Financial Planning for Young Professionals

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Introduction

Updated for 2020 with the changes in the tax laws and investment climate.

This financial planning primer has been developed for young professionals who are at the beginning of their careers and financial lives. It is targeted at professionals between 25 and 35 years of age, single or married and there is a separate chapter that discusses the important issues for families with young children. This advice is most appropriate for folks with less than $250,000 in investable assets (stocks, bonds, and cash). Consider this general advice and recommendations that will better prepare you financially, for the future. The actions and decisions that you take while you are young will be the basis of a successful midlife and retirement.

The motivation for developing this document was based in part on the errors that our older clients made years ago when they were young. Problem-causing decisions that can sidetrack your success include:

- Excessive spending and/or insufficient savings (sometimes having no savings at all)
- Not fully utilizing 401(k) plans or failing to take full advantage of a company's matching policy
- Investing too conservatively so that investments were not keeping up with inflation
- "Gambling" with investments rather than using asset allocation techniques to maximize risk-adjusted returns
- Incorrect insurance coverage
- Inadequate or no estate planning preparations

Each of the following chapters discusses a different aspect of your financial life, defines its important features, and provides general recommendations for your consideration. Understanding each of these areas and making smart decisions while you are young will make midlife much easier, greatly increase the probability of a successful, worry-free retirement and provide peace of mind.

1 – Current Financial Status

Discussion

FINANCIAL SNAPSHOT

Knowing your Net Worth is the first step in properly monitoring your financial progress over time. Complete the table and equation below. Enter the value of all the major assets that you own and total them to get the **Assets Total**. Then enter the values of all the debt you have and total them to get the **Liabilities Total**. Subtract the **Liabilities Total** from the **Assets Total** and enter that as your **Net Worth**.

Assets:			**Liabilities**	
Description	Amount		Description	Amount
Bank Acct - Checking	$		Student Loans	$
Bank Acct - Savings	$		Credit Card Debt	$
Car Value*	$		Car Loan	$
Home Value*	$		Home Loan - 1st	$
Retirement Accts - 401(k),403(b),457	$		Home Loan - 2nd	$
			Personal Loan/Other	$
Other Accts and Assets	$			
Assets Total	$		**Liabilities Total**	$

* Not the value you paid, but what it would sell for today.

Assets	$
- **Liabilities**	- $
= **Net Worth**	= $

The table below shows the range of Net Worth for Americans of different ages but keep in mind that this data varies greatly from one part of the country to another.

Age	Median Net Worth		
	30th Percentile	50th Percentile	70th Percentile
Under 35	$0	$6,682	$33,477
35-44	$4,058	$35,000	$128,430
45-54	$12,175	$84,542	$228,708
55-64	$39,057	$144,200	$333,750
Over 65	$68,783	$171,135	$334,870

Source: http://www.mybudget360.com/the-average-net-worth-by-age-real-estate-boost-housing-net-worth/

CASH FLOW

To balance your current financial needs and future goals, it's important to understand where you are financially compared to generally accepted guidelines.

1. Budgeting. The more you know about how you spend your money, the better equipped you will be to limit unnecessary spending and allocate those dollars to meet your short and long term goals. Budgeting can help you reach your savings goal, but if you, like most people, despise budgeting then a direct paycheck deferral is a good method to control spending and help ensure savings. You can use one of the following methods to budget and monitor expenses:
   - Pencil, Paper and a Calculator
   - Electronic spreadsheet
   - Quicken or Quickbooks
   - Online, using mint.com or a similar service

   Regardless of which budgeting method you choose, the goal is to try and save 20% of your salary between cash reserves, retirement accounts, etc. so that you will have plenty set aside for future needs.

2. Emergency Funds. Ideally, you should have between three and six months of after-tax expenses held in a combination of checking and high interest cash accounts to fall back on, in case of the unexpected.

3. Housing Expenses. In order to have enough to pay other expenses and save for the future, your personal residence costs (i.e. mortgage, insurance and property taxes or rent and insurance) should ideally not exceed 28%, or in a worst case scenario 33%, of your total gross income. Spending above this percentage of income can make it difficult to fund other goals. Use the worksheet below to determine your housing costs:

   - If you own a home, your housing expenses are:

Monthly Mortgage:	$	x 12 =	$
Annual Insurance Costs:		+	$
Annual Property Tax:		+	$
Annual Total		=	$

   - If you rent, your housing expenses are:

Monthly Rent:	$	x 12 =	$
Annual Insurance Costs:		+	$
Annual Total		=	$

   - Divide the housing expense total by your gross annual income to determine your ratio. If it's above 0.33 (meaning 33% aka the worst case scenario) strongly consider your options to reduce this expense or else increase your income.
   - If you own a house and use it as your personal residence, it is an asset but considered a "use item" and should not be viewed as an investment from a financial planning point of view.

4. Transportation expenses. These can be a high percentage of your current expenses. If you lease a car or buy a new car every few years, you are probably spending too much on transportation and you should monitor and reduce these expenses if at all possible. You need to decide what's more important to you - driving an expensive car now and possibly having a reduced quality of lifestyle during your retirement years, and possibly not being able to fund your other goals OR driving a less expensive car now and having more money to fund a better retirement and fund your future goals (say a bigger house or kids education).
5. Bank and Brokerage accounts. Keep your finances as simple as possible. The fewer accounts you maintain, the less paperwork there is to deal with and the easier it is to summarize your situation.

SAVING FOR SHORT TERM GOALS

Short term goals could include repaying a student loan, saving for a house down payment, replacing a car, or remodeling your current home. The money you may need to pay for any short term goals, say over the next five years, should be saved either in a bank, a money market account, or a short term bond type account. The returns on funds in these accounts are low (currently around 2% annually) but any loss of principal will be very small. As a rule of thumb:

1. Funds needed within the next two years should be saved in a bank account, a money market account, or a 2-year CD.
2. Funds needed between 2 and 5 years later can be invested in bank accounts, or in Ultra Short-Term or Short-Term Bond Mutual Funds, or in a 3 to 5 year CD.

The stock market is much too volatile as an investment vehicle for short term savings. While it's true that potential returns are higher, the risk of principal loss is too great (remember the stock market crash in 2008 and 2009, which went down by 50% and the recent crash).

SAVING A DOWN-PAYMENT ON A HOUSE

One major short term savings goal is the accumulation of sufficient funds for a down payment on a house and currently most lenders require at least a 20% down payment for the purchase of a primary residence. The dollars saved for this purpose should be saved in a Money Market account, savings, CD or Ultra-Short-Term Bond Mutual Fund. These types of investments may have low returns, but they are also very low risk. The following table shows the monthly savings that would be needed to put 20% down on various priced houses.

Target Home Price	Needed Down-Payment	Monthly Savings (5 Years at 2% return) (starting from $0)
$400,000	$80,000	$1,268.89 per month
$500,000	$100,000	$1,586.11 per month
$600,000	$120,000	$1,903.33 per month
$700,000	$140,000	$2,220.55 per month
$800,000	$160,000	$2,537.77 per month

Assumptions: 1% annual return, consistent monthly savings, 5 year savings time period

General Recommendations

1. Review and optimize the BIG expenses first. The two largest components of most budgets are housing and transportation expenses. To reduce expenses and increase savings, target your largest expenses first, if you can. For example, if you are leasing a car for $500 a month it doesn't make much sense to prioritize saving $50 a month on Starbucks coffee.

2. Establish a method to monitor your spending, one you are comfortable with, and then do it monthly.

3. Develop and maintain a cash reserve to cover unexpected expenses and situations. For single folks, saving 6 months worth of expenses or take home pay is usually sufficient while for married folks with both working, 3 months of combined take home pay may be sufficient. If your income varies or if you are self-employed you should have a larger reserve than if you have a very steady income.

4. Cash reserves should be held in a high interest money market account such as ING Direct, Capital One or Ally Bank, all of which pay around 2% and can be established online. Or you can choose to use your local bank or credit union. Be sure to periodically shop around for better rates because they can and do change over time.

5. Once you have sufficient cash reserves and accounts established to meet your short term savings goals, the first long-term investing account you should open is a Roth account (though it can also be used for short term savings). In an emergency, contributions to a Roth can be withdrawn at any time without tax consequences. All funds in a Roth account, both contributions and earning, can be withdrawn without paying any taxes once you are age 59 1/2 and the Roth account is at least 5 years old.

6. Have a preset amount of dollars withdrawn from your paycheck and put directly into your savings accounts. Ideally you should save 20% of your income, with half of this going to long-term savings (401(k),403(b), 457 or IRA/Roth type accounts). The remainder of your savings should be split between short term savings goals (for a new car, house, etc.) and long-term savings goals (retirement, kids' education, business investments, etc.).

7. Use the following rules to allocate savings (in order):
   - Fund your cash reserves in a savings account that is VERY liquid.
   - Defer the amount into your 401K, 403b, or 457 accounts to maximize your employers' match; or maximize your IRA contributions, if no 401(k), 403(b), or 457 is offered.
   - Open a Roth account and contribute the maximum possible (up to $6,000 annually).
   - Contribute short term savings into a Money-Market or CD account to minimize loss of principal.
   - All additional savings can be used to increase your 401(k), 403(b), 457 salary deferral or saved in a taxable brokerage account (the taxable brokerage account is discussed in Chapter 3).

8. Consider selling your car and buying a less costly one if your car payment makes it difficult for you to reach your short and/or long-term goals.

