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Helping You Secure Your Future™

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Winter 2015 Newsletter:

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Think First, Then Sign (or Preferably Don't Sign) The Save Our Retirement Petition

Shiny. Sleek. Seductive. The smell of fresh leather. That new car scent. It's all too tempting, isn't it? As soon as I exited one vehicle and sauntered over to another, I saw a figure on the horizon walking breezily toward me. “Oh, goodie!”, I thought.

“Hello there!” I called out, even before he reached me. “Are you my transportation advisor?”, I sheepishly asked. “Would you be able to advise us on our transportation needs?” “Sure folks”, he replied. “By the way, the name's Duke. Duke Nukem, at your service.”

“So what do you think Duke? Should we buy a car today?”

Does anyone think that the above conversation actually happens in modern America? Does the average person not realize that Duke is not a transportation advisor, but is actually just a car salesman?

Taking a situation out of the present context we may be having difficulty understanding, and repositioning it into a different context that is more understandable, or with which we are more comfortable with, is one of the techniques we have oftentimes recommended. If you cannot understand what you are being told, re-frame the scenario and see if it still looks reasonable or logical to you.

And so it is in the financial services industry with the on again, off again talk of a universal fiduciary standard, which would apply to all financial services professionals, or at least all who give anything approaching investment advice to retirement plan participants.

The Dodd-Frank Financial Reform Law back in 2010 gave the SEC the rule making authority to come up with a universal fiduciary standard. It so far has not[1]. But trying to fit a square peg into a round hole may be easier.

The latest petition on the Web we recently came across is entitled “Save Our Retirement”[2]. This follows other petitions in recent years, even one for financial planners urging the SEC to create this universal fiduciary standard[3]. We have always resisted the urge to sign such petitions, which may seem a bit odd to our readers and even to some clients.

Our reasoning is that any universal fiduciary standard that is newly created, will almost certainly be a watered down standard. As a result, it will not help and could actually

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make matters worse for the general public, many of whom simply are unaware of even the basic distinction between a broker/agent and an investment adviser.

Evidence to support our view is easily found within the details. An Obama administration proposal for a uniform fiduciary standard includes what is termed "exemptions". A recent Chicago Tribune article reporting this story mentioned (our emphasis added):

"A White House fact sheet did not detail the [sic] precisely how the new exemptions would accommodate some of the industry's past concerns. The exemptions were described as "more principles-based" and the new proposals would not prohibit revenue-sharing or commissions or dictate how firms pay their advisors..."[4]

But herein lies the problem. Setting up a universal standard that the general public would remember and then creating any sort of exemptions to that standard, creates loopholes and marketing opportunities for anyone who can advertise "Yes, we follow a fiduciary standard of care", while carefully constructing a business model and sales presentation that is just enough on the right side of the exemption, to pass muster.

Up to this point in time, brokers, agents and other commission based product salespersons (CBPS) have operated under what is called the "suitability" standard. A recommended financial product need not be in the best interests of their client. It merely needs to be suitable. In reality, the suitability standard is very broad. Most investment and insurance products will be seen as being suitable for most clients.

Registered investment advisory firms (RIA), their representatives and individual investment advisers are already held to a fiduciary standard of care, that requires the client's interests to come first. The main point of contention with the RIA community is that they serve relatively wealthy clients, since they are almost always paid by a percentage of assets under management (AUM). This means that a gate keeping mechanism exists. If you don't bring them sufficient assets, they won't give you the time of day (but in a nice way, of course).

By contrast, one of the biggest points of contention with CBPS, is that if they acted as true fiduciaries, they could not make enough money serving smaller (in terms of assets) clients. As a result, the stated fear is that they would stop serving the less affluent.

Castling Financial Planning, Ltd. feels somewhat left out of the debate. Ignored, in other words. And we think that our prospective clients and other readers are being done a disservice, as a result.

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Here's why.

If we analyze the relationship between a CBPS and the product creator/seller, we should be able to easily see that the CBPS already has a fiduciary relationship with the company producing/creating/selling a financial product. For example, a stock broker must maintain a relationship with a broker/dealer and an insurance agent must have the authority to bind coverage on behalf of the insurance company.

Whether they are employees or independent contractors, these folks maintain an affiliation with the product provider (bank, broker/dealer, mutual fund company, insurance company) that provides them salary, upfront commissions, trailing commissions, bonuses, soft dollar payments, etc.

"A man cannot serve two masters." This principle dates back to English common law and even Biblical times. It is fully applicable today in all aspects of the economy. For example, a reputable law firm will not take both sides of a case, because of the natural adversarial relationship that exists between the two parties.

If any financial professional is already a fiduciary in any respect to the product seller, they cannot in good conscience, be a true fiduciary to the product buyer (to you, the client). Saying it's so, won't make it so, regardless of the pretty picture someone will paint over it.

Adding exemptions or exceptions just means that regulations will get denser and more difficult to fathom. But the major financial services firms have huge compliance departments with staffs of very knowledgeable people, including cadres of attorneys who will churn out ever "slicker and thicker" client contracts and advisory agreements. These will surely meet the letter of the law, while ignorant or disinterested politicians move on to other matters, not paying attention to the spirit of the law, which has been hollowed out.

CastlingFP believes this is why the SEC has not already come up with a universal fiduciary standard, almost five years after the Dodd-Frank law gave them the authority. The king can easily tell the alchemist: "I hereby authorize you to turn lead into gold. Commence when thou is ablest". This does not mean that the kingdom's coffers will at once become full.

