notes from the assabet

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Will Power, Won't Power

New Year's resolutions flow from many cultures across time and space. Traditionally, they have been aimed at closing the door on past sins or frailties in order to find release from poor health and oppression. Bonfires, exorcisms, parades and fireworks are among the many practices intended to usher in a new year of peace and prosperity. Around 4,000 years ago, Babylonians recognized the first day of a new year as a time to return borrowed items to neighbors, clearing the record of debts.

For 2010, many Americans will make resolutions for essentially the same purpose, understanding that clearing out bad practices will improve our fortunes in the coming year. For better or worse, we will tend to rely less on supernatural intervention and more on personal will power. (We leave it to each reader to decide which has the most promise.)

At Assabet Advisors, we figure that your weight, your addictions, your love life and your fitness regimen are your own business. However, we are interested in your financial practices and therefore offer these suggestions for New Year's resolutions.

1. **Create a personal estate inventory** thorough enough that it would enable a third party to easily measure your net worth and locate every account. Make it comprehensive, including retirement plans and insurance policies. List the names and contact information of professional advisors, as well as the location of your important papers. (Use the software at www.gggcpas.com.) Decide who will receive a copy, or at least be told how to access the inventory if it is needed.

2. **Get an understanding of your annual expenses**. Learn not only what it costs you to live, but what choices you are making without even recognizing them. There are two main benefits. First, planning for the future can't be done with any precision if you can't estimate your spending needs. To save for college costs, you need to know what will be left over from your income after expenses. To prepare for retirement, you need to know your future income needs which are best estimated using current spending.

Second, for most of us, being able to see how and where we spend is an eye-opener, prompting us to reduce outlays in one or two areas. It helps us to prioritize. I might determine, for example, that I want to spend less on my gardens to enjoy more travel.

If you use a credit card (paid off monthly, of course) for nearly all of your expenses, and categorize areas of expense using Quicken software, you can achieve a fairly clear awareness of your current spending patterns.

3. **Talk to your family about your financial situation**. Some people come from families in which financial discussions and sharing information about personal finances intergenerationally is quite normal. I come from old Yankees who are squeamish when sex or money are mentioned. Yet I've learned, and not from example, that I am my daughter's first economics and finance professor. It is my job to impart financial knowledge and values. As she was growing up, her father and I made her aware of our charitable giving and tithes and offerings. Now that she's out of college and "Will Power" cont'd p. 2

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"Will Power" (continued)

independent, I send her a copy of my personal estate inventory. This helps her to observe how I make financial decisions. Also, as my only beneficiary as well as my executor, she will have easy access to necessary information when I depart this earthly realm.

A guide published by Home Instead Senior Care ("The 40-70 Rule/The 70-40 Rule") offers tips on how senior parents can initiate conversations with their boomer children, and vice versa. The guide suggests that when the child turns 40, or the parent turns 70, it's time to start talking about money and a range of other topics. The survey on which this guide is based found that for 21% of adult children, broaching the topic of money with their parents was extremely challenging. Without those conversations, adult children can't know a parents' ability to pay for their own care, and they won't be able to factor the potential for inheritance, or the lack of it, into their own plans.

3. **Take care of financial "chores."** Review your insurance coverage. Your liabilities may have changed, requiring different types and levels of coverage. At the same time, rates may have dropped. Also review your estate documents: will, durable power of attorney, health care proxy, trust documents, etc. These need to be to updated periodically in order to comprehend changes in your personal situation as well as in the law.

4. **Examine your charitable giving.** Most of us have a sense of ourselves as adequately generous, but few of us know how much we actually give relative to our net worth or our income. Figure it out. Evaluate your giving level in the light of your values. Are you giving the right amount? Then look at your giving priorities. Do you really want to give three times as much to your college as you do to your favorite social service charity? Finally, consider opening a charitable giving account. This enables you to reduce long-term capital gains by easily making contributions with low cost basis stocks, to manage the timing of your charitable giving, to simplify your charitable record-keeping, and to better manage the timing of your tax deductions.

Peter Drucker reminds us to be SMART about our goals, making them Specific, Measurable, Achievable, Realistic and Timely. Some of the resolutions outlined above can be broken down into smaller parts, making them specific and achievable, or assigned a deadline, making them measurable and timely.