9. If you don't have an adequate down payment to purchase your first house, consider an equity sharing arrangement with your parents or another investor. This can be an effective technique to purchase a house if you haven't saved enough, but there are two caveats: Choose your investor partner very carefully (yes, even your parents) and make sure you have a contract to cover the legal aspects of this arrangement.

10. Consolidate the number of bank and brokerage accounts you have to make record keeping and accounting simpler.

2 – Debt Management

Discussion

Debt is money that is borrowed (i.e. a loan) that must be paid back over time. Some loans require both principal and interest be paid back over a fixed term. Other loans, such as a credit card or open-ended bank line of credit, provide a more flexible borrowing capability with interest charged monthly but without a fixed term repayment. With this type of loan, the monthly principal repayment could vary and will be dependent on the actual amount outstanding over the billing period while interest charges will accrue. To obtain a loan, you “typically” must convince the lender that you have the capability to repay both the principal and interest of that loan. Your credit history and/or your FICO score is generally used by the lender to determine whether you are eligible for a loan and to assess the interest rate you would pay on that loan.

It’s been said that debt can be a double-edged sword; while it is a tool that can be used to improve your current and future lifestyle, if used incorrectly it can be “dangerous.” Used incorrectly, debt can destroy your credit history and cause significant damage to your net worth and finances. A loan can be good or bad. A loan that is small relative to income and which is used to purchase an appreciating asset or to further education is considered a "good" loan and can help your finances. On the other hand, a loan that is large relative to income or used to purchase a “depreciating” asset can be viewed as a "bad" loan which can introduce stress and risk into both your finances and lifestyle.

When a borrower stops making payments on a loan, the loan is said to be in "default." For most loans, default will instantly result in additional fees, and perhaps a significant increase in the interest rate charged on your other (or future) loans (even those from a different lender). Lenders have the right to periodically request an updated credit history on a borrower and a loan default is clearly a bright red flag. Having a poor credit score can impact your car and home insurance rates and can even impact your being hired as employers do check an applicant’s credit history.

To discharge most debt without paying it back a borrower must go through bankruptcy, which is a court-supervised process that may or may not result in the discharge or elimination of most loans. There are some notable exclusions which cannot be discharged such as student loan debt, tax debt, child support or alimony obligations.

Generally, once you have gone through bankruptcy, a record will remain on your credit history for a period of seven years. Lenders will likely not perceive you as a good credit risk meaning that a loan, if you can even get one, will likely come at a very high interest rate, commensurate with the risk that the lender is taking.

Types of Loans

Mortgage: A loan on real estate (house, condo, office building, etc.). In the long run, mortgages are generally the least expensive and best type of debt. The government allows a tax deduction for mortgage interest paid, and various government agencies can assist borrowers who are first time home owners or who display a financial need. Since the financial crisis that began in 2008, lenders have been reining in their exposure and holding applicants to more stringent set of criteria and as a result, mortgage loans have become more difficult to obtain. Though a down payment equivalent to 20% of the purchase price is typically required, mortgage interest rates are currently near historical lows (under 4.5% for most borrowers) thus they are very attractive to future homeowners. In most states, mortgages are a non-recourse loan, which means that in the case of a default the lender can foreclose on the property, but can't attach any of your other assets.

401(k) Loan: A loan from your own 401(k) account. Most 401(k) plans will allow you to borrow up to 50% of your 401(k) balance, up to a maximum $50,000. The loan is repaid from your salary with after-tax funds (reducing your deferral into 401(k) investments), but any additional salary deferral can be invested for retirement. This is a "demand loan," which means if you lose your job the loan must be immediately repaid or else it converts to a 401(k) distribution which is then subject to income taxes and a 10% penalty.

Student Loan: A special kind of personal loan used exclusively to pay for college expenses (tuition, room and board, books, etc.). A student loan is typically offered through the college directly and may be guaranteed by the federal government. The student loan may be subsidized or unsubsidized. A subsidized loan will accrue interest on the principal amount but payment is not required until after graduation. An unsubsidized loan will have payments that start shortly after the last disbursement. These loans generally have interest rates that vary between 3% and 7% and, depending on the type of student loan, repayment can sometimes be deferred until several months after graduation from college. Reasonable amounts of student debt (say $10,000 to $20,000) are probably acceptable, especially if the degree that you obtain will increase your income. As previously mentioned, with rare exceptions, student loan debt CANNOT be discharged in bankruptcy and WILL require repayment. In certain professions work credit can reduce the loan balance. Student loan interest payments are tax deductible up to $2,500 per year, but does phase-out if you have a large income.

Vehicle Loan: A loan used to purchase a car or truck. Interest rates can vary widely (0% to 12%) and are generally dependent upon your creditworthiness; vehicle loans are often subsidized by the manufacturer or dealer in order to facilitate the vehicle purchase; however frequently an all cash purchase will have a lower price Using a loan to purchase an affordable vehicle with a low interest rate may be a good use of credit, but an expensive lease or loan on an expensive car, is a bad use of credit. Defaulting on a car loan will generally result in the vehicle being repossessed, though it should be noted that that does not discharge the loan. Vehicle loans can be discharged in bankruptcy. Car loan interest payments are not generally tax deductible (unless the car is used in a business).

A vehicle lease is a contract that allows you to use a car for a period of time, and then return the car to the dealership. There generally are maintenance requirements and mileage restrictions (with significant charges for exceeding those limits) for leased cars. A leased car is not your asset, and a lease is not a loan.

Credit Card: A revolving line of credit that is prequalified up to a specific limit. Credit cards can be used to purchase items, goods and services, as a deposit for a car rental or to reserve a hotel room, and can, in an emergency, provide a cash advance. Interest rates are typically very high (12% to 30%) and loan balances can grow very large if only the minimum monthly payment is made. Payments are applied first to interest and then to principal. Credit card debt can sometimes be discharged in bankruptcy, but not always. Credit Card interest payments are not tax deductible.

Personal/Business Loan: A fixed loan provided on a personal basis or to a business, generally unsecured (without collateral). Interest rates are typically high (7% to 20%) and these types of loan can be difficult to obtain from legitimate sources. Repayment is typically a fixed amount per month over a specific term (24, 36, 48 months, etc.). Generally, these loans can be discharged in bankruptcy. Personal loan interest is not tax deductible, business loan interest is tax deductible against business revenue.

Creditworthiness

Lenders use a potential borrower's credit history to decide whether to make a loan, to assess the size of a loan they are willing to offer, and to determine the interest rate they intend to charge. Once you have a credit card or other loan, your credit history is determined by three major credit agencies, Experian, Trans Union and Equifax. These agencies keep track of all credit transactions, your repayment history, and the total available credit.

Credit worthiness is usually encapsulated in your "FICO" score. This score is produced from a proprietary evaluation process that "grades" your credit history and produces a score that predicates the likelihood of loan repayment. Good scores are generally above 700, mediocre scores between 600 and 700, and bad scores below 600. The FICO algorithm may differ among the credit reporting agency and is a well-guarded secret. Missing payments, bankruptcy, other loan defaults, and having too much open credit will lower your FICO score. Conversely, making your payments on time, paying the balance in full (or at least more than the required minimum due) can help to improve your FICO score.

It is not advisable to use an advance fee service that promises to "fix" your FICO score. These types of services are, for all intents and purposes, scams that won't help, and may, in fact, further damage your credit score. If there are errors in your credit reports, you can dispute them yourself and have the errors removed (however, correct information cannot be removed).

General Recommendations about Loans

1. Mortgages. Mortgages are the best type of loans for several reasons: they have the lowest interest rates, provide tax benefits, and the value of a house (normally) appreciates or at least keeps up with inflation, allowing for increased net-worth. Buying a home is a huge commitment and should not be undertaken without a long-term timeframe in mind and the understanding that property maintenance is required. Currently, most banks will require at least a 20% down-payment and sufficient income to afford the Principal, Interest, Taxes and Insurance (PITI).
2. 401(k) Loans. A 401(k) loan is not recommended but sometimes can help with short term needs. Any time you take a loan against your 401(k) plan you should have a specific and rapid repayment plan in place. The biggest risk or danger is the loss of your job; in that case, the 401(k) loan becomes immediately due, or else you will have to report the outstanding loan balance as income on your taxes and pay a 10% penalty. Payments on a 401(k) loan are not tax deductible.
3. Student Loans. As previously stated, student loans are considered good debt if they are used to increase future earnings and used in moderation. Student loan interest rates are lower than credit cards but higher than mortgages or home-equity lines of credit. Student loan interest is tax deductible up to $2,500 per year (income limits apply). Though it is offered and on the face of it appears to be a smart move, you should be very careful about consolidating your student loans. Generally, you can only consolidate the loans once, and then the interest rate is locked in forever, so timing is key. Since student loan debt can NEVER be discharged (or, again, only with very rare exceptions), each student loan should be viewed as a lifetime commitment.
4. Vehicle Loan or Lease. Since cars are depreciating assets, buying them with cash and keeping them for as long as possible makes the most financial sense. Excessive vehicle debt is a common situation for young folks. Buying a small affordable car, either for cash or with a small loan, is the best plan.
5. Credit Card Debt. These are the worst loans, but the easiest to get. The interest rates are VERY high and variable, and they are not tax deductible. It is best to use credit cards for convenience and then pay them off every month. The payments that are due when carrying a large credit card balance can prevent you from saving and investing for other goals.

   If you have credit card debt, the best plan is to pay it off before any other savings (except the cash reserve). It's a bad deal to pay 20% interest (or more) on a credit card balance, while earning only about 1 to 2% on your savings.

