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Ready for Your Optimal Life? First, Ask the Right Questions.

Frank J. Corrado, CFP®, CPA

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Remember the first time an adult you respected told you, "If you're having a difficult time deciding what is the right thing to do — just listen to your gut. Deep down, if it's right, you'll ***feel*** it."

That's exactly how I felt the first time I was introduced to the concept of ***appreciative inquiry***. After years of providing excellent financial planning service to my clients, the traditional model I'd been trained in just didn't feel right anymore. As a successful financial advisor helping clients build their net worth, I was questioning the impact I was having. Sure, I was helping them make more money through better investing and financial strategies, but I felt strongly that there was more that I should, and wanted, to be bringing to the table in these relationships.

So I started searching for a way of serving clients that felt right. Then I found *Appreciative Moments*, by Dr. Ed Jacobson. Appreciative inquiry (AI) is a conversation model that engages stakeholders in ***self-determined change***. The diagram to the right does a pretty good job illustrating the process of building on the existing positives in a client's life. My first exposure = Mind Blown. This ***felt*** right.

Advice vs. Guidance: Yes, There's a Difference

I was great at giving my clients financial advice. What I discovered through AI was that even more valuable is the opportunity to offer clients guidance. Advice gives recommendations to solve a problem. Guidance helps someone figure out how they can solve their problem. In my current practice, AI gives me a great communication tool to empower my clients. Through AI, I help them discover their true passions and motivations, and set truly personal, meaningful goals that catapult them into their optimal life.

Let me share an example of why AI is now embedded in our practice.

As I was sitting with a colleague the other day, we started sharing tidbits of interesting stories we are reading on social media. After a few minutes, she stopped. "Frank, what do you think about this?" she asked, handing the phone to me.

I did a quick scan. The blogger had started canning his own food (and just put up 24 jars of pickles). What started out as a test to see how much money he could save putting up his own fruits and vegetables quickly became an obsession. He shared how he delightedly told his friend — also his business coach — how he was saving an average of $1.30 a jar by making his own pickles. His friend-coach's response, "You're not really saving money; you'd make more money using the time you spend canning to grow your business." In other words, according to the 'friend-coach', Time = Money = Value.

Appreciative Inquiry and True Client-Centered Conversations

The article my colleague shared with me that day was a perfect example of traditional advice given in a financial planning relationship. However, I wanted to deliver a different level of professional service to clients — one that helps them identify and achieve their true life's purpose - their optimal life. The operating assumption of Life Guidance is that more money is not the answer but rather a means to achieving one's optimal life. Appreciative inquiry is the heart of the financial life guidance process. We want to under-

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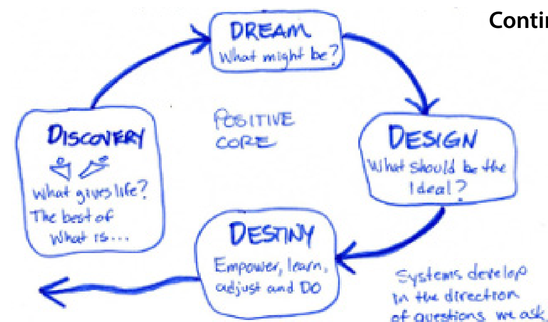

Source: Cooperrider et al

The Importance of Knowing Your Risk Capacity

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If you have worked with a financial advisor, you are likely to have a good understanding of risk tolerance, but you may not be as familiar with risk capacity.

Both are important in determining how much risk you should be taking in your portfolio for your unique financial situation.

Defining Risk Tolerance and Risk Capacity

Risk Tolerance is a psychological factor – it is all about your behavior and mental attitude. It is related to how well you can handle downturns in the market. An investor who can sleep well at night, and not sell investments when the market goes down 30% or more, has a high-risk tolerance; an investor who obsesses over a down market, panics, and sells, has a low-risk tolerance.

Investors with a higher risk tolerance would typically have a higher percentage of their portfolio allocated to equities (stocks) and riskier fixed-income investments, such as high-yield bonds. Even though these investors are exposed to greater potential loss, they also have the potential to get higher returns.

Investors with a lower risk tolerance would typically have a lower percentage of their portfolio allocated to equities, and a higher percentage in lower-risk assets such as government treasury bonds and CDs.