Up to now, the problem has not been a lack of regulation within the financial services industry. It has been a lack of prominent disclosure. This has resulted in the general public not knowing the difference between those who practice the fiduciary standard and those who uphold the much weaker, suitability, standard.

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If the commission based side of the business operates at only a "suitability" level and the investment adviser side only wants affluent clients, where can Middle America turn for help?

While most of the players, pundits and politicians claim that the less than affluent will not be served, they ignore the very business model we have espoused from day one, at ***CastlingFP***:

Affordable Hourly, Non-Product Selling and Non-AUM based
Financial Planning and Investment Advisory Services

The business models of the past, namely commission based and asset based, have not really served the general public all that well. If this were not the case, there would not be a growing level of dissatisfaction and Americans would be, generally speaking, better prepared for retirement. Could anyone seriously argue this point?

At its core, we believe this is due to the flawed nature of combining product sales, asset management and advice into one package. At best, you get an expensive, proprietary, non-fiduciary based solution. At worst, you get Bernie Madoff.

All real advice should be based upon totally objective and independent analysis. We stress the word analysis. Anything less is a sales presentation.

(Personal Story Time: Long, long ago, before I was doing this professionally, before I learned it professionally, before I was doing it in my own life, before I learned it on my own, I formulated the following piece of advice, based upon experience, which I have always followed: ***Never, ever, take financial advice from anyone who sells a financial product. Period. End of Story. No exceptions.***)

I realize that this paints a dark picture. It is only half meant to. When you know what you want and you consult with a salesperson to get it, that is perfectly fine and reasonable. This suggestion is certainly not meant to banish salespeople.

But just as the car salesman we introduced earlier, was not really a "transportation adviser", we recommend you simply ask the financial professional these questions:

1. At the end of the day, what business are you really in, financial planning or product selling?
2. Does it mean that you will help me solve my financial issues, even if no product sale takes place?
3. Even if no assets are brought under your firm's management?

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4. Are alternative courses of action given equal weight, such as those that result in no product sales to you, less or no AUM for your firm, or result in assets being directed elsewhere, if that were to be in my best interest?

CastlingFP can answer these questions unequivocally:

1. We never sell products, guaranteed. We do analysis, not sales.
2. Yes, definitely. We focus on the who, what, when, where, why and how of personal finance.
3. Yes, since there is never a distinction; we do not have custody of client assets.
4. Yes, most definitely. Help with 401(k)s, various broker/dealers, self-directed IRAs, debt reduction, mortgage prepayment, etc. are all possible.

So what type of solution do we propose for the financial services industry? Simple. Let's stop adding more confusing regulations and start with basic "***prominent disclosure***". What do we mean by that? We begin with disclosure that is about as obvious as the surgeon general's warning on a pack of cigarettes.

We recommend that before any financial professional asks a client to sign anything, he or she should complete and sign the following prominent disclosure, or something similar that would also be presented in plain English.

__ (**YES**) I uphold a fiduciary standard of care in all my client interactions.

__ (**NO**) I do not uphold a fiduciary standard of care in all my client interactions.

IMPORTANT NOTE TO CLIENT:
The fiduciary standard obligates the financial professional to put the interests of you, the client(s), ahead of his/her own or that of his/her firm.

If the financial professional has not checked the **YES** box and your intent is mostly or solely to obtain advice and not simply to purchase financial products, you are hereby put on notice that your interests *may* be better served by consulting a fiduciary.

This disclosure should be signed by both the financial adviser as well as the prospective client(s). Each party should retain a copy.

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Along with enforcing prominent disclosure, we think that the role of government should be to foster competition. In the financial advisory industry, fewer than 1% of all advisers operate with an hourly business model. Of these, only a fraction can truly call themselves "affordable". ***CastlingFP*** is one of them. But we are microscopic minnows in a big ocean. The Internet has brought us all together, but regulation ties us up with red tape and excessive costs. In fact, government could have set up the following business/practice standard, but has chosen not to:

1. Fiduciary standard of care in all client interactions.
2. No product selling in order to avoid conflicts of interest.
3. No affiliations with product sellers in order to avoid conflicts of interest.
4. No custody of client assets.
5. No discretion over client accounts.
6. Hourly or fixed fee compensation ONLY, just like an accountant or dentist.
7. Focus on being the client's trusted adviser, not a slick talking product salesperson, or a "wealth manager" who makes a nice living off of their clients' wealth.

In exchange, dear government, give us the opportunity to serve clients throughout the country, without the cost or regulatory burden of registering in every single state individually, or being limited to only a few clients in those states where we are not yet registered.

We as small business people, could serve the under-served, whether locally in person, or via telephone, Internet or email.

<u>Serving middle class clients at a price they can afford and that still makes for a viable business model is possible, but only if the potential costs were whittled down from where they currently are</u>. The biggest obstacle is regulation and excessive costs from the same government that maintains it is looking out for the small investor and average American.

Now you know why we won't sign any of these petitions in their present form. But we'd like to know what you think. Please drop us a line with your thoughts, concerns, suggestions or even rants!

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Inflation? Nah. This Ain't No Inflation! I Just had to Increase my Prices

Saurry Plopkin lives in a rent controlled apartment in New York City. For the last twenty five years, he has managed to live on the annuity payments from a trust fund created by his long deceased parents.

Saurry (pronounced sort of like "sorry") has managed to live on mostly bottled water, saltine crackers, overripe fruits and vegetables he buys for next to nothing from a local market (they're just glad to get rid of them) and of course his favorite items, consumer electronics.