6. Personal or business loans. Generally tailored for a specific situation and not usually available to most young professionals. Avoid all check cashing loans, payday loans, and loan sharks. The fees and costs of these types of loans are VERY HIGH and can spiral out of control.

General Recommendations for Debt Problems

1. If your overall debt load is causing severe problems and conflicts within your family, consider using the services of a free credit counseling service. A good service to consider is the ***National Foundation for Credit Counseling*.**

2. If you are having problems making mortgage payments, there are a few options:

   - Consider selling the house and moving into a cheaper living situation.
   - Consider renting a room in your home for extra cash flow.
   - Use one of the government or bank programs to refinance your mortgage. These programs have names like HARP, NAFA, FHA refinance, and others. Do your own research, NEVER use a service that requires a prepayment before helping as they generally are not worth the fees they charge. Contact your bank or mortgage servicer as a first step.

3. Tips for credit card debt:

   - Always pay your credit card on time to avoid late fees and increases in interest rates. Automatic payments will guarantee that the bill is paid on time.
   - Never take cash advances (which attract the highest interest rates) with your credit card.
   - If you have accumulated credit card debt, pick a strategy to reduce this debt and follow through. Don't use an "advance fee" credit counseling service as most of these services are merely scams that will not help you.
   - Consider transferring balances to a zero-interest credit card as an interim step.
   - For help as to the best way to pay off the credit cards go to:

     http://www.consumer.ftc.gov/articles/0145-settling-credit-card-debt

4. Consider selling your car and buying a less costly vehicle if your car payment is making it difficult for you to reach other short and long term goals. It is possible that the value of the car is less than the outstanding loan amount. This may require you to either wait to sell the car, or pay an additional amount to discharge the car loan.

5. Go to **www.annualcreditreport.com** to get a free credit report from the three agencies. Look for any unusual listings or errors and contact the reporting agency to have any errors corrected. It is seldom worthwhile to pay for a monthly credit reporting service. You can check with each agency for free once every 12 months (Tip: stagger the request dates to one every four months so that you will have a better and earlier picture of any negative changes to your credit history).

3 – Investing and Investments

Discussion

When investing for retirement and other long-term goals (i.e. longer than five years) you need to invest for both growth and long-term preservation of principal. The goal is to have the highest returns for the level of risk that is appropriate for you. Typical investments used for long-term investing include stocks, bonds, real estate (REITs) and commodities.

Mutual Funds or Exchange Traded Funds (ETFs) which hold a broad collection of individual securities are the best way to invest, with passively managed Mutual Funds and ETFs being the lowest cost approach. Mutual Funds and ETFs provide automatic diversification by holding lots of different individual investments. Additionally, you can construct a portfolio that contains different Mutual Funds (or ETFs) owning different types of investments, which would provide even greater diversification.

Types of Investments

Stocks: An investment that signifies ownership of a corporation and represents a claim on assets and earnings; shares of stocks are also called equities. Stock shares of public corporations are bought and sold on exchanges through stock brokers (e.g. Charles Schwab, E-Trade, etc.). Owning stock in an individual corporation is more risky since sometimes the share price can go up dramatically. Other times the corporation can fail (remember Enron?) and then the stock shares become worthless. Many advisors believe equities should be owned through Mutual Funds or ETFs that hold shares in many different corporations; that reduces the risk of an individual corporate failure, but may limit potential returns.

Bonds: An investment in which the investor's money is loaned to a corporation, government or government agency. Bonds are issued for a fixed term and generally have a fixed interest rate. Buying an individual bond is less risky than an individual stock, but for the majority of investors, bonds should be owned through a Mutual Fund or ETF. Bond Mutual Funds and ETFs hold many different bonds with different terms and interest rates and investors in a bond fund are paid dividends monthly or quarterly. The price of a Bond Mutual Fund and ETFs are sensitive to overall interest rates; if interest rates rise then bond fund share prices will fall (and vice versa).

Mutual Funds: An investment vehicle that uses dollars from many investors to buy a collection of assets under a fund manager which operates the Mutual Fund according to specified guidelines. Typically, these assets are stocks and bonds, but can also include REITs or more exotic assets. Mutual Funds always have a specific investment philosophy and buy and sell assets by following this philosophy as outlined in the fund prospectus.

There are two main classes of Mutual Funds, namely actively managed and passive managed. Active management involves analysts and traders who buy and sell regularly in an attempt to derive a better return than a chosen index (sometimes the entire market is the index). Passive management means that there is no attempt to buy and sell in such a way as to beat the market. Passive management usually leads to lower costs, fees and taxes than for an active strategy.

One passive approach is using an index to specify what to buy and sell; an example of a frequently used index is the S&P 500. Rebalancing the index occurs once or twice a year at which time some stocks are dropped from the index while others are added, and still others may have their percentage of ownership changed in the index. Since this happens at most twice per year there is not much trading in passive funds. This results in lower costs and lower tax impacts than from an active strategy.

Historically, active management is much more expensive and performs worse than passive management over time. We recommend using passively managed funds in most asset classes.

Mutual Funds can be purchased directly from a mutual fund company (such as Vanguard or Fidelity), or through a broker. We recommend buying Mutual Funds through a broker due to the large number of available types of funds, and the convenience of having all assets shown on a single statement. Mutual Funds can either be "Load" funds or "No-Load" funds. Load funds charge an initial fee to buy the fund which can range from 2% up to 5%, or else will have a charge to get out of the fund in the first few years; these funds have an "A,""B"or "C" after the fund name. No-load funds do not charge these commissions. Historical data has shown that no-load funds perform better than load funds, at a lower overall cost, thus we recommend only purchasing no-load Mutual Funds. In addition, Mutual Funds have different share classes that charge different annual expenses or marketing fees. Buying no-load passively managed funds or ETFs will tend to minimize the investment expense. X or Y class shares tend to be the cheapest with A, B and C class shares more expensive.

Index Funds and ETFs: Index funds and most ETFs (Exchange Traded Funds) are passively managed Mutual Funds that provide very low-cost exposure to broad segments of different types of investments. Index Mutual Funds are generally no-load and have very low expense ratios (meaning they are cheap to own). ETFs are often index funds that are purchased, like shares of stock, through a broker, but each ETF share represents a holding in all the components of the chosen index. There are ETFs for almost every type of investment imaginable, and ETF expense ratios tend to be low. Vanguard has some of the best and cheapest index funds and ETFs available.

Target Date Funds: Most 401(k) plans offer Target Date Mutual Funds as a "Core" investment option. Target Date Mutual Funds hold a mixture of cash, bonds, stocks, and other assets in different percentages based upon when the invested dollars will be needed. For example, a 2025 target date fund is designed for someone that will retire in 2025. The philosophy of Target Date Funds is to hold mostly cash and bonds closer to the retirement date, and mostly stocks when the retirement date is in the future. The fund manager will dynamically shift how the funds are invested over time to reduce investment risk as the "target" date gets closer.

Real Estate: Investment Real Estate is not your personal residence; rather it is an investment in securities called Real Estate Investment Trusts (REITs). REITs are similar to stocks, except that they only own real property or mortgages on real property. The best way to get exposure to investment real estate is to own a REIT index Mutual Fund or ETF. Owning actual properties (e.g. a rental apartment building) has many complex issues and is beyond the scope of this section.

Commodities: An investment in a physical commodity such as corn, wheat, oil, gold, etc., used as part of other activities or in the production of other goods. The prices of commodities can be extremely volatile and they can be difficult for small investors to own. We consider commodities only appropriate for large portfolios, not beginning investors.

Investments are categorized into asset classes that tend to have different long-term characteristics such as annual returns and levels of volatility (how much prices change in any given year). The table which follows shows inflation-adjusted returns data and price volatility from 1973 through 2016 for seven different major asset classes.

Asset Class	Average Annual Returns 1973 - 2016	Average Annual Price Volatility 1973 - 2016
Large Cap US Stocks	6.05%	+/- 15.8%
Small Cap US Stocks	6.60%	+/- 20.0%
International Stocks	6.75%	+/- 17.3%
T-Bonds (long-term bonds)	3.23%	+/- 11.7%
T-Bonds (intermediate term bonds)	3.10%	+/- 5.5%
T-Bills (short-term bonds)	2.30%	+/- 1.2%
Real Estate Investment Trusts	5.95%	+/- 18.35%
Commodities	4.00%	+/- 17.6%

Source: https://fi360.zendesk.com/hc/en-us/articles/203085788-Capital-Markets-Assumptions

This demonstrates that to achieve higher potential returns you must be able to tolerate much higher price volatility (wider up and down range of prices).

Investment Decision Factors

When investing there are seven main factors to consider:

1. Time Factor: For what period of time will the money be invested.
2. Diversification: Having your money spread amongst multiple asset classes decreases some types of risk.
3. Allocation: The mix of investment types, usually between equity and fixed income.
4. Tax implications: Having different types of investment accounts to maximize your after-tax returns.
5. Investment Selection: Choosing specific investments.
6. Risk Tolerance: How comfortable you are with loss of value in a down market.
7. Investment Timing: When to start investing and adding to your investments over time.

THE TIME FACTOR

In a young person's portfolio, a key factor is "time." Consistent investing and compounding returns over long time intervals will provide the most growth in the portfolio. For example, saving $1,000 per year for 40 years will result in your having $250,000 at the end of that time (assuming 8% interest compounded annually). Want to be a millionaire when you retire? You just need to save $4,000 a year starting in your early 20's.

