

# Financial *focus*



SPRING 2019

## In This Issue



### What Would You Do If You Missed Two Paychecks?

- Zach Teutsch



### Bootstrapping Your Way to Financial Independence

-Judy McNary CFP®, MBA, MS



### Staying on Track: The Five Technical Principles of Financial Success

- Steven Clark, CFP®, EA



### Every Investor Owes a Debt of Gratitude to the Late John C. Bogle

- Tim Sullivan CFP®, EA

that they worry about having enough resources to weather a storm. It's why prioritizing an emergency fund is likely to make your nights more restful and your financial life more resilient for years to come.

Early in my career, when I suggested to working families that they put away three to six months of earnings in an untouched emergency fund, most would look at me in shock. Many people didn't have adequate savings, and they weren't alone—most Americans have very little set aside. According to the Federal Reserve, 41 percent of Americans could not cover an unplanned \$400 expense without incurring credit card debt they wouldn't be able to pay off that month. Only about half of Americans have an emergency fund at all.

**Saving for an emergency fund is hard. Here's how to start:**

**1) Take baby steps:** When just starting out, ignore the advice of three to six months savings for now. Instead, just try to save \$500. If the goal feels achievable, you'll be much more motivated to get started. The momentum and feeling of success from achieving your goal will help you take the next step. Focus on getting started. Once you have saved \$500, keep going!

**2) Think of it as giving future you a loan:** Imagine sitting at a table with a future version of you. Consider what emergency future you might be facing. Get specific: Have you wrecked your car? Is it a medical issue? Do you need to travel for a family emergency? Say yes to future you; drop it in your emergency fund.

**3) Automate saving so you don't forget:** It's very hard to remember to do something every week or every month. It's harder yet to take action consistently. Don't try to remember—set up an automated solution to do it for you.

**4) If you are a spender, make it annoying to access your emergency fund:** For those who are disciplined savers and careful spenders, it's just fine to keep the money in a checking account. For people who have a history of impulsive spending, credit card debt, or trouble setting limits, having the money visible and readily accessible may be too tempting. Consider putting the money into an account at a different institution. That way, if you log in to your checking account, you won't see the emergency fund.

**5) Have an accountability partner:** If you don't have an emergency fund or you have one and it isn't adequate, you are not alone. Choose a friend or family member and set goals together. Every so often, check back in about how you're doing with your savings. Knowing you'll need to report back might offer the extra accountability you need.

## What Would You Do If You Missed Two Paychecks?

Zach Teutsch  
Washington, DC

The government shutdown went on for 35 days which meant that nearly 800,000 government employees and about a million contractors missed two paychecks. Furloughed workers took out high-interest loans and visited food pantries to get meals on the table. Though workers are still digging out, the worst of the nightmare is over.

For the rest of the country looking on, the question of what we would do if we missed two paychecks was on many people's minds. For many, it was no mystery—they wouldn't be able to afford it.

There is near-universal agreement among financial advisors: Always have an emergency fund—money set aside for unexpected costs such as medical bills, a broken-down car, or when the government is locked in a legislative battle that leaves you furloughed for a month.

In my 15 years of doing this job, I find people are rarely kept up at night because they worry about the specifics of tax-efficient investment or an inability to calculate interest rates. It is much more likely

Continued on page 2

# Bootstrapping Your Way to *Financial Independence*

Judy McNary CFP®, MBA, MS  
Boulder, CO

From my experience as serial software entrepreneur, strategic planning consultant, author, and financial advisor, I have learned what it takes for a business to succeed. When it comes to financing a new enterprise, there are a variety of options available, yet the underlying principles are the same. Those who opt to self-finance or bootstrap do so for a variety of reasons. It may be that traditional financing is too costly or not available. Prospective equity investors may demand too large an ownership stake or attach too many strings. It may simply be that a new entrepreneur wants complete control. Regardless of the reason for bootstrapping, the principles laid out here can put a new business on the path to success.

