financial focus

Building your financial foundation

TEMPLETON
FINANCIAL PLANNING
PO Box 15833
Pittsburgh, PA 15244
724-695-1087
steve@templetonfp.com
www.templetonfp.com

Steve Templeton, CFP®, EA

SUMMER 2013

HELPFUL TIPS ABOUT 401(K) INVESTMENT PLANS

by Erin Beahr Stroudsburg, PA

Finding how much your investments really cost can be difficult, but not impossible. You can scour your statements for fees, look up your funds on Morningstar, or ask your advisor.

Unfortunately, 401(k) plans have been among the least transparent investment vehicles and often are believed to be a free service from your employer (they're not). New rules aimed at making sure those costs are clear to you recently took effect.

What's the Big Deal About 401(k) Costs?

Plenty. Some employers do cover the costs of a plan, but most pass them along to the participants. Those transaction fees, administration fees, commissions, and the like, can add up to a significant drag on your investment returns over time. Plan costs vary depending on the type of investment, plan administrator, salesperson, and even the size of the plan. The new rules require two types of disclosures: an annual notice with fund expenses and quarterly notices with actual fees paid.

Annual Statement

If you have money in a 401(k), as a current participant or you have a leftover from a previous job, you should have received your first annual notice from the plan before August 30, 2012. "Easy to understand," unfortunately, was not one of the requirements, so this document can be dense. The annual notice provides information about investment choices within your plan, historical performance, and performance based against a benchmark, such as the S&P 500.

The notice also details fund expenses, or the costs associated with running each fund. These are expressed as a percentage and the actual dollar amount cost for every $1,000 invested.

You may notice that some funds cost more to run than others. International funds, for instance, are typically more costly than large cap index funds. The international fund may use an investment manager, whereas the index fund does not need management. Additionally, funds within plans run by insurance companies tend to have higher expenses than those in institutional investment companies like Schwab, Fidelity, or Vanguard.

You won't see these expense charges as subtractions on your 401(k) statements. They are taken out of the fund returns, so the effect is a reduction in performance. According to the U.S. Government Accountability Office, the average fund expense for larger plans (more than $10 million in assets) is 1.08%, and it is 1.9% for smaller plans, although some funds can carry expense charges upward of 2%. Some may tack on an additional 1% for management or charge commissions.

Quarterly Statement

Later this fall, you will receive your first quarterly statement. These statements disclose the actual dollars paid for administration. You may see fees paid for

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FINANCIAL TIPS FOR YOUNG ADULTS

by Linda Leitz, Colorado Springs, CO

There are some great financial strategies that make a sound financial life achievable. But there are also some mistakes that can slow down or stop young adults from getting started on a good financial path:

✔ *Bad debt.*

It's easy to live beyond your means. Credit cards can be a convenience, but in the age of debit cards, there isn't much need for credit cards. If you do use credit cards, pay them off completely each month. Doing this builds your credit history in a positive way, so when you're ready to borrow money at a reasonable level for a good reason—your first home, a reliable car—it'll be easier.

Don't stress about student loans unless they're astronomical. Student loans can help you get an education that will lead to higher earnings. They're cheaper than credit cards, and for many people right out of college or trade school, the interest is tax deductible.

✔ *Living your parents' lifestyle.*

That doesn't mean you can't love shag carpet and Woodstock. What it does mean is that it took your parents lots of work and time to build up to their lifestyle. Take a close look at what your income will allow you to spend. Let that drive everything from how much you pay in rent (maybe a roommate makes sense), what kind of car you have (a solid used car will work until you make more and can buy a new car), and your social life (got to have that—look for fun ways to enjoy friends without running up credit cards).

✔ *No financial safety net.*

Your parents will help you out if you get in a bind. Right? That's not a safety net; that's a bad financial decision for both you and your parents. Think how you'd feel about paying all your parents' bills when they retire. They need to be saving for their future, and you do too. So with your income driving your lifestyle, you'll stay out of debt. When deciding how much you can spend, save at least 10% of what you make. For the first year or so, put it in a basic savings or money market account.

✔ *No saving for the future.*

You're young, so why burden yourself with saving for days 30 or 40 years from now? Because working on it now gives you more options. Someday you won't want to work—or at least it's nice to have the option not to. The money you save now has longer to grow and compound. So saving early means you have to save less over your lifetime. Start now and let your money do some of the work of meeting your financial goals.

Avoid going the wrong direction as you start out. It saves you the trouble of cleaning up your finances later.

EXIT PLANNING FOR SMALL BUSINESS OWNERS

by Larry Soukup Buena Vista, CO

I recently read that 9 million of America's 15 million business owners were born in 1964 or earlier. One of them turns age 65 every 57 seconds. As of 2012 the number of business owners wanting to sell increased by five times over 2004. This trend will continue for the next 10 to 15 years.

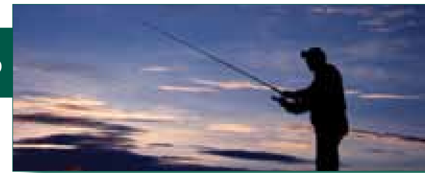
The big question is whether these baby boomers are ready to exit their businesses. Being ready means having a plan in place. People can think of exit planning as they do personal estate planning. It should be done thoroughly once and then reviewed and updated periodically. It's a road map for the business owner's future

It might involve selling the business outright, adding qualified staff and working part time, or keeping the business and playing the role of a passive investor. An exit plan is a comprehensive integrated plan that takes into account personal, business, legal, financial, tax, and estate planning considerations.

