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Financial Tuneups

by Phil Dyer

Let's face it: there is a huge amount of contradictory, and often misleading, financial information available to American consumers. The Internet is awash with financial sites touting "get-rich-quick" schemes that promise to make you an "insta-millionaire" with only a small investment, and bookstore shelves are groaning under the weight of "expert" financial books. Meanwhile, late-night infomercials promise easy living with no-money-down real estate, easy stock-trading systems, or investments in rare coins for only three easy payments of $19.99! It is sometimes difficult for hard-working people with busy lives to know where to turn for the best financial advice. Concerns about whether an advisor truly is looking out for the interests of the client or simply is a slick salesperson are warranted, and consumers are wise to ask tough questions when interviewing an advisor or evaluating a financial product being offered to them.

Recently, three MOAA members, all at various points in their military careers and with different financial issues, sought advice from hourly, fee-only certified financial planners (CFPs) through MOAA's sponsored financial planning partnership, the Garrett Planning Network (GPN). Their financial tuneups highlight challenges faced by many active duty officers and offer creative potential solutions provided by experts. Read on for tips you might implement in your own situation.

Name: LT. Mark Turner, USN
SitRep: Turner is married and currently does not have any children; he and his wife have an adjustable-rate mortgage on their new home.
Planner: Rick Mayes, CFP, of Mayes Financial Planning in Carlsbad, Calif.

Challenging situations: Mark Turner is a Navy physician at Camp Pendleton, Calif., and will be deployed to Iraq soon after finishing his residency. Mark's wife, Janis, is a sales representative for a pharmaceutical company. They own a house in San Diego and are looking forward to an exciting future together. However, both still have student loans from college, a car loan, and credit card debt. In addition, like many new homeowners, they purchased their home with an adjustable-rate mortgage and now face the daunting prospect of their mortgage payments rising 50 percent or more over the next two or three years.

So far, the Turners' investment experience is limited to a brokerage firm that sold them systematic investment plans and whole life insurance for military personnel. Recently, a sales representative of another national financial services firm approached them with a proposal to consolidate their debts into a much larger mortgage and add additional life insurance. They had questions about this proposal and sought a second opinion from Rick Mayes, CFP, of Mayes Financial Planning in Carlsbad, Calif.

The Turners also sought advice in different areas:

***** Their adjustable mortgage payments could rise from $1,700 a month to as much as $3,000 a month over the next several years, but there is a 36-month prepayment penalty. They also are not paying down the principal on their home equity line of credit (HELOC) balance, which helped them to buy the house, while their student loan, auto loan, and credit card payments amount to almost $1,800 a month. Should they take the debt consolidation proposal?

* Do they need the added life insurance proposed by the sales representative, or should they keep the whole life policies they already have?

After working through the planning process, Mayes offered several solutions to help the Turners. He proposed they prioritize available cash flow, following a schedule put together to focus on the most important priorities. These include continuing contributions to their Roth IRAs, building a cash reserve, covering the increased mortgage payments for the short term, and paying down other loans in priority order.

Mayes also recommended they refinance their mortgage and HELOC balance after the prepayment period expires in six months. A referral to a mortgage broker allowed Janis to refinance an improved mortgage while Mark was in Iraq. Mayes did not recommend their other loans be consolidated into the new mortgage. Though that might provide temporary cash flow relief, the longer-term repayments would be much more expensive.

The Turners' Roth IRA accounts were moved from the commissioned broker to a discount brokerage firm offering a broad range of lower-cost investments. Mayes also suggested the Turners add additional level-term life insurance to adequately cover their financial future.

"Now we have someone we can trust that will give us the straight story, and that isn't selling products. We feel like we are on the right track to a bright financial future," Janis says.

Name: 1st Lt. Alex Green, USAF

SitRep: Green is on active duty and engaged; he and his fiancée want to start a family soon after marriage.

Planner: Kim Jones, CFP, of Jones Strategic Financial Planning LLC in Broomfield, Colo.

Just getting started: Air Force 1st Lt. Alex Green, newly engaged and a recent graduate of the U.S. Air Force Academy, Colorado Springs, Colo., has several key financial concerns. Like many young officers, he used a USAA cadet loan to buy a car. He also is carrying credit card debt and a loan for the engagement ring he recently purchased for Sandy Jackson, his fiancée. He contacted Kim Jones, CFP, of Jones Strategic Financial Planning LLC in Broomfield, Colo.

Because Green is about to be married, Jones suggested they include Jackson's finances in the decision process. Her finances complicated the picture somewhat, because she has both student loans and a car loan. She also is paying nearly $4,500 annually for a life insurance policy providing limited coverage. Since the couple plan to start a family shortly after marriage, adequate insurance coverage at a reasonable cost is a key concern.

Jones first assisted the couple in crafting a debt-reduction plan to pay off all debts except Green's car loan, which has a very low interest rate. They jointly developed a program to get rid of all other debts within six months and scheduled a follow-up meeting with Jones to keep them on track.