For long-term savings, the up and down short-term movements of the various markets should be of little concern. You have a long time before retirement. What happens over 15, 20 and 30 years is really what matters, not any short-term fluctuation. This long-term investing horizon means you should primarily be invested in stock or equities. The table which follows shows the Dow Jones Industrial Index returns (including reinvested dividends) over different intervals from 1905 to 2010.

Dow Jones Industrial Index Annual Statistics over the Time Interval	Time Interval			
	1 Year	5 Years	10 Years	20 Years
Average Annual Return	11.5%	10%	10%	10%
Greatest Loss	-48%	-18%	-1.3%	2.5%*
Greatest Gain	91%	30%	19.5%	18%

* Greatest loss over any 20 year period is not a loss, but actually a 2.5% gain.
Source: http://observationsandnotes.blogspot.com/2009/03/average-annual-stock-market-return.html
Note: Large losses (max 52.7%) have occurred within single year periods. Over the next few years the DJI has always recovered.

The most important thing to notice is that the stock market has NEVER lost money over ANY 20 year interval (including those 20 year intervals which included the Great Depression of 1929, as well as the various economic downturns and recessions in recent years). The average annual returns are still 10% per year. It is important for any long-term portfolio to include a significant percentage of stock investments.

You might ask if stock market losses aren't a significant risk to a long-term portfolio, then what is. You might be surprised to learn that it's inflation. In the USA, the average inflation rate has been 3.23% annually. This translates to prices on most goods doubling every 20 years. On some "goods," like healthcare and college tuition, inflation has been much higher, averaging around 5% annually. Inflation is the single greatest risk to any long-term portfolio and therefore the design and allocation of your portfolio must provide returns large enough to provide real (after inflation) growth.

DIVERSIFICATION

Academic studies have shown that for long term savings the highest risk adjusted returns come from being invested in many different investments. In any given year there is no way to predict which investment sector will be hot and thus provide significant returns. Investing in lots of different investments or asset classes maximizes the chances of "catching" the hot investment for that year. The table that follows shows which asset classes had the higher returns in each year between 2002 and 2018.

The importance of diversification

From year to year, there's no telling which asset class will be the best performer – a strong argument for portfolio diversification.

Patchwork ranking of the best to worst performing asset classes from 2010 to 3Q 2020

2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	YTD 2020
Small-Cap Growth 29.09%	Long-Term Bonds 29.93%	Small-Cap Value 18.05%	Small-Cap Growth 43.30%	Real Estate 31.78%	Large-Cap Growth 5.67%	Small-Cap Value 31.74%	Large-Cap Growth 30.21%	Cash 1.86%	Large-Cap Growth 36.39%	Large-Cap Growth 24.33%
Real Estate 28.60%	Real Estate 9.24%	Real Estate 17.59%	Small-Cap Value 34.52%	Long-Term Bonds 25.07%	Real Estate 4.23%	High-Yield Bonds 17.49%	International Stocks 25.03%	Convertibles 0.15%	Small-Cap Growth 28.48%	Convertibles 22.18%
Small-Cap Value 24.50%	Intermediate-Term Bonds 7.84%	Large-Cap Value 17.51%	Large-Cap Growth 33.48%	Large-Cap Value 13.45%	Intermediate-Term Bonds 0.55%	Large-Cap Value 17.34%	Small-Cap Growth 22.17%	Intermediate-Term Bonds 0.01%	Large-Cap Value 26.54%	Long-Term Bonds 21.35%
Commodities 16.83%	International Bonds 5.91%	International Stocks 17.32%	Large-Cap Value 32.53%	Large-Cap Growth 13.05%	Cash 0.03%	Commodities 11.77%	Convertibles 13.70%	Large-Cap Growth -1.51%	Real Estate 25.76%	Intermediate-Term Bonds 6.79%
Convertibles 16.77%	High-Yield Bonds 4.38%	High-Yield Bonds 15.58%	Convertibles 24.92%	Convertibles 9.44%	International Stocks -0.81%	Small-Cap Growth 11.32%	Large-Cap Value 13.66%	International Bonds -1.68%	Convertibles 23.15%	International Bonds 5.63%
Large-Cap Growth 16.71%	Large-Cap Growth 2.64%	Large-Cap Growth 15.26%	International Stocks 22.78%	Intermediate-Term Bonds 5.97%	Long-Term Bonds -1.21%	Convertibles 10.43%	International Bonds 9.92%	Long-Term Bonds -1.84%	Small-Cap Value 22.39%	Small-Cap Growth 3.88%
Large-Cap Value 15.51%	Large-Cap Value 0.39%	Convertibles 14.96%	High-Yield Bonds 7.42%	Small-Cap Growth 5.60%	Small-Cap Growth -1.38%	Real Estate 7.24%	Long-Term Bonds 8.53%	High-Yield Bonds -2.26%	International Stocks 22.01%	Cash 0.56%
High-Yield Bonds 15.19%	Cash 0.08%	Small-Cap Growth 14.59%	Real Estate 1.86%	Small-Cap Value 4.22%	Convertibles -2.99%	Large-Cap Growth 7.08%	Small-Cap Value 7.84%	Real Estate -4.84%	Long-Term Bonds 14.83%	High-Yield Bonds -0.30%
Long-Term Bonds 9.38%	Small-Cap Growth -2.91%	Intermediate-Term Bonds 4.21%	Cash 0.05%	High-Yield Bonds 2.50%	Large-Cap Value -3.83%	Intermediate-Term Bonds 2.65%	High-Yield Bonds 7.48%	Large-Cap Value -8.27%	High-Yield Bonds 14.41%	International Stocks -7.09%
International Stocks 7.75%	Convertibles -5.18%	Long-Term Bonds 3.56%	Intermediate-Term Bonds -2.02%	Cash 0.03%	High-Yield Bonds -4.64%	International Bonds 1.86%	Real Estate 4.18%	Small-Cap Growth -9.31%	Intermediate-Term Bonds 8.72%	Large-Cap Value -11.58%
International Bonds 6.78%	Small-Cap Value -5.50%	International Bonds 0.84%	International Bonds -5.08%	International Bonds -2.53%	International Bonds -4.84%	Long-Term Bonds 1.33%	Intermediate-Term Bonds 3.54%	Commodities -11.25%	Commodities 7.69%	Commodities -12.08%
Intermediate-Term Bonds 6.54%	International Stocks -12.14%	Cash 0.07%	Commodities -9.52%	International Stocks -4.90%	Small-Cap Value -7.47%	International Stocks 1.00%	Commodities 1.70%	Small-Cap Value -12.86%	International Bonds 5.23%	Real Estate -16.74%
Cash 0.13%	Commodities -13.32%	Commodities -1.06%	Long-Term Bonds -12.66%	Commodities -17.01%	Commodities -24.66%	Cash 0.27%	Cash 0.84%	International Stocks -13.79%	Cash 2.25%	Small-Cap Value -21.54%

Source: Morningstar Direct. Data as of 9/30/2020.

Notice that NO single asset class has been the best performing every year (or even over a large number of years). A portfolio needs to be exposed to many different asset classes to have the highest chance of meeting or beating market averages. Another benefit of spreading your savings among different asset classes is risk reduction. The chart also shows that some asset classes which were best in some years were the worst performers in other years. Spreading the risk around greatly reduces the chances of being stuck in the wrong investments.

ALLOCATION

Asset Allocation is the methodology used to achieve the benefits of diversification. Owning a portfolio of investments that consists of a mixture of different asset classes will provide the highest return for a particular risk level. You can't choose the returns of an investment portfolio; you can only choose the level of risk in your portfolio. Using Modern Portfolio Theory and historical data, a set of weights can be assigned to different asset classes to construct a portfolio that maximize overall returns for that level of risk. The recommendation section provides some example portfolios based upon Modern Portfolio theory that contain recommended asset classes and the percentages to invest in each asset class.

TAX IMPLICATION

The type of investment account determines how gains (and losses) from investments are taxed. There are three main types of accounts:

- Deferred Accounts - 401(k), 403(b), 457, and IRAs: Contributions to these accounts can be deducted from current income, providing current tax savings. These accounts will grow without any taxes due. Upon withdrawal (after 59½ years of age) all withdrawals are treated as ordinary income and taxed at the rate that applies to you in that year.

- Roth Accounts: Contributions to a Roth are not tax deductible. Roth accounts will grow without any taxes due. Contributions to a Roth account can be withdrawn at any time without any tax consequences. After the age of 59½ years and provided the account is older than 5 years, all withdrawals are tax free.

- Taxable Brokerage Account: This is a taxable investment account where taxes are due on all dividends, interest and any realized profits (i.e. investments sold at a profit).

To increase the tax efficiency of a retirement portfolio, position assets using the following general rules, in sequence:

a. First allocate fixed income investments (Bonds and REITs) in the tax-deferred account (IRA, 401(k), 403(b) or 457).

b. Purchase high potential return investments (Emerging Markets, Small Cap, REITs) in a Roth account.

c. Purchase the rest of the investments in the taxable brokerage account or via additional allocations within the 401(k), 403(b) or 457 accounts without worrying about the tax consequences.

d. Passively managed Mutual Funds and ETFs are best in taxable accounts. Actively managed Mutual funds should be owned in Deferred or Roth accounts to minimize annual taxes.

INVESTMENT SELECTION CRITERIA

What criteria should be used to select the specific investments within a diversified portfolio? If you had a Magic 8-Ball, you could select the hottest stock or bond in the hottest asset class each year. In the real world, though, those Magic 8-Balls are just kids' toys with no special powers, and despite the song-and-dance that you get from those so-called investment gurus who claim to have "special" knowledge and "special" investing skills NOBODY beats the market over time. The best thing you can do is invest in the market for each asset class and capture the market returns.

