CALLAN CAPITAL

THE IMPORTANCE OF A FINANCIAL PLAN

Goal Planning, Investment and Tax Planning and Insurance and Estate Planning

+ GOAL PLANNING

A customized, well- designed financial plan is discussed at the inception of relationships at Callan Capital and is critical to helping clients achieve their unique goals and objectives. A financial plan encompasses all areas important to an estate, including investment management, debt management, tax-minimization, trust and estate planning, risk mitigation, philanthropic planning, education and financial independence. The primary purpose of a financial plan is to bring confidence and peace of mind to clients as they make important wealth decisions.

The first step in financial planning is data gathering and goal planning. We ask a series of questions to determine client objectives in the areas of retirement, risk tolerance, liquidity needs, spending needs, time horizon, philanthropic goals, sources of income, family dynamics, family and charitable gifting and asset and entity information. With this information, we then gather relevant documentation such as asset statements, wills, trusts, tax returns, stock options/ RSU information, property and casualty and life insurance statements.

Retirement, or financial independence, is often the main objective of financial plans. Retirement typically means a client stops working and generating employment income and requires enough savings to live a specific lifestyle until life expectancy. Financial independence is the flexibility to retire without the desire to retire. In other words, many clients continue to work because they're capable and enjoy it well beyond the point where they are financially capable of retiring.

As part of the planning process, we run a Monte Carlo analysis which includes a thousand possibilities on asset returns and shows the client a probability of success, or certain outcomes by using a set of assumptions. We prefer this method over a Straight-Line calculation, since the Straight-Line calculation assumes the same rate of return each year, which does not account for uncertainty or volatility. The Monte Carlo method is often used in investment and retirement planning to project the likelihood of achieving one's retirement goals and whether or not a retiree will have enough income to live on for life, given a wide range of possible outcomes in the markets. The underlying assumptions for these calculations typically include life expectancy, interest rates, age, the amount of the investment portfolio that is withdrawn each year and the portfolio asset allocation. At Callan Capital, a successful outcome is 80% probability that the situation will occur.

Education planning has become an increasingly important part of a financial plan given recent tuition hikes and the rising cost of education. The 10-year historical inflation rate for education related costs is approximately 5%, while the 10-year average rate of inflation for non-education related expenses is much lower. It is important to start early, and save frequently, and grow your money tax-free using either a 529 plan or a Coverdell ESA. To learn more about education planning, please read our article here.

Once a financial plan is designed and implemented, it's important to monitor progress, review information and adjust the plan as necessary to take into account changing circumstances and objectives.

+ INVESTMENT & TAX PLANNING

Investment and tax planning – more specifically asset allocation and tax-efficient investing – are important parts of a well-designed, customized financial plan and integral to growing and maintaining wealth.

Asset allocation is an investment strategy that allots a portfolio's assets into different asset classes (stocks, bonds and cash equivalents) according to an individual's risk tolerance, financial goals and time horizon. The collection, or allocation of investments owned may be the most important determinant of return given the amount of risk taken. It's important to remember that there is no "correct" asset allocation for everyone, the best allocation for an individual depends on your comfort level and ability to meet your financial goals.

Since all investments have risk, the balance between risk and reward can be managed through portfolio holdings and diversification. Building a diversified portfolio includes looking for assets whose returns haven't historically moved in the same direction. Therefore, even if a portion of the portfolio is declining, a portion is hopefully growing. Broad diversification reduces a portfolio's risks while providing opportunity to benefit from the markets' best performers. At Callan, we've developed a process for investors to stay the course and remain disciplines through market volatility.

Tax efficient investing is an important driver of portfolio return as well as an integral part of financial planning. Under the umbrella of tax efficient investing, you can consider tax loss harvesting, asset location and use of exchange traded funds (ETFs).

Tax loss harvesting involves selling securities in the portfolio at a loss to offset gains and income. If you know specific realized gains incurred in a year, you can actively seek securities to sell at a loss to offset those realized gains. By reducing capital gains, taxes are lowered while maintaining an expected level of risk.

Asset location involves placing tax inefficient assets (like taxable bonds) in qualified retirement accounts (IRA, IRA Rollover, Roth IRA) and tax efficient assets (like stocks) in taxable investment accounts (like a joint or trust account). Tax inefficient assets like high-yield bonds generate income on an ongoing basis that is often taxed at a high income tax rate. Thus, it makes sense to put these types of assets in a qualified retirement account that is not subject to immediate taxes, so the tax liability is deferred (or negated in the case of a Roth IRA) for the investor. Tax efficient assets like equities produce a capital gain that is taxed at a lower rate (0-20% plus state taxes, if applicable, depending on income). Therefore, it is beneficial to place these types of investments in an account that is subject to taxes.

Both tax efficient and inefficient assets may be an important part of any well-diversified portfolio, but serve an investor best in a specific type of account within a portfolio. While tax implications shouldn't be the primary driver of investment decisions, being smart about locating different assets for tax purposes can provide a tailwind to long-term returns.

ETFs provide certain tax benefits over building a portfolio of single stocks or mutual funds. ETFs typically have lower capital gain distributions than a mutual fund and are often payable only upon sale of the ETF, while a mutual fund passes capital gains to investors through the life of the investment. Other non-tax related benefits to ETFs include trading flexibility, low trading costs and portfolio diversification.