It's still not our business, but losing weight and quitting smoking are good ideas too.

Peter Drucker, The Practice of Management, 1954

Year-End Economic and Financial Review

Opinions about the state of the economy and the forecast for 2010 are all over the place. To the degree that there is a consensus, it is one of cautious optimism, a sense that a mild recovery is underway but menaced by potential roadblocks. In the U.S., consumer spending has begun to grow, despite the new ethic of frugality. A number of leading employment indicators have signaled improvement yet unemployment remains high. U.S. exports are up on higher demand from recovering overseas economies. Manufacturing activity and productivity both have been rising. In this context, the U.S. stock market (S&P 500 Index) grew by 23.5% in 2009, in spite of a more than 18% decline by early March.

Large cap foreign stocks performed in line with US domestic large caps in 2009, while emerging markets soared. The MSCI Emerging Markets Index was up more than 73%. Corporate bonds outperformed Treasuries. The ML High Yield Master grew 57.5 % as investors reached for yield not available in other market sectors.

Many analysts fear that the improvements can't be sustained. To a large degree, economic recovery has depended upon the federal government through massive fiscal stimulation, targeted tax breaks and an historically accommodative monetary policy. Through the summer, home sales were buoyed by first-time homebuyer tax breaks and low interest rates, causing a rise in home prices. By year-end, those had faded and experts warn of another flood of foreclosures in 2010. The Federal Reserve Board must maintain a balance, keeping economic growth on track without raising inflationary expectations. World economies face similar challenges as they try to smooth the way to a sustainable recovery. And then there are the potential trainwrecks from financial or political crises. We are in economic recovery and have enjoyed solid investment gains, but the road ahead is very uncertain.

What Money Can Buy

At year-end, our financial choices and values become more pronounced. It's a time when we search for the perfect gift for each person, sometimes aghast at what we're spending. It's a time when the virtues of peace and love are promoted, turning our attention to others, particularly those in need. And it's the end of the tax year and therefore a time to complete our charitable deductions for the year. Along with the catalogues from LL Bean and the holiday cards, our mailboxes are full of appeals for worthy causes from charitable organizations. Some of the larger organizations have designed their appeal to resemble retail catalogues, suggesting holiday "gifts" at different price levels. The coincidence of all of these factors causes us to reflect on our spending decisions at year-end more than at any other time of year.

It's a struggle that we, as affluent citizens of the world, share. Most of us are not weighing the gift purchase of Neiman Marcus' "Fantasy Gift" the $25,000 Customized Cupcake Car (with matching hat) versus building 8 houses in Rwanda for impoverished single mothers and their children. Few of us are not deciding between a Tiffany's $10,000 Atlas Cocktail Watch and two Heifer International "Gift Arks" to "save the world 2-by-2" each with 15 pairs of animals. But we are making implicit tradeoffs at other levels: $300 can buy a Brookstone Upright Gaming Exercise Bike OR a gift of corn and bean seeds for 15 Cambodian farmers. $100 can buy a Red Sox resin table lamp OR the planting of 8 trees in Israel.

For $50 we can give someone a personalized Gunslinger Barbeque Belt OR we can provide a year of school fees and supplies for 3 African children.

It's hard to decide between buying gifts for friends and relatives who have no real needs, and providing life-giving support to those whose lives are defined by critical need. Like many others, I negotiate with the requirements of our culture, buying the unnecessary gifts, while also giving to charity. For the amount that I spend on the gifts, I pretend that I haven't made a choice. But I have.

The tension that is heightened at year-end fades as the new year progresses. As much as I give away, I still buy unnecessary items for my house and yard with money that could be helping young girls escape from sexual slavery. I make tradeoffs that I can't fully rationalize.

Pricing the Pooch

In a recent conversation with a client about household expenses and budgeting, the question of buying a dog arose. As her investment advisor, we sought to advise our client on the financial impact of having a pet. Our research was not entirely academic. Between the Ushman and Phelps households respectively, we have Ted Williams David Ortiz, a sweet 3 year-old Goldendoodle, and Jester, a 5 year-old tabby cat and Glory, a 3 year-old tortoiseshell rescued from the street. Given our experience of financially supporting these 3 beloved creatures, we were not surprised by the ASPCA summary of pet care costs. Here they are, first for a large dog, then for a single cat:

Initial Capital outlay (not including the cost of the pet) Spay or neuter: $220/$145, other initial medical: $70/$130, Collar & leash: $35/$10, Litter box (cat): $25, Crate/carrier: $125/$40, scratching post (cat): $15, training (dog): $110. (Cats don't need training. They are perfect.)