The best way to capture market type returns is to use passively managed Mutual Funds or ETFs (of which index funds are a type). Passively managed Mutual Funds own all (or most) investments within a particular asset class and are designed to capture market returns. Most asset classes have passively managed Mutual Funds and choosing them is pretty easy; simply select the fund with the lowest expenses and broadest exposure. In many cases, a Vanguard index fund is a great selection. ETFs are a good choice as they have lower expenses and better tax treatment in a taxable account.

RISK TOLERANCE

Most investment advisors use risk tolerance (how comfortable a client is with market volatility) as a major factor in choosing investments. For young professionals with lots of time before needing to fund their goals, risk tolerance is generally the least important criteria in determining your asset allocation. Until you are within 15 years of retirement, your portfolio should contain mostly equity investments and instead of being worried about market declines, consider those times as opportunities to purchase more good quality index fund shares at lower prices.

INVESTMENT TIMING

The table in the retirement chapter (see page 21) shows that an earlier start in savings for retirement will result in a much higher final portfolio balance. As such, the best time to start purchasing investments is sooner rather than later. Over long time periods, the specific month or even year that an investment is purchased doesn't matter. What matters is to get exposure to the markets and allow the natural growth of continuous savings, reinvested dividends and interest earned to grow your portfolio. Studies have shown that consistent buying has the best outcome in building a portfolio because nobody can time the market, and waiting to purchase usually results in missing the market's upside moves.

This same rationale applies to selling within a young person's portfolio. Since the portfolio is growing by both continuous savings and the returns of already owned investments, there is NEVER a need to sell assets. If the portfolio has become unbalanced (see the recommendation section for a discussion of annual rebalancing) then just by shifting NEW savings dollars into the under-represented asset classes should be enough to get the portfolio back into balance. If you never sell, there are no tax considerations and other trading costs don't apply.

General Savings Recommendations

1. First fund your cash reserve in an account that is very liquid but safe. Savings for short term goals (i.e. those less than 5 years away) should be in Money Market funds or short-term CDs at a credit union or bank. These investments have low returns, but no risk of principal loss.
2. Next, capture the maximum "match" offered by your employer for the 401(k), 403(b), 457 or other deferred accounts offered through your workplace by contributing at the level needed to get the maximum. Typically, a 6% to 8% deferral will capture the maximum match.
3. After investing in your deferred retirement plan (step 2 above), the next investment account to open is a Roth account. All young folks should be maximizing their savings (up to $6,000 annually) in a Roth. Roth accounts can also be used for short term savings since you can withdraw your contributions at any time without tax consequences. There are income limits to opening and funding a Roth account; check online to make sure your income is below the Roth contribution limit (in 2018, the limit for singles is $135,000 of Adjusted-Gross-Income or AGI).
4. If you have additional savings left afterward, you have a couple of choices: 1) increase your 401(k) salary deferral or 2) open a taxable brokerage account and target additional retirement savings into this account. To open a taxable brokerage account, talk to a discount broker (Charles Schwab, TD-Ameritrade, E-Trade, Vanguard, etc).

Portfolio Recommendations

1. Our recommended retirement portfolios use two types of investments: Index Mutual Funds (or their ETF versions) and Target Date Mutual Funds.
2. If your deferred account plan (401(k), 403(b), 457, or IRA) offers the following 3 Index funds, they can be used to create a low cost, market performance portfolio:
    - Total Stock Market Index Fund
    - Total International Stock Market Index Fund
    - Total Bond Market Index Fund

    If your deferred plan does not offer those funds, then we recommend using Target Date Mutual Funds. Almost all 401(k), 403(b) and 457 plans offer a variety of Target Date Mutual Funds that can provide market exposure and automatic asset class diversification. Target Date funds do have a higher cost than Index funds, thus Index funds should be your first choice (if offered).

3. The Index Funds listed above and Target Date Mutual Funds do not provide exposure to all the asset classes (specifically Emerging Markets, US Small Cap and International Small Cap) that are appropriate for a young professional's portfolio and these additional asset classes should be held in Roth or taxable accounts.

4. For larger portfolios, say above $250,000, you should consult with a fee-only investment professional who can design a customized high performing, risk adjusted portfolio from a combination of the passively managed funds available within deferred accounts, and ETFs and index funds held in taxable and Roth accounts.

5. For young professionals whose total investment assets are less than $250,000 the following 3 portfolios are general recommendations; just select a particular portfolio based upon your age (assuming that you plan to work into your 60's).

   These portfolios are targeted for growth, and work best with ongoing new purchases over time. You'll note that we didn't include separate Cash or Short-Term Bond asset class because these are long-term growth portfolios. Cash for short term goals should be held outside of the retirement portfolio as described in General Savings section

Age	General Allocation	Recommended Portfolio
Under 30 Years old	90% Stock, 10% Bonds	YP90_10
30 to 35 Years old	80% Stock, 20% Bonds	YP80_20
35 to 45 Years old	70% Stock, 30% Bonds	YP70_30
Over 45 Years old	Customized Portfolio	

6. When setting up an IRA, Roth or Taxable Brokerage account, be sure to open an account that can purchase ETFs as these are the most cost-effective investment vehicles.

7. If you decide to purchase ETF shares, you need to first figure out how many shares to purchase. To do this, take the dollar amount of the investment you wish to make, divide it by the daily price of the ETF, and then round down to the nearest whole share count.

8. For non-retirement account assets (i.e. those not in 401(k), 403(b) or 457 accounts), select the option to automatically reinvest dividends and capital gains distributions. If this option isn't available in the accounts at your broker, make sure to manually reinvest these distributions at least on an annual basis (though quarterly is better).

9. If you are investing in a taxable brokerage account, Roth, or IRA, make new purchases of investments each quarter. To keep trading costs low buy only one of the recommended investments in each quarter. Do not buy all investments every time, but be sure to eventually purchase everything in the correct percentages.

10. Guidelines for Annual Review:

    a. Once each year, you should check your accounts and invest any accumulated cash as specified in the investment instructions (below).

    b. When you reach 45 years old and your asset level exceeds $250,000 you should consult with a fee-only investment professional to switch to a customized portfolio.

11. If you are married, make sure your spouse is the primary beneficiary on all IRAs and other deferred accounts (401(k), 403(b), and 457), and list contingent beneficiaries as well. If you are not married, designate a living beneficiary or your estate as beneficiary.

Specific Portfolio Investments

For implementing the following portfolios, invest your dollars into the specific investments shown using the specified percentages (based upon the chosen portfolio). For investment purchases that involve fees (Roth or Taxable accounts) buy only one investment at a time to minimize purchase costs, but over the course of time, buy all investments.

Account Type	Investments	Contribution Percentage for Each Investment			
			YP90_10	YP80_20	YP70_30
Deferred Account: 401(k),403(b),457	Total Stock Market Index		50%	45%	40%
	Total International Market Index		40%	35%	30%
	Total Bond Market Index		10%	20%	30%
	Target Date 2050 Fund		100%	0%	0%
	Target Date 2035 Fund		0%	100%	0%
	Target Date 2030 Fund		0%	0%	100%
Roth Account	Vanguard Emerging Markets Index	VWO	34%	34%	34%
	Vanguard Small Cap Index	VB	33%	33%	33%
	WisdomTree Intl Small Cap, Div	DLS	33%	33%	33%
Taxable Brokerage Account	Vanguard REIT Index	VNQ	20%	30%	40%
	Vanguard Total Stock Market Index	VTI	50%	35%	25%
	Vanguard Developed Markets Index	VEA	30%	25%	15%
	Vanguard Total Bond Index	BND	0%	10%	20%

4 – Retirement Planning

Discussion

For someone who is between the ages of 25 and 35 there is little need for detailed retirement projections. Many of the assumptions used in retirement planning will change in the course of the next 30 to 40 years, which is why retirement projections which are that far into the future are really of little value. For now, it's important to lay the foundation for a successful retirement and the two key components necessary for a strong foundation are good spending habits and consistent tax efficient saving.

In the past, retirement planning was simple. You worked for a company that had a Defined Benefit Plan or pension and in retirement you received a pension check plus Social Security payments. With this guaranteed income, retirement planning was pretty easy. Those days are long gone. With the elimination of most company pension plans, it is up to each individual to create the retirement lifestyle that they want. Social Security payments are a nice benefit, but generally are too little to fund a comfortable retirement without additional resources. This means that you need to save for retirement and to begin saving as soon as possible.

This section outlines some of the mechanics of retirement savings followed by general recommendations.

- For most folks, there are three types of "special" retirement plans or accounts available:

  a) Qualified Plans at work: 401(k) (regular or Roth), 403(b) or 457. These plans allow you to make tax deductible contributions from your paycheck up to $19,000 annually (in 2019). Income taxes are paid upon withdrawal but that is likely many years in the future. Other companies offer Simple IRA's or SEP IRA's; both have different features.

  b) Individual Retirement Accounts (IRAs): This type of account allows tax deductible savings up to $6,000 annually and taxes are paid upon withdrawal.

  c) Roth Accounts: If you qualify, these types of accounts allow you to save up to $6,000 per year in after-tax money. There is no income tax on withdrawals after you reach the age of 59 ½.

  Of course, there are many special rules and restrictions associated with these accounts, but they generally don't apply to young professionals. The most important IRS rule is: if your employer offers a 401(k), 403(b), or 457, then you can't deduct contributions to an IRA from your income taxes. If this is your situation, you may be able to deposit additional savings into a Roth account, depending upon your income.

