FINANCIAL ARCHITECTS INC.

Capital Blueprints for the Future

Volume 16 Number 4
Fourth Quarter 2007

505 South Third St.
Suite 300
Louisville, KY 40202
(502) 589-1772
www.lifetimesolution.com

GETTING UNBOXED

In *The Three Boxes of Life: And How to Get Out of Them*, author Richard Bolles described the three periods of life as (1) youth, (2) adulthood, and (3) old age. He observed that life in each stage seems to be conducted without much consciousness or preparation for life in the next stage.

"Life in each period seems to be conducted without much consciousness or preparation for life in the next period."

High school and college graduates almost universally express that they learned very little in school to help them find jobs or to be successful in their careers. Likewise, workers approaching the end of their careers realize they are ill prepared for life in retirement. Thus, as Bolles explained, "these three periods—in their isolation from one another—end up looking (or feeling) like three boxes."

Bolles also observed that the box-like nature of these phases of our lives is further accentuated by the way we spend our time. The first period is devoted to learning, the second period is devoted to working, and the third period is devoted to leisure. Instead, Bolles contends, we would benefit more by experiencing a better balance between learning, working, and leisure in each period of life.

In this way, wouldn't we feel more satisfied and more fulfilled? Wouldn't we be maturing as individuals in more positive ways? Wouldn't we be better prepared to transition into the next phase of life?

Meanwhile, as we contemplate these questions, we must live with the reality that "the system" does not advance this perspective on living our lives and preparing for the future. Therefore, it is really up to us as individuals to get "unboxed"—to be proactive in (1) balancing learning, work, and leisure in each stage of life; and (2) using our current life stage to prepare for the next life stage.

The advice of Dr. Phyllis Moen is similar to that of Bolles. As the Director of the Cornell Retirement and Well-Being Study, her research has led her to conclude that retirement planning should be "a life-long regimen rather than a later-life concession." In addition, she encourages individuals to "pursue an unconventional life course and to be proactive in developing their own opportunities." ■

THE RISK TOLERANCE CONTINUUM

Those who are either averse or addicted to financial risks are operating in economic “danger zones,” and both types are jeopardizing their long-term financial security.

When you are making a financial decision, do you intentionally weigh the potential risks and rewards? Is weighing that balance more of a rational or emotional process for you? In other words, do you tend to rely more on facts or on feelings?

For example, when Karla got a promotion at the architectural firm where she is employed, she gave serious consideration to buying a new car. She thought about the practical and emotional rewards of having a new car such as: 1) having a dependable means of transportation, 2) getting better gas mileage, 3) portraying a successful image to her clients, and 4) experiencing the pride and pleasure that comes with owning a new car (there’s nothing like that new car smell!).

Karla also pondered the risks of purchasing a new car: 1) higher insurance premiums, 2) increased expenses which would reduce the amount she could invest in her retirement plan, 3) unknown gas and maintenance costs, and (4) the emotional weight of greater financial obligations.

Like Karla, when making financial decisions, we all consider the risks and rewards we might experience. However, some of us focus more on the potential losses (risks) and some of us focus more on the potential gains (rewards).

In the world of investing, when someone asks you about your “risk tolerance,” they are really asking you about your emotional response to the possibility of loss versus the possibility of gain. At one end of the risk tolerance continuum are those individuals who are averse to risk. They focus their thinking on the “loss” part of the equation. For them, “risk” is anxiety producing and a factor to be avoided. They want to stick with the known and predictable. They value stability in their financial lives above all else and are willing to sacrifice higher returns to achieve that sense of guarantee.

At the opposite end of the risk tolerance continuum are those who are addicted to risk. They focus on the “gain” part of the equation. For them risk is exciting and alluring; the potential for financial reward is irresistible. In order to “get rich quick,” they are willing to gamble with their money. Financially speaking, they get a kick out of living on the edge and taking chances.

Both of these examples of risk tolerance, risk aversion and risk addiction, are the extremes. Individuals at either end of the risk continuum operate more on feelings than on facts. Those who are either averse or addicted to financial risk are operating in economic “danger zones,” and both types are jeopardizing their long-term financial security.

Therefore, it is important to seek the middle ground on the risk tolerance continuum and to commit to becoming a calculated risk taker. In making wise financial decisions, the calculated risk taker does not avoid risk or exploit risk, but rather learns to manage risk.

It is interesting to note that financial education and self-awareness can “cure” both the risk avoider and the risk exploiter. Knowledge and insight is the antidote for overcoming the emotional responses that can sabotage sound money management and investment decisions.

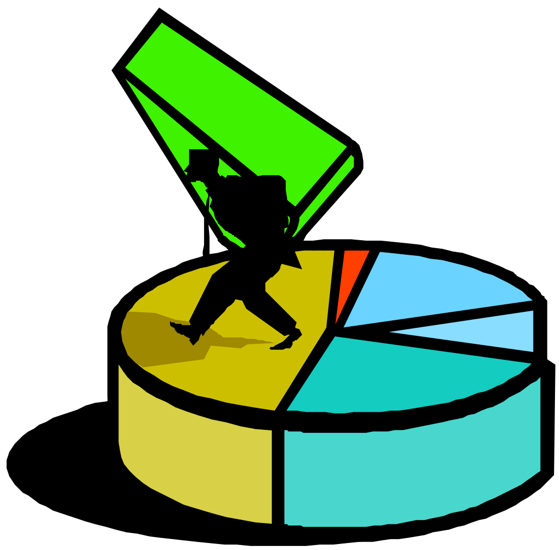
Therefore, to become a calculated risk taker, you must first become aware of the underlying emotional motivators that repel you or draw you to financial risk. Take time to reflect on the factors that frame your money attitudes and behaviors. In addition, ask yourself if you tend to swing back and forth between risk aversion and risk addiction depending on the kind of financial decision you are making.

The next step is to educate yourself so that you

Continue on page 4

Dividing the Family Pie
Are Equal Slices Best?

When planning the division of your assets, you may believe in a policy of "share and share alike." This is perhaps the easiest method, and often the way to avoid conflicts and complaints of favoritism. But does equality necessarily equate to fairness? After all, fairness is only relative, especially when one considers factors such as age, talents/skills, interests, needs, and degrees of material success. A more practical approach to the division of assets may be one in which you recognize and compensate for differences in the abilities and needs of your children, even at the risk of producing some conflict. Through your estate plan, you have a chance to provide a measure of fairness that you children may not otherwise have found in their own lives.



To emphasize the point, consider the following scenarios:

1. Disparity in Age: Assume you have two children, ages 22 and 14. Should you split your estate in half, even though the 22-year-old has been through years of private school education and college and the 14-year-old has just started high school?

2. Income and Net Worth: Assume your daughter becomes a partner in an investment banking firm and quickly builds up $3 million in assets, while your son becomes a sales manager who earns $30,000 per year. Should you leave your estate in equal parts to your son and daughter?

3. Previous Giving: Assume you have given your 24-year-old son $100,000 worth of stock in your business as an inducement for him to work with you. You have not, however, given your 18-year-old son a similar gift. Should you divide the assets in your estate on an equal basis?

4. Investments Given to Children: Assume you have given one child stock in Company XYZ that has risen in value to $300,000. You have given another child stock in Company BCD, which has gone bankrupt. How should you then allocate the balance of your assets?

In all of the above examples, an equal division of property has the potential to create or perpetuate unequal results. This is not to say you cannot choose an unequal result, but it does point out the need for financial and estate planning that leads to reasoned decisions about how you leave your property.

Listen First

Fortunately, there are ways for you to achieve fairer results. Your first step should be to speak with your children. You may choose to speak with each child individually or hold a family conference. (Obviously, you will have to serve as proxy for your very young children.) Help them to verbalize their hopes, dreams, and expectations, as well as their worries, concerns, and frustrations. By listening first, you may gain valuable insights into how you can divide your estate constructively without causing jealousy and resentment. The decisions may be difficult to make, but in the long run, your family will appreciate your goal of trying to reach an agreement that addresses each child's individuality.

