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HOT M&A TARGET: SOLO ADVISERS P. 27

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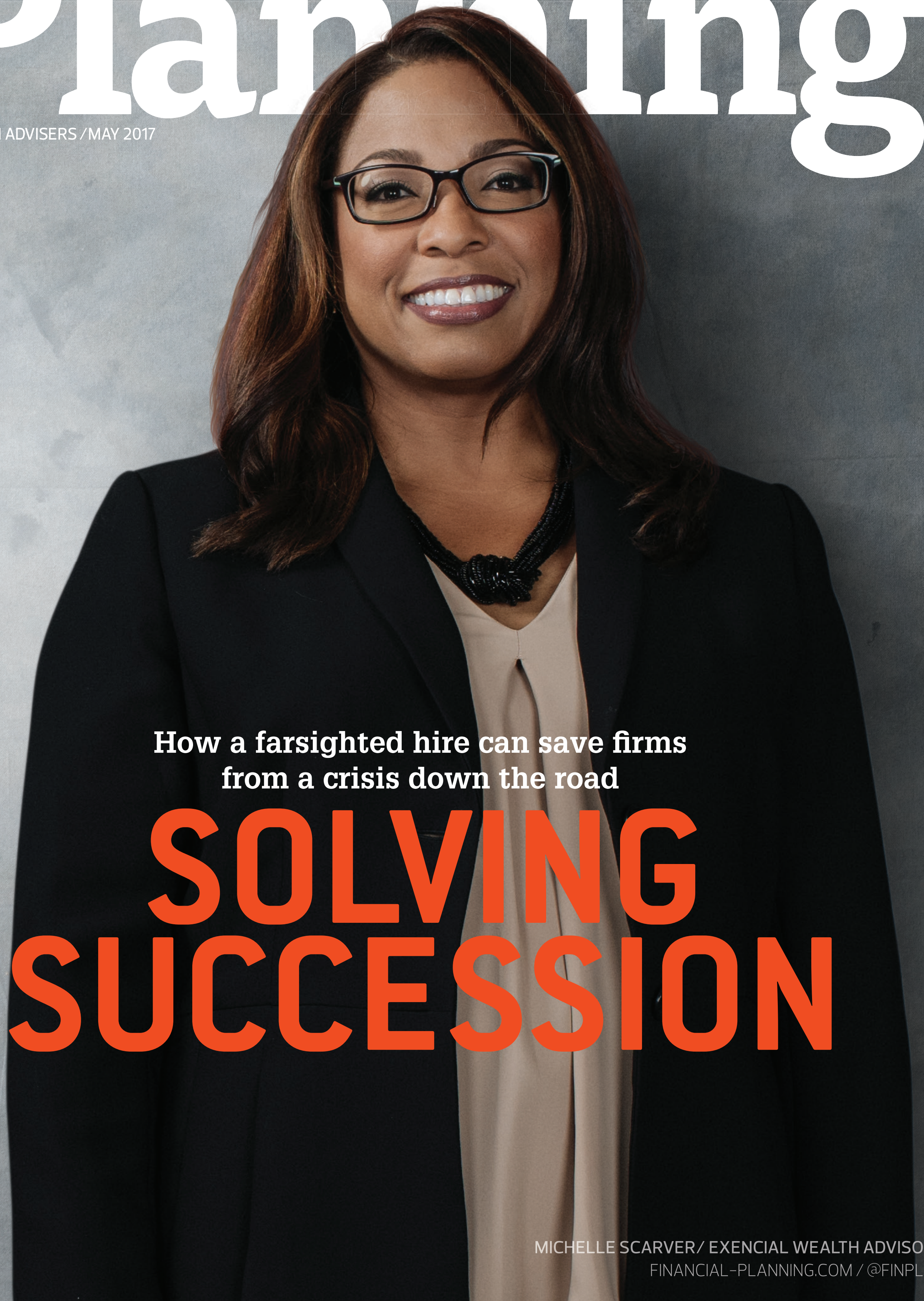

How a farsighted hire can save firms from a crisis down the road

SOLVING SUCCESSION

MICHELLE SCARVER/ EXCENCIAL WEALTH ADVISORS

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Michelle Scarver joined Netting & Pace in 1999. She is helping move the firm beyond the founders, Conrad Netting and Don Pace, and through its acquisition by Exencial Wealth Advisors.

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GIVING INSIGHT

Talking About Home Downsizing

Clients often have unrealistic expectations about downsizing their home and approach this big decision more emotionally than financially. These talking points can help advisers hold this challenging conversation. To watch the video, go to http://bit.ly/2nFqY4L

Sound Off: Protect and Serve

In response to an article on FINRA's new rules to protect seniors, adviser and *Financial Planning* contributor Carolyn McClanahan of Jacksonville, Florida-based firm Life Planning Partners tweeted:

"Important! Advisers need to learn about this."

What do you think? Type the link into your browser to join the conversation: http://bit.ly/2pOXCOo

EVENTS

MAY		JUNE	JULY
16-19 **NAPFA Spring Conference** Bellevue, Washington http://bit.ly/2pyXJNB	**21-23** **Fi360 Conference** Nashville, Tennessee http://bit.ly/2fNWJmK	**14-16** **Pershing Insite** San Diego http://bit.ly/1QeT1dr	**11-12** **In|Vest** New York http://bit.ly/1T97nON

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EDITOR'S VIEW

Not a 'Widgets Factory'

Succession planning is easy to talk about. It's much harder for planners to actually plan for.

A YEAR AGO THIS MONTH, ADVISOR GROUP ASKED THE PLANNERS affiliated with its network of independent broker-dealers if they had documented succession plans. The results from the 744 who responded weren't particularly unusual, but that's what made them disheartening. Almost 82% of the survey respondents said no, they hadn't created a plan. The reason? More than half said they "couldn't find the right person," according to the survey.

"Unlike a lot of businesses where you just sell to the highest bidder, these businesses are built on human relationships," Advisor Group CEO Jamie Price told me during a visit to *Financial Planning's* New York offices last month. "These advisers are really emotional about it. It's not like selling a widgets factory."

So the firm took matters into its own hands. It began pouring resources into a succession planning department. Last year alone, Price tells me, the department facilitated about 100 internal transition plans.

The advisers who received that help are the lucky ones. Countless firm founders are still paralyzed when it comes to appointing an heir apparent. They're even stuck on what kind of succession they'd like to see, whether it be an internal transition or a merger with another firm. The indecision has far reaching ramifications. Among them, clients may refrain from referrals if they don't have a clear sense of who will handle accounts when their adviser retires, *FP* Senior Editor Ann Marsh tells me.

Marsh, who wrote this month's feature, "Solving Succession," said she was surprised when a source told her that firm founders should already be thinking about their last day on their first day.

Sure, that's a tall order. Fortunately, no matter where advisers are in their career, it's never too late to start planning, Marsh says.

"Many firms put into place stopgap solutions with key man or other insurance policies," Marsh tells me. During her reporting, Marsh spoke with several firms that have been relying on these strategies until their internal succession plans are fully operational. "That can be the right way to go until you sort your strategy out," she says. Among other approaches, "hire a succession consultant or enroll in a custodian's transition program to put the mechanics of succession in place."

Whatever you do, she says, "get started." *—Chelsea Emery*

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BENCHMARK

DATA-BASED INSIGHT FROM *FINANCIAL PLANNING* AND SOURCEMEDIA RESEARCH

RETIREMENT ADVISER CONFIDENCE INDEX

Clients See a Risk of Correction

Investors' risk tolerance dropped sharply, even though planning firms were enjoying growth in retirement product sales, advisers said.

A MEASURE OF CLIENTS' RISK TOLERANCE DROPPED to its lowest point since November over concerns that stocks are overvalued and that the administration of President Trump may cause market turmoil, advisers said in this month's Retirement Adviser Confidence Index, *Financial Planning's* monthly barometer of business conditions for wealth managers.

"I believe Trump's uncertain governing style and the quick rise of the markets have made clients nervous," one adviser wrote.

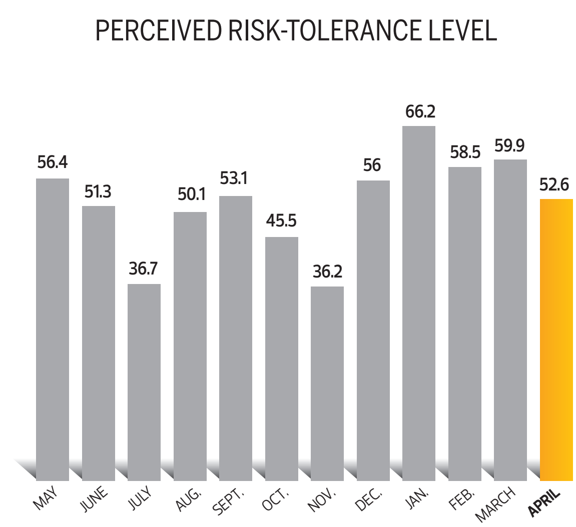
The overall index ticked down half a point to 54.8, and risk tolerance dropped 7.3 points to 52.6.

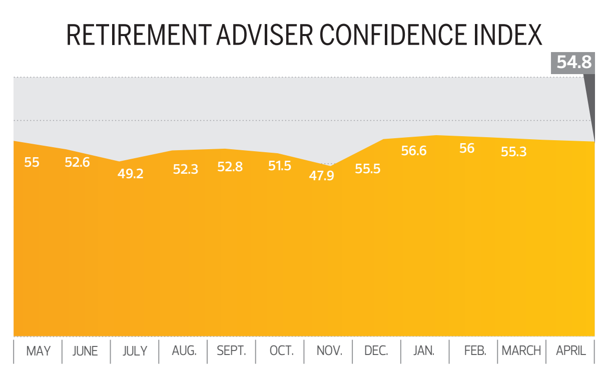
While the risk tolerance measure dropped as a whole, some planners reported that the bull market had prompted their clients to become more optimistic.