Recurring annual costs: Food: $235/$115. medical (exam, vaccinations, and preventative treatments only): $260/$160, Toys & treats: $75/$25, Litter (cat):$165, License (dog): $15, Health insurance: $225/$175, grooming if required (dog):$408. The ASPCA doesn't mention boarding costs but the Ushmans pay $35 a night to give Ted safety, comfort and a lot of TLC.

We are barely rational about our own pets so we don't reduce our client's dog decision to weighing the costs. In dealing with our clients, we understand that decisions cannot be "all about money." Wealth is so much more than financial assets. The most important goals for our lives cannot be expressed in dollars and cents. Helping our client find the balance between financial feasibility and securing the deeper rewards of life (including the love, companionship and entertainment of pet stewardship) has to be our objective.

http://www.aspca.org/pet-care/

The Road Not Taken

Experts in investor behavior know that investors have a far more difficult time selling a losing investment than selling a winner. They explain that the regret over the results of having done something is more acute than the regret from the results of inaction. For example, the investor who sells out of a losing stock in April, only to see the price double between May and December, experiences greater regret than the investor who considered buying the same stock in April but ultimately passed on the opportunity. The financial outcome is the same. The emotional impact is different.

Investors usually don't have much trouble selling out of a stock that has gained in value. It can go into their annals of "wise investment decisions." On the other hand, they are apt to hold a losing stock too long. They wait for it to gain in value in order to avoid acknowledging to their spouse, their accountant, or themselves that they made an error in judgment. As the security price continues to decline, the fear of regret intensifies, making a sale even harder to contemplate.

Some investors who decide against making a certain investment (inaction) will follow the security, tracking its price. Often you'll hear someone tell you that he "*should have* bought XYZ company when it was at $4.30." He may be kicking himself, but his regret is not likely as intense as the regret for having made a purchase that lost value.

It seems to be human nature to place greater importance on action than on inaction, even though both are a choice. Action is more visible, the results easier to measure. How does this tendency play out in other areas of life? The relative regret of buying something only to see it advertised for less a week later, versus missing a super sale...having taken "the wrong" job versus the opportunity you turned down? Hopefully you don't have greater regret over the girl you married versus the one you let get away.

For investors, the lesson is to equalize the regret from action and inaction. Try to reduce the regret you may feel at selling a loser. Don't lose more by waiting for a recovery that may never happen. Try to give more weight to the potential regret for the road not taken: for not selecting an investment advisor, for delaying contributions to a 401(k), for ignoring the need to rebalance an asset allocation that is seriously off target, for postponing the purchase of insurance.

Jim Licato, "Regret and Risk," Morningstar Advisor, Oct/Nov, 2009, www.investorhome.com/psychology and behavioral finance

Your Home — No Longer a Castle?

Many builders are responding to the preference of post-crash buyers of new homes for smaller and simpler houses. In order to attract buyers, they are amending their models, not only reducing overall size, but cutting expensive luxury features as well. Gone are the guest suite, private theaters or exercise rooms, large butler's pantries, separate formal living rooms and massive foyers. Some new designs also omit fireplaces, replacing them with a "media wall" (wall space to hang a TV).

To a large extent, the shift reflects a reaction to job insecurity and limited credit. However, John Wieland, a Southern builder of exclusive subdivisions, believes it reflects a fundamental change in how people want to live, and that the preference won't revert back to the McMansion era. Especially with the demographic bulge of "Boomers" entering retirement, a greater percentage of the population will be seeking smaller living spaces, not expanding.

There is one new feature to the newer homes: a home office, permitting the occupant to telecommute or self-employ.

Amy Pyle, The Home of the Future," www.wallettop.com, 12/5/09, Michael Phillips, "Builders Downsize the Dream Home," Wall Street Journal, 11/13/09