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It's a Family Act

If “all the world's a stage,” and we each have our exits and entrances as Shakespeare proposed in *As You Like It*, then family-based investing might be compared to a three-part production.

- ▲ Act One, we are young investors, with much to learn, but time is on our side. Our definition of financial “success” is usually vague.
- ▲ Act Two, the spotlight shifts to a mid-life role. We're typically at the peak of our earning power even as our investment horizon shortens. We have thought about what it will take to achieve financial independence and sought advice to pursue our goals.
- ▲ Act Three, enter retirement; our objectives shift. We've achieved financial independence; we now require specialized expertise on how to move from accumulation to withdrawal and wealth transfer.

Of course transition from one act to the next is rarely so consistent or obvious. But, it can be helpful to consider some of the distinct challenges and opportunities we typically encounter along the way.

Recognizing these types of milestones is helpful in pursuing your own investment objectives. It becomes even more important if you also seek to build a multigenerational wealth strategy to span your immediate or extended family's long-term goals.

What are some of the characteristics for each generation of investor? How do they impact individual investment decisions? How can family discussions and planning maximize efficient wealth accumulation, enhancement and transfer among and across generations?

In this issue of *The Educated Investor*, we address these questions as we focus on investing across generations.

Act One — The Young Investor



Setting the stage

The biggest advantage of youthful saving and investing is being able to maximize the “snowball” effect of compounding during your long investment horizon — the ability to earn on your reinvested earnings.

For example, consider two investors. When “Sally” is 25 years old, she begins saving \$5,000 annually for 10 years. By 34, she has set aside \$50,000. “Sam” waits until he's 35 to begin saving. He then saves \$5,000 annually for 30 years, or \$150,000. Yet when they each reach 65, if we assume that they've both been earning a hypothetical 7 percent annualized return on their savings (including compounding), Sally's portfolio is worth \$563,000 versus \$505,000 for Sam's. Because Sally let compounding begin its work early on, she generated a larger portfolio in the end.

Facing adversity

Saving when you are young can be difficult. Earned income is often minimal. Paying off college debt, purchasing a first home, starting a family — these and other more immediate goals make it difficult to set aside funds reserved for future wealth.

Act One (continued)

In addition, a clear understanding of how to build wealth may not yet have formed. For example, only eight states currently require their high schools to offer financial literacy courses. Education at home can be equally lacking. A University of Michigan survey found that money was the second biggest topic for teenage/parent disagreements. There also has been considerable misinformation in the popular press. The latest flashy trend or hot stock tip seems to receive far more attention than less “newsworthy” discussions related to building and maintaining robust portfolios using time-tested, academically based tenets of Modern Portfolio Theory.

Wealth strategies

- ▲ **Become better educated.** Consider some of the resources below. If possible, seek the advice of a fee-only registered investment advisor who espouses construction of low-cost, passively managed portfolios according to a disciplined investment strategy.
- ▲ **Develop a plan.** Determine how much you expect to save each month. By saving first and then spending what’s left, you’re less likely to miss what you’re setting aside. As part of your spending budget, include a cushion for emergencies, so your savings aren’t depleted by the inevitable unforeseen circumstances.
- ▲ **Start saving.** Find even small expenses you can eliminate. If you receive “found money” (tax returns, gifts, bonuses) save at least a portion. Familiarize yourself with your company’s retirement plan and take maximum advantage of it. As described above, the rewards of starting young, even with modest amounts, are not to be underestimated!
- ▲ **Move from saving to diversified, low-cost investing.** Investments are expected to earn more than savings and more than inflation, but you also risk losing some or all of your money. Diversification is a key ingredient to help minimize (not eliminate) the risk involved. Keeping costs low also helps maximize expected returns.
- ▲ **Plan as a family.** Participate in family meetings to discuss generational wealth strategies (as described further in acts two and three).

Additional resources

- ▲ Charles Schwab Foundation Money Matters: www.schwab.com/public/schwab/nn/m/finlit.html
- ▲ AICPA, 360 Degrees of Financial Literacy: www.360financialliteracy.org/
- ▲ *Worth*, “Teach Your Children Well,” an interview with Jamie Johnson, 24-year-old heir to the Johnson & Johnson fortune: www.worth.com (search for Jamie Johnson).

Act Two — The Mid-Life Investor



Setting the stage

Particularly if you (and/or your spouse or partner) have managed to invest during your early years, act two of your investment performance should give your family portfolio a chance to shine. Your investment horizon remains relatively long. Your capacity for earned income grows. Wealth from parents, grandparents or other family members may be transitioning to you for stewardship. You may have increased opportunities to invest in company retirement plans as well as increased access to investment or wealth advisors. By now, you’ve probably selected your personal measurement of financial independence: what your portfolio size needs to be for you to feel like you could stop working whenever you wish, and still achieve your and your family’s objectives.

Facing adversity

Time. That pretty much sums it up. As the sandwich generation, you may find your time and energy divided among at least children and parents, if not an extended family, one or more careers, and philanthropic or community responsibilities. If you are accustomed to your spouse managing the family wealth while you focus on other priorities, you may be unsure how to proceed if you are required to assume the role.

Wealth strategies

- ▲ **Continue or start an investment plan.** If you already have a written investment policy, you’re one step ahead. But do revisit it periodically to ensure it still reflects your long-term goals and appropriate risk tolerances (your ability, need and willingness to take on investment risk in exchange for commensurate expected rewards).
- ▲ **Continue or start to invest.** Again, you’ll be better off if you’ve been saving and investing all along, but if

you've not yet been able to, the sooner the better. If possible, work with an investment advisor as described above. He or she also can ensure that your assets are allocated to ensure proper diversification and located for maximum tax efficiency.

