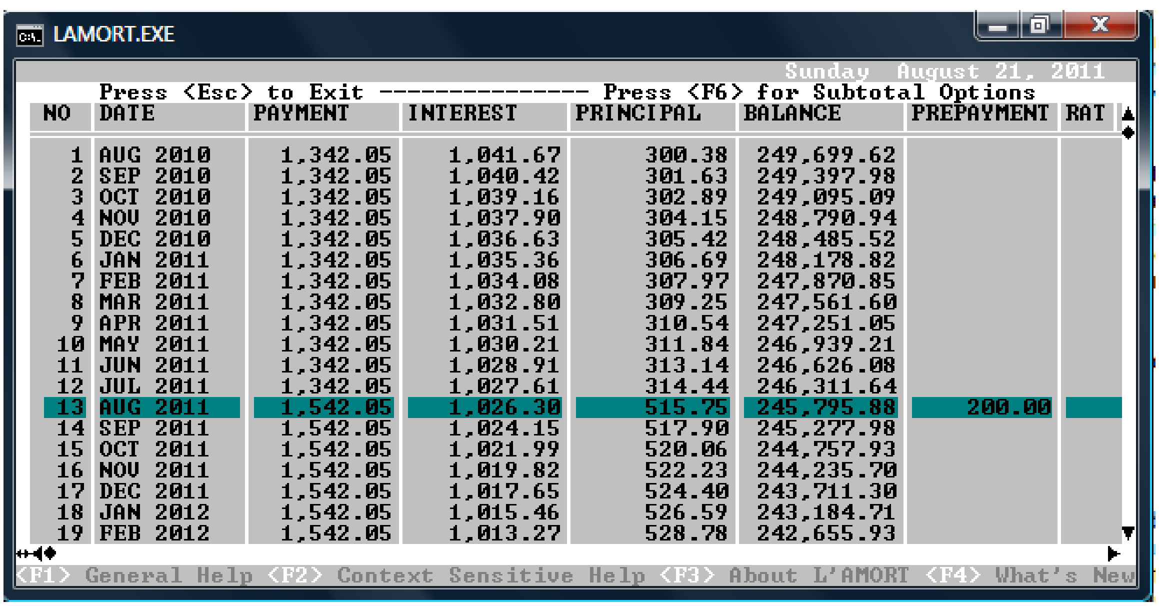
For this example, the target retirement date is August, 2033. Using ***L'Amort***, we can rapidly try various prepayment amounts, starting at August 2011 and see the amortization schedule dynamically change, giving us a new payoff date with each trial. After a couple attempts, we find that simply adding $200 to their regular payment, beginning August 2011, will result in the loan being paid off with payment #276 (July 2033).

Not only does this stay within their budget, but it also satisfies their goal of being mortgage free at their retirement date.

What if inflation or interest rates on savings products change dramatically or quickly? No problem. The strategy can simply be suspended until conditions change once again.

We recommend that you always make the prepayments using the mortgage servicer's Website and automate it at the same time. Both the regular payment and prepayment amounts can typically be debited from your checking account electronically, usually as late as the 15th of the month after the payment is due. This maximizes "float" in your favor, while making the servicer responsible for executing the EFT/ACH "pull". Be certain that sufficient funds remain in your checking account to cover the total amounts being paid.

As always, should you have any questions or run into any difficulties, Castling Financial Planning, Ltd. can help with your individual calculations and evaluate your present financial situation, to determine if, when, how and by how much, mortgage prepayment could work for you.



NO	DATE	PAYMENT	INTEREST	PRINCIPAL	BALANCE	PREPAYMENT	RAT
1	AUG 2010	1,342.05	1,041.67	300.38	249,699.62		
2	SEP 2010	1,342.05	1,040.42	301.63	249,397.98		
3	OCT 2010	1,342.05	1,039.16	302.89	249,095.09		
4	NOV 2010	1,342.05	1,037.90	304.15	248,790.94		
5	DEC 2010	1,342.05	1,036.63	305.42	248,485.52		
6	JAN 2011	1,342.05	1,035.36	306.69	248,178.82		
7	FEB 2011	1,342.05	1,034.08	307.97	247,870.85		
8	MAR 2011	1,342.05	1,032.80	309.25	247,561.60		
9	APR 2011	1,342.05	1,031.51	310.54	247,251.05		
10	MAY 2011	1,342.05	1,030.21	311.84	246,939.21		
11	JUN 2011	1,342.05	1,028.91	313.14	246,626.08		
12	JUL 2011	1,342.05	1,027.61	314.44	246,311.64		
13	AUG 2011	1,542.05	1,026.30	515.75	245,795.88	200.00	
14	SEP 2011	1,542.05	1,024.15	517.90	245,277.98		
15	OCT 2011	1,542.05	1,021.99	520.06	244,757.93		
16	NOV 2011	1,542.05	1,019.82	522.23	244,235.70		
17	DEC 2011	1,542.05	1,017.65	524.40	243,711.30		
18	JAN 2012	1,542.05	1,015.46	526.59	243,184.71		
19	FEB 2012	1,542.05	1,013.27	528.78	242,655.93		