"We started a 100% equities portfolio as an option for our clients," one adviser said. "Since the markets have been doing so well, a lot of our clients had been asking for something even more aggressive than our 80/20 aggressive portfolio."

Over the month, advisers noted tax-season gains in sales of retirement products, new employer-sponsored plans and contributions into existing plans. There was growth in the fees advisers collected for retirement services, and increases across the board in the three other categories measuring monthly trends in retirement plan volume. Most advisers described the improvements as a Tax Day boost.

"It's tax season, so there are more people becoming interested in IRAs to lower their tax burden," according





The Retirement Adviser Confidence Index, published in partnership with ADP®, is created by the editors of Financial Planning *and is based on a monthly survey of about 300 advisers. Visit financial-planning.com for more results.*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to one adviser.

Another said: "Tax season usually brings on new retirement plans for small business owners and self-employed" clients.

The Retirement Adviser Confidence Index is composed of 10 factors — including asset allocations, investment product recommendations, economic and risk factors, taxes and planning fees — to track trends in wealth management. RACI readings below 50 indicate deteriorating business conditions, while readings over 50 indicate improvements.

This month's results also feature *Financial Planning's* Retirement Readiness Index, which asks advisers to track their clients' preparedness. The analysis tracks factors that include retirement status, income replacement ability, dependence on Social Security and vulnerability to big economic shifts.

Advisers are very confident in their clients' ability to retire: Based on 308 responses, the Retirement Readiness Assessment shows a confidence level of 95%.

That said, many advisers reported they were concerned about how long-term health care costs would affect their clients' retirement prospects down the road. More than 60% of high-net-worth clients would be vulnerable to a rise in health care costs, according to the survey.

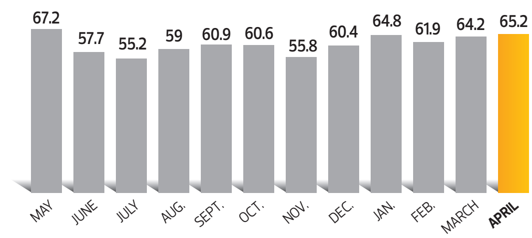
"I think the need for long-term care is a critical concern in order to protect estate values," one adviser said. Another wrote: "Health care costs are the biggest risk, and unknown. It's important currently to all clients."

On the heels of the equities market rally after the election of President Trump, advisers are concerned their clients' retirement would be affected by a significant decline. Over 70% of high-net-worth clients would be vulnerable if equities slumped.

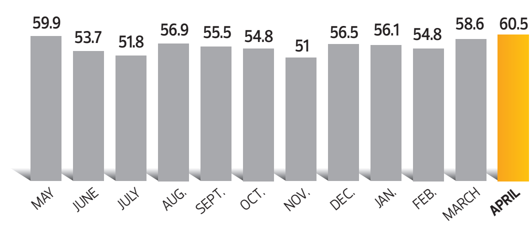
"We know market fluctuations will happen and, after some record highs, we need to maintain and balance the emotions of investors," one adviser wrote.

—*Tobias Salinger* **FP**

DOLLAR AMOUNT OF ALL CONTRIBUTIONS RECEIVED



TOTAL NUMBER OF RETIREMENT PRODUCTS SOLD TO CLIENTS



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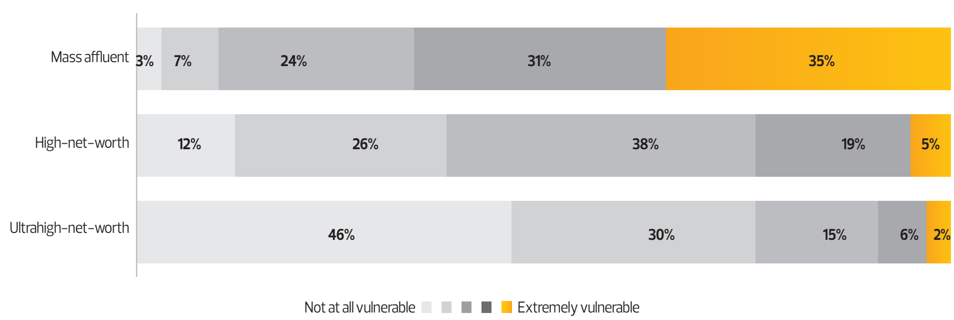
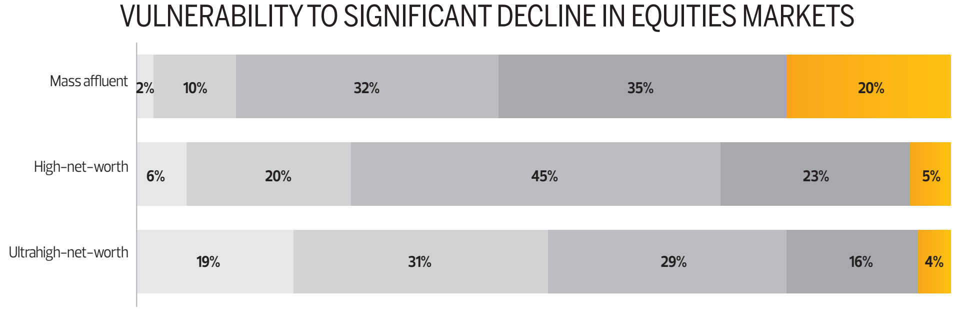
VULNERABILITY TO SIGNIFICANT INCREASE IN HEALTH CARE COSTS



VULNERABILITY TO SIGNIFICANT DECLINE IN EQUITIES MARKETS



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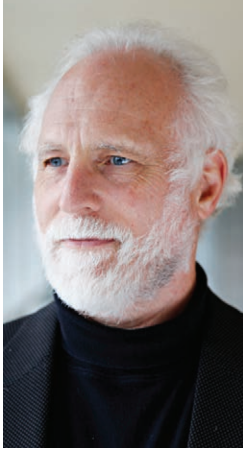

INDUSTRY INSIGHT
VERES

Finding the Next Wave of Clients

What trends are on the horizon for advisers seeking new clients? Targeted social media ads, freemiums and 'snackable' content, Bob Veres says.

THIS WAS BEFORE MY TIME, BUT they tell me that cold calling was once a very effective marketing strategy — until, of course, it wasn't. I personally remember when advisory firms routinely attracted dozens or even hundreds of prospects to cheesy prepackaged seminars until attendance gradually began to slip away.

Now I'm hearing that a recent innovation — appreciation events where clients are invited to bring along friends — is starting to lose its effectiveness, either because clients are no longer bringing their friends or because their guests are too far outside the advisory firm's target market.

Marketing trends come and go with the inevitability of sunrise and sunset. The question is: what's next on the horizon?

To find out, I talked with three marketing experts who work with planning firms: Kristen Luke of Kaleido in San Diego, Megan Carpenter of FiComm Partners in Los Angeles and Lauren Hong of Out & About Communications, also in San Diego.

Luke says marketing now is about reaching clients at a moment that they're experiencing a pain point — either money in motion like an inheritance or a settlement, or a life event like a career change, divorce or imminent retirement. "If you've identified what those pain points are," she says, you can "focus on really targeted campaigns using online channels."

Carpenter recommends that you start by defining your target audience, and then craft a message that talks directly to them.

You can research your niche on a website called Ask Your Target Market, which allows advisers to create a precise definition of the type of people they want to reach, and then pose questions that will be sent only to people who fit that description, such as: "What is your greatest financial challenge?" Or: "What service would you be most interested in getting from a financial planner?"

Marketing now is about reaching clients at a moment that they're experiencing a pain point.

FREEMIUMS

Armed with this information, you can create what Luke and others call a freemium: an e-book or video on, for example, the best ways clients can maximize charitable activities. Interested parties can download the freemium simply by giving their email address.

The conversations you have with new clients are one good source of content. Hong recommends you create a Q&A freemium that is regularly updated with answers to questions clients have posed to you recently.

To let prospective clients in your target niche know about the freemium, buy advertising on social media sites.

"The sites," Luke says, "let you pinpoint, for example, people who are charitably inclined, living within 25 miles of San Diego, with at least $1 million of investable assets over age 55, who have shown an interest in charitable endeavors." She estimates the cost per click to get someone to your site will

fall between $1 and $2.

That doesn't, of course, guarantee that the prospect will download your freemium. So instead of sending people to your home page, create a specific landing page for the freemium, Luke recommends. That landing page should have a catchy headline and bullet points that describe what prospects can expect to receive when they download the resource. Ask just for a name and email address, since the more data you demand before they get to the download, the less likely that people will fill it out.

The list of interested parties is what Carpenter calls the "mouth of the funnel." In the middle of the funnel, you want to gradually develop an online relationship with these people, so they trust you enough to call you. Since the prospect is likely to be experiencing a pain point when he or she downloaded the freemium, the first two months can be crucial; you want to send out additional materials on the subject. Carpenter recommends "snackable" content; short pieces that are easy to read, focusing on different angles of the same core problem.

In addition, Luke says, you want to have a call to action: "If you want more information or advice on this issue, please go to our website and schedule an appointment."

Whenever prospects click on an email with a link, you should ask them an additional question, like: "What is your biggest financial concern?" "Get them to interact a little bit on your website before they get to the content," Carpenter says, "so you can learn more about your prospective client."

She adds that the so-called smart web has opened up a lot of opportunities in the middle of the funnel.

