

# Financial Checkup

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# Financial Checkup

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Dear John and Sue,

Thank you for the opportunity to demonstrate our ability to deliver personal financial advice via the internet.

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Your Financial Checkup consists of four parts:

1. Identification of your position on the Cambridge Financial Life Cycle©
2. Explanation of the Ten (10) Financial Life Stages
3. Analysis of your financial habits (Five Fundamentals of Fiscal Fitness©)
4. Calculation of dollars wasted because you're not using all your tax shelters
5. Calculation of dollars wasted because you're paying unnecessary investment expenses

# Financial Checkup

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## ***Your Financial Position***








We have calculated both your 1) biological and 2) financial positions on the *Cambridge Financial Life Cycle*®.


- 1) Assuming we have your date of birth correct, you are 37 years old and Sue is 39 years old. By age, you fall into the **Early Accumulation** stage.
  
- 2) We have also calculated your financial position on the life cycle. Your annual income is \$65,700 and your net worth is about \$365,795. Since your net worth is 6 times your annual income, financially you are at the **Rapid Accumulation** stage. Congratulations! Your financial position is ahead of your biological position. You have outperformed our financial expectations of our benchmark for most people in your age bracket.


The Life Cycle on the following page will help you visualize your financial position:

# Financial Checkup

Your Age Position  
↓  
Your Financial Position  
↓

Stage	Toddler	Childhood	Teenage Years	Building The Foundation	Early Accumulation	Rapid Accumulation	Financial Independence	Conservation	Distribution	Sunset
Transition Point	 Money is to eat	 Receives allowance	 Earn own money	 Becomes self-supporting	 Net worth more than annual income	 Investment earnings exceed savings	 Investment earnings = 50% or more of living costs	 Live off investment earnings + retirement pension	 Have more than you can spend in a life time	 Less than 12 months to live
Net Worth	n/a	n/a	n/a	Less than annual income	1 – 3x annual income	3 – 7x annual income	n/a	n/a	n/a	n/a
Investment Portfolio	n/a	n/a	n/a	n/a	n/a	n/a	7 - 10x annual living expenses	10 - 15x annual living expenses	More than 15x annual living expenses	n/a
Strategy	Concept: Don't eat money	Concepts: Accumulation, Convertibility, Relative value	Concepts: Budgeting, Earned income, Money makes money	Five fundamentals of fiscal fitness	Diversity into stocks and bonds	Focus risk and optimize tax efficiency	Start doing what you really like to do, Start business, Semi-retire, etc., Supplement earnings with investment income	Consolidation, Lower risk investments	Start giving money away - kids, charities, etc.,	Distribute assets, Reduce estate taxes, Viatical strategies
Typical Asset Allocation	n/a	n/a	n/a	75% Interest earning  25% Equities	50% Interest earning  50% Equities	40% Interest earning  60% Equities	50% Interest earning  50% Equities	60% Interest earning  40% Equities	75% Interest earning  25% Equities	n/a
Typical Age	0 - 5	6 - 12	13 - 19	20 - 30	30 - 40	40 - 55	55 - 70	70 - 85	85+	

 Your Financial Position is ahead of your Age Position

 Your Age Position

## The Ten (10) Financial Stages of Life

The Cambridge Financial Life Cycle is a benchmark which divides your life into ten typical financial stages. There are specific wealth building strategies for each stage and financial ratios that mark the transition from one stage to the next. The most unreliable indicator on the Financial Life Cycle is the age range. People can spend 50 years stuck in a stage or skip it altogether. A divorce can move people backward and commitment to a financial plan can jump them forward. So don't be discouraged if you're "behind" and don't get too excited if you're "ahead".

