

Moving Into the Black

For one fictional partner, a budget fix can bring that Italian villa.



Wealth
Management
TruSts & Estates
A Practice Focus

BY DAWN J. BENNETT

Almost every day, another report proves that, for Americans, retirement is a back-burner issue. Interestingly, highly compensated American legal eagles are just about as guilty as the rest.

Most attorneys find the idea of retirement very appealing. What a relief to put aside the long workday, the billable hours, the time stolen from the family, and the red-eye flights from client offices!

But, like most of today's retirees, they will not be content to sit in rocking chairs on front porches. They will be active and want choices, and those choices—whether a villa in Italy, a ski-in/ski-out home in the Rockies, or a house at the beach—will cost money.

It would make sense for a goal-oriented attorney who has labored for years and finally achieved partner status to begin putting aside extra money for retirement. But surprisingly, most do not. As a matter of fact, I see many who decide to seek financial counsel only seven to 10 years before their target retirement date. In many cases, that is just too late.

How do such accomplished professionals lose their way?

In my 20-odd years as a financial adviser and wealth manager, I have identified five financial felonies that attorneys frequently commit:

(1) Maintaining a perceived image. Many attorneys feel compelled to live in a certain way to keep up appearances. But as Thomas Jefferson said, "Pride costs more than hunger, thirst, and cold."

(2) Failure to develop a financial plan for today *and* tomorrow.

(3) Failure to fund and maintain accounts required to achieve financial goals.

(4) Failure to diversify investment portfolios or to invest for the long term.

(5) Failure to fully participate at the maximum level in *all* retirement programs available through the law firm or the U.S. government (not just the 401(k) plan or an Individual Retirement Account).

A LITIGATOR'S IMAGE

For illustration purposes, consider the profile of a litigator

with a large law firm—a 45-year-old male who is divorced, remarried, and the father of two children. This is a composite of several situations that I have seen and worked with. I have found that it is very difficult for attorneys to bare their financial souls because of the professional persona that they feel they are expected to maintain. The persona and the reality are often very different.

This partner earns \$800,000 annually before taxes and \$464,000 annually after taxes. He is in a 42 percent tax bracket and has a monthly after-tax income of \$38,667. His wife is a professional who has elected to be a stay-at-home mom. She is an active volunteer for various charities and the children's school.

Does this attorney commit the first financial felony—maintaining a perceived image? He and his wife have two large monthly mortgage payments, children in private schools, country-club membership, a live-in nanny, weekly maid service, and monthly detailing of their two cars.

The market value of their home was in excess of \$1 million at one point, and the vacation home on Cape Cod was valued at approximately \$900,000. But the value of both properties has fallen over the past two years.

Still, every time the attorney and his wife think of their savings, they include this real estate (which they have not paid off). They are living with a false sense of wealth based on the one-time value of their real-estate holdings. This manifests itself in the couple's frequent references to what the homes were worth, with little recognition of the cyclical nature of the real-estate market and the risks of carrying two large mortgages. They are victims of self-delusion: On several levels, they are living in a precarious house of cards.

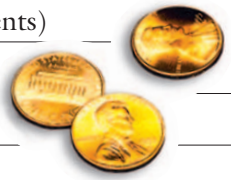
What about the second financial felony—the failure to develop a financial plan for today and tomorrow? A quick look at the couple's monthly budget indicates a pattern of overspending and an inability to differentiate between wants and needs.

For example, how does the monthly deficit of \$6,265 get handled? One approach would be to add on to the credit-card debt and make minimum payments until the year-end bonus arrives, with the thought that "I'm only 45 and can make up this chump change with my eyes closed."



A Partner's Monthly Budget

EXPENSE	BEFORE	AFTER
Mortgages (primary and vacation homes)	\$7,300	\$7,300
Household Help (gardener, maid, live-in nanny)	\$2,883	\$2,683
Utilities (gas, electric, water, phone)	\$575	\$575
Groceries	\$1,500	\$800
Eating Out/Entertaining	\$1,000	\$500
Clothing	\$2,000	\$1,000
Private School (two children)	\$4,333	\$4,333
Car Payments (loan and lease)	\$1,500	\$1,000
Car Maintenance (detailing, gas)	\$1,220	\$970
Insurance (life and health)	\$1,500	\$1,500
Investment (retirement, college, etc.)	\$3,574	\$3,574
Charitable Giving	\$2,667	\$2,667
Alimony	\$8,000	\$8,000
Credit-Card Debt (\$10,000 at 12.99 percent)	\$250	\$750
Relaxation (travel, country-club membership)	\$1,730	\$0
Luxury Goods (Chanel handbag, Mercedes loan payments)	\$4,900	\$0
Total Expenses	\$44,932	\$35,652
Savings on After-Tax Income of \$38,667	-\$6,265	\$3,015



Here's the reality: Making only the minimum payment on a \$10,000 debt means that the debt will take almost 19 years to erase and that the total interest paid, on top of the original debt, will be \$6,961! If the goal were to pay the debt off in two years, payments would need to increase to \$470 per month, and the total interest paid would be \$1,287.