"You can tell who is clicking on your emails, and what else they're looking at on your website," she says. "You can tell where they go when they leave. This prospect keeps clicking on the market commentaries. Another person bounces off the market-

The so-called smart web enables an adviser to learn a lot about a prospective client: who is clicking on your emails, what they look at on your site and where they go online when they leave.

ing commentaries and lingers on the retirement planning articles."

The next time they go back to the page, the website is going to recognize their IP address and send them into a preferred content funnel, so they keep finding subjects of interest.

Carpenter says her adviser clients have been surprised to discover that prospects and clients aren't as fascinated by their market commentaries as they had thought.

Hong says that even after they've downloaded the freemium and other content, prospects won't call until they've checked out your website with a critical eye. Carpenter estimates, based on a variety of studies, that you have anywhere from six to nine seconds to make an impression.

The solution? Hong recommends that instead of talking about your years in the business, find a way to communicate the benefits you provide to clients. If you do talk about yourself, share personal details. "One of the first places prospects will go is your bio, and I think you have to be vulnerable there," she says.

Carpenter says personalization is the new differentiator. A firm she works with creates personalized video performance statements. They start: "Bob, we're going to talk a little bit about how the markets performed in the last quarter, and what we're looking for ahead in the market. We want to start by talking specifically about how your portfolio has performed."

The interesting thing, Carpenter says, is that this firm didn't have to record a thousand videos to make this happen. "They were able to use technology to overlay each client's actual account balance onto the video," she explains, "so there was only one video, with different intros."

This is just a quick look at the new high-tech marketing reality. As always, the early adopters will reap the most benefits. Those who come late risk arriving just as targeted ads on social media, freemiums and snackable content have become as ineffective as cold calling is today. **FP**

Bob Veres, a *Financial Planning* columnist in San Diego, is publisher of Inside Information, an information service for financial advisers. Visit financial-planning.com to post comments on his columns or email them to bob@bobveres.com. Follow him on Twitter at @BobVeres.

NEW GENERATION
GRANT

A Pivot Toward Awareness

'The past couple of years have been the hardest of my life,' says Dave Grant, who changed his business model and personal practices.

FOR THE PAST TWO YEARS, I'VE BEEN devouring the print and video material of Gary Vaynerchuk. Vaynerchuk is a serial entrepreneur who emigrated from Belarus 35 years ago. After building his family wine business, he is now growing a social media marketing agency in Manhattan.

While he has lots of entrepreneurial messages, one has stuck with me as I have battled various business challenges: Being self-aware is the greatest trait you can master.

The past couple of years have been the hardest of my life. My three-year-old solo RIA almost ground to a halt through client attrition. I've questioned whether I can effectively run a business and if my emotions, finances and marriage can withstand the struggles of trying to build one.

I went through a period of intense anxiety, confusion and stress, which triggered physical symptoms that led me to seek medical advice. In times of crippling self-doubt, I even applied for jobs, hoping that a dependable income would be able to make my problems disappear.

In the end, by deliberately slowing myself at various points and taking time to reflect on what's been happening, I've become aware of some things which I hope will make the future look very different. With a complete rebranding, with lots of help from fellow advisers and a CPA, my business is starting to come back to life.

My main concern used to be running out of capital. With the small amount of excess income I earned through my RIA and freelance projects, I managed to build a small business emergency fund. I didn't foresee, however, how discouraging it would be when I had to take money out of this account during down periods.

It was worrisome on a balance sheet level, but demoralizing on a self-esteem level.

In realizing that I may run out of money, I sought out permanent job opportunities. One caught my eye in which I could work at home for much of the time but also travel to large companies to deliver financial workshops. The salary and benefits package were great and it seemed that, on paper, this would solve all of my problems.

But during the long interview process, I narrowly failed a verbal pop quiz relating to CFP material. I could apply again in three months, and the team members strongly encouraged me to set up a new interview date as they were excited to have me join.

FREEDOM TRUMPS MONEY

I got that news in the car after I dropped my son off at school. It was with a mixture of disappointment and relief that I read that email, and I took 15 minutes to try to understand why I was feeling such mixed emotions.

I hadn't realized that by interviewing for a job, I was pushing down an important, entrepreneurial part of myself. When that door closed, I felt the spirit inside of me kick

Trying to become more self-aware has caused me to look at parts of my life that made no sense and parts that I didn't like, both personally and professionally.

alive again. Being free is much more important to me than I had thought. Knowing that my business is 100% in my control makes me happy.

BUSINESS NEEDS, PERSONAL GOALS

I've always held $100,000 as a personal income goal. I know it's possible to earn that much running my own business, but I'm climbing from zero with no salary to act as a floor. Having that amount in my head and being so far away from it became overbearing. I decided to examine why that number seemed so important and soon realized it was based on conversations with peers.

So I reverse-engineered my income goal to match our personal family goals. In looking at how much we wanted to save for retirement, college and other expenses, I determined that earning $75,000 would enable us to achieve these comfortably.

If I'm able to generate this amount in gross personal income, I can either put more time into my practice, or stop growing and pursue personal goals. When I get to that point, it will be another reflective period as I seek to become more self-aware of what I want to do and what my family needs.

If someone had told me that running a business would have led to as many sleepless nights as raising a newborn, I wouldn't have believed them. Rather than question why I couldn't let things run off my back, I had to come to terms with knowing that this is how it is for me — my desire for a quiet, peaceful life will be tested when business gets tough.

One area in which I need to improve is knowing when to ask for help, whether it's from study group members, family members or mental health professionals. I hope I can more quickly recognize when things get hard and raise that white flag a little quicker next time.

For several years, I've been convinced the sole-ownership model is best for me, so I can reap 100% of the revenue.

Yet I came to the hard realization that my business wasn't growing at the speed I would like, and a partnership might be necessary.

Almost serendipitously, after my RIA rebranding in the summer of 2016, my accountant reached out to see if I would be interested in partnering. He had a small AUM-based RIA he wanted to transfer to someone else and also wanted to align himself with an adviser for his current tax practice and future marketing efforts.

After analyzing how this partnership would stay on point with my current level of self-awareness, we decided to move forward. I'm happy to share this portion of 100% with someone else.

HAPPINESS AS A CHOICE

I have a slightly pessimistic viewpoint on life, and I don't like it. Part of that relates to being British, where it is natural to be cynical and maintain a sarcastic sense of humor, but it also stems from what I watch and read.

I found if I stayed away from social media and from consuming the news, my mood lifted. I was less cynical, my conversations with people were more positive, and I started naturally looking for the positive side of things. I've now removed all social media and news bookmarks from my computer and phone.

I've also become a diligent subscriber to the "miracle morning" movement, based on the book and course designed by Hal Elrod, where the first 90 minutes of my day (starting at 5:30 a.m.) are spent in meditation, aspirations, journaling, reading daily devotionals and exercising.

When it comes time for my kids to wake up and our routine to begin, my mindset has been cemented for the day. I've found I'm a happier dad, a more attentive husband and a more-focused business owner and planner.

Trying to become more self-aware has caused me to look at parts of my life that made no sense and parts that I didn't like, both personally and professionally. In looking at these things, I hope I can grow and become a better man and business owner. I'd challenge you to examine yourself to see how you can improve. **FP**

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Dave Grant, a *Financial Planning* columnist, is founder of the planning firm Retirement Matters in Cary, Illinois. He is also the founder of NAPFA Genesis, a networking group for young fee-only planners. Follow him on Twitter at @davegrant82.

Setting the Scene for Success

To be persuasive, financial advisors need to understand the subtle ways in which they can shape a positive meeting environment and change a client's negative moods, counsels Tim Sanders. An author and expert on motivation, emotional talent and sales innovation, Tim is a Hartford Funds Human-Centric Insights panelist, and the author of the New York Times Best Seller Love Is the Killer App: How to Win Business and Influence Friends.

How can financial advisors set the scene to persuade their clients to take a course of action?

You have to prepare for the meeting, beyond what you're actually going to say. There's a body of research that suggests that the best salespeople in the world spend more time crafting the conditions of their meetings, and the key framing questions they will ask, than they do making their presentation's points.

If you think in advance about where the customer or prospect will be, how they might be feeling that day and what you can do to make them predisposed to change and acceptance of new ideas, that increases your performance dramatically.

Research says that when a person is in a negative mood, it has a huge impact on their brain's working memory. It's going to create enormous lapses in critical thinking. You will say things to them that they will either not understand or reject, even if it's good advice.

What factors does a financial advisor control that can lead to negative moods?

A bad mood can be created by how we hold meetings. If your client is going to drive across town in heavy traffic to meet with you, you have dramatically increased the odds that they will be in a negative mood when they reach you.

If you have a meeting the day after some dramatic event in the client's life, chances are they will have a negative mood hangover. For the same reason, I recommend rescheduling sales meetings that happen to be scheduled to take place after a national tragedy.

You can also influence their mood by where and when you have the meeting. Lots of financial advisors like to have meetings during a meal. No problem with that. But there's no value going to one of those loud restaurants where your entire conversation is punctuated by interruptions. It happens all the time; we want to take them where the best burger is. I'd rather take them to a place where there is an edible burger, but we're not going to be interrupted.

How can a financial advisor improve a client's mood while they are in the FA's office?