LAMORT.EXE

Sunday August 21, 2011

Press <Esc> to Exit --------------- Press <F6> for Subtotal Options

NO	DATE	PAYMENT	INTEREST	PRINCIPAL	BALANCE	PREPAYMENT	RAT
259	FEB 2032	1,542.05	107.66	1,434.39	24,403.79		
260	MAR 2032	1,542.05	101.68	1,440.37	22,963.42		
261	APR 2032	1,542.05	95.68	1,446.37	21,517.05		
262	MAY 2032	1,542.05	89.65	1,452.40	20,064.66		
263	JUN 2032	1,542.05	83.60	1,458.45	18,606.21		
264	JUL 2032	1,542.05	77.53	1,464.52	17,141.69		
265	AUG 2032	1,542.05	71.42	1,470.63	15,671.06		
266	SEP 2032	1,542.05	65.30	1,476.75	14,194.31		
267	OCT 2032	1,542.05	59.14	1,482.91	12,711.40		
268	NOV 2032	1,542.05	52.96	1,489.09	11,222.31		
269	DEC 2032	1,542.05	46.76	1,495.29	9,727.02		
270	JAN 2033	1,542.05	40.53	1,501.52	8,225.50		
271	FEB 2033	1,542.05	34.27	1,507.78	6,717.73		
272	MAR 2033	1,542.05	27.99	1,514.06	5,203.67		
273	APR 2033	1,542.05	21.68	1,520.37	3,683.30		
274	MAY 2033	1,542.05	15.35	1,526.70	2,156.60		
275	JUN 2033	1,542.05	8.99	1,533.06	623.53		
276	JUL 2033	626.13	2.60	623.53	0.00		
277	AUG 2033	0.00	0.00	0.00	0.00		

<F1> General Help <F2> Context Sensitive Help <F3> About L'AMORT <F4> What's New

The Castling Defensive Portfolio: Mid-Year Update and a Look at How We Measure Risk

Our model portfolio for conservative investors, is one whose asset allocation and other details we freely share with the general public. It's an example of our analytical abilities, knowledge of asset allocation and ability to pick real life, low cost investment products. This combination attempts to meet an objective that we have labeled as "target return". Specifically, it seeks a 7.2% net pretax annualized return across multiple rolling periods, while maintaining the lowest risk metric we can find.

In the first half of 2011, the Castling Defensive Portfolio marched on, returning a positive 3.64%, net pretax.

Including the recent market correction and banking panic in Europe, the year-to-date total return through August 19th is still a positive 1.23%.

For your review, the next two tables display both the specific investments that make up the Castling Defensive Portfolio, as well as their allocations, expense ratios, minimum initial investment amounts and how to apportion an investment in each so as to meet the minimums and adhere to the overall asset allocation requirements of the portfolio ($75,000 would be required).

#	The Castling Defensive Portfolio:	Ticker Symbol	% Allocation	Expenses
1	FDIC Insured Certificates of Deposit (Avg. of High Yielding)	Bank CD's	9%	0.00%
2	Vanguard Short-Term Treasury Investor Shares	VFISX	9%	0.22%
3	Vanguard Short-Term Investment-Grade Investor Shares	VFSTX	9%	0.26%
4	Vanguard Intermediate-Term Treasury Investor Shares	VFITX	12%	0.25%
5	Vanguard Inflation-Protected Securities Investor Shares	VIPSX	12%	0.25%
6	Vanguard GNMA Investor Shares	VFIIX	11%	0.23%
7	Vanguard Wellesley Income Investor Shares	VWINX	11%	0.33%
8	Royce Special Equity Investment Class Shares	RYSEX	15%	1.15%
9	Vanguard REIT Index Investor Shares	VGSIX	8%	0.26%
10	Vanguard Total International Stock Index	VGTSX	4%	0.32%
	Totals		**100%**	**0.37%**

Ticker Symbol	Minimum Investment	Keeping Allocation
Bank CD's	Varies	$6,750
VFISX	$3,000	$6,750
VFSTX	$3,000	$6,750
VFITX	$3,000	$9,000
VIPSX	$3,000	$9,000
VFIIX	$3,000	$8,250
VWINX	$3,000	$8,250
RYSEX	$2,000	$11,250
VGSIX	$3,000	$6,000
VGTSX	$3,000	$3,000
Totals		**$75,000**

All return data below is sourced from the Vanguard and Royce Websites[1,2]. Bank CD yield data was gathered from multiple sources and simply uses the highest yields found over the time period in question.

The first half 3.64% return is the composite of the individual investments' returns shown below, multiplied by the weighting arrived at from our original analysis. While we reserve the right to modify the recommended weightings in the future, we undertake any and all changes only after applying our rigorous analytical techniques and avoid chasing "hot" funds or sectors, trendy ideas or other gimmicks. Consistency is our keyword.

Ticker Symbol	% Allocation	2011 to Jun 30	2011 to Aug 19
Bank CD's	9%	0.50%	0.70%
VFISX	9%	1.10%	2.13%
VFSTX	9%	1.61%	1.99%
VFITX	12%	2.96%	8.52%
VIPSX	12%	5.31%	12.06%
VFIIX	11%	3.31%	6.24%
VWINX	11%	5.09%	3.16%
RYSEX	15%	3.11%	-13.37%
VGSIX	8%	10.24%	-2.52%
VGTSX	4%	3.68%	-12.44%
	100%	**Total Return:**	**Total Return:**
Castling Defensive Portfolio:		**3.64%**	**1.23%**

Next, let's compare annualized and cumulative returns (2000 through the first half of 2011) versus three high quality mutual funds from Vanguard, the S&P 500 index fund (VFINX), the Wellington fund (VWELX) and the more conservative Wellesley Income Fund (VWINX).

How does Castling Financial Planning, Ltd. add value? By focusing on consistency and risk, not by pushing financial products or gathering assets. The Castling Defensive Portfolio exceeded its objective of a 7.2% net pretax, annualized return. From the beginning of 2000 through the end of the first half of 2011, our model portfolio achieved a 7.72% net pretax, annualized return, which was higher than that of any of the three individual Vanguard funds.

The risk point to be made is about something called "Coefficient of Variation" (CoV). This is a relatively simple statistical metric that measures the standard deviation (a measure of dispersion or variability) of the year by year returns divided by the annualized return. One technical point is that we use the geometric mean or annualized return in the denominator, instead of the arithmetic mean (simple average), because it provides a more conservative measure, thus highlighting risk more clearly.

Since Wellesley Income turned in the best performance of the three mentioned, let's compare in more detail. Our portfolio performed only slightly better than it based on return (7.72% versus 7.42%). No changes in asset allocation were made over this time period and end of year re-balancing was assumed.

However, the difference in CoV is striking (0.69 versus 0.92). Looked at another way, the difference between these two numbers is 25%. Exhibiting a quarter less risk, while achieving as good a return, while also meeting and exceeding its own target return objective. Now do you see why we call it Castling?

If this kind of analysis interests you and you are not already a client, please let us know. Please also keep in mind that all investing involves some risk. Please review our disclosures at the end of this report for more information.

	2011 to Jun 30
Castling	
Cumulative Return	135.29%
VWINX	
Cumulative Return	127.79%
VFINX	
Cumulative Return	9.77%
VWELX	
Cumulative Return	111.77%
Growth of $10,000	$23,529
Compared to VWINX	$22,779
Compared to VFINX	$10,977
Compared to VWELX	$21,177
Castling Defensive Portfolio	
Annualized Return	***7.72%***
Standard Deviation	*5.30%*
Coefficient of Variation	*0.69*
VWELX	
Annualized Return	**6.74%**
Standard Deviation	*12.03%*
Coefficient of Variation	*1.78*
VWINX	
Annualized Return	**7.42%**
Standard Deviation	*6.81%*
Coefficient of Variation	*0.92*
VFINX	
Annualized Return	**0.81%**
Standard Deviation	*19.51%*
Coefficient of Variation	*23.98*

References

1. Information about all Vanguard funds, including their performance, was obtained through the Vanguard Financial Advisor Website. This same information is available to investors at: http://personal.vanguard.com.

2. Information about the Royce Special Equity Fund, including performance, was obtained through the Royce Funds Advisor Website. This same information is available to investors at: http://www.roycefunds.com.

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Point your Internet browser to the Securities and Exchange Commission (SEC) Website at:

http://www.adviserinfo.sec.gov/IAPD/Content/Search/iapd_OrgSearch.aspx

(If this page has moved or changed, go to the SEC home page at: http://www.sec.gov/ and follow the links for information on Advisers.)

In the Firm Name search box, enter the word: “Castling” without quotes and make sure Type of firm Search is set to “Starts With”.

Click on the Go button.

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Click on the “Illinois” link showed on the next page.

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