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Raising Money-Wise Kids

by Mike Palmer, CFP®

Over the last several months, I've had discussions with several clients of varying ages with a common theme echoing through our conversations – a lack of financial mentoring. Irrespective of a family's wealth, it is all too common for parents to neglect the teaching of basic personal finance. Many parents approach the subject of personal finance with the same trepidation they do sex education.

We often ask prospective clients whether their existing investment program and financial plan is "by default" or "by design." For the vast majority it is the former, so it is no surprise that families have difficulty discussing money. I've been keenly aware of this recently as my two oldest sons (ages 11 & 9) have started asking money questions. "Are we rich?" my nine-year-old asked me recently. I froze momentarily, thinking of how best to navigate the family finance minefield. Yet I recovered and framed a 15-minute conversation that I think answered his question, provided context applicable to a nine-year-old (PlayStation!), and encouraged him to ask me other questions he had about money.

Part of the reason that I think our conversation was a success is that he has followed up with other questions; and while they've been challenging, we've established a dialogue on the subject, one built on trust. He knows I'm willing to talk openly about the subject, and I try to take adult financial concepts and simplify them so they have application to his understanding of the world.

As with other parenting tasks, it isn't necessarily easy, and there is no guarantee the financial seeds we sow will take root, but I'm optimistic that as he matures our discussions will bear fruit. Allow me to share several ideas that may help others in educating children or grandchildren:

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NOTABLE QUOTE

"In raising your children spend half as much money and twice as much time."

Benjamin Franklin

The Trust Company of the South is a fee-only independent trust company and financial planning firm focused on serving the needs of affluent individuals, families, and non-profit institutions.

Market Commentary

by Mike Palmer, CFP®

As we tell prospective clients (and frequently remind existing clients), don't hire us for our accuracy in "forecasting" the market. Our belief is investment success is primarily the result of discipline and asset allocation, not our crystal ball clarity. I was recently asked by a prospective client to explain our investment approach and to discuss under what circumstances we make asset allocation adjustments to portfolios. This is an excellent question and a distinction from market timing that many find difficult to grasp. I offered the following example that may be helpful to others, so I'll share it with readers.

In early 2004, we met with a husband and wife to review their accounts and discuss potential investment changes. The relationship was unique in that the client employed our firm primarily as fiduciary for accounts that required a corporate trustee and looked to another financial advisor for investment recommendations. At our meeting we made several investment recommendations, including the inclusion of REITs in their portfolio.

The client politely thanked us for our work and explained they wanted their other advisor to review our presentation. Two weeks later we received word they didn't want to act upon our recommendations. Their other advisor felt "REITs were overvalued."

Obviously, the decision to exclude REITs turned out to be a poor one. At the time, REITs were coming off a year of stellar returns (up 37% in 2003), and any number of market "seers" pontificated that REITs were due for a fall. But our professional experience indicates that conventional wisdom rarely is.

From January 2004 through March 2006, the NAREIT equity index returned 26.3% on an annualized basis. Today, many of the same "experts" are again making the case for REIT valuations being overextended. They may be correct, or they may be like a broken clock: right twice a day. Our rationale for including any asset class in a portfolio remains applicable to REITs today – they lower portfolio variance and enhance returns over time. Valuations rarely get so askew as to warrant complete exclusion; and one must be correct twice, on the exit and the reentry, a feat that seems easy in theory but is fleeting in practice. Our belief is simple – rarely does the total exclusion of an asset class bring about favorable outcomes.

This belief segues nicely into a recent column by one of my favorite financial writers, Nick Murray. In the April issue of *Financial Advisor,* Murray outlines what he describes as the fatal disconnect: the decoupling of financial goals and investment strategy. When done properly, long-term investing is seamlessly aligned with the lifetime goals of the investor. According to Murray there is a perfect balance about goal-driven investing. As long as the portfolio remains the servant to the plan, harmony reigns.

But too often we relent to human temptation. The seductive serpents of the financial press distract us: you can beat this thing. You're smart. You needn't rely on personal initiative, hard work, and thrift to build your wealth. Don't be bound by tiresome patience and discipline. You can short-cut the time-tested tenets of asset allocation and diversification to be rich now!