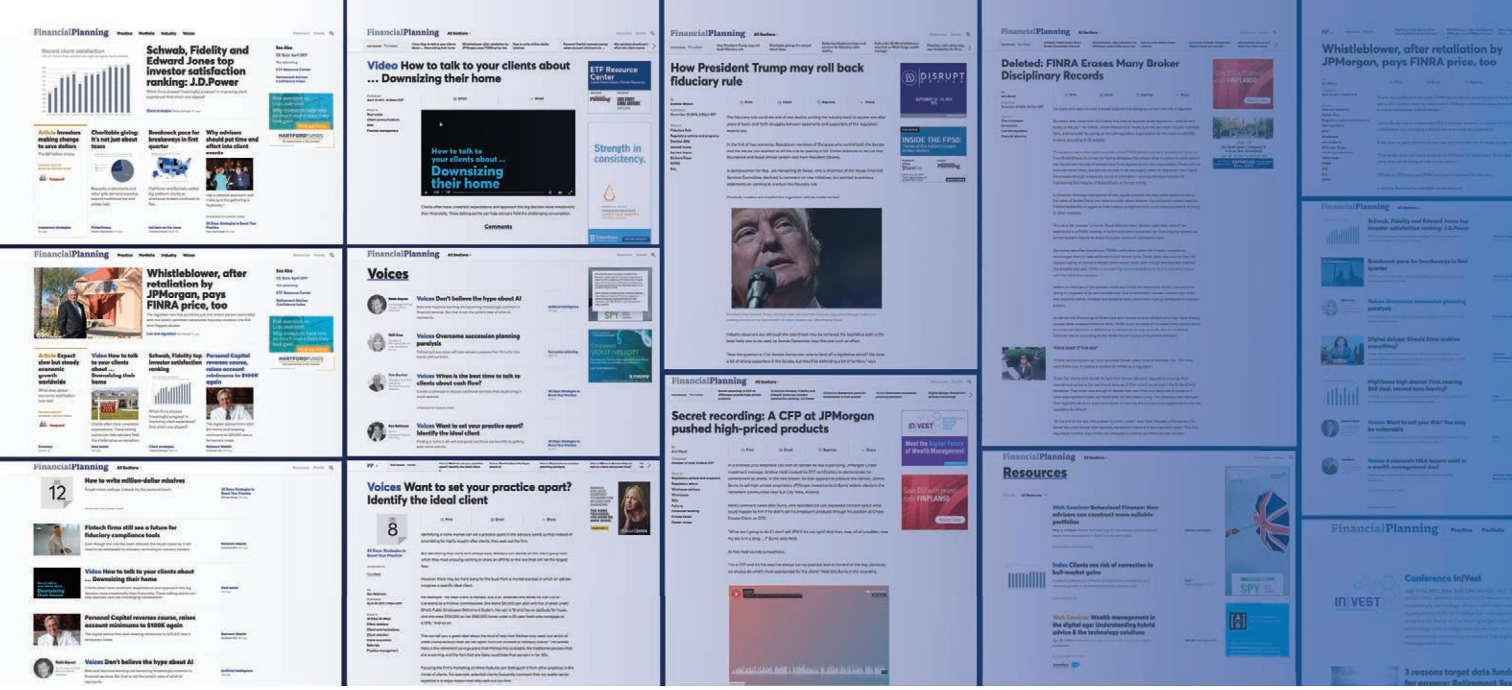
I love to have meetings where there is sunshine. Sunshine changes mood states. There is also another very good body of research that says when your office has fresh flowers, you've created a better environment for people to be predisposed to listen to you.

You want to sit across from your client with no obstructions in the way. When you sit behind that big desk, you're invoking the assistant vice principal meetings of our childhoods. In my office, I have a sitting area with two red leather chairs. Sit in those, and now we're having an Oprah moment rather than an assistant vice principal moment.

It's easy to ask someone, "So, how are things going?" That's an open-ended question that could lead to a negative conversation. I prefer to start conversations by asking clients, "What's your 'wow' project? What are you working on that you're excited about?" If you start off a discussion with someone's passion project, even if it's something very personal to them like a hobby, you're going to help improve their mood.

Steve Jobs was famous for taking long walks around the Apple campus with employees and business partners, and he did it for a very strategic reason. He put them in sunshine with zero interruptions. That's why he was the master of persuasion.

All investments are subject to risk, including the possible loss of principal.



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HUMAN CAPITAL

CRUZ

Succeeding in Succession

Is your firm paralyzed by the prospect of transitioning to a new generation of leaders? Kelli Cruz offers steps to help it prepare for a future without you.

Advisory firms must have the right people in place at the correct time so that the exit of an owner is efficient and effective.

I RECENTLY WORKED WITH AN adviser whose firm has been expanding its ownership for 10 years. He summed up the process that is underway: "Succession planning should be about doing what's best for the clients, the business and protecting all of your constituencies." In other words, succession planning is about taking care of your firm's future.

Succession is an integral part of a broader strategic planning process that seeks to address two important goals: how the business will grow and create value for clients, owners and employees, and how the business will transition a new generation while preserving its reputation and legacy.

Most successions are managed as a phased-out exit. In Phase 1, the owner backs away from the daily operations. In Phase 2, the owner delegates responsibilities for the firm and clients. In Phase 3, the owner sells the ownership stake.

Advisory firms must have the right people in place at the correct time to make the process efficient and effective.

The following framework and checklist can guide to your succession planning:

ASSESSING HUMAN CAPITAL

The critical starting point is assessing the state of your human capital and your policies for taking care of your future talent.

What is the average age of your employees? What percentage of your employee base is retiring within five years? What is your process for identifying employees with a high potential to take on leadership roles? How do you ensure that you are training the right individuals for leadership roles and measuring them accordingly?

The answers to these questions will help to assess the current state of your human capital and identify possible in-house succession candidates.

FINDING A SUITABLE PARTNER

To make succession planning effective when seeking an outside partner, firms need to focus on the core competencies of successful partners.

Because there is no substitute for observing and working with people over time to gauge their cultural and leadership qualifications, you should try to determine if a potential succession partner has the characteristics to be a future leader.

Next, you need to provide them with opportunities that will allow you to see how this potential succession partner will respond to different events and situations. Owners not only have to be able to grow revenue, bring in new clients and be outstanding advisers; they also must have the ability to lead and to manage.

The character and culture fit of a potential succession partner — his or her shared vision and leadership — is an important criterion. Current owners may have to work side by side with the new owners for years, perhaps even decades.

Here is a set of skills to look for in partner candidates:

- Leadership and management ability
- Cultural fit
- Shared firm core values and vision
- Tenure with firm
- Skill in developing and mentoring staff members
- Risk management aptitude.

FORESEEING THE FUTURE

Furthermore, I suggest developing a solid understanding of the most significant challenges your firm and the advisory industry will face in the next five to 10 years. This list includes such matters as fee pressures, competition from robo advisers, an aging client base and so on.

This list will help you identify the skills and experiences that future partners will need in order to lead the firm past these hurdles. Fight the tendency to think the answer is to find a younger version of yourself.

Leadership succession requires looking through the windshield rather than into the rear-view mirror.

Many owners see the value of a succession planning strategy, but simply don't know where to start. It's similar to a state of paralysis. Even those with a plan tend to delay moving forward.

Why are so many advisory firm owners basically doing nothing?

First, there is a "if it's not broke, why fix it" mentality. There's nothing pushing them to change.

Second, many firm owners nearing retirement don't know what they'll do with their time when they stop working. Giving up the corner office seems too final, and the fear of what comes next in life holds them back from moving forward with a plan.

Third is the issue of finding a suitable successor. In most cases the answer involves hiring more than one person to replace what originally took one person to build.

Fight the tendency to think the answer for solving future problems is to find a younger version of yourself.

Succession Planning Checklist

- ❑ Set a clear vision and strategy for your business by creating a formal 3 to 5 year business plan.
- ❑ Benchmark your business performance year over year.
- ❑ Regularly communicate the firm's vision and strategy.
- ❑ Standardize the client experience and systematize processes and workflows.
- ❑ Have a clearly defined process for firm governance and decision making by designing and executing the right organizational structure.

- ❑ Align your human capital practices with the business plan:
  - ✓Recruit proactively for key talent — not reactively
  - ✓Establish competitive compensation plans
  - ✓Provide regular employee performance feedback
  - ✓Focus on employee development and career paths by formalize training and educational programs

BE OPEN TO CHANGE

Be prepared to revisit and revise your plan along the way. Confidence in the sustainability of a succession plan drops after it is implemented, so don't be surprised if you have to re-examine your plan regularly.

One firm I spoke with said that it had implemented several transitions over several years. Only now are the firm's leaders beginning to feel that their plan is flexible enough to suit any situation they may face in the future. FP

Kelli Cruz is a *Financial Planning* columnist and the founder of Cruz Consulting Group in San Francisco. Follow her on Twitter at @KelliCruzSF.

Hot M&A Target: Solo Advisers

RIAs are eager to acquire assets and smaller firms are a prime focus, according to a new survey.

BY CHARLES PAIKERT

OFTEN OVERLOOKED, SOLO ADVISERS NOW APPEAR to be the belles of the M&A ball.

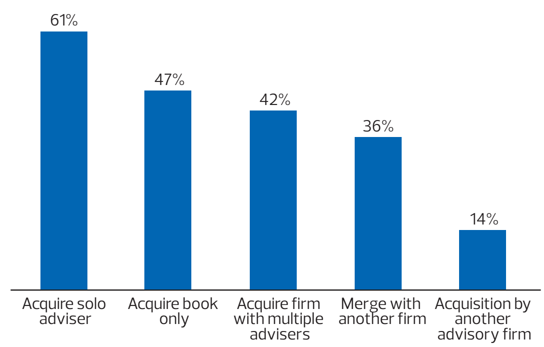
More than 60% of RIAs considering an M&A transaction in the next five years plan to acquire a solo shop, and 47% want to acquire a smaller firm's accounts by buying its book of business, according to an RIA survey by FA Insight, a division of TD Ameritrade Institutional. The aging adviser population is driving both supply and demand for their practices and clients, says Vanessa Oligino, TD Ameritrade's director of business performance solutions.