Since a sale is the most common exit for a business owner, here are some points to keep in mind if your end game is to sell your business:

- ***Start the process early.*** Begin preparing several years before the sale. Try to increase revenues and reduce expenses to show a strong bottom line. Make sure your financial records are accurate and up to date.
- ***Your assets should be ready for sale.*** This includes tangible assets like inventory and equipment as well as intangible assets such as leases and contracts. All these should be assignable to the buyer.
- ***Because most business transactions are structured as asset sales,*** the buyer may want to do extensive due diligence on all assets of the business, so make sure your documentation is well organized.
- ***Begin making yourself less essential.*** From a buyer's perspective, it's better if the current owner is not critical to the success of the business. Start training a management team to take over important business functions.
- ***Get professional help.*** Experienced advisors will help you value the business, address legal, tax, and accounting issues, and help you market your business opportunity. They can also help you screen potential buyers, assist you through the due diligence process, and help you negotiate the ultimate sales price and terms.
- ***As you go through the sales process, stay focused on running and growing your business.*** Even if you are moving ahead with a potential buyer, it's important to remember that a deal can unravel at any time. Keep working on growing your business until the sale has closed and the money is in the bank.
- ***You'll want to keep the sales process confidential*** as long as possible so that you don't endanger any customer, employee, or vendor relationships. Most serious buyers will honor this and keep their communications confidential until most of their due diligence on the business has been completed.
- ***Finally, be prepared to say no and walk away from the table***. If you think the price is too low or the deal isn't right for some other reason, move on to the next opportunity. Nothing says that your exit strategy needs to be carved in stone.

Stay flexible because your life and goals change over time. In the end, it all comes down to what's most important to you.



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legal and accounting services, administration fees for back office operations and online access, record keeping services, or loan processing. Some fees that may not be disclosed are those paid out of revenue sharing through the expense charges (from the annual statement). So you may still not see all the expenses of your plan clearly, but it will be an improvement.

How Does My Plan Compare?

That is still a question that remains. Seeing the fees disclosed in isolation does not give you a good picture of whether they are high, low, or average. Certainly all plans must have associated costs, but some are clearly a better deal than others. That's where a company called BrightScope comes in. On its website, www.brightscope.com, you can look up not only your plan but also others in your industry and see how your plan stacks up.

What About 403(b) Plans?

The disclosure rules only apply to plans covered by the Employee Retirement Income Security Act (ERISA), which does include some 403(b) plans. But that means school district voluntary 403(b) plans are not covered, which is a shame because, in my experience, school district 403(b) plans are quite expensive compared to their 401(k) counterparts. Because of record keeping requirements, school districts typically have approved lists of vendors to choose from, and most come with high fees or annuity-based products.

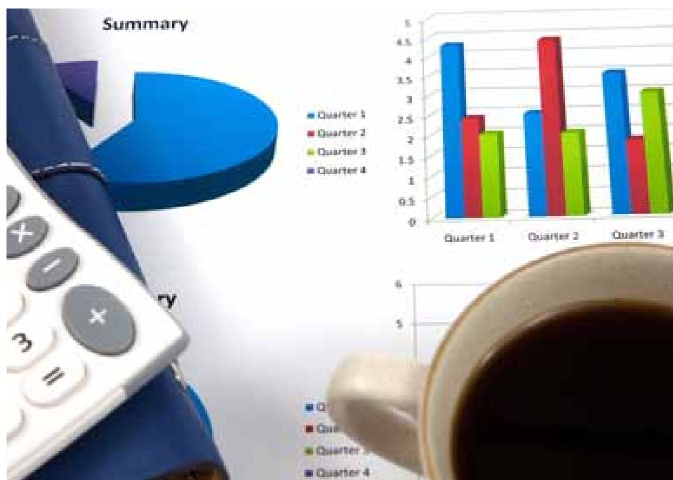
Locally, I have not yet seen a low-cost option in the bunch. Most are designed to pay compensation to an advisor representative, through a commission or a percentage fee, which is fine if you will be using the services of the advisor, agree to that method of compensation, and, most of all, are aware of the costs. But if you are a do-it-yourself investor or have your own independent advisor, you may be paying for a service you do not need. And you may not even realize you are paying for the service.

Thankfully, the 403(b) Transparency Taskforce recently developed a 403(b) Model Disclosure Form to disclose fees and make comparisons among providers. If you are a teacher enrolled in a 403(b), be sure to get this form so you can make an informed decision. Also check out www.403bwise.com, a website that advocates for better plans and offers education on plan information.

What Do I Do Now?

Use the information provided in your annual statement to make prudent investment decisions. Your decisions should not be completely driven by the expense charges, but they certainly factor into performance.

Should you stop investing if you don't like what you find out about your plan? Not necessarily, especially with a 401(k) providing a match. The match should outweigh the extra expenses you are paying with your plan. For plans without a match, such as a 403(b), the decision is trickier. In some cases, you may not be eligible to deduct an IRA contribution or contribute to a Roth, and your plan may be the only tax-advantaged option for retirement savings. For an old 401(k) that isn't up to snuff, you may want to roll the funds over to your own IRA, where you can control the costs and investment choices yourself.



If you find your current plan has excessively high fund expense charges compared to similar funds in other plans or higher than average administration fees or commissions, spread the word to your co-workers and talk to your employer. As a fiduciary of your plan, your employer should be working in your best interest and may be persuaded to search for a better deal. Those fees directly affect your retirement success—and that of the employer if he or she participates as well—so it's worth investigating.

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