Although understanding risk tolerance is important, it should not be the only determining factor in how much risk an investor should take in their portfolio. Risk capacity, as explained below, is also a very important factor to consider.

Risk Capacity has to do with the impact a market downturn would have on your ability to reach your goals. This is different from risk tolerance, which is about how you feel about risk and how much risk you are willing to take. Risk capacity is about whether you can financially afford to take a certain amount of risk.

Factors affecting risk capacity include your time horizon for when you need to tap into your investments, the withdrawal rate needed from the portfolio, the length of time you need to draw from the portfolio, the availability of other assets, and the amount of liquidity needed now and in the future.

Risk Capacity Examples

As an example, consider Jim, who is single and 35 years old, has 30 to 35 years until he plans retirement, has sufficient liquidity, has a stable corporate job in a profession with strong demand, and does not foresee a need to tap into investments prior to retirement. Based on this information, Jim has a high-risk capacity at this time. Given his overall financial situation, he can afford to take on higher risk in his portfolio. A major market downturn would not have any material effect on his financial well-being.

Now consider Laura, who is also 35 years old, but her situation is quite different. She owns her own business, supports a family of four, has an unstable job outlook as her business is still struggling to survive, and does not have sufficient liquidity as she puts almost all earnings back into the business. She has 30 to 35 years until she plans retirement just like Jim; however, she needs to tap into her portfolio in the next few years to help support her family while building her business. Based on this information, Laura has a low-risk capacity at this time. Given her overall financial situation, she cannot afford to take on as much risk as Jim in her portfolio. A major market downturn in the next few years could have a negative impact on her family's financial well-being.

Notice in these examples there is no mention of each investor's

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Ready for Your Optimal Life?

First, Ask the Right Questions. (Cont.)

stand, "**What** is good here? How do we get more of it?"

"Did the author say whether he enjoyed making pickles?" I asked my colleague.

"What?"

"Maybe he enjoys making pickles," I speculated. "Maybe, the smell of pickles reminds him of time spent with his extended family, his grandmother. Maybe," I continued, "he loves the feel of the jars as he fills them and the challenge of measuring the ingredients for the perfect taste. Maybe the real payoff for him is the satisfaction of coming up with different recipes and sharing something he created with others. Maybe his time is really being spent on building business - a new pickling business!

"If his friend-coach didn't ask any of these questions," I continued, "and the author didn't ask himself or even know to ask — how does he know the real value of each jar of pickles?" Being empathetic, asking those probing questions — questions that encourage our clients to truly focus on their emotions and the motives for their behaviors — this is the value added using appreciative inquiry.

Make Your Own Pickles

By using appreciative inquiry techniques, we can all build richer experiences and relationships with those we care about. When we are truly appreciative and inquiring, we want to ask questions that help us connect with others and appreciate the positives. This is the beginning of true conversation and discovering what's truly important to that client.

The next time you speak to your spouse or your child, instead of asking them, "How was your day?" try it differently with, "Tell me what was great about your day."

See what happens. See how they respond. See how you feel.

All Hat, No Cattle

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I recently received the current issue of ***Forbes Life***, a recurring supplement to my Forbes magazine subscription. By the time I finished flipping through it I felt like a total loser who has missed out on so much that life has to offer. Here are some of the advertisements that reached out to me:

Raidho stereo speakers at $48,500 each in burled walnut

A Patek Philippe watch for $87,100

The Trendsetter, a Louis Vuitton leather briefcase, for only $4,150

A $440 tie and a $9,210 suit by Kiton; $995 shoes by Bally

Some of the marketing slogans were: "Engineered for Performance," "Live Your Passion," "British Chic, Swiss Excellence," and "Life is a Collection of Experiences;" and of course, "Engineered to Leave Nothing Beyond Your Control, The All-New 2017 Corvette Stingray." Wow, that new Stingray is sooo sweeeet!

At some point I began fantasizing about how good I would look, gray hair and all, with a Patek Philippe on my wrist, Bally shoes on my feet, wearing a Kiton suit, with a Louis Vuitton briefcase on the passenger seat beside me in my All-New 2017 Stingray! Hey, I want to "Live my Passion" and experience that "British Chic, Swiss Excellence," don't you?