But solo advisers and small firms who haven't been able to keep up with the costs and demands of a fast-changing industry have also been a contributing factor to the demand, Oligino says.

"Practices that haven't been able to succeed are looking to partner with someone who can help them accelerate their growth," she says.

Solo advisers targeted for M&As

Deals for sole practitioner's firms are the most commonly cited type under consideration.



Source: TD Ameritrade Institutional

PATIENCE REQUIRED

But both buyers and sellers have to be patient, Oligino warns.

"I think people believe [a successful M&A transaction] happens a lot faster than it actually does," she explains. "People think it will happen in the next 12 months, but it could take from three to five years."

Buyers of solo practices or small firms are usually not large themselves, often having less than $500,000 in assets. As a result, these firms do not have access to the cash available to acquirers such as large RIAs or private equity firms. That's why deal terms are so important, Oligino notes, especially requirements that solo advisers and principals of small firms stay on for a certain period of time after they are acquired.

"How long a seller stays on to make the transition as seamless as possible is a very important consideration," Oligino says. "It can make all the difference between a good deal and a bad one."

The survey confirmed that the RIA M&A boom shows no signs of slowing. Three-quarters of the 234 firms surveyed by FA Insight said they expect to be in a transaction over the next five years, and interest in M&A transactions increased proportionally to a firm's size. Indeed, 100% of firms generating $4 million to $8 million in revenue annually said they expect to enter a transaction within the next five years.

Among advisers with $1.5 million to $4 million in revenue, 76% expect to be involved in a transaction over the next five years, up from 50% who said they completed a deal in the previous five years.

Oligino doesn't see headwinds that may slow down the frenetic pace of M&A deals. Even a market downturn may not be a deterrent, she speculates. "Sellers may not be as attractive because they'll have less assets," Oligino says, "but buyers may see [a downturn] as a good time to buy, because firms will be undervalued." FP

Charles Paikert is a senior editor of *Financial Planning*. Follow him on Twitter at @paikert.

Edelman Jumps into M&A

The personality-driven RIA, backed by private equity money, plans to 'move quickly' to make acquisitions in markets it already serves.

BY CHARLES PAIKERT

EDELMAN FINANCIAL SERVICES, ONE OF THE advisory industry's largest RIAs with over $17 billion in assets, is plunging into the crowded, competitive and capital-intensive M&A game.

"We've decided to engage in M&A activity," says Executive Chairman Ric Edelman. "We decided to do this for the first time ever."

Backed by majority shareholder Hellman & Friedman, the private equity firm that has long been a major LPL Financial shareholder, Edelman Financial hopes to establish a national brand and become "America's planning firm," says Edelman, whose syndicated radio show, seminars and books drive the RIA's brand.

The company's board of directors concluded it was impossible to accomplish that goal with inorganic growth, according to Edelman.

The RIA's CFO, Rene Chaze, will lead Edelman's M&A and strategic alliance efforts, which will include several new hires. "We need more players on the field," Chaze says. "We're ramping up our capability and are going to be moving quickly in the [acquisitions] space."

Executive Chairman Ric Edelman says his eponymous RIA needs inorganic growth to become a national brand.

STRATEGY: GO DEEP, NOT WIDE

While Edelman didn't say how many advisory firms his firm hopes to acquire this year, he did say the RIA is targeting an additional $2 billion in assets in 2017.

Edelman has currently 43 offices in 16 states, but the firm plans to grow by "going deeper" instead of wider, according to Edelman, and it intends to open more offices in existing markets instead of moving into new cities.

"We're going to add advisers in existing markets instead of building out," Edelman explains. "It's faster and cheaper and preserves a huge growth opportunity. We're having trouble keeping up with current demand in cities like New York and San Francisco."

To be sure, Edelman is entering an extremely aggressive and active M&A market.

Deep-pocketed investors and aggregators such as AMG Wealth Partners, Focus Financial Partners, United Capital and HighTower Advisors are already scouring the country for potential RIA sellers. Also in the hunt are a number of fast-growing RIAs including Savant, Mercer Advisors, Mariner Wealth Advisors, Wealth Enhancement Group, Aspiriant and Beacon Pointe.

SELLER INERTIA?

"Edelman's value proposition will resonate with a certain segment of the market," says David DeVoe, an M&A expert and managing partner of San Francisco-based consulting firm DeVoe & Co. "The established brand, scale and infrastructure will be attractive to firms seeking to compete more effectively in an increasingly competitive market."

But Edelman, like other potential buyers, also faces "a key challenge, the inertia of a potential seller," according to DeVoe. "These are business owners who generally enjoy what they are doing and are making a good living. There isn't pressure to do a transaction."

What's more, the intense — and plentiful — competition means "there are lots of flavors of ice cream, so it will be important to see some interesting differentiation for Edelman's acquisition model," says investment banker Liz Nesvold, managing partner of New York-based Silver Lane Advisors.

EASY TO 'LOSE DISCIPLINE'

Edelman also risks overpaying for deals, says Corey Kupfer, managing principal of Kupfer & Associates, a New York-based law firm with a specialty in RIA transactions.

The company may have an advantage over other buyers because it is well-capitalized by Hellman & Freidman and "can act quickly to take advantage of a good deal and offer more cash than some other buyers," Kupfer says.

But, he cautions: "In competitive M&A markets when PE firms are pushing for growth, it is easy for a firm like Edelman to lose deal discipline."

COMPATABILITY

Edelman says any RIA his eponymous firm buys has to be compatible with Edelman Financial's focus on financial education, which includes over 600 financial seminars in addition to Edelman's own radio show and numerous books, including his most recent, "The Truth About Your Future."

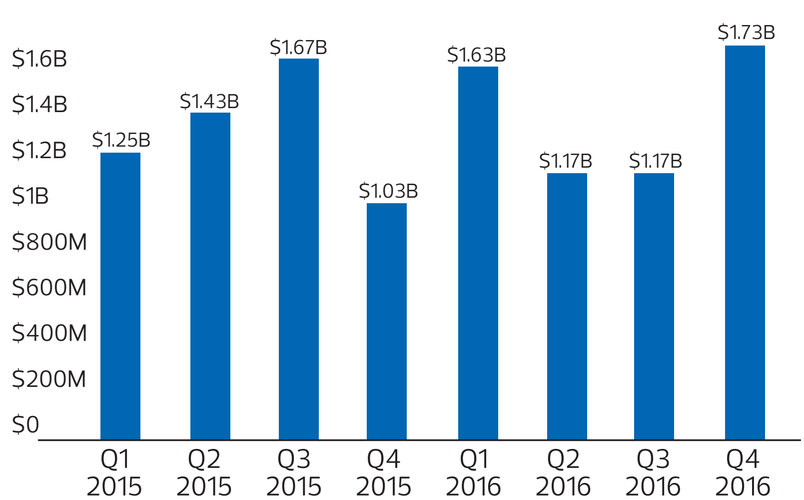
Edelman will look at market comparables such as AUM, multiple of earnings and multiple of discounted cash flow when valuing firms, Chaze says. A wide range of firms will be evaluated, he adds, from "incremental" purchases of RIA with as little as $100 million in AUM to "transformative" deals targeting firms with $5 billion or more in assets.

"That's where it gets really exciting," Chaze says. **FP**

"It will be important to see some interesting differentiation for Edelman's acquisition model," says Liz Nesvold of Silver Lane Advisors.

RIA M&A deal value jumps

Average transaction size hit a record high in the fourth quarter.



Source: Charles Schwab Advisor Services

Charles Paikert is a senior editor of *Financial Planning*. Follow him on Twitter at @paikert.

Giving: It's Not Just About Taxes

Bequests, endowments and other gifts demand expertise beyond traditional tax and estate help.

BY MARTIN M. SHENKMAN

CHARITABLE GIVING IS TOO OFTEN THOUGHT ABOUT as a matter of tax planning – identifying highly appreciated securities to donate and creating complex structures like charitable remainder trusts and charitable lead trusts.

But the estate tax has declined in relevance for most donors as the federal estate tax exemption has soared – it is $5.49 million per individual this year. Further, as a candidate, President Trump advocated repealing the tax entirely. What's more, only 18 states and the District of Columbia now have an estate tax, so even state estate tax savings are irrelevant for most donors.

The reality is that taxes have always been a secondary component of the charitable giving process and now may be less critical than ever before. As tax planning has become less relevant, personal goals and the role of the adviser have gained in importance. For decades, clients planning a major gift would often focus with their advisers on maximizing the tax benefits of the donation. By contrast, today's prospective donor may need to weigh the impact of a major gift on future financial security.

If a retired client has a 30-year planning horizon, how will a major gift or a long-term charitable commitment affect his ability to meet decades-long financial targets? The focus is changing as the worries of funding for long post-retirement years have overshadowed tax and estate planning.

COMPREHENSIVE FORECASTING

A result of this change in focus should be more comprehensive financial forecasting to guide a client on how to structure large donations. More complex gift structures may be in order. A client may be willing to commit certain dollars now and in the future, but she might wish to make other commitments contingent on her future financial condition. The giver may pay part of a charitable pledge currently and the balance upon some future event, all to permit the client to remain secure financially.

Here's an example: A donor wishes to commit $500,000 to a charity. This may consist of an outright gift of $100,000 now and the funding of a $400,000 charitable remainder trust. If the donor's financial status is secure in future years, she might donate some or all of the annuity payment she receives from the CRT to the charity. If in 10 years she is still meeting her financial targets, she could donate her remaining annuity interest in the CRT to the charity, thereby accelerating the entire gift.

Such discussions are more likely to involve the charitable gift officer and the adviser — rather than the client's estate attorney, as may have been more common in the past.