His tiny flat is literally filled to the brim with various gadgets. The latest models and features? With Saurry, it's already "been there, done that". Saurry enjoys his life and does not regret what others would consider to be a relatively meaningless and sedentary existence.

Oh, but let's not look down upon Mr. Plopkin's apparent lack of ambition and initiative. As he puts it, "Why should I be a 'W-2 *Robotnik*'? You do it if you want to, but leave me out of it. Whatever".

Instead, we can learn a valuable lesson from Saurry. Back in 1990 when he received the first payment from his trust fund, he was told by his father, "Saurry, listen to me. Don't be a dumb, lazy bum like your older brother. In order to make these payments last the rest of your life, they're never going to increase. Got it? At some point, you're going to have to go out and look for a job. Saurry? Are you listening to me?"

But Saurry was no dummy. In fact, he's quite intelligent. His father's stern warning prompted him into action. He thought "How could I insure the standard of living I desire and never be impacted by inflation, thereby preserving the purchasing power of my annuity payments?" Or perhaps his musings were not quite so eloquent. Instead, Saurry would blurt out, "I don't need to look for no stinkin job. After all, I'm no 'W-2 *Robotnik*', understand?"

Saurry then proceeded to adjust his spending month by month, to balance price increases in certain necessities (what the rest of us call our staples), with price decreases in what he considered to be his own necessities (consumer electronics). The end result? No impact from inflation over a twenty five year period. And yes, he did watch the Big Game on his 70", 4-K, 3-D, Curved Panel, 7.1 Surround Sound, "Smell the Crowd" TV, along with his friends. Of course, they had to supply the food and beverages, in order to get invited over.

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So what does Saurry have in common with the Consumer Price Index? Not much. In that case, should we even bother considering it?

Let's face it. Inflation is a boring topic. The purpose of a silly story is to convey the general message that the impact of rising prices over time (i.e. inflation) can be felt differently by different people. What each of them see and feel is completely real to them and does not represent subjective distortion or selective memory.

Government "bean counters" from the Bureau of Labor Statistics (BLS) take great care in producing measurements, such as the Consumer Price Index for all Urban Consumers, aka CPI-U. If they state that annual inflation is running at only 1.7%, but your personal life tells you a much different story (Yikes! Prices are much higher!), are they lying to you, or are you imagining things? Neither.

What seems to be missing in this discussion, is a little thing called "weightings". All CPI measurements assume a basket of "goods and services" taken in different metropolitan areas, across different time periods. There is a relatively large number of items in each basket. For instance, bacon, pork chops and ham are three different items, all under the "Pork" category, which is under "Meats", which in turn is under "Meats, poultry and fish", under "Meats, poultry, fish and eggs", under "Food at home", under "Food" and (finally) under "Food and beverages". This last "component" is given a 14.9% weighting in the CPI-U, with bacon comprising only 0.138% of those 14.9 percentage points[5].

"Wait a minute! We buy a lot more bacon than that! I smell a conspiracy!" It is easy to see that what each of us considers important enough to spend our money on, can and does vary by wide margins. If we simply took the Consumer Price Index as being perfectly representative of our particular situation, we would undoubtedly be wrong. And by a wide margin. The CPI-U attempts to represent the price level for a consumer with preferences exactly as represented in the weightings of its components. No more and no less. Here are the major components summarized at the end of 2013[6]:

Major Components of the CPI-U	Weighting
Food and beverages	14.9%
Housing	41.4%
Apparel	3.4%
Transportation	16.4%
Medical care	7.6%
Recreation	5.8%
Education and communication	7.1%
Other goods and services	3.4%
Total	100.0%

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When it comes to incorporating inflation estimates into our own financial planning, "some assembly may be required".

For most people, inflation may be an afterthought. They may assume a number and then use it. Or worse yet, it is not factored into their estimates at all. At first glance, this may not look bad. But the long term corrosive effects of inflation become evident down the road. Think of how much you spent on a meal at a nice restaurant, the last time you dined out. How much would that same meal have cost you twenty years ago, including drinks, tax and tip?

On the other hand, overcompensating by dropping in a larger than life estimate for inflation may easily result in our goals looking beyond our reach. This can cause people to give up hope and as a result, get paralyzed into inaction. The issue arises not just during the accumulation phase of life. During the distribution phase in retirement, assuming too high a rate of inflation could cause us to need to increase our required rate of return, beyond the point where we feel comfortable. In other words, we assume we need much more than we really do, causing us to take a lot more risk with our investments.

Is there another way? ***Castling Financial Planning, Ltd.*** has been studying inflation's effect on the family budget, both during accumulation and distribution phases of life.

We feel that the best way to handle inflation is to start by going back to your/family's budget/spending plan and look at the relative weighting of each line item or category listed (e.g. the amount you budgeted divided by the overall monthly budget amount or income available). This is yet another reason to have some sort budget, even if it's as rough as a piece of sandpaper. It is better to start with something concrete and then work to refine it, rather than to skip it entirely and pretend that you're doing an imaginary mental exercise. Begin by simply tracking all spending that you are reasonably able to do. Use your online accounts via bank checking and credit card statements, as your guide. The truly tiny "stick of gum" purchases can be compressed into one "Misc." line item. Ask us for our free ***Budget Template***. Being a simple spreadsheet, it is infinitely customizable into something that makes sense for your individual circumstances.

You may find that the weightings for the major spending areas in your life differ dramatically from the table above. Moving from the accumulation to distribution phase of your life (i.e. retirement) may mean that the relative weightings shift yet again. That is another reason why we recommend not only having a "Current" budget column, but at least one other, showing the planned spending amount for that category in retirement.