As Murray so eloquently writes: "When we bite into the apple of 'outperformance' – when the focus of our portfolio shifts from our financial goals to the markets themselves – that's the original sin, the mother of all mistakes. **The critical issue is that 'outperformance' isn't a financial goal."**

The foundation for our investment strategy is built on the principles of accepting asset class returns and building investment portfolios diversified not only *within* asset classes, but *across* asset classes. Our wisdom is the acceptance of a simple strategy that leads to inevitable success. The goals, desires and dreams of our clients deserve nothing less.

Tax Update

by John Slayton, CFP®

As this piece goes to print, the Tax Reform Act of 2005 is before the House and Senate Conference Committee, which is attempting to reconcile differences between the two bills passed by the two bodies late last year. **HUGE** issues include the continuation of the reduced tax rates on capital gains and dividends and the Alternative Minimum Tax (sometimes described as the elephant standing in the corner of the room that no one wants to acknowledge). The temporarily increased AMT exemptions ended after 2005; and if something is not changed in 2006, up to 20 million taxpayers will be paying AMT this year. Everyone recognizes that AMT is broken and is impacting taxpayers that it was never intended to, but no one knows how to replace the lost tax revenue to fix it. AMT is starting to look like Social Security (the other elephant over in the corner), an ominous problem that is becoming too expensive (financially and politically) to repair. Held hostage in Conference deliberations over these weighty quandaries are charitable tax issues, such as the direct rollover of IRA assets to charities without recognizing income and the long sought-after charitable deduction for non-itemizers. Unfortunately, allowing non-itemizers to deduct up to $420 in annual charitable contributions will be paid for with a floor of $420 of non-deductible contributions imposed on itemizers. This may expand the universe of charitable givers, but may not prove to be the best news for our itemizing readers. More news to follow on these developing matters.

FUN FACT

Why Is It Called A Piggy Bank?

No one invented the piggy bank. The piggy banks' origin owes more to the history of language than to an individual inventor. In Old English (around the 15th century) there was a word pygg which referred to a type of orange clay. People made all kinds of useful objects out of clay, including dishes and jars to hold spare change. Around the 18th century, the word *pygg* now sounded the same as the word for the animal "pig". An unknown person(s) thought to shape a *pygg* jar, to look just like a real "pig". Perhaps an order came in for a *pygg* jar and the potter misunderstood.

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Behind the Scenes at Trust Company of the South

>> **Bill Noble** has been appointed to the Nash Community College Foundation board.

>> **John Slayton** gave a presentation entitled "Current Tax and Investment Issues Affecting Endowments" at the NC CORD annual meeting.

>> In January, **Mike Palmer, Jill Johnson,** and **Linda Paul** attended a continuing education program hosted by Abacus Planning Group in Columbia, SC.

>> **Mike Palmer** was quoted in David Drucker's MorningstarAdvisor.com column entitled "Boomer Psychology."

>> **John Slayton** is serving as Adjunct Professor of Finance at Elon University's Love School of Business.

>> **Aaron Bennett** has been admitted to Elon University's inaugural law school class. Please join us in wishing Aaron much success. He will be leaving the firm to start school in August.

>> **Bill Smith, Mike Palmer,** and **Jill Johnson** attended the Trust Advisors Forum in Pinehurst in February.

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>> **Aim Small, Miss Small** – Don't be afraid of allowing children to make mistakes with money. It is much better that they make a mistake with $50 as a teenager and hopefully learn from it than being insulated from failure.

>> **Don't Underestimate Their Ability** – Using creative analogies can be challenging, but rewarding. My boys earned $10 cutting a neighbor's lawn. When they came home with money in hand, I used the occasion to explain about how earnings get reduced by taxes. Watching me take $1 from their hand made quite an impression!

>> **Make Learning Fun!** – There are books on money for kids of all ages. Think about giving such a book for a birthday gift.

>> **Try A Parent Match** – The concept of delayed gratification is one with which we all need help. Encourage saving for big ticket items by offering to match what children save towards a desired purchase.

>> **Discuss What Things Cost** – For our two oldest boys I've reviewed their 529 plan statements with them from time to time and told them how much a year of college costs. The older they get, the more appreciation they'll have for this cost; and they'll have witnessed firsthand the benefits of long-term savings.

While a "rich" life is never measured in monetary terms, financial self-reliance is an important life skill that all parents and grandparents should encourage. It may prove to be a multi-generational legacy with unimagined benefits.