Here's another example: A donor would like to make a large visible commitment to a charity in which she is a board member. To address cash flow concerns, the donor funds part of the donation now and the balance with a life insurance policy. That way she feels more confident that if she dies prematurely her spouse will not be burdened by a large bequest. Further, since the bequest provides no estate tax benefit, she prefers the current income tax deduction for the amount she gives the charity each year to pay her premium.

Giving a remainder interest in a residence can permit a client to assure the intended charity will receive a valuable bequest even while she retains the economic benefit of continuing to live in that residence for life.

Sometimes, clients planning a large charitable gift will factor long-term care considerations into the plan. Long-term care insurance coverage may be purchased as part of the charitable planning to assure the donor a safety net.

THE DIVORCE FACTOR

Divorce has rarely been a part of the discussion about charitable giving, but perhaps it should be. Planners have long advised clients contemplating marriage to address prenuptial agreements.

As a general rule, it is useful to factor in the possibility of a divorce even if there is no immediate reason to suspect a marriage is on the rocks. The concept of dividing a CRT or splitting a private foundation could be drafted into the governing documents at inception. Donor agreements could address the financial and naming considerations of a divorce if it were to happen.

Baby boomers have changed many institutions in our society as they have moved up the age continuum. Charitable giving is no different. For many boomers, charity is not merely about writing a check, but also about making a difference and often about being actively involved in that process. There are many ways, depending on the client's interest and goals, to tailor a donation to meet a wide range of client personal objectives.

For baby boomers dabbling with an encore career in the charitable arena, the mechanism to meld these goals is a written agreement with the charity.

Specify how the donation will be used by the charity. Clarifying what a donor wants can be quite different than what the donor and charity were separately inferring from the conversations they had leading up to the agreement.

Consider adding milestones at which additional donations will be made. When the charity fulfills certain program goals, then the next payment will be triggered. What investment management or other fees might the charity charge the donor's fund? Will the charity allocate a portion of the initial gift or each year's withdrawals to general charitable administrative expenses?

What happens if the purpose of the gift is no longer relevant? For example, a client finances a significant planned gift to endow research for a disease and that disease is cured. Such contingencies should be addressed at the beginning.

A significant issue addressed in many donor agreements is the right and manner to name the gift. What prominence will be given to the donation? Where and how will it be acknowledged?

THE ADVISORY TEAM

As clients seeking estate and financial planning advice get older, there may be a greater need to involve a care manager on the planning team to outline future medical costs and to assure that the financial modeling supporting the gift is realistic.

Relying on a client's current budget or assumed cost of living is not realistic for a client who has a major health challenge like Parkinson's disease or another severe chronic disorder.

Given the greater emphasis on non-tax aspects of planning, the major giving officer from the charitable organizations the client is seeking to benefit will play a more prominent role in the planning team.

Clients may not be willing to pay high attorney billing rates for discussions exploring values or for holding of family meetings to discuss broad general considerations about formulating a charitable giving strategy. Some lawyers and CPAs are not comfortable with these discussions.

By contrast, the wealth manager may have staff members with life coaching experience, and the planned-giving professional may have spent much of her career facilitating these discussions. FP

Clarifying what a donor wants can be quite different than what the donor and charity were separately inferring from the conversations they had.

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Martin M. Shenkman, CPA, PFS, JD, is a *Financial Planning* contributing writer and an estate planner in Fort Lee, New Jersey. He is founder of Shenkman Law.

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SOLVING SUCCESSI

The time to handle your succession plan is now. For the nation's aging RIA founders, it's either bliss – or the abyss.

BY ANN MARSH

Often, the only way to get control is to give it up.

It's the kind of puzzle Buddhist monks contemplate when they consider the contradictions of life. It's also an uncomfortable truth for the first generation of independent planners, who are grappling with the prospect of their firms' futures without them.

Or failing to plan, as the highly ironic case may be.

"For a lot of advisers, their comfort zone is their client relationship. They want to keep control of clients," says Tim Chase, CEO of WMS Partners in Towson, Maryland, who is in the enviable position of having an internal succession plan in place at the firm he helped found. "As long as they do that, those [younger planners] below them can never rise up."

Nor can their firms.

But advisers who do plan ahead can create tremendous value in the form of equity, unlimited growth potential and a Zen-like peace of mind for all involved. The many beneficiaries include clients, ambitious younger partners and the founders themselves.

Chase, 53, has been working on a succession plan for the past 10 years, along with his co-founder Martin Eby, allowing time for a gradual but profound evolution.

Over the years, Chase and Eby have encouraged younger partners at WMS to buy into the 25-year-old firm that now has $3.4 billion in assets under management. Typically, they do so at a rate of about half a percent per year.

Annual income produced by the shares helps finance purchases: If, for

PHOTO BY JOSHUA ROBERTS

ON

Adviser Tim Chase is about to hand over the reins to his firm, WMS Partners. He says he couldn't be happier.

example, a partner put $20,000 down to buy a $100,000 stake, about $12,000 to $14,000 in annual income can pay it off in less than 10 years, Chase says.

The firm is growing so quickly – it has doubled in size over the past five years – that partners are eager to buy in, Chase says.

With 56 employees today, WMS is expected to grow to about 100 within the next five years, Chase says. Senior partners are somewhat reluctant sellers of appreciating shares, but over time they have come to realize that offloading equity is key to making internal transitions work, he adds.

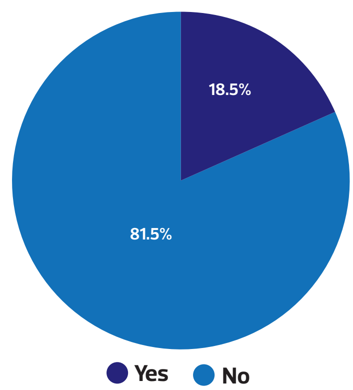
Another important element to WMS' plan is protective provisions, such as requiring any partner who tries to take a client and leave to buy that business from the firm. It also helps that Chase, Eby and another partner retain veto power over the younger generation through their majority stake in the firm.

As a result, even the prospect of relinquishing his CEO role to a younger partner in the next year doesn't worry Chase. He expects he'll become chairman and drive as hard as ever toward recruiting top-flight talent and building the firm's strategic direction, while not being distracted by daily operational issues.

"There are no issues at all," he says. "I know the decisions we make today as a 15-partner firm are infinitely better than when we were a two-partner firm. The difference between an empowered team and an individual is night and day."

In other words: surrender to win.

Do You Have a Written Succession Plan?



Source: Advisor Group survey of 744 advisers, conducted May 2016

Successful succession planning "has so much potential to unlock power within an organization," says David DeVoe, founder of DeVoe & Co., an investment bank and consulting firm that advises firms on continuity.

The issue is a pressing one: The average age of firms founders is 61, and many are still working well into their 70s, according to DeVoe & Co.

FORECAST: M&A WAVE AHEAD

In all, 60% of RIAs either have no succession plan or have one that isn't ready for implementation, Fidelity found in its most recent RIA benchmarking study.

And without a plan, firms lose the chance to unlock one of their most valuable opportunities: engaging in M&A. This is particularly true now, as the M&A pace has picked up.

There were 142 M&A transactions last year in the advisory space, compared with 59 in 2013, DeVoe & Co. found. And DeVoe forecasts an unprecedented increase in M&A in the RIA space over the next five to seven years.

The pressure to consolidate is relentless, driven in part by higher operating costs for regulatory compliance and technological evolution, both of which are pushing companies to band together for scale. Many in the industry expect the best of today's RIAs to grow into the super brands of tomorrow, positioned to rival or even displace the wirehouses and banks.

But only marketable firms – those with either fully viable enterprises or even just loyal books of business that will follow a founder's recommendation to an unrelated successor firm – can do a deal.

That's why DeVoe and other experts are urging founders to start thinking about succession at the very beginning of their careers.

As an example of how well early planning can work out, DeVoe needn't look further than one of his own partners, industry éminence grise Tim Kochis, who helped build one of the country's largest RIAs.

Kochis, who now works with DeVoe at his consulting practice, co-founded an RIA, Kochis Fitz, more than 25 years ago. Within a few years of the firm's launch, Kochis and his partner, Linda Fitz, had already transferred stakes to new partners.

"The earlier you start the equity transfer and get serious about what equity ownership means – how much governance, how much control is part of that ownership – it plows the path for management transition," Kochis says.

In 2008, Kochis Fitz merged with wealth management firm Quintile. This combination would go on to create one of the largest – and most

ONE REASON NOT TO DELAY SUCCESSION PLANNING? "MAN PROPOSES. GOD DISPOSES," SAYS SUCCESSION CONSULTANT PHILIP PALAVEEV.

broadly owned — independent RIAs in the industry, Los Angeles-based Aspiriant, with 57 partners. Kochis retains a stake and sits on the firm's board.

Planning for succession from the very start also changes the kinds of hires that firms make, Kochis and others say. Hiring someone who can eventually replace you is quite different from hiring someone to merely fill a job.

If a firm brings on planners and future equity partners who are possible future CEOs, then it is in a position to have a long-term internal succession strategy. Yet many don't. It's an exceedingly common mistake made by firm founders, who often find the consequences extend far beyond everyday workplace frustrations. Subpar hires can suppress a firm's value and, thereby, the value of a founder's retirement.

And firms that don't plan, even after decades in the business, risk running out of time to come up with any solution at all.

DeVoe recalls a midsized San Francisco firm whose founder died of an aneurysm, years ago, in his late 50s.

As clients took their assets elsewhere, DeVoe says, "Over the course of months a $600 million firm [in assets under management] literally just disappeared from the marketplace."