Next they tackled their life insurance coverage. Green has the maximum Servicemembers' Group Life Insurance coverage of $400,000 and already had purchased an additional $250,000 term policy through military-friendly Army-Air Force Mutual Aid Association, but Jones is concerned that might not be enough once children come along. She recommended increasing the term coverage for Green to $800,000 once they start a family. After consulting a life insurance expert, they also decide to cash out Jackson's very expensive whole life policy and replace it with a $400,000, 20-year level premium term policy, which will lower Jackson's insurance costs from $4,500 a year to just $215.

They use the $360 a month of freed-up cash flow to increase their retirement savings, especially after Jones showed them how much the extra savings could add up to over the next 40 or so years. Jackson had been contributing a minimal amount to her 401(k) plan, but Jones recommended she increase the contribution enough to capture the maximum employer matching contribution and fully fund a Roth IRA each year ($4,000 annually). Jones selected the Vanguard Wellington Fund (five-year average return of 11.37 percent, 0.30 percent expense ratio) - a stable, low-cost balanced fund investing in both stocks and bonds - for the Roth IRA and helped Jackson reallocate her 401(k) plan as part of the couple's overall asset mix.

Although Green's Thrift Savings Plan (TSP) account doesn't benefit from matching funds, it does provide an excellent low-cost investment vehicle. Jones recommended he initially target 10 percent of his pretax pay - split between the TSP and a Roth IRA - and increase the amount to 15 percent once the couple's debts have been paid off. She recommended the Vanguard Wellington for Green's Roth IRA and an allocation of 40 percent C Fund (common stock), 20 percent S Fund (small cap stock), 20 percent I Fund (international stock), and 20 percent G Fund (government bond) for the TSP.

At the close of the meeting, Jones provided Green and Jackson with a detailed set of implementation instructions, carefully reviewed their debt-reduction plan, and helped them finalize their detailed cash-flow spreadsheet. The soon-to-be newlyweds are pleased they will start their new lives together on firm financial ground.

Name: Capt. Chris Coddington, USAF

SitRep: Coddington is married with two young daughters and wants to invest the money from his home's sale.
Planner: Buzz Livingston, CFP, of Livingston Financial Planning Inc. in Santa Rosa Beach, Fla.

Moving forward: Capt. Chris Coddington, USAF, is a pilot stationed at Eglin AFB, Fla. His wife, Yvette, is an adjunct professor at the University of Maryland. When Chris was reassigned to Eglin, they had a nice windfall from the sale of their previous home. According to Chris: "[We] didn't want to make any mistakes with that money. We had just come out of a bad relationship with a previous advisor and were skeptical of anyone claiming to have our best financial interests in mind."

They chose to work with Buzz Livingston, CFP, of Livingston Financial Planning Inc., in Santa Rosa Beach, Fla. His firm appealed to them because he provides investment management along with financial planning on a strictly hourly basis - and accepts no commissions of any type.

"After we did a comprehensive plan for [the Coddingtons], the first area we agreed that needed to be addressed was the mutual fund choices inside their IRAs," Livingston says. He recommended DFA Funds' 100-percent Global Equity fund to replace the couple's Fidelity Destiny II.

"By using a no-load fund, which trades without a 5.75-percent up-front fee, we were able to lower their annual cost to fund their IRA by $460 a year along with the annual fees charged by the previous provider. DFA does not charge a 12b-1 marketing fee, so the Coddingtons could lower their annual expense ratio by two-thirds. In addition, we were able to diversify their portfolio by including asset classes such as emerging markets and U.S. small caps," Livingston says.

For their taxable account, Livingston recommended the Coddingtons use low-cost index funds or Exchange Traded Funds in lieu of individual stocks. Livingston pointed out there is too much risk in trying to choose stocks, and it is difficult to get the necessary diversification into small or international companies with individual stocks.

Livingston also encouraged Chris to increase his TSP contributions. "The TSP is one of the best retirement plans available," he says. He also recommended future contributions include the fixed income option inside Chris' TSP to reduce portfolio volatility.

Although Chris had a will from when he was stationed at Okinawa, Yvette did not have one. Livingston recommended Chris update his will and Yvette prepare one, along with a health care directive and medical power of attorney.

One weakness Livingston noted was that no beneficiaries were designated for Chris' TSP. Without a designated beneficiary, the survivors would face a burdensome income tax liability that could approach $10,000. With a beneficiary designation, this liability could be deferred. He also had the Coddingtons update the beneficiary designations on IRAs that Chris had funded prior to his marriage and recommended their two daughters be included as second beneficiaries.

The Coddingtons are pleased with the sound advice they received from Livingston. "We now feel more secure financially and have a good grasp on what we need to do to meet our financial goals," says Chris.

Selecting Your Own Financial Advisor:

Important considerations when selecting a financial advisor are experience, competence, and compensation. Consider looking for an advisor with several years of experience and one or more of the following designations: CFP, CPA/PFS, ChFC, CFA, or RFC. Financial advisors are compensated in a variety of ways - commission, fee plus commission, and fee-only (which can include hourly fees, retainer fees, or a percentage of assets under management). There are pros and cons to each compensation method - not every method is right for every consumer. Regardless of compensation method, an advisory should act as a fiduciary, with your best interests foremost. Both the Garrett Planning Network and the National Association of Personal Financial Advisors have excellent advisor interview forms available for download at their respective Web sites, www.garrettplanning.com and www.napfa.org.