- ▲ **Continue your education.** Even if you have been playing a secondary role in your family's wealth management, don't assume that can't change. Learn at least the initial steps you would take to assume the lead, such as how to contact your family's trusted advisor(s), and the location of your assets and key planning documents.
- ▲ **Initiate estate planning.** If you wish to transition your wealth to future generations and/or leave a charitable legacy, tools such as trusts, wills, living wills and durable powers of attorney should be prepared to reflect your goals.
- ▲ **Initiate risk management planning.** Risk management tools can bridge the gap between your current wealth and how much you would need if unforeseen circumstances prevented you from achieving your goals. Whether your needs are modest or extensive, a qualified wealth strategist can help you analyze that gap, and implement the right tools for the job.
- ▲ **Initiate vital dialogue.** The Rockefellers do it. So do the Hearsts and the *New York Times*' Sulzberger family. Regular, carefully planned family meetings can move your wealth strategies beyond your immediate investment horizon and into the higher level of tax- and investment efficiency made possible with multigenerational planning. We leave you with resources below for learning more about how to maximize the effectiveness of family dialogue.

Additional resources

- ▲ *Family Wealth*, James E. Hughes Jr. Copyright 2004, Bloomberg Press.
- ▲ *Preparing Heirs*, Roy O. Williams and Vic Preisser. Copyright 2003, Robert D. Reed Publishers.
- ▲ *The Only Guide to a Winning Investment Strategy You'll Ever Need*, Larry E. Swedroe. Copyright 2005, St. Martin's Press.
- ▲ TIAA-CREF, "Charting Your Course: A Financial Guide for Women," www.tiaa-cref.org/pubs/pdf/take_charge.pdf.

Act Three — The Retiring Investor



Setting the stage

You have now reached your personal goals for financial independence and are ready to retire. That does not mean your journey is ended; it is merely shifting to exciting new directions where your opportunities, if anything, broaden. Even measured globally, we are all on average living healthier, longer, more affluent lives than previous generations. In *The Birth of Plenty*, William Bernstein describes how worldwide quality of life has improved during the past 50 years by almost any measure: life expectancy, GDP, literacy, infant mortality and educational levels.

Facing adversity

Of course all roads have their rough spots, and the road into retirement is no exception. Many traditional benefit systems (Social Security, Medicare and pension plans) are eroding, even as health care and long-term care demands and costs are on the rise. Broad economic trends aside, you also face entirely new challenges within your investment portfolio. You may be an expert by now at putting assets in. But are you prepared to begin taking them out?

Wealth strategies

- ▲ **Plan for your retirement.** As you approach retirement, consult with your advisor on how and when you hope to achieve your financial independence. You can use initial and ongoing Monte Carlo analysis to help you form and maintain realistic goals. As your goals shift, your portfolio allocation may also need to be reconsidered, potentially tilted toward protecting your assets rather than amassing more.
- ▲ **Plan for efficient wealth transfer.** If your wealth is divided among generations within your family, ensure that each portfolio is allocated properly for each generation's risk tolerances. If you transfer wealth from one generation to the next, ensure allocations shift accordingly and tax-deferred accounts are handled

properly. Similarly, to maximize the value and efficiency of your charitable gifts, the timing, amount and method of donation should be carefully planned.

- ▲ **Revisit risk management options.** Upon achieving financial independence, your risk management needs shift from filling the gap (now that you've already crossed it) to playing a key role in protecting against excessive withdrawal, estate tax management and related concerns.
- ▲ **Finalize and share your wealth transfer objectives.** It is conservatively estimated that \$41 trillion of wealth transfer is expected by 2052. It is important to prepare for it — and to share your preparations as appropriate. Openly discussed estate planning and risk management can make it easier for beneficiaries to form their own plans, help maximize tax efficiency during wealth transfer, and help protect hard-earned wealth while fostering your own worry-free retirement.
- ▲ **Share your history and your values along with your wealth.** Countless sources agree on this key ingredient shared by thriving families and organizations. As described by James E. Hughes Jr. in his book, *Family Wealth*, “Family stories are the glue that binds together individual family members. Every family I know that is successfully preserving its wealth sets aside time at its family gatherings for the sharing of its unique history. Both young and old tell the stories and in this way discover their common bonds and values.”



Additional resources

- ▲ *The Birth of Plenty*, William Bernstein. Copyright 2004, McGraw-Hill.
- ▲ *Worth*, “100 Year Plan Introduction: Making Meaning of Wealth Across Generations,” first of a multi-part series: www.worth.com (search for “100 Year Plan Introduction”).
- ▲ *The MetLife Market Survey of Nursing Home and Home Care Costs*, September 2006. Search for “What’s New?” in the MetLife Mature Market Institute® at www.metlife.com.

Our Basic Tenets

Our objective is to design portfolios using passive asset class funds that maximize investors’ returns within their tolerance for risk. Here is what sets us apart:

- Fee-only investment management
- A disciplined investment strategy
- Access to institutional no-load passive asset class funds
- Fixed income expertise
- An investment approach based on research by Nobel Prize-winning economists
- Continued access to academic research
- A tax-efficient focus, with valuable tax and estate-planning ideas
- Risk tolerance assessment
- Periodic portfolio rebalancing
- Regular communications and state-of-the-art reporting

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CYPRESS ASSET MANAGEMENT

1 N. Seventh St., Pekin, IL 61554

Phone: 309-347-2440

Fax: 309-347-7705

www.cypram.com