- The fourth type of retirement account does not have any special tax advantages; it's a bank or brokerage account designated for retirement. Taxes are paid every year on dividends, interest and capital gains (though typically at a lower rate). In retirement, withdrawals from this account will have the lowest tax rates (except for Roth accounts).

- Annuities are another type of account designed for retirement. However, we DO NOT recommend using annuities except in very special situations as they generally have VERY high fees and are not appropriate for younger investors.

- Utilizing a combination of these different types of accounts to save for retirement will help to maximize the probability of success.

The table on the next page shows some example retirement accounts' ending values at age 65, based upon starting age and level of savings. The dollars within the table are the estimated ending values (assuming there are no withdrawals before age 65). As you can see, the dollars saved in your 20's are "golden;" they have the longest time to compound and provide the biggest contribution to retirement funds.

Annual Investment	Age to start investing				
	20	25	30	35	40
$1,000	$386,506	$259,066	$172,317	$113,283	$73,106
$5,000	$1,932,528	$1,295,282	$861,584	$566,416	$365,529
$17,000	$6,570,595	$4,403,960	$2,929,385	$1,925,815	$1,242,800

Assumptions: 8% annual return, consistent annual savings, retirement age 65

General Recommendations

1. Consistent savings and investing is the most important habit for a successful retirement. An automatic transfer from a paycheck into a savings account or retirement account is by far the easiest and most painless way to save. If the money never makes it into your checking account, then you can't spend it.

2. A good goal is to save a minimum of 10% of your pre-tax income for retirement. But if you save 15% of your pre-tax income, there is a good chance of having extras (vacation house, travel, etc.) during your retirement.

3. Maximize any 401(k), 403(b), or 457 matching benefits by deferring enough salary to capture the full employer match. Think of your employer match as "free" money that your employer provides you with as an incentive to save in the qualified plan. Verify with your employer the conditions of the matching provision and be sure you defer enough to get the maximum match.

4. After maximizing your 401(k), 403(b), or 457 matching benefit, you should then maximize savings with a Roth account by saving up to $6,000 annually. Only contribute above the match level if you can maximize the Roth savings and fund short term goals.

5. Check your 401(k), 403(b), or 457 plan "fact sheet;" if your employer doesn't offer a match, and the Mutual Funds within your 401(k) are high cost (for example, greater than 1% expense ratio), then you should consider splitting your contributions equally between the 401(k), the Roth account and a taxable account targeted to retirement. Use the investment discussion in Chapter 3 to allocate these dollars to specific asset classes and Mutual Funds.

6. Maximize IRA savings. If your employer doesn't offer a 401(k), 403(b) or 457 plan, then you should save $6,000 annually into an IRA. If your annual salary is less than $117,000, then save in a Roth account. If your annual salary is more than $117,000, then save in a tax-deductible IRA. While this level of saving isn't sufficient, it is at least a good start.

7. Save some retirement funds into a taxable bank or brokerage account. At retirement, withdrawals from these accounts pay a lower tax rate (generally the capital gains tax rate) than withdrawals from an IRA or other qualified plan.

8. Make sure all accounts have a designated beneficiary. It should be your spouse if you are married or if you are single, a family member and/or close friend. You also need to have contingent beneficiaries in case both of you should die in the same accident.

5 – Estate Planning

Discussion

As a young person, you may not feel a need for estate planning, but everyone needs a contingency plan just in case the unexpected happens. Proper estate planning documents are critical for a number of reasons: injuries which require hospitalization, incapacity that prevents you from making decisions or handling your own financial affairs, or your premature death.

For someone who is 25 to 35 years old with no children and who does not own a home, there is no need for a fancy plan to distribute your assets upon your death. A simple Will can distribute your assets. If you own a house, a Revocable Living Trust is preferred in California since it will avoid probate (see below).

The additional documents that are part of the estate plan are MUCH more important to you while you are alive. These include: Financial Power of Attorney, Advance Healthcare Directive and HIPAA information release form.

If you have children, see Chapter 8 for the additional estate planning that is REQUIRED of parents.

Estate Planning Terms and Documents

Probate. Probate is a court-supervised process that is used to distribute assets from an estate to the heir(s) of that estate. In some states, probate is efficient and inexpensive. In California, the probate process is, unfortunately, complex and expensive, typically costing between 5% and 8% of the estate's value. Through careful planning, probate can be avoided.

Will. A Will is a document which only specifies the disposition of your assets upon your death and which comes into effect only upon your death. Assets distributed by a Will are generally subject to probate which can be expensive (again, depending upon state laws). It also specifies who cares for your children if both parents are deceased.

Trust. A Trust is a document that specifies the disposition of your assets after you die; it also covers incapacity, and can address certain other situations while you are still living. Assets distributed by a Trust are NOT subject to probate. Revocable Living Trusts do not have any income tax advantages, but could have estate tax advantages for large estates.

Financial Power of Attorney. This is a document that allows someone to make financial decisions for you or on your behalf. The Power of Attorney can become effective upon signing, or can become effective upon a specific event (such as becoming physically or mentally incapacitated). Once you die, the Power of Attorney ceases to be in effect and the Trust or Will takes precedence and specifies your wishes.

Advance Healthcare Directive. This is a document that specifies who can make healthcare decisions for you if you become incapacitated, and may include restrictions on medical intervention and any other healthcare decisions you want to specify.

HIPAA Information Release. This is a document that specifies who can receive your medical information if you become incapacitated.

To learn more go to:

https://www.nerdwallet.com/blog/investing/10-keys-to-proper-estate-planning/

There are a few ways to obtain estate planning documents:

a. Using an attorney who specializes in Estate Planning is the best, albeit most expensive method. Check your company's employee benefits; some include consultations with estate lawyers.

b. WillMaker software is cheaper but a less complete method.

c. If you do not need a living Trust, you can go to our website where there are links to online versions of a Will, Power of Attorney, Advance Healthcare Directive, and HIPAA release. These documents are targeted to California residents; for residents of other states check your local online resources. The link to the Archer Pointe Wealth Management website is:

http://www.archerpointewm.com/resources

General Recommendations

The following should not be construed as legal advice, and is provided for educational purposes only.

1. Decide how you are going to obtain your estate planning documents: A Will or Trust (if you own real estate), Durable Power of Attorney for finances, Advance Healthcare Directive, and HIPAA Information Release.

2. Identify and list who you would like to be in control of administering your affairs if you were incapacitated or deceased. Consider if these people can act individually or only as a group. You should designate backup individuals, as well.

3. Identify and list who you would want to receive, and in what percentage, the proceeds from your estate upon your death. Include name, relationship and date of birth. Remember that life insurance and retirement accounts have their own forms that must be completed regarding beneficiaries.

4. Review and confirm that the beneficiary designations on any retirement accounts reflect your current wishes. Be sure to have contingent beneficiary designations, as well.

5. Identify the individual who you authorize to make medical decisions on your behalf should you be unable to do so. You should also name two backup individuals.

6. Remember to review and consult with your attorney if your family situation or assets dramatically change, as your documents may need to be changed or amended.

Estate Planning Document Recommendations

The following should not be construed as legal advice, and is provided for educational purposes only.

1. All young professionals need the following documents:
    - Durable Power of Attorney for Finances
    - Advance Healthcare Directive
    - HIPAA Information Release

2. If you do not own anything except retirement and bank accounts, then you can designate who the accounts go to with a beneficiary designation.

3. If you have children, you need a Will to specify guardianship upon your death.

4. If you own Real Estate, a Revocable Living Trust is the best document to avoid probate and specify your wishes upon incapacity or your death.

5. Store a complete set of copies of your estate planning and other important documents at your home. The originals should be stored, safe from fire, theft, etc. in a safety deposit box, or another safe location (preferably in a bank or other location, not in your house).

6. If you own a house, be sure to title your home in the name of the Trust (your attorney should do this for you). Additionally, any investment accounts outside of retirement plans (not 401(k), 403(b), 457, IRA, Roth, etc.) should be assigned to the Trust (banks and brokerages can assist with this conversion).

7. Give a photocopy of the Advance Healthcare Directive and the HIPAA release form to all those you have named, as well as to your primary physician.

8. Carry a list of important contact people and their phone numbers. On your cell phone, after the name of the person(s) to contact in an emergency, make an entry such as “emergency” or “ICE" (for "In Case of Emergency").

Digital Estate Planning

Digital Estate Planning is the process of managing and documenting the digital aspects of your life so that, upon your incapacity or death, your wishes in regard to these assets are satisfied. One group of digital assets are the financial sites: banks, brokerages, credit cards, bill pay sites, PayPal, and other types of accounts that can be accessed online (and in some cases, only online). The other “group” of digital assets are social and communication-type sites: email, social media, Facebook, Twitter, photo sharing, etc. Keeping track of all these accounts can be overwhelming, even when you are young and vital. As you age, it may become harder and harder to keep track of all the locations of these accounts, their login details, and even their contents.

Following the steps below will greatly assist your appointed representative to help you during your incapacity and will facilitate the transfer of your digital assets to your heirs upon your passing.

Digital Estate Planning Recommendations

The following should not be construed as legal advice, and is provided for educational purposes only.

1. For all of your financial sites which have online access and passwords you should also have offline documentation which you keep in a known location. That will allow your trustees, designated Power-of-Attorneys or executor to access these accounts when needed. It is recommended that this documentation be stored in a secure location, preferably near or with your other estate planning documents and that they be updated regularly.

You should be very careful with this information. Theft, identity theft, and other crimes are possible if this information should fall into the wrong hands.