I have worked with a wide range of business owners, from consultants and software developers to retail store owners, to graphic designers, engineers, photographers, therapists, and food distributors, and time and time again—unless you are launching with a pre-established stream of income—it takes three years to get a business off the ground. I want to offer recommendations to help you through these early years and position you for greater success beyond. The general timeline goes as follows:

**Year One: Initially, optimism reigns.** The product or service is so amazing that everyone needs it, wants it, and will line up at your door to buy it. Actually, it doesn't really work that way. It takes time to develop interest, and it takes interest to develop customers and clients. By the end of the first year, a new business has generally lost money; revenues are less than expenses. This is normal, not a reason to throw in the towel. There are three important steps to take at this point:

1) Surround yourself with supportive people. If a business isn't an overnight blockbuster, I've found that many people are quick to disparage it. Stay away from them and spend time with others in similar situations so you can support each other. When someone asks how your business is going, respond that you're putting the profits back in at this point. This is code to fellow entrepreneurs and they'll offer words of encouragement.

2) Keep a tight handle on your spending. It's a tricky balance, but until your revenues rise, your time is not worth as much as your money. Learn how to do things yourself, learn how to do without, and spend wisely. I have seen more than a few businesses not make it past the first year because the owners felt it was important to have staff and office space they couldn't afford. Only add staff who add to bottom line; learn how to do the books and handle clerical tasks yourself. Don't spend what you can't afford. Stay busy.

3) Talk with your financial advisor about tax-saving opportunities available to you in a low-income year. It might be an inexpensive time to make Roth IRA conversions or sell low-basis stock for little to no capital gains tax.

**Year Two: You're making headway.** Typically, in the second year, businesses generate enough revenue to cover expenses plus a little bit, though you're not making anything close to what you made "before." That's okay. In the second year, make sure you have the following covered:

1) Keep a tight handle on your spending. Sound familiar? Frugality remains a big part of your life and, by this point, you are probably comfortable doing many things yourself to help keep costs down. If you've been subsidizing your business with part-time work of some sort, you'll still need to do this in the second year, but you can begin to scale back.

2) Get feedback from existing customers and clients. What do they like? What don't they like? Why did they choose your product or service? Use this information to develop the most cost-effective marketing plan you can. Build on these successes.

3) Help support those just getting going on their first year; it keeps you humble.

Continued on page 3

## What Would You Do If You Missed Two Paychecks? (Cont.)

**6) If you take out money, put it back:** I had a friend who was hired as a high-paid corporate lawyer and asked what tips I had for him. Among the things we discussed was the importance of emergency savings. A few years later, during the 2008 crisis, he was laid off. When we talked about it, I told him, "This is why you set up a rainy-day fund—it's raining." He got an embarrassed look and said there was nothing significant left, since a year earlier he'd had car troubles. He clarified that I hadn't said anything about putting money back in if you take it out.

If you take money out, put it back! Bad news often comes in bunches. It's important to rebuild your stability by replenishing your emergency fund quickly.

**7) If you could use professional help, make sure you get it:** Many industry lobbyists work hard to keep the US system difficult to navigate. There's a dizzying range of financial decisions. If you want professional advice, you might find it at no cost through an employee assistance program at work. If you'd like to hire a financial advisor, consider avoiding conflicts by choosing a fiduciary adviser. I recommend making sure they don't accept commissions.

**8) Support candidates who want to improve our safety net:** Rather than individuals struggling to set aside money to cover health care costs or job loss, it'd be better if the US had an adequate safety net. Americans live in a country where it is usually financially prudent to leave money tied up in low-return emergency funds. That's a policy failure. Of course, we should do the prudent thing for our households—but we should work toward a future where each family doesn't have to allocate funds in this wasteful and inefficient way.

Many people read about the government shutdown and got the uneasy feeling that if something like that happened to them, they'd be in trouble. Almost everyone will have an unexpected drop in income or a significant unforeseen expense. Emergency funds can be the difference between a sinkhole of debt that's hard to escape and financial stability. You can start right now.