In ***The Great Gatsby***, F. Scott Fitzgerald said that the "very rich are different from you and me," and those who can easily afford the consumer items that I mentioned above are very different from most of us; but they are a tiny minority of the American population. I think that we can learn much more from the type of people that Dr. Thomas Stanley interviewed for his best seller, ***The Millionaire Next Door***. He interviewed 994 millionaires (folks whose net worth is at least $1 million excluding their homes) and discovered that "the really rich often don't look anything like what we think they should look like." They are usually thrifty and don't drive the latest model cars, wear the most expensive clothes, or live in the fanciest homes. In short, they often look very much like you or me.

One of the prevalent misconceptions in our culture is that spending equates to wealth. We see folks with a lot of fancy possessions and assume that they have a lot of money. It may turn out that their possessions are a better indicator of their credit rating than their actual wealth. Wealth is only accumulated when someone lives on less than they make, regardless of their incomes.

It appears that the "average millionaire" in America has at least two characteristics that distinguish them from many others. First, they have a habit of spending less than they make since they believe to do otherwise would be irrational. And, second, they place a priority on saving for the future because they realize a day is coming when they will no longer be able, or willing, to continue working.

One of the questions often asked Dr. Stanley is, "What good does it do to have all that money if you don't spend it?" He responds that his research has shown that people who feel financially secure also feel happy and that happy people tend to live below their means. Those who aspire to wealth sometimes feel that buying the trappings of wealth will make them feel happy, but that feeling seldom lasts for long and those purchases often create problems for them.

One of the "average millionaires" interviewed by Dr. Stanley owned a diesel engine overhaul shop in Texas and spent much of his time in grease-stained jeans. In typical Texan fashion his assessment of some of his neighbors who showed signs of aspiring to wealth was that they were "all hat, no cattle." He claimed he didn't have much of a hat, but that he did have lots of "cattle."

In his latest book, ***Stop Acting Rich: And Start Living Like a Real Millionaire***, Dr. Stanley says that most of us can either act rich, or be rich, but not both. Thus, I have trashed the idea of ever wearing a Patek Philippe as well as the current issue of Forbes Life. Although far from the most important thing in life, still money matters, especially the money one saves by spending less than what one makes.

The Importance of Knowing Your Risk Capacity (Cont.)

risk tolerance. We have no idea whether they have high or low-risk tolerances, and we did not need to know this in order to determine their risk capacity.

Combining Risk Tolerance with Risk Capacity

Now that we have an understanding of the risk capacity of our investors, how would risk tolerance be applied to their situations? First, assume Jim has a low-risk tolerance and is not willing to take on the amount of risk his risk capacity indicates he could. That is perfectly okay because he has to be able to sleep at night and not worry about his investments, and it does not affect his financial well-being. Next, assume Jim has a high-risk tolerance and is willing to take the amount of risk indicated by his risk capacity. That is okay too, as explained above in the analysis of his risk capacity.

Consider Laura – assume she has a high-risk tolerance and would be willing to take on more risk than her risk capacity indicates. Just because she feels she could handle the higher risk, it does not mean she should take higher risk than her risk capacity indicates, because she cannot afford to take on more risk at this time.

Summary

Risk tolerance is difficult to quantify since it is based on your emotions and ability to handle major market downturns. Because risk capacity is based on your goals, it can be more easily quantified. It takes into consideration factors such as your need for cash and liquidity, your investing time horizon, the length of time you need to draw from the portfolio, and your ability to withstand a major market downturn without affecting your goals or harming you financially.

Here are a few rules of thumb to use as a guide to help determine risk capacity:

- When the need for liquidity increases, risk capacity decreases.
- When the time horizon increases, risk capacity increases.
- When the importance of the investments increases, risk capacity decreases.

Your risk tolerance and your risk capacity may be aligned with one another, or they may not. Both are likely to change over time depending upon where you are in your financial life cycle and depending upon your unique circumstances along the way, which is one reason why a financial plan needs to be monitored and adjusted regularly.