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Why do we go to all this trouble? Take "Housing" as an example. This is a broad category that includes not only "owner's equivalent rent of primary residence", but household energy usage, other utilities, lawn care, appliances, even dishes and flatware. Is it 41% of your current spending? What will it be in retirement?

This brings up several key points to keep in mind.

1. The first step should be to determine how much you are currently spending in each category, although a useful budget will probably break it down into components that make the most sense to you (e.g. mortgage principal and interest separate from property taxes, insurance, electricity, etc).
2. Project which expenses will change in retirement, either by a little or by a lot. For example, we usually recommend that most clients plan on paying off their mortgage by the time they fully retire. This of course, does not eliminate the "Housing" spending category, since taxes, insurance and repairs will always be necessary, as well as other related items.
3. Estimate the inflationary increases likely in each spending line item, that will remain in retirement. This is where ***CastlingFP*** can add value for our clients, by providing our estimates based upon an analysis of your needs, while using data we obtain from multiple sources, including the government's BLS.
4. Lastly, a few spending categories may be brand new in retirement. Let's say you would like to take up a new hobby that you simply do not have time for during your working years. Not only would it be difficult to forecast what this may cost you in retirement, it may be difficult to know for sure that you'll still want to take up the new activity at that point. Most people continue enjoying the same recreational pursuits in retirement. But it would be useful for the adventurer type to do some research before committing funds to a new hobby. It may also be wise to start small. So be absolutely sure that you want to buy that llama ranch!

As an alternative to the federal government's suite of CPI statistics, some other measurements of inflation attempt to take a different approach. The American Institute for Economic Research (AIER) came up with their Everyday Price Index a few years ago (EPI)[7]. This index focuses on the food, energy and other categories that make up "everyday spending". It is naturally more volatile than the CPI, especially compared with the core CPI that strips out food and energy.

Regardless of the measurements being used, the main focus of this discussion is to make sure we understand the weightings as they apply to our own spending. We began with Mr. Saurry Plopkin insulating himself completely from the effects of inflation. Whether we could do the same is seriously in doubt. We then briefly explained how the CPI is constructed and demonstrated how the government's numbers can be simultaneously both

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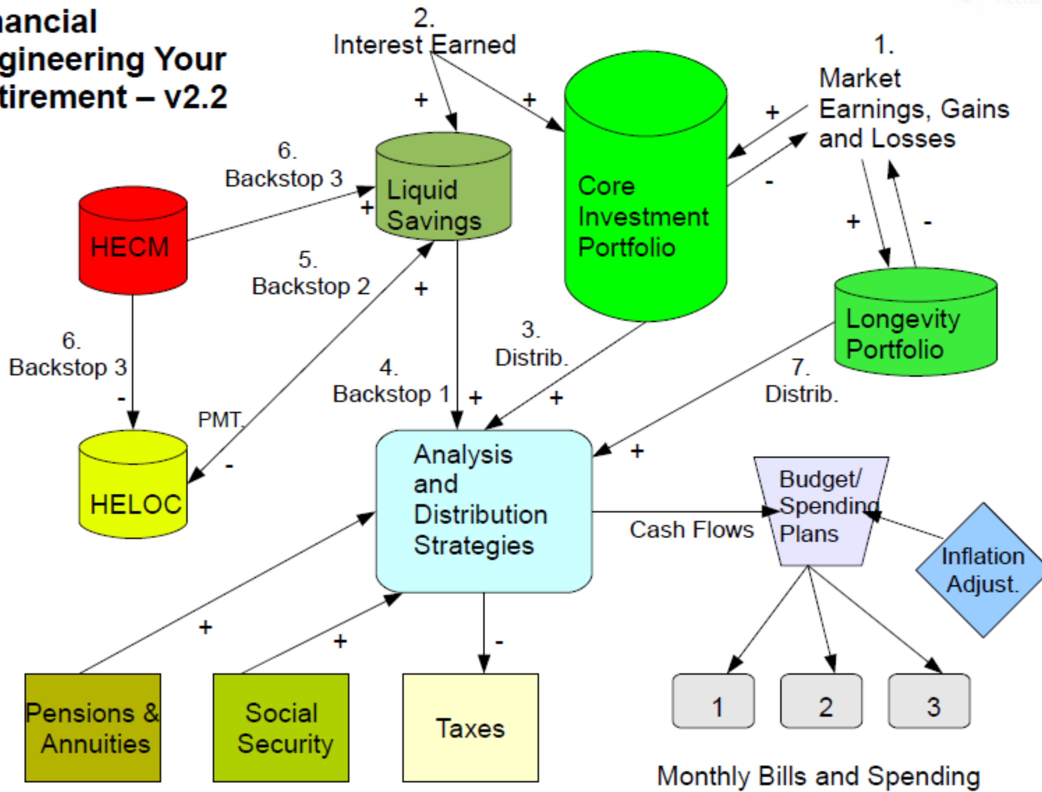
"correct" and "incorrect". A final example may shed some more light. In reviewing 20 year annualized CPI data recently, what really got our attention are the following two stats[8]:

Goods Excluding Food and Energy: +0.3%
Services Excluding Energy: +2.8%

We believe this helps to explain why some people maintain that consumer price inflation is very low, while others take the view that it is rising. You may be able to buy a suit of clothes today for *less* than what you paid in 1995 (although we may take issue with the quality). But try to get your car repaired, plumbing fixed or dental issue taken care of, for a price approximating what you paid two decades ago. Not likely. The rate of inflation for services may be 5-10 times that of most manufactured goods.