2. Some digital assets have real monetary value (i.e. PayPal, online gaming accounts, etc.) and how these valuable assets are treated upon your incapacitation or death is determined by the "Service Agreement" between you as the original account holder and the site service provider. In some cases, these assets automatically transition to the estate, in other cases they may revert to the company that operates the website, while in other cases the ownership is unknown and may have to be established in court. The post-death disposition and status of any digital asset with real monetary value should be explored and understood while the account holder is still alive and able to modify or adjust the site contract (service agreement).

3. For your social and communication sites consider what could happen if you became incapacitated or passed away. What would happen to all these accounts? Will your family and heirs be able to access the stored digital photos? What about the last emails between you and your family? Laws regarding post-mortem access to digital accounts are very inconsistent. At this time, only five states allow executors and estate trustees complete access to these accounts. In other states, your estate may have to go to court to be allowed access to these accounts. Some sites allow you to specify actions to be taken before the account goes dormant or is deleted. But, in general, it can be VERY difficult for your heirs and estate managers to retrieve digital information after your death without your login information.

   Taking some proactive steps to document and manage your digital presence will be of benefit to you as you age, and prove even more important for your estate managers upon your passing. For all digital websites, you should understand their policies with regard to deceased account owners. For example, Yahoo and Google both restrict account access from family members and may even delete accounts once a death certificate is received. Some accounts will automatically be deleted after a period of inactivity. When setting up accounts on a website, explore the settings or options available to you, keeping in mind how to maintain continued access if you become disabled or are deceased. Some websites will send email notifications to a backup or secondary email account before the primary account is deleted due to inactivity.

4. Documenting your digital presence and providing this information to your estate managers and heirs may allow them to access the information in the event of your incapacity or death. If you decide to allow such access to your digital life, providing the account information, login credentials, passwords, and answers to security questions may allow for the saving and the transfer of your digital presence to your family and friends. However, it's possible that sharing account login information and the password may violate the "Service Agreement" of a particular website. For these particular websites you will have to decide whether to continue using that website, weigh the consequences of violating the "Service Agreement," or just ignore the "Service Agreement" terms.

   And though this was already mentioned, it is important enough to reiterate; be very careful with whom you share this information. Much of this data is very personal and could allow online mischief, even with criminal intent, if it were to fall into the wrong hands.

6 – Risk Mitigation and Insurance

Discussion

Insurance is to protect your life, your property from damage, and your finances from lawsuits. In general, a simple financial life only requires simple insurance. There are three main types of personal insurance that can be purchased: Life Insurance, Property and Casualty Insurance, and Disability and Health Insurance.

If you have children, see Chapter 8 for additional insurance information.

Insurance Terms and Policy Types

Life Insurance

Insuring your life pays the named beneficiary the proceeds of the policy in the event of your death. There are two main types of Life Insurance: Term and Permanent.

Term Insurance. This is "pure" Life Insurance that pays the beneficiary a specified sum of money upon the death of the insured. A Term Policy lasts for a specified number of years. If there is no distribution during that period due to the policyholder's death, then at the end of the term the policy simply ends. There is no residual value built up within the policy (in other words it has no cash value) and the payout is zero after the term ends. The Term Insurance market is VERY competitive and this is the lowest cost type of Life Insurance.

Permanent Life Insurance. This is a combination of a Term Policy and an investment account. A permanent policy lasts until you die, assuming the premium payments are made regularly. It is "permanent" because the higher premiums are invested by the insurance company, and the investment proceeds cover the higher insurance costs as you get older. There are three main types of Permanent Insurance: Whole, Variable and Universal. There is no need for any details about these polices at this time since there is little need for a young person to buy this type of insurance.

Permanent Insurance should only be purchased for very specific purposes. Some of the valid reasons to buy Permanent Insurance are: business succession insurance, estate tax planning, a special needs child, a divorce requirement or the potential to increase coverage without a health exam. If you have any of these special situations that are appropriate for Permanent Insurance, work with a trusted agent to procure the best policy with the lowest cost. Always get a second opinion before buying permanent insurance.

Property and Casualty Insurance

Property and Casualty Insurance is just as it sounds; it is protection for your property and casualty (lawsuit) protection. This type of insurance is purchased to cover specific objects that you may own. The general classes of this insurance are:

Renters Insurance. This covers your personal property in a rental, and provides casualty protection for things that may happen within the rental. It is very inexpensive and worthwhile at about $150 to $300 per year.

Auto Insurance. This covers accidents and damage caused by you while driving your automobile(s). Generally, this insurance covers all drivers when in a covered car (but not always, ask the agent). Most folks are under-insured for the liability portion of their auto insurance and over-insured for the property damage portion.

Home Owner’s Insurance. This is insurance to protect your home from fire, water (not flood), smoke, vandalism, etc. Generally provides casualty insurance for lawsuits that target you as the homeowner.

Boat, Computer, Jewelry, etc. Insurance. This covers loss or damage to a specific item. This type of policy should be purchased for major items if the cost is low and if the item isn't already covered by another policy (homeowner’s, for example).

Umbrella Liability Insurance. This type of policy increases the casualty (lawsuit) coverage for other policies (auto, homeowner’s, etc.). It is usually fairly inexpensive insurance and worthwhile if you have significant assets or income.

Extended Warranty Policies. Extends the warranty repair period for major purchases (cars, appliances, etc.). In general, it is not a good bet to purchase these policies. Statistics from the companies that offer them show that only about 20% of premium dollars are used to repair the items and the other 80% is profit for the selling company.

<u>Health and Disability Insurance</u>.

This type of insurance is often provided by your employer but sometimes you must purchase this insurance as a standalone policy. If you want to purchase either Health or Disability Insurance in the private market, please work with a trusted broker who represents many carriers, since this is a complicated area.

Health Insurance. Health Insurance provides payments to doctors and hospitals to cover medical expenses. With the changes in 2014 (ObamaCare) the market for private Health Insurance has changed. Use the Health Care Exchanges or work with a healthcare insurance agent if you need to purchase private Health Insurance. If you currently have private Health Insurance, be sure to compare your current coverage annually with the new options offered each year.

Disability Insurance. Disability Insurance provides replacement income if you are injured and unable to work. Typically, this is VERY expensive if purchased privately and can have lots of exclusions and conditions to receive payments. Again, consult a broker who specializes in this coverage before purchasing.

General Recommendations

1. Think very carefully before purchasing Life Insurance. Life Insurance generally isn't needed unless you have others who are dependent upon your income (children, elderly dependent parents, etc.). Married couples without children may need some insurance to make up for the lost income of a deceased spouse. However, if both spouses are working, the group policies offered through your respective employers may be sufficient.

   Life Insurance is a product that is sold, not bought. The result is that Life Insurance salesmen (or saleswomen) can easily take advantage of your inexperience and naiveté, and create fear which often results in a bigger sale and commission for them, rather then what is appropriate for you. Very few people need Permanent Life Insurance unless you have a VERY special life situation.

2. If you have a specific need for a Life Insurance policy, consider Term Insurance first. Pick out a length of time you will need coverage (for example 10, 15 or 20 years) and buy a "level term policy" for that interval of time. You should comparison shop between at least three companies before purchasing.

3. If you have children, see Chapter 8 for specific insurance recommendations.

4. Always accept the free Group Life Insurance offered by your company, but think carefully before purchasing additional coverage through the group plan. It is easy to buy extra coverage through work, but it may be significantly more expensive than a Term Policy purchased privately.
5. If you own a home, purchase Homeowner's Insurance. Work with your agent to determine the correct level of coverage based on the expected cost to rebuild your house if it burnt to the ground. Consider selecting a higher deductible to reduce the premium, but don't skimp on the liability coverage. Losing a lawsuit can devastate your finances.
6. If you rent, consider Renters Insurance. This is very inexpensive coverage and will help if fire or theft occurs, and will also help if you are sued over something that happens within the rental.
7. Purchase Auto Insurance for all cars. Again, don't skimp on the liability and property damage coverage; lawsuits are all too common in automobile accidents and you will want the extra coverage. Decide what level of deductible you can afford and balance that with the higher premium costs. Consider dropping Collision and Comprehensive coverage on older cars.
8. If you have other major assets (boats, motor homes, etc.) consider specific coverage for each.
9. Do not purchase Extended Warranty policies as they are almost always a bad deal. It usually doesn't make sense to purchase insurance for small items (computers, cell phones, etc.). If you are worried about the reliability of the product you purchase, maybe you should do some research and buy a more reliable version of the same item! However, if the policy offers significant extra benefits (Apple-care tech support, for example) then it may be worthwhile.
10. Consult with a trusted insurance broker when purchasing private Health or Disability insurance.

7 – Stock Options, RSUs and ESPP Shares

Discussion

If you are fortunate enough to receive Stock Option Grants or Restricted Stock Units (RSUs) from your company, or if you have access to an Employee Stock Purchase Plan (ESPP), you have the opportunity to acquire assets (and build your portfolio) at a discount. The types of options or RSUs you receive and how you exercise them can greatly affect your financial outcome and tax consequences. How you buy and sell ESPP shares and how long you hold them can also affect the diversification of your portfolio.

Definitions and Descriptions

Stock Options. Generally called a Stock Option Grant, it is a contract between you and your company that allows you to buy shares of the company's stock in the future at a specified price (the grant price). Stock options typically vest over some specific number of years and also generally expire if not exercised. If the stock has increased in value you can choose to exercise the options and acquire the stock at the option price (which is lower than the market price). You can then either hold the stock in your portfolio or sell the stock to realize the profit.