Every year, the succession consultant Philip Palaveev says he gets calls from firm founders who have been diagnosed with cancer. Often it's too late to do anything about the complex and time-consuming process of succession, Palaveev says. Many experts advise a 10-year runway to plan for internal succession.

"Man proposes, God disposes," Palaveev says. "Nature may retire us before we are ready."

Four years ago, after paying his respects at a flurry of funerals, Conrad Netting realized it was time to look the prospect of succession straight in the face. He and his co-founder, Don Pace, were nearing 70 after building their tax-focused practice, Netting & Pace of San Antonio, Texas, to nearly $200 million in client assets.

It was during a Schwab transitions program that Netting decided it was time to take action. "We thought, we really have to protect our clients, number one, and our employees, number two, and ourselves, number three," Netting says. "That was the order with which we felt like the procedure needed to go."

The pair and their partner Michelle Scarver — nearly 25 years their junior — spent nearly seven months figuring out how the firm had evolved over the years. With Schwab's help, they defined what they wanted out of a transition. They ended up with a 21-page document that itemized all these details and became a blueprint DeVoe used when he became their consultant.

Along the way, they discovered they had come to the subject of succession too late to accomplish their first choice: a fully internal plan. Had they started their planning a decade earlier, their talented younger planners might have bought into the firm.

By the time the co-founders began to think beyond their own tenures, the firm's valuation was so high that a buy-in was too expensive.

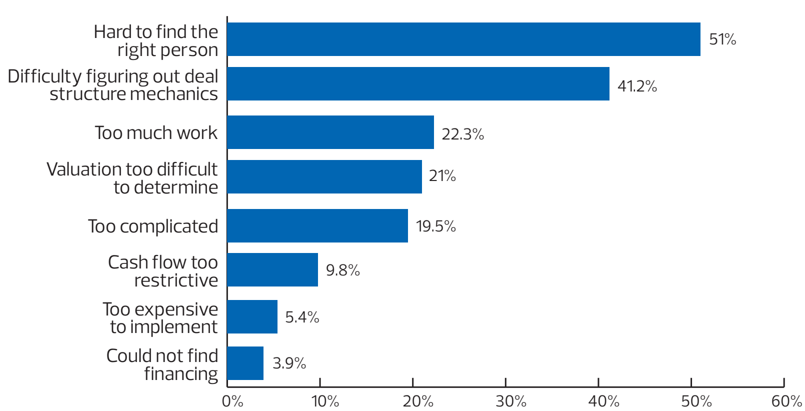
Yet, fortunately, nearly 20 years earlier, the co-founders had landed a great hire in Scarver who would help solve their succession challenge.

In 1999, Netting advertised for a tax preparer as part of the partners' plan to build a holistic planning practice. Scarver, an experienced investment manager with a banking background, called to respond.

While she had no experience in tax preparation, Scarver told them she was a CPA with a personal financial specialist credential, a still-new designation

THINK ABOUT SUCCESSION PLANNING FROM THE MOMENT YOU LAUNCH YOUR FIRM, SAYS DAVID DEVOE, FOUNDER OF DEVOE & CO.

If You Don't Have a Written Succession Plan, Why Not? (Choose all that apply)



Source: Advisor Group survey of 744 advisers, conducted May 2016 that was then less than a decade old.

Even over the phone, Netting says, they could sense that "this is absolutely somebody we are looking for: the nouveau CPA who is looking just beyond the standard skill sets.'"

Nearly nine months pregnant when she was hired, Scarver took the job, had her baby and grew into a position of authority, slowly taking over more and more management as heir apparent, albeit one without an equity stake. The trio orchestrated the shift so gradually that, Netting says, the transition of authority has been seamless for clients.

Though they hadn't brought Scarver on as a partner earlier, she became the key to making their late-in-the-game succession strategy work.

In 2014, the three planners went looking for potential buyers using their 21-page manifesto, and met with more than 20 prospects.

In April of last year, another tax-focused firm, Oklahoma City-based Exencial Wealth Advisors, with $1.8 billion in AUM ("They're us, but bigger," Scarver says), bought Netting & Pace for undisclosed terms, and made all three planners equity partners.

As a fully operational next-generation leader, Scarver was key to the transaction. "The impression I got from everyone was it wasn't much of a deal without Michelle," Netting says.

Without her, Scarver says, "the concern would have been, 'Would the clients have stayed on?' This is a very personal business. The two years that we were contemplating this, we were really positioning this to clients by saying that, if Conrad and Don aren't here, Michelle will take care of you."

Today, Netting adds, "we can absolutely with a straight face tell our clients that very little has changed. There was no giant exodus to the Oklahoma office. Exencial signed a five-year lease on our space. They signed contracts with Michelle and me and Don, so we aren't going anywhere."

Calling All Succession Laggards

Six strategies to deploy as your retirement date nears:

- **Get insurance:** Purchase coverage to enable firm successors to buy your family members out of your stake.
- **Partnership planning:** Sign a buy–sell agreement with another RIA who shares your investment philosophy.
- **Consider selling:** If you don't have a successor in–house, selling to a larger firm creates an automatic succession plan.
- **Groom your successor:** Start coaching your heir apparent to run the business.
- **Get help:** Hire a succession consultant or enroll in a custodian's transition program to put the mechanics of succession in place.
- **Finance:** Explore financing solutions offered by SBA lenders, consolidators and insurance policies to ensure successor(s) can afford your firm.

MANDATORY SUCCESSION PLANNING IS UNDER CONSIDERATION AT THE SEC AS A POTENTIAL FIDUCIARY REQUIREMENT FOR ALL RIAs.

The deal exemplifies two of DeVoe's key points: Smart hires and early planning are essential to getting deals done. "When you put a succession plan in place, you are mitigating risk," he says.

RAREFIED, ENLIGHTENED STATE

A smartly designed succession plan sets into motion a virtuous cycle, which throws off many benefits. With a clear road forward, clients feel more secure and often start making new rounds of referrals, DeVoe adds.

Another reason to move sooner rather than later: Mandatory succession planning is under consideration at the SEC as a potential fiduciary requirement for all RIAs.

And, finally, founders find they have more freedom to do what they want with their time and lives, having achieved that rarefied enlightened state that comes with learning to let go.

"Michelle doesn't come running to me with the drama of the day," says Netting, who still works full-time most days at the office, just because he wants to. He's a trustee on half a dozen clients' trusts.

"I will do that as long as I have any breath in me," he says, but he can also take time to play the piano and work on a long-standing book project.

"I used to think I was chained to the desk and that was really where my love was," Netting says. "But when you can wipe your brow and say the clients are taken care of and the employees are taken care of, you can kind of take care of yourself." **FP**

Ann Marsh is a senior editor and the West Coast bureau chief of *Financial Planning*. Follow her on Twitter at @Ann_Marsh.

ALSO IN PRACTICE: P. 42: Should I … Fire a Client?

Building a Strong Media Presence

Polishing your public voice helps build credibility with clients and could lead to referrals. But it has to be done correctly.

BY CAROLYN McCLANAHAN

MEDIA EXPOSURE CAN HELP YOUR PRACTICE IN A number of ways — it can improve credibility, provide free exposure and give you a solid voice in the profession. I'm very fortunate to have created a decent media presence over the years, through consistent and thoughtful work.

Here's how you can build your own presence, without the aid of a pricey public relations firm.

DELIVER VALUE AND PASSION

The first key to working with the media successfully is that you must passionately offer information that adds value to others. By providing good evidence and material, you can become a regular resource for journalists. I call this "earned media."

Even if your service is holistic, you likely have some area of practice that you might be particularly excited about. Identify it, learn everything you can about that field and prepare to share that information with the world.

My medical background led to my enthusiasm for topics that intersected medicine and personal finance. Early in my planning career, I recognized that I could help clients get better insurance rates by making certain they had clean medical records and tidied up any health problems before submitting an application.

I put together a talk for my study group on how I did this, and they were floored by the information. This led to an invitation to speak at a financial planning conference. My session was attended by a member of the press and resulted in my first interview.

Over the years, I've developed more topics of interest that are of value to planners and their clients, and I've communicated them in various ways.

Discussions about health care reform, dealing with money issues during terminal and serious illness, and elder financial safety issues have become very hot themes for talks and authored articles. The press then picks up the information and shares it with their readers. This has helped me to build my own public presence.

Carolyn McClanahan's Twitter image is personal and whimsical.

GIVE BACK TO THE PROFESSION

All professions require sharing between peers, so experts can learn from each other. This is where membership organizations such as NAPFA and the FPA can come into play for planners.

Early in my career, I volunteered to serve on a NAPFA regional board, and eventually the national board. NAPFA and the FPA provide media training to board members so they know how to work with the press; this is incredibly valuable. Additionally, the press regularly calls the organizations directly to interview board members.

You should also make it a point to attend conferences. The press frequents conferences to get story ideas, and they often seek to talk to advisers who are there. Introduce yourself, ask what they write about and suggest topics you would like to read about in their publication. There is a good chance they will interview you.

BE ACTIVE IN SOCIAL MEDIA

Journalists appreciate feedback and the sharing of their work. Online journalists are often measured by the number of clicks their articles receive. If you like a piece you see in the press, or you are included in an article, tell the journalist you appreciate the piece, and share it on your social media channels. Be sure to clearly point to the publication and the author with all of your posts.

If you have a comment that could improve a piece or be fodder for a future article, share your thoughts with the writer through email or a phone call.

Be vocal, authentic and kind in your social media posts. Touchy and controversial subjects can become great articles, so be brave and address tough subjects in your social media posts. However, never attack a person. Respectfully engage those who share points of view with which you don't agree. Be generous in sharing the work of others and giving them credit.