+ INSURANCE & ESTATE PLANNING

Risk management and estate planning are important parts of every financial plan. There are many types of risk addressed in a well-drafted financial plan – risk caused by stock market declines, economic instability, death, disability and loss of income. These unforeseen events can have devastating financial implications to finances and alter the anticipated outcome of a financial plan. While risk is impossible to avoid, risks like death, disability and loss of income can be managed appropriately through insurance. Insurance should be used to transfer risk that has a low probability but with high financial consequence. In a well-crafted plan, all forms of insurance should be considered, reviewed and implemented where appropriate.

The premature death of a family member can have a major financial impact to survivors and loved ones. It is important to insure the economic void that would be created in the event of death through life insurance. Calculating the present value of future earnings that would otherwise be lost is a prudent first step. Term life insurance policies are the least expensive and typically cover the income earner over their years of employment and potential lost earnings. Similarly, disability can cause major financial hardship, yet disability insurance is often overlooked. If the primary income earner in a family is unable to complete their work duties, the financial loss can be devastating. Depending on an individual's age, the risk of disability is greater than the risk of death and can create the same financial loss to the family.

Long-term care insurance helps to pay for the cost of long-term care that is not covered by health insurance, Medicare or Medicaid. Individuals who need long-term care may not be able to dress, bathe, walk, or eat by themselves. The insurance covers facilities such as assisted living, home care, hospice, nursing homes, etc. Long-term care has become increasingly important as people live longer. However, we believe Long Term Care is often unnecessary and over sold. If someone has a net worth of over $2 – $3 million, they can typically self-insure for the most common long-term care needs. In addition, long-term care coverage can be quite pricey and is often not used at all so we suggest you speak to your advisor about whether to purchase coverage.

Along with risk management, estate planning is a critical piece to a comprehensive financial plan. It encompasses arranging for an individual's estate during life and after death. Estate planning involves having documents in place to ensure that one's wishes are met in the event of death or incapacity. In addition, a financial plan can help mitigate or eliminate the death tax associated with large estates.

The first step in a sound estate plan is establishing a revocable living trust. During the grantors life, a revocable trust is amendable and all the assets and income within the trust are available to the grantor. After the grantor dies, the trust becomes irrevocable and dictates how the assets are distributed to various beneficiaries and avoid expensive and lengthy probate proceedings. It also typically includes language for naming guardians of minor children, directives for end-of- life medical care, assigns power of attorney for financial decisions in the event of incapacity, and names representatives for health care in the event an individual is unable to make decisions. All the assets in a revocable trust are included in the grantors estate for estate tax purposes so there are no tax advantages. For high net-worth individuals, more sophisticated planning is often needed to avoid or reduce estate taxes.

Spreading gifts throughout one's lifetime is a great strategy to help reduce estate taxes. Currently, one can gift up to $14,000 per recipient per year and make direct payments to medical and educational providers on behalf of loved ones free of any estate or gift taxes. Each individual can transfer $5.49 million during life and/or at death. In other words, under current law you can give away up to $5.49 million during your lifetime, above the annual $14,000 exclusion and any payments made directly to medical and educational providers on someone else's behalf—and still avoid gift tax.

When large gifts are made, grantors will typically set up an irrevocable trust as the recipient of the gifts. Unlike outright gifts to beneficiaries, gifting to an irrevocable trust allows the grantor to set parameters on how and when the funds are accessed. It can also offer another layer of creditor protection for the beneficiaries if set up properly. When the beneficiaries are minor children, it's common to see provisions allowing the children access once they reach adulthood. It's also common to see these trusts being funded with permanent life insurance based on the grantor(s) life. The death benefit pays the trust tax free upon death of the grantor(s). This is referred to as an irrevocable life insurance trust.

Charitable giving is a good way to reap tax benefits, make a positive contribution to society and can be a useful strategy for high wage earners. Ideally, you'd want to gift in a year when you have substantial income at the highest taxable rate. An individual can gift either cash or securities (or other assets), though there are distinct benefits to gifting appreciated securities. If an individual has an appreciated stock position and is inclined to charitable gifting, it may make sense to gift all or a portion of the stock so that you can get a tax deduction and avoid paying capital gains tax. You would essentially get all of the asset's appreciation out of your estate and receive a deduction. It may be beneficial to use a Donor Advised Fund or a Charitable Remainder Trust (CRUT) as part of your gifting strategy. More information on both of those vehicles can be found here. Though it is important to manage risk and minimize taxes through prudent planning, it is never possible to avoid them altogether (only in some cases can estate taxes be completely avoided).

A customized, well-designed financial plan brings clarity and direction to financial choices clients make every day. Goal planning, investment and tax planning and insurance and estate planning are essential elements of a financial plan that together, create a client's holistic wealth picture. The peace of mind offered by a well-constructed financial plan is invaluable to help clients navigate periods of market volatility and stay on course to achieve financial goals.

1250 PROSPECT STREET, SUITE ONE LA JOLLA, CA 92037 (858) 551-3800 OR (866) 912-4888 FAX (858) 551-3801