Incentive Stock Options (ISOs). This is an Option issued by a company before it goes public (typically for very low prices) as an incentive for valued employees. When ISO options are exercised, no income taxes are due, but this exercise event may result in higher Alternative Minimum Tax (AMT) in the year of exercise. If the stock is sold after being held for at least one year the total gain (from grant price to sales price) is taxed as Long Term Capital Gains (at either 15% or 20% tax rate).

Non-Qualified Stock Options (NQSOs). This type of option is issued by a company after their stock becomes publicly traded. The option price is the market price on the date of the grant. When exercised, the difference between the grant price and market price on the date of exercise becomes W-2 reportable income. If the stock is sold after being held for at least one year the extra gain (from exercise date price to final sales price) is taxed as Long Term Capital Gains (at either 15% or 20% tax rate).

Restricted Stock Units (RSUs). These are shares of a company stock given to employees as a bonus. The ability for the employee to sell these RSUs typically vests over time, but once the shares have vested, they are fully owned by the employee. As RSUs vest, their value is included as W-2 income. If the RSU stock is sold after being held for at least one year the extra gain (from the vest price to sales price) is taxed as Long Term Capital Gains (at either 15% or 20% tax rate).

Employee Stock Purchase Plan (ESPP). This is a plan that allows employees to purchase the company's stock at a discount relative to the market price. Typically, contributions to the plan are withheld from your paycheck for six months and then ESPP shares are purchased with the accumulated funds at the lower of the current price or some price in the past (often the lowest recent price). Some companies additionally reduce the purchase price by up to 15%. You own the shares immediately, but the taxes owed upon the sale of the shares will vary depending upon how long you actually held the shares.

Each of these instruments should be handled differently to maximize your after-tax gains and minimize the risk to your overall portfolio.

Incentive Stock Options (ISOs) have the most profit potential and the largest risk. Since ISOs typically only cost pennies per share, they can provide huge gains when a company goes public for $10 or $20 per share. The after-tax gain is maximized by exercising the ISO options, holding the stock for one year, then selling and only paying the capital gains tax rate on the proceeds. The "trap" is that AMT, or Alternative Minimum Tax, is owed on the gain from exercise price to market price in the year of exercise, and if the stock price drops significantly before it is sold you may owe tax on gains not realized. If you have ISOs you should see a Tax specialist before exercising or selling them.

The best way to think of in-the-money Non-Qualified Stock Options (NQSOs) is as an "employee bonus" that you can award to yourself whenever you want. Since all NQSO profits are taxed as ordinary W-2 income when the option is exercised there is only one correct strategy to maximize the after-tax profits and that is to do a "same day exercise and sale" of the option shares. In this process, the options are exercised for the specified number of shares and the shares are immediately sold in the marketplace. The option cost, withholding taxes, and fees are subtracted from the proceeds and you receive a check for the remainder.

Restricted Stock Units (RSUs) are the latest form of stock compensation that companies are using with valued employees. RSUs have advantages over options in that you own the shares after they vest, moreover RSUs don't expire. However, since RSUs are expensive for companies to grant, they typically issue smaller numbers of RSU shares to each employee. There is no special tax planning needed for RSUs; you pay ordinary W-2 income on the shares received as they vest and typically pay capital gains taxes on the proceeds when the RSU shares are sold. The percentage of RSU shares in your portfolio should be monitored to ensure it doesn't get too high, subjecting you to excessive risk.

With regards to Stock Options and RSUs, the biggest danger is holding them too long. You should understand that these instruments are only pieces of paper which give you certain rights, but you can't buy a house, pay for college, or buy a vacation home with a stock option. They need to be exercised and sold to realize any gains and the proceeds then used to enhance your lifestyle. It is very important to have a sales strategy when any Stock Options or RSUs are granted. Either pick a price to sell at, or pick a time to sell, or employ a combination of the two approaches but just holding the shares forever, or waiting for the "perfect" price or the "right" time is a recipe for disaster. A good rule of thumb for younger employees is:

> *If the value of any single stock or in-the-money Stock Options is higher than 25% of your total portfolio, you should be actively selling those shares to get the position below 25%. As the RSUs or Stock Option shares vest and their value becomes higher than 25% of your portfolio, exercise and sell.*

Employee Stock Purchase Plans (ESPPs) are different from Stock Options and RSUs. ESPPs are an enhanced savings vehicle which allows dollars deferred from your paycheck to be augmented by the company via the share pricing mechanism, or by a discount price, or perhaps both. Holding too large a position in your company stock can introduce significant risk into your portfolio; use the aforementioned 25% rule to diversify your portfolio, thus reducing overall risk.

To minimize the taxes owed on the sale of ESPP shares, the simplest rule is to hold the shares for two years. Bear in mind that if the share price declines over those two years, you can actually lose money on the ESPP plan. Even if your ESPP shares are under the purchase price, you should sell them if your company stock is greater than 25% of your total portfolio.

General Recommendations

1. If your company offers an ESPP with a purchase discount, sign up and defer the maximum salary into the plan. After every ESPP plan purchase of company shares you have three options:
   a. Sell the shares immediately and capture the discount. You will pay ordinary income taxes on both the discount and any gains. This is no risk and provides a guaranteed return.
   b. Hold the shares for 18 months and then sell. You will pay ordinary income taxes on the discount and long term capital gain taxes on any gains. However, this option introduces risk since the stock price can fall over the holding period.
   c. Hold the shares for a long period hoping for a larger gain. You will pay ordinary income taxes on the discount and long term capital gain taxes on any gains. This is the riskiest strategy since you are now holding your employer's stock. It is important to sell these shares if the company stock exceeds 25% of your liquid net worth.
2. The most important thing about Stock Option Grants is to understand the significance of the dates associated with them. Options vest over a period of time and expire if not exercised before the grant ends. When offered a grant, you must accept it within a certain window, then the vesting should be monitored to keep the overall portfolio in balance. Finally, the option MUST be exercised before its expiration or any potential profit is lost.
3. Have a sell plan for all RSU and Stock Option shares. It requires discipline to sell these shares in all cases. When the stock price is increasing, greed may prevent you from selling. When the stock price is falling, regret may prevent you from selling. Having a pre-determined sales plan based upon price and/or time targets can help.
4. Sell ESPP, RSU and in-the-money Stock Option shares if their value is greater than 25% of your total portfolio. This rule will greatly reduce the overall risk to your portfolio. Everybody has heard stories of folks who held lots of company stock (think Apple) and became rich. However, there are just as many Enron stories as there are Apple stories.
5. If you are granted Incentive Stock Options see a Tax specialist before exercising or selling these option shares.
6. Don't try to optimize the tax treatment of options, RSUs, or ESPP sales. Listen to the old saying "Never let the tax tail wag the profit dog."

8 – Additional Topics for Young Families

Discussion

As a young couple with children, there are some additional topics you need to consider in your financial life. Since you have children, your estate plan, insurance needs and medium term savings goals are different from those without kids.

Estate Planning

If you have children, YOU MUST HAVE AN ESTATE PLAN! You MUST specify who will be the guardian of your children should you and your spouse both die. Additionally, you should specify how your assets and insurance proceeds are to be used to benefit the children. If this isn't defined, the state will use its own rules to assign guardians for your children and your estate assets may or may not be used as you would have wanted. It is CRITICAL to create a Will and/or Trust that specifies your wishes.

Insurance Planning

If you have children, Life Insurance becomes important. You will need enough Life Insurance to provide salary replacement, pay for college and pay other expenses should you not be here with your income. Generally, the best option is level premium Term Insurance with a timeframe that covers the period when your children are dependents (up to age 18 or 22). As a general guideline, purchasing Term Life Insurance that is 10 times your annual salary is a good minimum. If you have any group Life Insurance through your employer, subtract this coverage amount from the calculated amount of Term Life to be purchased.

College/Educational Funding

If you have children, you may want to provide for their education. Most children need assistance from their parents in paying for college and some children will attend private elementary, middle, and/or high school.

College education costs have been rising by 5% annually and if this continues, in the future, very few families will be able to afford to pay for college. It is likely that the increases in education costs will moderate over the next few years and/or different class models (online courses, internship programs, etc.) will reduce college costs. Even so, it is a good idea to save significant sums in a 529 plan for college expenses; these tax beneficial plans allow savings to grow tax free and for tax free withdrawals for education expenses.

The earlier you start saving for college the less money that needs to be saved each month. The table below shows the monthly savings needed to accumulate the targeted amount of college funds, assuming funds are saved in a 529 education account for 18 years, and earn an average of 6% annually. If you start saving for college when the baby is born, the amount each month isn't painful and has the most time for compound growth to help.

Target Savings Amount	Monthly Savings (18 Years at 6% return) (starting from $0)
$80,000	$206.53 per month
$100,000	$258.16 per month
$125,000	$322.70 per month
$150,000	$387.24 per month
$200,000	$516.32 per month

General Recommendations

1. Use an estate planning attorney to draft your estate planning documents. Specify who will be the guardian of your minor children in the event of your death or incapacity. Specify how you want your assets used to benefit the children.
2. Purchase Term Life Insurance so that you have coverage that is a minimum of 10 times your annual salary. Purchase a level term policy that will last until your youngest child is either 18 or 22 (if you plan for them to be college students). DO NOT purchase permanent insurance.
3. Implement a college savings plan. Use 529 accounts to optimize the tax efficiency of your college savings. If you are sure you will have pre-college education expenses (elementary or high school), save for that also but don't scrimp on the college savings.

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