# Financial Checkup

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## Life Stages #1 & 2: Toddler & Childhood

The first two stages are Toddler (Early Childhood) and Childhood. During the Toddler stage (0-5) we believe that money is to eat. Our parents teach us that eating money is not a sound financial strategy (or healthy habit). By Childhood, which we define as age 6 to 12, our parents have taught us three more financial concepts: *accumulation*, *convertibility* and *relative value*. In the old days parents taught us to accumulate when they gave us an allowance and a piggy bank in which we had to save some of the allowance. We learned about convertibility when our parents let us spend some of our allowance to buy things. Relative value means we learned that dimes are worth more than nickels even though dimes are smaller.

## Life Stage #3: Teenage Years

During the Teenage years, from about 12 to 19, we learn three more concepts: *budgeting*, *earned income* and how *money makes money*. We learn about budgeting when our parents give us a clothing allowance and make us buy our own clothes. We learn about earned income when we buy something, fix it up and sell it for a profit or when we babysit or mow lawns for money. During this stage, some children get sidetracked with the idea of moving out on their own, but that seems to be occurring less frequently.

Most of our beliefs about money are acquired by the time we are 12-19 years old. Unfortunately, some of these beliefs are dysfunctional and prevent us from achieving financial independence. We encounter many adults stuck in the next financial stage because they have never learned about budgeting or how *money makes money*. Their parents never taught them the *power of compounding interest* by helping them to open a savings or investment account and adding to it regularly.

## Life Stage #4: Building the Foundation

During our 20s, we enter the Building the Foundation stage. During these years we become completely self-supporting. These are the critical years where we establish the financial habits that will determine our financial future. We call these habits the Five Fundamentals of Fiscal Fitness. It is not all unusual for some people to never get past this stage because they haven't grasped the goal of *Financial Freedom* and what it takes to get there.

There are three basic ways to acquire money: the first is by affiliation - you marry it, inherit it, or are given it. It's common to think that this is the easy way to wealth, but in our experience it seldom is. Money obtained this way seldom lasts because the recipient hasn't learned the basic concept of how to invest money. Thus "a fool and his money are soon parted". The second way to get money is to earn it by the sweat of your brow. While this is honorable, most people yearn to get to a point in their life where they can do what they want to do (self-actualization) without having to worry about how much money they make. The third way to acquire money is to have your money make money for you. This means saving and investing until you have accumulated a pile of money big enough to earn more than you earn by the sweat of your brow. When your money makes enough money to cover your living expenses you have achieved *financial freedom*. Understanding this goal of financial independence is crucial for clients to get beyond the Building the Foundation stage.

# Financial Checkup

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## Life Stage #5: Early Accumulation

At the point, usually between 30 and 40, that our net worth exceeds our annual income, we move into the Early Accumulation stage. This is where basic investment begins and we teach clients how to diversify.

## Life Stage #6: Rapid Accumulation

At some point, usually between 40 and 55, when our net worth is three (3x) times our annual income; we reach the point at which the income from our investments exceeds our annual savings. At this point we move into the Rapid Accumulation stage and our net worth tends to grow exponentially.

## Life Stage #7: Financial Independence

At this point our key financial ratios change. Instead of measuring Net Worth/Income we calculate Investment Portfolio/Living Expenses. When our investable assets have grown to between seven and ten times (7-10x) our annual living expenses we pass into the stage of Financial Independence. This usually occurs between ages 55 and 70. At this stage we have options - to change jobs, semi-retire or have a mid-life crisis. At this point we can use some of the income from our investments to subsidize our living expenses so that we don't have to work full-time at a job we don't really like. At this point our strategic priorities also change from *accumulating* wealth to *conserving* wealth. Not going backwards becomes more important than moving forward.

## Life Stage #8: Conservation

When our investable assets are ten to fifteen times (10-15x) our living expenses, the earnings and any income from pensions are usually adequate so that we don't have to work any more. While many call this retirement, we call it the Conservation stage. We have arrived at our destination, so why should we risk going backwards just to accumulate a little more? Many clients find it difficult to invest conservatively after years of pursuing a "growth" portfolio. It seems "wasteful" to not try to get a higher investment return.