It may, therefore, be worthwhile to gauge Food and Energy using the EPI, while using two different components of the CPI: one for Goods and the other for Services. But the end result still depends upon the weightings you give, based upon your own spending.

We believe it is critical to include inflation in your financial planning, so we now add it to our diagram.



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Before You Bite on that "Free Dinner Seminar": Viewing Estate Planning in the Context of Your Overall Financial Plan

It was a gourmet meal, exactly as advertised, served at an upscale restaurant. The steak was excellent. The wine was at least as good as any we would have ordered on our own. The dessert plate, while relatively small, was artfully presented and smooth in flavor.

But what of the estate planning presentation, ostensibly the reason for our presence in the first place? Well, neither of us required any *Pepto-Bismol* afterwards, so that makes it alright then, correct?

Being invited from time to time to so-called "free" lunch or dinner seminars, hosted by financial product sellers or others in the industry, does give us a chance to survey how the product/service sellers approach their craft. We have yet to take their bait, however. The food is usually much better than the song and dance that follows.

In the last number of years, we have attended seminars given by two different estate planning attorneys/firms. There were a number of interesting observations we came away with and that leads to the purpose of this article: to provide an introduction to the way ***Castling Financial Planning, Ltd.*** views estate planning.

But first of all, we respect the need for attorneys to be involved in creating estate planning documents and providing legal advice. Neither of these areas falls under the role of ***CastlingFP***. We do not recommend that clients and prospective clients draft their own estate planning documents, such as wills or trusts, or rely solely on software programs to do the same.

(I don't think you should be your own dentist either, as I recall a *Three Stooges* episode involving a door knob as an improvised extraction device.)

But does this mean you should focus on finding the most capable estate planning attorney, then plunk down into his or her comfy chair and start burning up billable hours? We might add that those hours are pretty expensive in the first place. Theoretically, even the very best attorney, but one with whom you have never met, still needs time to get to know about you, your spouse, your family, your finances and your estate planning goals. Does this always happen?

So our question is whether there is an alternative to the two extremes of either: do-it-yourself estate planning (cheap, but of dubious quality), or hiring an estate planning attorney to handle everything from scratch (expensive).

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Our recommended approach still calls for using an estate planning attorney or general attorney with sufficient estate planning knowledge, but in a slightly different way. First, make sure you either educate yourself and prepare for estate planning, or use your financial adviser to help prepare you. The ***CastlingFP*** approach is to view estate planning in the context of your overall financial planning, before you take any subsequent steps.

Why would we say this? Well, let's go back to those dinner seminars. At the first, the attorney spent most of the presentation trying to scare the audience into all the bad things that were going to happen after the estate tax was scheduled to reappear in 2011. In addition, probate was described in such awful terms, that any sane person should conclude that it must be avoided, at any cost. At the second dinner, the attorney's response to a woman attending, who mentioned that she had already had estate planning documents drawn up a couple years earlier, “I'm sure that they're wrong!”. Again, fear was promoted by those in a position of superior power and authority. Later, that same person assured the audience that they would “save” at least fifteen (15) times the fee that he charges. Well, this is beginning to sound like a no brainer, right?

So why are we constantly repulsed by these assertions? How can you protect yourself?

The person laying out a particular scenario could trap you into thinking that it is likely or sufficiently probable to occur, such that you should definitely take his advice to purchase whatever legal advice or services are being offered, to guard against the bad result. But this approach may not be in your best interests. An objective third party looking at the situation may see nothing wrong with you overspending on legal services, as long as the attorney and law firm were competent and did not commit any fraud.

What we see as being absent is the direct linkage between what you want to accomplish (as part of your own financial planning) and the specific service being provided. What does this really mean? Time for another of our basic principles:

To a hammer, the 'rest of the world' looks like a bunch of nails. But to a member of the 'rest of the world', doesn't the 'rest of the world' look more like a mosaic?

So while the commission based product salesperson (CBPS) emphasizes financial products, since that is his business model, could estate planning attorneys sometimes emphasize overly complex solutions to estate planning, simply because it generates more billable hours? Are alternative courses of action thoroughly considered, even if (and especially if) the professional will receive less in the way of compensation, if any of them are chosen?

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This brings us to the simple questions we would encourage clients to ask, as part of any estate planning activity undertaken with any attorney or law firm:

1. Is what you are recommending the **simplest** way of getting my objectives met and why?
2. Is what you are recommending the **most cost effective** way of getting my objectives met and why?
3. Is what you are recommending the **most permanent** way of getting my objectives met and why?

Remember that you are a client, not a captive. Alternative course of actions should be identified and evaluated for each of these questions. At any point, if you do not understand the reasoning or explanation given, it's proper to call a "time-out", in order to get clarification. Any explanations that are not given in plain English need to be translated until you can understand them.

Let "why?" be your safe word. If the responses from the professional contain examples, cite statutes or case law, use other evidence or data and clearly present their point of view, then they are doing their job. However, if their response is similar to the following "Don't worry about it. *I'm the lawyer!*", you have reason enough to just pick up and leave (assuming you are not yet on the hook with them financially).

We are not picking on attorneys. The same treatment applies to any person holding themselves out to be a professional, in any discipline. Their fallback position should never be to cling to their credentials and prestige. Rather, it should be to provide objective facts and evidence that supports their position, in a manner that is understandable to you. The importance of this last point cannot be emphasized enough, in our opinion.