What if the attorney looks at these choices and decides that he's had enough and wants to get rid of this credit-card debt in one year? What a difference: He pays \$750 monthly, and after one year and three months, the credit-card debt is gone—and the total interest is \$733.

TOMORROW'S NEEDS

Let's address the third felony—the failure to fund the accounts needed to achieve a retirement goal. Our litigator does

not want to wait until he's 65 or 70 to retire. He is getting burned out and may want to leave when he is 60. Can he do it—or is a lack of discipline going to force him to postpone his goal?

Numbers do not lie: The focus in this budget is spending for today with minimal thought toward tomorrow's needs.

Our litigator is also guilty of felony four—failure to sufficiently diversify his investment portfolio or invest for the long term.

Our couple likes to think of themselves as multimillionaires, primarily because of their real-estate holdings. But the bulk of their investment portfolio is tied up in two nonliquid properties. Granted, everyone needs a home, and building equity by owning is, in most cases, better than renting. But wealth is built by owning companies as well as real estate—and securities offer the benefit of greater liquidity. Our couple should consider investing in diverse securities—income-oriented and

growth—and taking advantage of the benefits of compounding over time.

In doing so, they would be wise to consider efficient-frontier theory, first advanced by Harry Markowitz in 1952. It explores the creation of an optimal portfolio based on a universe of investments and a balance of risk.

Our attorney could learn from this theory. He has made the mistake of trying to “make up for lost time” by relying on tips about hot investments from friends in particular industries, which has resulted in his taking an aggressive position in just a few asset classes, such as technology, energy and oil, and foreign currency. This is true for both his retirement accounts and for the joint investment account with his wife.

But by limiting himself only to a few highly aggressive and speculative asset classes, he has created a pressure-filled, short-term investment horizon. He should have harnessed the strategy and power of the efficient frontier, which would have given him approximately 10 asset classes instead of his speculative three. The efficient-frontier strategy has proved over and over again to be one of the best ways to achieve consistent growth over time.

Finally, let’s consider felony number five—failure to use every retirement savings opportunity. Our attorney should be taking full advantage of all that his firm offers—not just the 401(k) plan with the employer match, but its profit-sharing plan, the limited partnership arrangements that can provide a lump-sum payment for them at retirement, disability programs, and key man life insurance.

A MATTER OF CHOICE

No matter what kind of lifestyle you choose to live and, eventually, carry on into retirement, it is really just that—a matter of choice. But aspiring to an affluent lifestyle in retirement without preparing for it is not realistic. Nor is it fair to place the burden of your retirement on someone else, like your children or the U.S. government.

Fortunately, our fictional litigator had a reality check, and he changed some things in his life. Look at his before-and-after money-management decisions.

- The weekly maid service was trimmed to \$200 per month.
- The food budget was trimmed to \$1,300 (with \$800 for family groceries, \$300 for dining out, and \$200 for entertaining).
- The monthly clothing budget was trimmed to \$1,000.
- The couple leased less expensive cars that are still stylish, yet cost less. In addition, washing and detailing the cars was limited to every other month.
- The miscellaneous category took the biggest hit and forced our couple to temporarily delay the gratification of both a Chanel bag and the budget-buster Mercedes. They increased the monthly credit-card payment to \$750 to pay off the debt as quickly as possible. By taking this important step, they realized they were saving almost \$7,000 in interest charges alone over an 18-year period.
- Travel and the country-club membership took a six-month sabbatical. The couple will use this time and those resources to re-evaluate their spending patterns and perhaps reorder priorities.
- Instead of a monthly deficit of nearly \$6,300, they now have in excess of \$3,000 a month to invest—for their retirement, their children’s education, or some other goal.
- They also decided not to listen to those “hot investment tips” from their friends anymore.

Their old way of spending was digging them into a \$75,000 annual deficit. By making a few adjustments (while not radically changing their lifestyle), our litigator and his wife were able to maintain their comfort level and still have an additional \$36,000 for savings and investment. Now they are on their way to owning their villa in Italy!

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