## Life Stage #9: Distribution

If we continue to practice the Five Fundamentals of Fiscal Fitness, we eventually reach the point where our net worth exceeds 15 times (>15x) our annual expenses. At this juncture we have more money than we can spend in our lifetime. We enter the Distribution stage. At this point we "invest in memories" and ensure our financial legacy. We gift money to children or fund a family cruise. We may gift money to charities, set up endowments and create an estate plan that will shape the values on our descendants.

## Life Stage #10: Terminal


The Terminal stage comes when we have less than 12 months to live, and we try to provide for the orderly distribution of the bulk of our assets.

# Financial Checkup

## Your Financial Habits

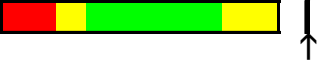

Clients who implement *The Five Fundamentals of Fiscal Fitness*® achieve Financial Independence and often become middle income millionaires. The Five Fundamentals are:

### 1. Save at least 10% of annual income

Indicator	Your score	Target	Function/Use
Savings rate	5% 	10 - 20%	Measures whether you are living within your means and how well you are balancing future against current needs.


You are saving 5% of your income. To fund your **future** needs you must save and invest at least 10% of everything you earn.

### 2. Have sufficient liquidity

Indicator	Your score	Target	Function/Use
Ready cash	96% 	10%	Measures your ability to pay bills and fund variable short term cash flow needs.
Emergency reserves	0% 	20%	Measures your ability to survive three catastrophic events within a six month period and make mortgage payments for 24 months.

You have 96% of your income ready cash and 0% emergency reserves. Ready cash liquidity is your cash or cash equivalents such as checking accounts, savings, money markets or CDs maturing in less than 18 months. Emergency reserves are US Savings Bonds or liquid assets held inside some type of tax-advantaged account, such as a CD inside an IRA or the cash value of a fixed rate life insurance policy.

### 3. Fully fund pensions

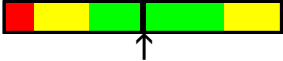
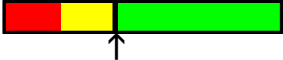



Indicator	Your score	Target	Function/Use
Pension Funding Ratio	6% 	80 - 100%	Measures your utilization of qualified tax shelters.

You are using about 6% of the capacity of you qualified tax shelters. For most middle income Americans, income taxes are the “elephant in the kitchen”. If you want to build wealth, you must “get the elephant out of the kitchen!” Funding your qualified retirement

# Financial Checkup

plans and IRAs counts towards meeting the first fundamental of saving 10%. For most people their retirement accounts are also an excellent place to build emergency reserves.


## 4. Buy the right house for your budget and be a savvy real estate investor

Indicator	Your score	Target	Function/Use
Home size ratio	2.2X 	3X - 3.75X	Indicates whether you own the appropriate size home.
Real Estate Leverage	2.1X 	2X - 5X	Measures positive financial leverage and inflation protection.
Real Estate percent	54% 	25 - 40%	Measure of diversification among three major asset classes. Each class provides major economic functions: Leveraged Real estate = inflation protection, Interest earning = safety & deflation protection, and Equities = growth during times of prosperity.
Interest Earning percent	20% 	25 - 40%	
Equities percent	26% 	25 - 40%	

The Fair Market Value (FMV) of your home is 2.2 times your income. Your investment (equity) in real estate is leveraged 2.1 times. Through positive financial leverage most people make more money on their home than any other single investment. A 30-year, fixed rate mortgage is your single best hedge against both expected and unexpected inflation.

Your total investable assets including your home are allocated 54% to real estate, 20% to interest earning, and 26% to equities. Unless you are a real estate professional, you should have about 1/3 of your total assets in each of the three major asset classes.

## 5. Pay off credit cards and consumer debt

Indicator	Your score	Target	Function/Use
Bad Debt Ratio	0% 	0 - 10%	Measures consumer or "bad" debt.

You have consumer debt that equals 0% of your income. When you pay interest on credit card purchases and furniture loan you are **"borrowing from your future to pay for your now"**. **Good debt**, like a 30-year fixed rate mortgage and student loans, helps you build wealth. Your house and education will grow in value as the debt disappears.