To demonstrate what we are talking about, let's go through the points we raised from the dinner seminars and address alternatives. The applicability of these alternatives depends upon your own individual circumstances. We are not giving you legal advice here, just stating facts.

The Last Will and Testament is the most basic legal document of estate planning. It formally declares one's own intent regarding the disposition of assets after death. Virtually everyone should have a will. To die without one, is termed dying "intestate". If you don't have a will, your state of residence has a "default will" for you. The laws of intestate succession will then control how an estate is settled[9].

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Maybe. Or maybe not. The term “operation of law” describes the legal means by which a transfer occurs automatically due to existing laws and not due to some document/agreement (including a will) or court order[10]. Many types of assets can be transferred in this way:

1. Life insurance death benefit proceeds
2. Pay-on-death bank accounts
3. Transfer-on-death brokerage accounts
4. IRAs
5. 401(s), pensions and other qualified retirement plans
6. Joint tenancy with rights of survivorship on various property, including real estate
7. Transfer on Death Instruments for real estate (depending on state law)[11]

The key to making this work automatically is setting named beneficiaries for as many of your assets as you possibly can. This is not an exercise that requires an attorney. An asset, such as an IRA, which passes via a named beneficiary, will not get transferred via the deceased's will, even if the will specifies a different person.

This concept does not eliminate the need for a will, but it does mean that specific asset transfers can occur in a more direct and automated fashion. Each account or asset should be reviewed. This is one of the estate planning activities that is also part of normal financial planning.

So when we have something that does pass through our will, we are then scared by the phrase “Your will won't avoid probate. How terrible!”.

Guess what? Probate is the legal process of proving that a will is valid and then administering the deceased's estate according to the terms laid out in the will[12]. There is nothing intrinsically wrong with probate, although many complain about it being a costly and public process. But its public nature is meant to minimize the chance that a shady relative (or complete stranger) secretly tries to take off with your assets. Costs vary by type and amount of assets going through probate as well as the local jurisdiction. An executor administering a will should probably get estimates from more than one probate attorney, unless the deceased had already selected who he wanted as his attorney.

Want to prevent probate? Our previous discussion on operation of law is a starting point. In the past, one of the major issues was that transferring real estate, such as a family home, when the surviving spouse passed away, was costly.

To avoid probate in this situation, a trust has often been recommended. The home is then retitled, in the name of the trust. There can be several valid reasons why a given

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individual, in their specific circumstances, needs a trust. But depending upon your state of residence, it is not necessarily the case that you need a trust, or must have your estate go through probate, in order to pass real estate to your heirs.

For example, consider developments in the State of Illinois a few years ago. The introduction of the Transfer on Death Instrument (TODI) authorizes owners to transfer their real estate outside of probate, using a prerecorded instrument[13]. This is a very low cost method that does not involve setting up a trust, retitling the real estate to be owned by the trust, or paying on-going legal fees to maintain the trust over time.

Another of the dinner seminar claims heard was that the estate planning attorney could save his clients at least fifteen times his fee! Astounding. But how is it verifiable? In reality, until the client passes away AND his spouse passes away AND their estate is completely settled, we won't know for sure. In fact even then, we would need to compare the estate plan he would have created versus alternative courses of action which would also have been available at the same time. Only then, could we tally up and see whether true savings were realized and if so, how much.

Consider the following questions:

What will the estate tax applicable exemption amount be when I die?

What will estate taxes be like when I die?

What will income taxes be like when I die?

How large an estate will I have when I die?

How large of an estate will my surviving spouse need to maintain her standard of living after I die?

OK, when will I die?

We have no idea as to the answer for the last question. But do we really know the answer for any of the others? On the other hand, do you honestly think an estate planning attorney, as learned and credentialed as he or she may be, has rock solid answers to any of the above questions?

One of the brutal realities of estate planning is that its present costs are in present value dollars. The future benefits are much more vague and tallied in much more distant dollars. By the same reasoning, we could ask ourselves, why not prepay and arrange our

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own funerals at a much younger age? We would be less influenced by emotion, based on the thinking that our end is in the far, distant future. We could be very rational. Oh sure.

But consider the value of $1 in your pocket today, versus $100 after your death. If someone depended upon my wealth or income, to whom I had pledged my support, I would want to make arrangements for their care and continued well being. Spending money today to create that estate plan I need and want, is money viewed as being well spent.

But if no one is directly depending upon my wealth or income after my death, it may be quite a different story. The $1 in my pocket today may be much more valuable than $100 after my death. (*Why? Because I don't care anymore, after all I'm dead, silly!*) Of course, this view may not be shared by the estate planning attorney who relies on the money you spend today. Your reluctance to spend more today, is to their detriment.

Another scare tactic that was previously oftentimes successful, was stressing how the surviving spouse's estate would be hit hard by estate taxes upon her death. Many wills and beneficiary designations of the "Honey, I love you" variety, often left 100% of the first to die spouse's estate to the surviving spouse. Under estate tax law and using estate tax rates going as far back as we can recall, no tax was due at that point (assuming the surviving spouse was a US citizen). But the surviving spouse was then left a much larger estate. If she were to now pass, the wrath of the estate taxman would be felt. Maybe. Maybe not.

One strategy that takes into account the fact that we would know the answer to the above questions about the future, but only when we arrived in the future. In other words, the surviving spouse would have a better idea about how much she would need to live on after he husband's demise, once that actually happened and not before.