Tax Alpha

Wendy Marsden, CFP®, CPA, MS

Greenfield, MA

No investment advisor can honestly tell you that they can make you an additional 10% return on your investments. However, I can honestly say that I can, in many instances, save you 10% of your investments through good tax planning. How, you ask? I've got a lot of strategies. Taken altogether, they form what we're calling "Tax Alpha".

It's pretty complex, so let's put some building blocks in place first.

- Tax-deferred "qualified retirement money" (deductible IRAs, 401ks, etc.) is going to be taxed when you take it out.
- Social security is untaxed if you live on social security and a small additional income. But if you have more than a minor amount of retirement income, social security becomes taxable. During that time when your social security is phasing in as taxable you're paying at either a 27.75% tax rate (if you were otherwise in the 15% bracket) or a 46.25% tax rate (for those who thought they were in the 25% bracket.) These high rates are a combination of the tax on your retirement income plus the additional tax on your social security income. Additional retirement income can also cause dividends and long-term capital gains to go from 0% to 15% taxed: it's a bitter reality that sneaks up on people taking IRA distributions!
- If you make over $85k single or $170k married filing joint, there's a surcharge on your Medicare premiums that works as a de facto extra tax. This is called the IRMAA threshold and it sounds like a good idea ("tax the rich") until you realize that higher Medicare premiums hit people who are merely taking distributions from their retirement plans for large purchases (like buying the RV they were saving up for, or paying for a nursing home).
- Required Minimum Distributions (RMDs, sometimes called MRDs) are the government's way of saying "we'll let you defer taxes so you can save more when you are young, but not forever." When you turn 70 ½, you must start paying taxes on a required minimum amount each year. Required distributions typically start after you're on social security and that's when you discover you're in the highest tax bracket of your life. (Not what you meant to do when you deferred the taxes, was it?!?)
- If you are in a low tax bracket, your tax rate on long-term gains and qualified dividends is currently at 0%. That means sometimes we can sell a stock to harvest the accumulated gain at 0% federal income tax!
- People talk about simplifying taxes as if it were all about changing the tax rates. It really isn't! Taxes are complex because you have so many ways to earn income, and so many ways to take deductions and credits. The actual tax calculation is easy-peasy. It's determining what your taxable income (after deductions and credits) is that is subject to much of our strategizing.

So, a tax-focused comprehensive planner (that's me) accounts for tax ramifications when providing investment advice. We look at several things at the same time:

- how much cash you need to fund your goals
- what tax bracket are you likely to be in after age 71
- how much room for additional income you have left in the same or lower tax brackets before age 71
- all while paying attention to the IRMAA thresholds that increase Medicare premiums

I have a truly scary Excel spreadsheet to help solve these problems. I also use various tax planning tools. But without getting into numbers, here are some examples.

Fran and Alex are retirees in their 60s. They need $50k/year to fund their retirement goals. They decide to delay taking social security until age 70. They still need money to live on now, though. Let's say they have $200k in after-tax money (plain old savings or investment accounts) and $900k in qualified retirement money (IRAs).

In this case I'd run some calculations to see what tax rate bracket they'll be in when they're 71, and I'd convert as much as possible of their Traditional IRA into Roth IRAs each year to pay lower taxes now rather than later. During the clever Roth conversion years, they live on the $200k after-tax money. The Roth conversions protect the IRA money from ever being taxed again, and reduces the size of their eventual required distributions after age 70 ½. The desired net effect avoids having their required minimum distributions being taxed in a 10% higher tax rate bracket.

Here's another case: Sage is still working, still accumulating, still growing assets. All of Sage's money is in workplace plans. When Sage retires, quite possibly not until age 70, there's going to be a massive required distribution (RMD) hitting at the same time as social security payments start. The trick here is to consider some other strategies; QLACs, donor advised funds, and the Roth side of a 401k.

Dale is early-career but has an inheritance. In Dale's case we'd pay attention to tax-loss harvesting of inherited taxable investments; have Dale contribute as much tax-deferred income as he can at high brackets; but use Roth contributions if Dale is in low tax brackets.

Everyone loves to save taxes. An investment advisor who is tax-focused and considers comprehensive financial planning goals will do a better job for you than the typical investment advisor. I am a member of the Alliance of Comprehensive Planners and that's how we work.

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