# Staying on Track: The Five Technical Principles of Financial Success

Steven Clark, CFP®, EA  
Coconut Creek, FL

When it comes to your financial future, there are things you cannot control such as the stock market, the economy, or major world events. To increase your odds of financial success, I believe it is more important to focus on the things you can control. My **Five-by-Five formula** for reaching your financial goals includes five behavioral and five technical principles you can control. Today we'll look at the five technical principles.

## Have the Proper Asset Allocation

Asset allocation pertains to how your portfolio is divided among asset classes, i.e. equities (stocks) and interest earning (cash and bonds). I believe having an appropriate asset allocation can help people control their emotions during the ups and downs of the markets. For example, assume someone has 80% of their portfolio invested in equities but is unable to sleep at night, constantly worries about their investments, and then sells when the market goes down 20%. This person has likely exceeded their risk tolerance. By selling every time the market goes down 20%, this person is sabotaging their financial plan. Having plenty of cash available to see you through downturns in the markets and for emergencies is also key to long-term success.

## Be Properly Diversified Within Asset Classes

Within each of the asset classes, it is important to diversify among different types of investments. For example, I believe the equity portion of the portfolio should be divided among US-based small capitalization, mid capitalization, and large capitalization stocks, as well as international stocks from developed countries and international stocks from emerging market countries. I believe the interest-earning portion of the portfolio should be divided among cash (and cash equivalents), treasury bonds, and corporate bonds. At any one time, nobody knows which investments are going to do well or struggle economically. Instead of guessing which type will do well, I believe it is better to diversify across many different types of investments. This spreads the risk around. At different times, different investments in the diversified portfolio will be doing better or worse than other investments.

## Rebalance Periodically

Over time, a portfolio will drift from its original asset allocation. When this happens, adjustments need to be made to get it back in alignment. For example, assume an investor starts out with an asset allocation of 60% equities and 40% interest-earning assets. Also, assume that the equity markets do well over time and this investor's asset allocation drifts to 80% equities and 20% interest-earning because stock prices increased in value while bonds went down in value. To get back to the original asset allocation, some equities could be sold and the proceeds added to the interest-earning part of the portfolio. Why is it important to rebalance? Asset allocation drift changes the risk and as a result, the portfolio may no longer align with the investor's risk tolerance or risk capacity.

## Be Tax Aware and Tax Efficient

When I meet with prospective clients the first time, I ask them to bring their last three years' tax returns to the meeting. I do this for several reasons. Not only do I learn more about them both personally and financially, but sometimes I find an opportunity to help them correct an error in their tax return that will save them money.



Often, when I meet a new prospect I learn that they experienced an unexpected tax surprise in a recent year and paid a large tax bill to the IRS. This happens when someone is not aware of their tax situation until it is time to file a return. I believe it is important to proactively manage the tax bill and avoid unexpected surprises.

I tell my clients that almost every financial decision they make has an impact on their taxes. When drawing money out of an IRA, selling investments in a brokerage account, buying or selling a house or other asset, it is important to know the effect on taxes. Proper planning can help identify opportunities to legally reduce or eliminate taxes.

## Keep Expenses Low

In general, I believe in investing in low-cost passive index mutual funds and ETFs. Historical data shows that over long periods of time, actively managed funds do not consistently outperform the benchmarks they are trying to beat. Index mutual funds and ETFs generally cost less than actively managed funds. As an example of the cost savings that can be achieved, if \$500,000 were invested in a portfolio of actively managed mutual funds with an average expense ratio of 1%, the annual expenses on the portfolio would be \$5,000. If \$500,000 were invested in index mutual funds with an average expense ratio of .10%, the average annual expenses would only be \$500. Over time, these savings add up.