Continued from page 2

can replace irrational responses with rational decisions. You'll reap high returns by increasing your financial knowledge. For example, you could take a course offered by your employer, a community college, or a trusted financial advisor. You could also read books on personal finance that offer sound advice based on proven principles, not the hottest trends or theories.

In addition, consider the following tips for becoming a calculated risk taker and effective financial decision maker:

- Take time to learn the basic differences and similarities between common savings and investment vehicles: savings accounts, money markets, certificates of deposit, bonds, mutual funds, and stocks.
- Learn how to categorize savings and investment vehicles as 1) cash equivalent, 2) income producing, 3) growth producing, or 4) speculative.
- Match savings and investment vehicles to financial goals: short-term goals to cash equivalents, mid-term goals to income producing, and long-term goals to growth producing. Put only "extra" investment dollars in the speculative category.
- "Don't put all your eggs in one basket." Spread savings and investment dollars across all categories and in a variety of savings and investment vehicles. ■

In My Opinion…

Robert J. Cole, Jr., CLU, ChFC, CASL, CFP®

Would You Move Back?

My wife's aunt (let's call her Jane) has been employed by the New Orleans police department for over fifty years. She serves as an administrative assistant to the Chief and also as the department's historian. Let me add that Jane could easily retire with full benefits.

In 2005, she was attending the Kentucky State Fair horse show (as she has done for many years) when the horror of hurricane Katrina began to unfold. Along with the rest of us, she watched in disbelief as Mother Nature again proved who is in charge of this planet. There was one BIG difference - this was her and her children's hometown. After weeks of struggle, she was finally able to get on the ground close enough to have a police escort back to the chaos. It took several more weeks before she was allowed to drive by her home of some forty five years. While not totally destroyed, it had been damaged enough that extensive work would have to be done to get it back in shape to be inhabited. Her two daughters were not so lucky; both of their homes were GONE.

What's this have to do with financial planning? Most of us who are charged with the responsibility of managing our clients' funds use numerous systems to make our decisions. The majority of them use historic data as the starting point for calculations. In addition, a good number of them use statistical analysis to make probability projections. These methods use past information to predict the *probability* of a given future outcome. The key word is probability because it is impossible to predict the future because of the ever changing underlying assumptions of averages. The word "average" is used rather carelessly by the media and most people equate it with "actual". For instance the "average" total rainfall for New Orleans in 2005 *might* have been normal but, since so much of it came in just a week, the outcome was dramatically different. The majority of *actual* outcomes do fall close to the *average* of all the outcomes but, 10% of the time, there is a wonderful or catastrophic *actual* outcome. Think about it --- in its lengthy history, New Orleans never took a direct hit from a major hurricane. Yet, the potential was always there. In 2005 it became a reality. If you experienced the "low probability" outcome, would that change your "risk taking" attitude and prevent your return? Many of the elderly are living out this behavior because of economic experiences from The Great Depression. If there is only a one-in-twenty chance that New Orleans would suffer the same type of event again, **would that keep you from returning**?

We are living in an age of geopolitical turmoil. The old East vs. West system collapsed with the economic demise of the Soviet Union. Our system, based on democracy and capitalism, is now being confronted by different systems, both in philosophy and by deeds. Many are wondering how these new challenges and opportunities will play out for U.S. investors. There is a ***small*** possibility (based on past history) that these challenges will end up with destruction --- an "economic" New Orleans. How does that knowledge affect your risk tolerance? If it does affect it, then you need to "model" such an outcome and develop a "disaster plan". If it doesn't, then it's business as usual.

Back to Aunt Jane. She returned to New Orleans and is performing her job for the police department in a temporary trailer. She has rebuilt her home and her children have made alternate living arrangements. She says that the city is her "home" and she is not leaving her culture. In fact, she is "investing" by working to help it return to its future. As for the possibility that the catastrophe will repeat itself, she and her family think the odds are in their favor.

Until next time, that's my opinion.

Robert J. Cole, Jr., CLU, ChFC, CASL, CFP®
President