For example, it would make a difference if she should be 65 at the time of his passing, versus 85; if his estate was now worth $5 million versus only $2 million; if the applicable estate and income tax laws were mostly the same or had drastically changed; if their children's careers were successful or not; if her own health was robust or not and so on.

We think you may see the picture by now. We are not trying to be critical of estate planning attorneys if they could not accurately predict the future. Who can? What we are critical of, is the notion that twenty years earlier, all of these questions could only have been answered with expensive solutions.

By contrast, a "qualified disclaimer" allows for the refusal of certain property after death. The property is then treated as never having been received by the beneficiary who was

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originally intended. This refusal can be used to avoid federal estate and gift tax.[14] The refusal can be for certain property or percentages of property. It does not need to be all or nothing. While it must be in writing and meet certain standards, it is once again an alternative course of action which is very inexpensive. The surviving spouse executing the qualified disclaimer cannot direct an asset's disposition. But this is where the deceased spouse's will could have specified what to do when assets are disclaimed in general or by specific persons, such as setting up contingent beneficiaries (i.e. the children).

Our main point is that the qualified disclaimer provides a fresh perspective. The surviving spouse may disclaim nothing if the estate has shrunk in value due to a recent stock market collapse, or disclaim a lot if she feels well provided for and would like to pass more assets to her children sooner and avoid estate taxes. Had the deceased spouse left his assets in a trust meant for their children, but with only trust income going to the surviving spouse in the interim, this may have been a less flexible solution that ultimately cost more to implement and maintain.

Our final dinner seminar talking point was the scare that estates would be taxed at relatively lower levels after the brief repeal of the estate tax in 2010. This fear undoubtedly caused a number of couples to plunk down several thousand dollars apiece to get trusts created. But what actually did happen? How about a five plus million dollar exclusion amount and spousal portability of the unused exclusion[15].

The exclusion is the amount of a taxable estate that is exempt from estate tax. It is now adjusted for inflation and exceeds five million dollars per person. What spousal portability means is that the first to die spouse does not lose his exclusion, simply by dying. Instead, the unused amount, perhaps entire amount, is passed on to the surviving spouse. This problem usually was resolved by creating trusts. Generally, there is an unlimited estate tax free transfer of assets to one's spouse (assuming he/she is a US citizen). Without portability or a trust, the second to die spouse would have only her single exclusion amount available, while perhaps having twice as big an estate as before.

So portability is a very good thing and also a relatively recent development over the past few years. One of the requirements is that an estate tax return must be filed for the first-to-die spouse, in order to claim the portability of the exclusion over to the surviving spouse. But this is a very small price to pay in order to receive the benefit of the unused exclusion. In fact, we would recommend that this be done by most surviving spouses, even if their deceased spouse was not wealthy. This action helps in case the surviving spouse suddenly has a big increase in wealth. More of it will then be shielded from estate taxes.

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The purpose of this article was to introduce estate planning from our financial planning perspective and to counteract some of the talking points heard at "free dinner seminars". Getting knowledgeable and organized should be two prerequisites before meeting with an estate planning attorney. Along those lines, one of the tools we have recommended to clients to help them get organized, is available from the **American Institute for Economic Research (AIER)** and it's an e-book called "If Something Should Happen". It's available free of charge from their Website[16].

Will even the best estate planning attorney, whom you have never previously met, understand your finances and your goals in one or even two meetings? Their time is also very expensive. Alternative courses of action should be discussed and evaluated. We recognize that some clients have unique needs and will require more complex solutions. But not everyone's needs are the same or will be complex. Starting a conversation with your own financial planner/***CastlingFP*** about estate planning, may allow you to consider alternative approaches before meeting with your attorney.

<u>We still recommend that you use an attorney for your estate planning documents</u>. <u>But let's use their time very wisely, in order to save you money</u>. <u>Prepare for that meeting by formulating your objectives and reviewing your assets ahead of time</u>.

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Castling Defensive Portfolio: Recap of 2014 and the Consistency that May Bore You to Tears

"You told me you wanted a smoother ride, so then why did you pick the roller coaster?" If it's a good thing to say what you mean and mean what you say, some investors like to do the opposite. Perhaps only after markets increase, would they state that they're willing to take on more risk.

We developed the Castling Defensive Portfolio (CDP) as a model portfolio for the most conservative investor, who still wanted to be called an investor. Its objective is to achieve a 7.2% annualized, pre-tax return, across a rolling period. And to do it with the least amount of volatility we could find, among all the asset allocations we tested in our database. We have not changed the asset allocation in all this time. We implemented it with a set of low cost funds. Only one change in the fund lineup has ever been made. The current investment vehicles are as follows:

The Castling Defensive Portfolio:	Ticker	% Allocation	Expenses	Equity %
FDIC Insured Certificates of Deposit (Avg. of High Yielding)	Bank CD's	9%	0.00%	0%
Vanguard Short-Term Treasury Investor Shares	VFISX	9%	0.20%	0%
Vanguard Short-Term Investment-Grade Investor Shares	VFSTX	9%	0.20%	0%
Vanguard Intermediate-Term Treasury Investor Shares	VFITX	12%	0.20%	0%
Vanguard Inflation-Protected Securities Investor Shares	VIPSX	12%	0.20%	0%
Vanguard GNMA Investor Shares	VFIIX	11%	0.21%	0%
Vanguard Wellesley Income Investor Shares	VWINX	11%	0.25%	4%
Vanguard Small Capitalization Value Index Investor Shares	VISVX	15%	0.24%	15%
Vanguard REIT Index Investor Shares	VGSIX	8%	0.24%	8%
Vanguard Total International Stock Index	VGTSX	4%	0.22%	4%
Totals		**100%**		**31%**

Our research has indicated that the proper allocation to stocks can have a much better chance of reaching the overall return objective, while still keeping volatility from getting out of hand.