# Bootstrapping Your Way to Financial Independence (Cont.)

**Year Three: This is the breakthrough year.** In the third year, business gels. You now pay yourself a decent wage and you finally feel you can exhale a bit. When someone asks how the business is doing, you can tell them sales are up 80% over the previous year and you've got no regrets. Priorities shift:

- 1) Your time is now worth more than your money. Take a hard look at the responsibilities you have. Identify a few outside your passion and expertise—these are candidates for outsourcing.
- 2) Talk to your financial advisor about setting up a solo 401(k). You need to save for retirement and you want to minimize your tax bill; this solution tackles both effectively.
- 3) Update your business plan. You can start by dusting off the one you created three years ago. Odds are good that business today looks quite different than what you initially envisioned. Invest time in developing a new strategic plan. Check in with this quarterly and update annually going forward. Always be open to new opportunities but remember that having a solid foundation and general plan keeps you from chasing the ones that aren't a good fit.

The initial three years of getting a business off the ground are risky, challenging, and oh so rewarding. Survive these and you are well on your way to bootstrapping yourself to financial independence.



# Every Investor Owes a Debt of Gratitude to the Late John C. Bogle

By Tim Sullivan CFP®, EA  
Columbia, MO

John C. Bogle passed away on January 16 at the age of 89. He was known as “Jack” to those around him, but better known as the founder of The Vanguard Group to the rest of the world. Today, The Vanguard Group or just “Vanguard” as it is widely known, is the largest mutual fund company on the planet with over \$5 trillion dollars in assets under management.

There was nothing commonplace about Mr. Bogle’s achievements in the world of finance. In 1999, Fortune magazine named him one of the investment industry’s four “Giants of the 20th Century.” That same year, he received the Woodrow Wilson Award from Princeton, his alma mater, for “distinguished achievement in the nation’s service.” Arthur Levitt Jr., former chairman of the Securities and Exchange Commission, once said, “Jack Bogle has given investors throughout the world more wisdom and good financial judgement than any person in the history of the markets.”

Regardless of his elite accomplishments, Mr. Bogle was a steadfast champion of the ordinary investor. In 1975, after getting fired from his role as President and CEO of a mutual fund management company when a merger with another company went terribly wrong, he started The Vanguard Group. There, he was able to start the first mutual fund company where the funds themselves were the owners of the company, and the fund managers oversaw the investments as opposed to being handed off to a management company that worked for its own shareholders.

A year later, Bogle established the First Index Investment Trust, the world’s first index fund. This fund tracked the return of the S&P 500 and did so while greatly reducing investment expenses for investors by lowering operating costs and eliminating commissions to brokers who sold the fund. This entire concept of trying to match the return of the market was largely derided at the time. Nevertheless, despite a slow start, Mr. Bogle pushed forward. Now known as the Vanguard 500 Index Fund, it has grown to be one of the largest funds in the industry with \$441 billion in assets.

Mr. Bogle fought to give everyday investors a “fair shake” when much of the financial industry was working against them. His favorite topic of scorn was the high fees associated with many mutual funds over the years. The rock bottom costs at Vanguard

have forced competitors to lower their fees across the board. So much so that William Baldwin, a senior investing contributor to Forbes, estimated the savings to investors at a collective \$100 billion annually.

Just over four years ago, I had the good fortune to meet Mr. Bogle in person. I had sent him a handwritten letter in a longshot effort to get him to participate in an Alliance of Comprehensive Planners conference—which happened to be in his adopted home town of Philadelphia. To my astonishment, he happily agreed.

He joined a small group of colleagues and me for lunch, and then I had the pleasure of leading an hour-long Q&A session with him. He answered the questions in typical Jack Bogle fashion, directly and comprehensively. Despite his age and frail physical condition, he was still quick-witted and sharp as a tack.

To a room full of fee-only advisors—many of whom would consider themselves “Bogleheads,” the lighthearted name given to those who are devout followers of Bogle’s investment preaching—it was a once in a lifetime experience, and I will always remember him fondly. There is no doubt that his voice in the investment community will be sorely missed, but his legacy will last for generations.

All content provided by members of:

