Tom & Tina Test

March 22, 2019

Introduction

When speaking with people, we often hear "I don't have a financial plan." This is not true. Everyone has a default financial plan. In its simplest form, your plan is the combination of what you earn, spend, invest, and protect. The question is not whether you have a plan, the question is whether you have a plan that projects success…based on your definition of success. This review will help answer that question.

We measure your probability of success, based on what is known today. We consider projections and assumptions about your future. This document is designed to provide a roadmap for current and future money decisions. Our process is dependent on your input.

Although we do our best to gain accurate data including the use of what have historically been conservative estimates; we know some assumptions used in this document will be incorrect at some level. It is important to remember financial planning is a process rather than an event. Your current plan review is a summary of recent discussions. As you review this summary, please bring any errors to our attention.

Where you are today

This is your initial plan review with Disciplined Money. We begin each plan review or update with a summary of where you are today.

- Tom is 50 years of age (01/01/1969).
    - Current income is estimated at $100,000 annually
- Tina is 45 years of age (01/01/1974).
    - Current income is estimated at $50,000 annually
- You are in good health
- You are Arizona residents
- You have two children
    - Sam - 11
    - Sarah – 8

Your retirement expectations include:

- Active Lifestyle
- Opportunity to Help Others
- Time with Friends and Family
- Less Stress – Peace of Mind

Your concerns include:

- Current or Future Health Care Issues
- Running Out of Money
- Cost of Health Care or Long Term Care

What you look to achieve…Your Intention

Your list of expectations helps create an overall intention. Here, we break down your vision into smaller pieces…often referred to as goals. We focus our attention on goals as they tend to be shorter term and more easily measured.

The goals we are measuring in this plan update include:

- Retirement
  - Tom looks to retire at age 65
  - Tina looks to retire at age 60
  - Based on actuarial estimates; Tom lives until age 92; Tina age 94
    - Based on current assumptions, your money needs to last 35 Years after you retire!
- Retirement Expenses (increased with inflation unless otherwise noted)
  - Living Expenses (annually)
    - $60,000 adjusted for inflation (2.25%)
    - $40,000 Tina alone retired
  - Health Care (annually)
    - $10,571 once you are Medicare eligible
    - $19,761 Tom Medicare, Tina retired before Medicare
    - $6,386 Tina alone Medicare
    - All healthcare estimates increase at a rate of 5.05%
  - Car/Truck
    - $30,000, when both are retired, recurring every 8 years until 'End of Plan'
  - Home Improvement
    - $1,000, when both are retired, recurring every year for 4 years until 'End of Plan'
  - Travel
    - $10,000, when both are retired, recurring every year for 15 years
  - College – Child 1
    - $10,000, in 2029, recurring every year for 4 years
  - College – Child 2
    - $10,000, in 2026, recurring every year for 4 years
  - New Home
    - $1, when both are retired

What you have today

As we consider where you want to be, our next step is to review what you have today.

- Guaranteed Income. This is an asset that is often overlooked when considering your ability to achieve future goals. The following are current assumptions, which will be reviewed and updated in future updates.

  - Social Security

Owner	1st Year Benefit	Collect at Age
Tom	$33,694	67
Tina	$22,856	67

- Other Retirement Income

Description	Owner	Value	Years
ASRS	Tom	$12,000	Tom's Retirement to 'End of Plan'

- Investments. You have multiple accounts with multiple custodians. We assume you aggregate your accounts to one custodian when you are able (currently constrained).
  - Taxable. Taxes have been paid. Future taxes will be paid on capital gains and dividends/interest.

Account	Owner	Amount	Annual Additions
Emergency Fund	Joint	25,000	-

  - Tax Deferred. Contributions were made tax free. All distributions will be taxed as ordinary income. Required distributions begin at age 70 ½. Annual additions include company match.

Account	Owner	Amount	Annual Additions
401k	Tina	$200,000	$19,000
403b	Tom	$125,000	$25,000
IRA	Tom	$200,000	-

  - Tax Free. Contributions were made after tax. Growth is tax free. No required distributions are required (this may change).

Account	Owner	Amount	Annual Additions
Roth IRA	Tina	$10,000	-

- Other Assets. These assets are usually not liquid. Some are assumed to help fund goals while others are not.
  - Home. Estimated value of $400,000 – NOT FUNDING GOALS
- Liabilities.
  - Home – 1st Mortgage: $150,000 balance; 3.500% Fixed; $1,500 monthly payment
- Net Worth: $810,000

The likelihood of achieving your financial/retirement goals and vision

Based on facts and assumptions listed above, your plan projects a 72% probability of success. When considering this result, we used an annual nominal portfolio return of 5.03% (2.78% real return). This return is based on a forward looking (lower) projection of returns based on current market conditions.

When using average return (same return every year), your plan projects 100% funding of Needs, Wants and Wishes WITH a safety margin of $513,404 in today's dollars (does not include real estate).

When considering Bad Timing (same return every year other than the first two years of retirement), your plan projects 100% funding of Needs, 79% funding of Wants and 0% funding of Wishes WITH a safety margin of $4 in today's dollars.

A review of the actions discussed/recommended in your current update

We find very few people have a plan that creates a near perfect outcome. In our opinion, there are two ways to "fail" retirement. One is the most obvious and frequently discussed. You run out of money before you run out of time. We refer to this as a "downside fail."

The other is talked about less frequently but could be considered a failure. If your goals include maximizing your lifestyle (spend more while living, leave less to heirs); laying on your death bed with a substantial amount of assets might create the "could of, would of, should of response." We refer to this as an "upside fail."

Based on our review of your goals and the projected probability of success for your plan, our primary focus will be on your likelihood of a "downside fail."

When your plan projects a downside fail, there are three common factors we review and consider:

Spending/Saving: We begin with the decision you have the greatest control over (most of the time). Your level of spending/saving tends to have the greatest impact when considering how to adjust your financial plan to better meet your goals.

When considering a downside fail, a factor you have a fair amount of control over is your level of spending. Spending less will help a plan that has the potential of a downside fail. I know…stating the obvious, but what most don't consider is the impact a small spending adjustment makes. In most plans, the adjustment to spending significantly outweighs the decision to increase market risk.

The obvious reason lower spending increases a plan's success is that you have more money. But what most don't consider is the impact of having that money invested. Finally, few consider how spending less today impacts what you'll likely spend in the future. You become accustomed to a certain lifestyle (what you spend). If you spend less today, you will likely spend less in retirement.

If you decrease your annual spending by $6,000, your probability of success is projected to be 83%. You fund 100% of your needs, wants and wishes with a projected safety margin of $784,231 when considering average returns. When considering bad timing, you fund 100% of your needs, wants and wishes with a projected safety margin of $349,688.

We share the various scenarios to show the importance spending has on your plan. The scenarios assume the level of spending is maintained throughout retirement. As you get closer to retirement, you may want to test the impact of spending more in the early years of retirement knowing you might have to cut spending later.

Time in Workforce: The time in the workforce impacts your plan's probability of success. We address your time in the workforce before portfolio risk because you hopefully have some level of control over this decision.

Some ask us to review their plan because they are either worried about being forced out of the workforce or they want to consider something less stressful (usually with lower pay).

If your plan projects an unacceptable probability of success, remaining (or reentering) in the workforce is a choice we review. The additional income is an obvious reason the choice improves your plan's success. But, you also spend less while in the workforce, allowing your portfolio more time to grow (hopefully). In addition, employers often provide benefits that cost more when paid individually (insurance is the most common example).

To test the effect of working longer, we assume you will maintain your original annual spending amount of $60,000. Your base plan has Tom "retiring" at 65 and Tina retiring at 60. If you both work one additional year, your projected probability of success is 82%. You fund 100% of your needs, wants and wishes with a projected safety margin of $792,735 when considering average returns. When considering bad timing, you fund 100% of your needs, wants and wishes with a projected safety margin of $338,866.

We share the various scenarios to provide information surrounding your need for employment. If you were offered a severance or adjustment to your employment, you have an idea if you could accept it from a financial viewpoint.

Adjusting your Portfolio: Financial advisors too often want to sell you an investment solution that "will make your plan work." Some promise high returns with little or no risk. Others suggest a guaranteed rate of return. What they fail to share is that the search for return (whether lower or higher) comes with risk.

When you remove one form of risk, you add another. Therefore, we save investments for last. We prefer to address the choices over which you have greater control before discussing risk (and return).

When a plan projects an unacceptable projected outcome, a common reaction is to accept additional market risk in hopes of gaining a higher return. Before we make that choice, we consider potential cash flow needs and your emotional risk tolerance. We also consider current market conditions.

Portfolio	Probability of Success	Safety Margin	Great Recession Return
Capital Preservation I (30% Stock)	70%	$74,072	-4%
Current (53% Stock)	83%	$684,007	-18%
Balanced II (50% Stock)	83%	$784,231	-21%

Equity Growth (100% Stock)	83%	$3,194,143	-51%

What could go wrong?

Before we proceed with implementation, let's consider what could derail your plan. In this section, we review and address the concerns listed in the program. We also measure the impact of the most common threats.

Insurance Type	Insured	Death Benefit
Life – Group Term	Tom	$100,000
Disability – Group	Tom	
Disability – Group	Tina	

Death: When considering the financial risk of death, we are measuring the probability of whether your family (or other dependents) would "succeed" without your income. The most common solution when considering this risk is life insurance. We remeasure the probability of success to determine if current coverage is adequate and discuss options if additional coverage is needed.

To determine if your current insurance coverage is adequate, we tested the scenario where Tom dies at age 51. With current coverage, your projected probability of success is 58%. You fund 100% of your goals with a projected safety margin of $48,136 when considering average returns. When considering bad timing, you fund 100% of all your goals with a projected safety margin of $212,784.

If you add an additional 250,000; 20-year term policy for Tom, your projected probability of success is 80%. You fund 100% of your goals with a projected safety margin of $839,466. We recommend a 20-year term policy because it coincides with the age when your children hopefully no longer rely on your income.

Tina chose not to have life insurance. If she were to reach the 'End of her Plan' next year (at age 46), your projected probability of success is 90%. While financially, the program says no insurance is needed, consider the fact Tom will now need to take both roles. He will have to work full time and care for the children. Tom may also want to temporarily (or permanently) reduce his workload to handle the emotional side of this loss. To prepare for this, we would recommend adding a $100,000 term policy (minimum) for Tina.

Disability: The risk of becoming disabled is similar to the risk of death. In both cases, we are testing the impact of losing income. There are a few key differences. First, if you passed, you would no longer have a living expense. If disabled, you would. Second, research says you are more likely to become disabled (before retirement years) than die.

Both Tom and Tina have 60% of pay coverage through age 65. No additional disability insurance is recommended.

Unexpected Expense: When creating or updating any financial plan, we know some assumptions will be wrong. Life serves up surprises…both good and bad. Although we include multiple goals in your plan, we realize there will be unexpected expenses. We address this by using lower (hopefully) projected returns. You have a Safety Margin of $478,289 when considering average return and $1 when considering bad timing.

Long Term/Medical Care: The cost of care continues to increase at a rate greater than default inflation. We address this by increasing the cost of health care at a rate of 5.05%. We feel this helps offset the risk of increasing costs. Arguably, rates have increased at a rate higher than this in the past few years. We do not believe it can continue at the current rate.

Per Genworth, a semi-private room at a long-term care facility in Arizona averages just over $76,000 in 2017. Home care and assisted living are less. Many are startled when they see this number. When we consider your need for Long-Term Care insurance, we consider a few items.

- Many "do the addition without doing the subtraction." In other words, we project you are spending $478,289 in retirement. You would likely shift some of those costs towards LTC.
- The cost of buying insurance can be expensive. This known cost may negatively affect other goals.
- Your safety margin of $478,289 when considering average returns ($1 with bad timing) can also be used to offset these costs.

"End of plan." We have come to the end of your plan. Your remaining assets are being passed to heirs. Your assets are passed to heirs via your estate plan. Like your financial plan, you have an estate plan. The courts will decide how to pass assets if you don't give clear and legal instructions.

> Tom and Tina recently updated their estate documents including a living trust that protects the children.

Summary and Next Steps.

We want to remind you financial planning is a process rather than an event. This should be the first step of a continued plan to review, measure and adjust (as needed) your retirement plan.

When we complete an initial plan review, we outline the three or four simple steps with the greatest impact on your plan's projection. We believe focusing on these steps provide discipline and permission.

Your four simple steps (and remove guilt)

1. Consider opening and funding Roth IRA accounts.
2. Maintain current 401k contributions.
3. Replenish emergency fund as needed
4. No additional debt
5. Spend difference (without guilt)

When to rebalance

You would benefit from additional market risk if you are paid for taking the additional risk. We feel the market is overvalued with multiple headwinds. We based current recommendations on a portfolio with 10% less stock than we would hold in a "normal" market. As we return to a "normal" market, we should

have a plan for when and how to add stock exposure back into your plan. To avoid the emotional challenge of adding stocks when the market is falling (valuations are better), we created a plan before the markets fall and emotions take over (for us as well).

If markets (measured by S&P 500) fall by 10% from high, we propose adding 5% to your stock allocation. If the S&P 500 fell an additional 10%, we recommend adding an additional 5% to stocks.

Going Forward

We offer three ways to work with Disciplined Money after your initial plan is complete. Given most of your assets are held within an employer sponsored plan, we do not feel you need the additional expense of ongoing management. The other two choices are an hourly agreement or a retainer agreement.

If moving forward with an hourly agreement, you will contact Disciplined Money as needed. The cost of future projects will be determined by the number of hours needed to complete the project. A retainer agreement provides ongoing access and updates without direct management. Annual retainer fees are based on six hours per year.

We feel you are comfortable managing your investments, which would bode well for moving forward with an hourly agreement. As you get closer to retirement, you may want additional access and guidance. When you get to that point, please let us know.

Summary

Your initial inputs created a plan that didn't project the probability of success desired. As we adjusted the plan (mostly spending), the plan increased the likelihood of success. The current plan projects a high level of success with a few considerations that would likely improve results.

- We didn't include real estate in our projections.
- We maintained consistent living expense throughout retirement.

While the current plan projects success, we recommend reviewing the inputs and measuring the outputs periodically.

If you have questions, comments or suggestions, please let us know.