Performance (including back-testing) demonstrates this. From 2000-2014, a fifteen (15) year period, only one calendar year loss was recorded. That was in 2008 and came in at -6.15%. While still a loss, compared to most other investments, this was hardly a drubbing. In fact, it was more like a scratch.

This bring us to another important principle.

If your investment portfolio's asset allocation matches
your willingness to take risk
and your ability to take risk

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and your need to take risk,
you are more likely to stick with it through thick and thin.

This can be critical. The investor whose portfolio crashed in 2008, causing them to turn around and sell at the bottom of the market, was not doing themselves any favor.

In reviewing 2014, the CDP missed its target, but still returned 6.71%. We must stress that the objective is to achieve a 7.2% return in a rolling period, not necessarily on an annual basis. So if we look at the five year period 2010-2014, we see a slightly improved picture (below). The five year annualized return is 7.03%. While still below the 7.2% target, we did not miss by much.

Castling Defensive Portfolio (CDP) Comparison	2010	2011	2012	2013	2014
Castling Defensive Portfolio Yearly Returns	10.05%	5.26%	7.48%	5.74%	6.71%
Back-Tested Cumulative Return Since 2000	127.03%	138.96%	156.84%	171.59%	189.81%
Hypothetical Growth of $10,000 Since 2000	$22,703	$23,896	$25,684	$27,159	$28,981
Annualized Return (2000-2014)			***7.53%***	***7.40%***	***7.35%***
Standard Deviation (2000-2014)			***4.99%***	***4.82%***	***4.65%***
Coefficient of Variation (2000-2014)			***0.66***	***0.65***	***0.63***
Wellesley Income (VWINX) Yearly Returns	10.65%	9.63%	10.06%	9.19%	8.07%
Back-Tested Cumulative Return Since 2000	116.76%	137.63%	161.54%	185.57%	208.62%
Hypothetical Growth of $10,000 Since 2000	$21,676	$23,763	$26,154	$28,557	$30,862
Annualized Return (2000-2014)			**7.68%**	**7.78%**	**7.80%**
Standard Deviation (2000-2014)			***6.55%***	***6.30%***	***6.07%***
Coefficient of Variation (2000-2014)			***0.85***	***0.81***	***0.78***
Wellington (VWELX) Yearly Returns	10.94%	3.85%	12.57%	19.66%	9.82%
Back-Tested Cumulative Return Since 2000	101.48%	109.23%	135.53%	181.84%	209.52%
Hypothetical Growth of $10,000 Since 2000	$20,148	$20,923	$23,553	$28,184	$30,952
Annualized Return (2000-2014)			**6.81%**	**7.68%**	**7.82%**
Standard Deviation (2000-2014)			***11.65%***	***11.65%***	***11.24%***
Coefficient of Variation (2000-2014)			***1.71***	***1.52***	***1.44***
Vanguard 500 Index (VFINX) Yearly Returns	14.91%	1.97%	15.82%	32.18%	13.51%
Back-Tested Cumulative Return Since 2000	3.60%	5.64%	22.36%	61.73%	83.58%
Hypothetical Growth of $10,000 Since 2000	$10,360	$10,564	$12,236	$16,173	$18,358
Annualized Return (2000-2014)			**1.56%**	**3.49%**	**4.13%**
Standard Deviation (2000-2014)			***19.02%***	***19.83%***	***19.22%***
Coefficient of Variation (2000-2014)			***12.16***	***5.68***	***4.65***

Over the last six years, very low yields in the bond market have depressed some of the returns. Rather than try and increase risk in the fixed income side, we have stressed a disciplined asset allocation and maintained very low investment related expenses.

Our approach for clients has been to look for asset allocations that provide more consistency, just like a smoother ride is more consistent than a roller coaster. The way we

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measure this is through a statistic called coefficient of variation (CoV). It directly measures the variability per unit of return.

In the table above, we compare the CDP versus three other highly regarded funds from Vanguard: Wellesley Income (which is also proportionally included in the CDP), Wellington (closed to new investors) and 500 Index (one of the oldest funds that tracks the S&P 500® index)[17].

During bull markets, the funds with much higher allocations to stocks will normally post higher returns. This is nothing unusual. But during bear markets and flat markets, the situation is usually reversed.

But what should really catch your attention is the long term return and long term risk measurements. 500 Index has only a 4.13% annualized return in the entire 15 year period under measurement. Its CoV is over seven times that of our portfolio, at 4.65.

A CoV of 1.0 basically means that the total risk of the fund was commensurate with the return it provided. A value greater than one means that it delivered more risk than return over the measurement period.

We would caution anyone thinking that their problems would be solved simply by selecting an investment whose CoV was zero. A five year CD could deliver no variability whatsoever, but the 1.x% return will probably not help you reach your goals. An insurance based product may also have little or no volatility. But it may not even be an actual investment. It may come with huge fees and may also tie up your money for a decade with surrender charges.

So what could help? How about our independent analysis of your unique situation, coupled with our knowledge of market performance, our analytical approach and access to truly low cost and high quality investment products? Please keep in mind that the CDP is simply a model portfolio and does not represent investment advice directed to anyone in particular. But it's a starting point in the conversation.

Would you like a smoother ride or would you rather get back on that roller coaster?

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