# Financial Checkup

**Bad debt**, like interest on credit cards and consumer loans, destroys wealth. Cars, TVs, etc. usually decline in value as soon as you drive them off the parking lot.

## ***Tax Savings from a Financial Plan***

A key to building wealth is “Don’t turn down free money.” That’s the principal behind Fundamental #3. When you maximize contributions to your qualified retirement plans you keep three types of free money: 1) the taxes you normally owe the government, 2) the interest earned on the government’s tax dollars which are now inside your retirement plan and 3) the interest earned on the interest. By maximizing your pre-tax contributions you accept the government’s “free” money, build wealth faster and are able to retire sooner.

You told us you were putting \$3,000 into your qualified retirement plans. The legal maximum that you can contribute is \$49,425. While you may not be able to contribute the legal maximum every year, our analysis indicates you can contribute much more than your current \$3,000/year. We recommend you contribute an additional \$10,140/year for a total of \$13,140/year. By not contributing the additional \$10,140/year, you are paying an unnecessary \$1,990/year in taxes. In the table below we have calculated the value of this “free money” (\$1,990/year tax savings) invested in a conservative portfolio of stocks and bonds\* over 1 year, 10 years and by the time Sue turns 65. The table assumes you remain in the same tax bracket every year.

	<b>Value of this advice</b>
Amount saved each year	<b>\$1,990</b>
Balance after 1 <sup>st</sup> year (*)	<b>\$2,143</b>
Balance after 10 years (*)	<b>\$30,609</b>
Balance by the time Sue turns 65 (*)	<b>\$163,674</b>

(\*) Annual return 8%, average fund operating expenses 0.3%.

There’s an added bonus. Money in qualified retirement plans is protected from creditors by federal law (ERISA). Even though OJ Simpson was convicted of murder in civil court, the judge could not use his NFL pension money to pay the monetary damages awarded to the victims’ families. Maximizing your tax shelters is the fastest way to build wealth that can’t be taken from you. We estimate that a financial plan that shows you how to maximize pre-tax contributions to your qualified retirement plan(s) could be worth **\$2,143** over 1 year, **\$30,609** over 10 years and **\$163,674** by the time Sue turns 65.

## ***Savings from Investment Advice***

Do you know how much you paying in investment expenses? To help you understand the impact of fund expenses the SEC has posted an online calculator at



# Financial Checkup

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<http://www.sec.gov/investor/tools/mfcc/mfcc-intsec.htm>. The average expense ratio of your funds is \$1,401/year. We estimate that you could save \$1,242/year if you invested in comparable Vanguard funds with lower operating expenses. In the table below we have calculated the value of that savings invested in a conservative portfolio of stocks and bonds\* over 1 year, 10 years and until you turn 65. We have not included savings from trading costs, loads and other fees, so this should be a conservative estimate of your annual unnecessary expenses.

	<b>Total</b>
Amount invested currently	<b>\$100,146</b>
Current average expenses/year	<b>\$1,401</b>
Efficient expenses/year	<b>\$156</b>
Savings after 1 <sup>st</sup> year	<b>\$1,242</b>
Savings after 10 years	<b>\$23,276</b>
Savings by the time Sue turns 65	<b>\$185,170</b>

(\*) Annual return 8%, average fund operating expenses 0.3%.

Investment advice that considers fund operating expenses could save you **\$1,242** over 1 year, **\$23,276** over 10 years, and **\$185,170** by the time Sue turns 65. These numbers do *not* include the savings on any *future* investments you might make or investments past age 65.

Thank you for the opportunity to be your personal financial guides as you begin your journey to FIPOM.

[Click here](#) to buy a comprehensive Financial Plan for \$95

[Click here](#) to consult with an advisor for \$150

Respectfully,

*Robert J. Schumann*

Robert J. Schumann, MDiv MA MBA CFP® EA AIF®  
Chief Advice Officer

