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FINANCIAL SERVICES

# Financial Advisory & Outlook

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## Money : The Knowns, Unknowns and Unknown Unknowns.

In a press briefing on February 12, 2002, then Secretary of Defense, Donald Rumsfeld, was addressing the absence of evidence linking the government of Iraq with supplying weapons of mass destruction to terrorist groups. He stated:

> ***"There are known knowns; there are things we know we know. There are known unknowns; that is to say, there are things that we know we don't know. But there are also unknown unknowns – there are things we don't know we don't know."***

Welcome to my world as a financial planner. As a planner, I help people develop and navigate a life course that is both rewarding and fulfilling for them. We identify and set life goals with a plan to manage the journey to achieve those goals. Secretary Rumsfeld's classifications are a way we can describe some of the experiences we may find as we chart a way to manage the achievement of our life goals.

**The known knowns** –are assets we bring for use to accomplish those goals, both financial and non-financial. We know that if the plan developed is followed, there is a reasonably good chance of success.

**The known unknowns** – acknowledge that there will be surprises along the way that will have either a positive or a negative impact on our life journey. Things like a loss of a job, a heart attack, stroke, an extended illness or winning the lottery.

**The unknown unknowns** – reflect life altering events such as divorce, death and adverse health conditions like cancer, Parkinson, Alzheimer or various forms of arthritis.

The part most challenging is developing contingency plans or ways to deal with the **known unknowns** and the **unknown unknowns**.

**It is like a journey by car at night.** Unfortunately, we are only able to see what the headlights reveal. As we roll along different opportunities come into view. We deal with what we know now and hopefully have time to react to changes as they are presented. Life presents similar opportunities.

In the beginning we get excited planning our trip and making sure we have all we need for the journey. We may even take the car to a mechanic to make sure the tires are good, the oil and filter are changed and the necessary maintenance is completed. We fill up the gas tank so we know we are starting out completely ready. As we start out we feel confident we have dealt with all the **known knowns**.

Traveling in the summer time, we know there will be construction projects along the way. The contingency plan for dealing with this **known unknown** is to travel at night because the construction workers may not be working hence minimizing the impact of construction delay.

On May 23, 2013 a couple of Pacific Northwest families experienced an **unknown unknown**. Driving north on I-5 just north of Mt. Vernon, Washington two cars were crossing the Skagit River when the bridge span they were on dropped out from under them. They ended up in the river and were fortunate that there were people around to help get them out of the wreckage.

**Don't get mesmerized.** One of the experiences I sometimes get when driving distances is the hypnotic effect of those white lines zipping by. Something brings me back to reality and I'm left trying to figure out how I got so far without knowing it.

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**Regular check-ins help.** For many, life provides similar experiences. Often, one of those reality checks is kids going off to college. It is not uncommon for a couple to have to reintroduce themselves to each other at this time. You have been so involved with raising kids, checking in with your life goals got shelved. Empty nest time seems to provide a high incidence of divorce. Often, you are just so busy living life that life passes you by. Interests that were common at one time may be no longer. Some of those longer term plans such as retirement have not received the attention needed and now seem more challenging to accomplish. One of the benefits to regularly checking in with your life goals is to ensure that you and your life partner continue to travel the same path.

**Balance helps.** When presenting seminars on retirement I often use the analogy of a three legged stool. Each leg represents an investment segment in your portfolio; taxable, tax-deferred and tax free.

We get bombarded with information about stuffing all we can into our retirement plans. As we make contributions, the tax benefit is attractive but we don't consider what the tax cost for distributions will be.

**Plan for the known unknowns.** Often a client will be comfortable with their retirement income, but all of a sudden they turn 70½ and are forced to take more than was planned from their retirement plans. Not only does this increase taxable income because of the required distribution but also may increase how much of their social security benefits will be exposed to income tax. By developing an investment strategy that balances the three legs of the stool, contingency plans can be put in place that helps manage the tax impact.

In addition to the income tax consequences, there are the implications of estate planning. Yes, with the new exclusion limits for federal estate taxes, most of us will not have to be concerned with federal estate taxes. But death taxes for the state you live in may be a different story. For example in the State of Oregon, death taxes begin at $1,000,000.

**Turn the headlights on.** Occasionally, people will come in for planning help and discover their goals, at least from a financial standpoint, may be more difficult to accomplish than they first thought. Sometimes they ask, 'Why bother, my goals are not reachable?'

To me this is like turning off your headlights and driving in the dark. There may be pot holes in the road, debris fallen from another vehicle – or worse yet a sink hole. Without some contingency planning (turning on the headlights) you may not be prepared for those hazards. Yes, you may be disappointed with your preparedness but at least you will have an idea of where you are and a better idea of what you have to deal with.

**Subtle behavioral changes can make a big difference.** Often people have balances on their credit cards. When I discuss the development of an emergency reserve their response is – interest rates are low and I'm paying north of 20% finance charges on my credit cards – wouldn't it be better to use the credit cards as my emergency reserve and the funds that would go to the emergency reserve to be used instead to pay down the credit card debt in order to reduce the finance charges?

Financially and logically this would make sense but from a behavioral standpoint it fails. Setting up an emergency reserve and drawing a line in the sand for the credit cards that says – NO MORE – seems to be more beneficial. Without that line drawn in the sand it remains easy to continue to use the credit cards and after one or two emergencies the credit limit is reached and your emergency reserve is gone.

**A journey begins with the first step.** There is a saying in the planning business – people spend more time planning a vacation than they do planning their life. For many the thought of developing a life plan is so daunting they never start. Usually, taking the first step is the hardest. I like breaking things down into small incremental steps, so I may suggest let's begin with the development of a spending plan for the next year. Once that has been accomplished it is easy to ask how the second year will be different from the present. Before you know it a five year plan is in place.

**So the question for you is – how is your journey progressing?** Do you need help in planning your journey or can I help with some roadside assistance.

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