I once tweeted a comment about how I didn't agree with Dave Ramsey's investment advice, although I liked his work on budgeting. He saw the tweet and immediately begin attacking me directly. This generated a number of interviews and increased my number of Twitter followers. Many people took notice of how I stayed respectful when he was being very unkind.

RESPECT JOURNALISTS' DEADLINES

Journalists are frequently on very tight deadlines. At my firm, the staff knows to make their calls a priority. If you are unable to speak with a journalist immediately, ask for their deadline.

Write down talking points before your interview. Keep your answers concise and quotable. Stay on topic and don't ramble. Think in terms of tweets; after sharing your thoughts, try to sum up points that would easily fit into a tweet.

It is okay to be controversial as long as you can back up your points.

DON'T FAKE IT UNTIL YOU MAKE IT

If you do not know the answer to a question, don't wing it. Tell the journalist you don't know but that you'll find out or refer them to a source who will. Blowing smoke is an instant credibility killer, and it's likely the journalist will never call you back if you fake an answer.

If an article topic isn't in your wheelhouse, help the journalist find someone who can assist them. You've then helped two people during the same day, and creating good karma is rewarding.

Don't think about asking to see the article before it goes to print. This just isn't done in journalism. If you demand this, you may never hear from that journalist again.

Most of the time, the publication will do a fine job. Every now and again, mistakes will be made. Let the insignificant mistakes go, and bring the journalist's attention to the larger ones. On rare occasions, the journalist may portray you negatively. You have to let that go, too, and be more careful the next time you work with that journalist. Never get too attached to the outcome of one article.

TRANSLATE INTO BUSINESS

Metrics on a media presence cannot be measured directly.

Marketing is a constant process. Deliver incredible service, be a reliable resource to your clients, be authentic, share your passion for what you do and keep your clients happy. Word will get around.

A media presence helps build credibility with clients, and could lead to referrals. If your happy clients see you in the press, they are proud, and they will often tell their friends.

During one of my appearances on CNBC, a client happened to be working out in his country club gym. He saw me on television and shouted, "That's my financial planner!"

It doesn't get any better than that. There is a reason the majority of the new clients at my firm come from current clients, despite the fact that we never ask for referrals.

And our marketing budget? Zero.

It takes time and effort, but working with the media can have incredible rewards. Find your passion and go for it. **FP**

If an article topic isn't in your wheelhouse, help the journalist find someone who can assist them. You've then helped two people during the same day, and creating good karma is rewarding.

Carolyn McClanahan, a CFP and M.D., is a *Financial Planning* contributing writer and director of financial planning at Life Planning Partners in Jacksonville, Florida. Follow her on Twitter at @CarolynMcC.

Should I ... Fire a Client?

Sometimes they are bigoted. Others are rude. And some are just not a good match.

BY INGRID CASE

ADOBE STOCK

YEARS AGO, ONE OF JEFFREY TOMANENG'S CLIENTS came into his office and made some casually scathing anti-Semitic remarks.

"Somehow he started talking about Jews — they lie, they cheat. I couldn't believe what I was hearing. I stopped him, let him know that I was offended, told him I was going to make a request to have his account reassigned and asked him to leave my office," says Tomaneng, who is currently an adviser at Lincoln Investment in Waltham, Massachusetts.

His boss at the time wasn't happy, because Tomaneng was sending away assets under management. "I didn't care at the time and I would do the same thing today," he says.

Tomaneng's decision to fire that client was an easy one for him. But other situations involving difficult clients may be murkier. When, if ever, should you ask a client to leave your practice?

IS THE CLIENT INTERESTED IN YOUR ADVICE?

If a client doesn't really care what you say, the relationship probably won't work. Another Tomaneng client had $100,000 in a 403(b) through her job as a schoolteacher. Unfortunately, she also had a massive shopping problem.

"Her home was like something out of the television show 'Hoarders,'" Tomaneng says.

"She was spending more than she made each month, had a loan balance against her retirement and was asking her landlord to write a delinquency notice every month so she could increase her loan balance beyond the usual maximum-through-hardship distributions," he says.

Tomaneng explained that the client needed to dial back her spending and replenish her savings, but his advice fell on deaf ears. "She wasn't interested in helping herself. We were just processing her paperwork," he says. Tomaneng removed himself from the account.

Robert Schmansky, president of Clear Financial Advisors in Livonia, Michigan, recalls a separated couple who needed a disproportionate amount of time-intensive management.

The husband was the first problem. "In the first quarter of 2015, his investments were down along with the market, and I started getting angry emails, always within a day or two from the end of the month," Schmansky says. Although he sends monthly emails and quarterly market updates, the clients weren't satisfied. "They demanded to know at the end of each month why their accounts weren't growing," he says.

The client wouldn't respond to Schmansky's attempts to set up an appointment to talk, so Schmansky disengaged — which brought even angrier email. "He was mean. I've had clients be very upset about misinterpretations of things, but they've been willing to talk and listen," Schmansky says. "Clients have to be nice. That's critical."

After Schmansky let the husband go, the wife started sending him similarly aggressive emails, and Schmansky fired her. Total revenue from both accounts? "Less than $10," Schmansky says. **FP**

Ingrid Case, a *Financial Planning* contributing writer in Minneapolis, is a former senior editor for *Bloomberg Markets*.

TECH ZONE

ALSO IN TECHZONE: P. 46: AI-Backed Behavior Predictors

FinMason Assesses Risk

As the bull market ages, it's a smart time to ensure that clients are on the right track with their portfolios. A new platform helps them do that.

BY JOEL BRUCKENSTEIN

THE LAST MAJOR STOCK MARKET DOWNTURN clearly demonstrated the inadequacy of many risk assessment tools deployed by financial service professionals.

With the possible exception of FinaMetrica, which was used by only a very small percentage of the adviser population at the time, the tools available a decade ago proved woefully inadequate at predicting how clients would react during a major market downturn.

As a result, far too many clients found themselves with portfolios that were inappropriate. In many cases, this resulted in emotional anxiety and/or financial loss.

Because of the inadequacies that were exposed almost a decade ago, some enterprising folks saw an opportunity to create better risk assessment tools. Within the past decade, we've seen a steady flow of new entrants into the field. Riskalyze has been by far the most successful commercially, but there have been others, including PocketRisk and RiXtrema.

In light of this, does the industry need yet another risk assessment tool? Kendrick Wakeman, CEO of FinMason, believes it does, and, after examining the company's platform, I think he is on to something.

With the current bull market over eight years old and perhaps seeming a bit long in the tooth, it seems like an opportune time to ensure that clients and prospects are not shouldering more risk than is appropriate.

FinMason offers more than just a risk tolerance assessment tool. The company also offers a robust analytics platform that can be used for portfolio monitoring, compliance and more; application program interfaces that can deliver institutional-grade analytics and proprietary data sets; and a lead-generation tool. Let's examine each in turn.

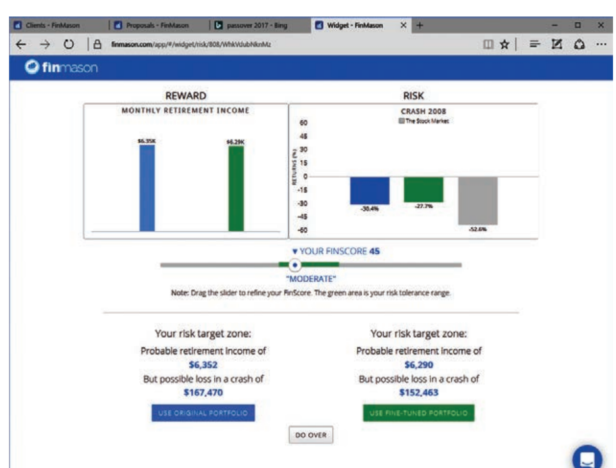
RISK ASSESSMENT

FinScore Pro, the risk assessment tool, can be white labeled for your advisory firm. To begin the process, you can initiate a risk assessment by supplying a link to a prospect or client, or by viewing it with the client on a web page. The web-based assessment also displays well on mobile devices.

FinScore Pro starts off by asking the client a few simple questions about his or her knowledge of investments, special circumstances, stock market experience in 2008, age, years to retirement, estimated Social Security payments (a specific number if known, or the platform's estimate based upon current income), current contributions to a retirement plan and current investment assets.

Additional questions can be added at the firm or adviser level. The answers to these questions do not directly impact the risk score, but they can alert the adviser to additional issues that can impact the client relationship.

FinMason uses this information to calculate the client's estimated monthly retirement income based upon two portfolios with different risk characteristics. It then asks her to choose between the two portfolios. For example, Portfolio 1 is estimated to generate $15,084 monthly but lose 30.4% in a crash. Portfolio 2 is estimated to generate $15,291 monthly but lose 35.1% in a crash. The client must decide whether the extra $207 per month justifies a poten-



tial extra downside of 4.7 percentage points in a crash.

In the risk chart, the software provides an S&P 500 loss of 52% as a benchmark. If the client selects the less volatile portfolio, they will get a lower-yielding portfolio to compare it with. For example, she'll now choose between Portfolio 1 and a portfolio that generates $14,787 per month, with a downside of 25%. If she chooses Portfolio 1, the exercise is over. The client's risk score has been reached.

THE COMPARISON PROCESS

If not, the client will get a new set of portfolios to choose from. Wakeman likens the process to going to the eye doctor, who continually checks the patient's eyes through various lenses until the optimal set is identified.

The appealing aspect of this exercise is that it constantly forces the client or prospect to balance risk and reward. It illustrates that if the client wants greater retirement income, they will need to assume more potential downside risk. Conversely, it shows that if the client already has sufficient financial resources, they may be able to scale back risk. The FinMason approach is not unique, but the execution is well done.

Once the client's initial score is arrived at, a page displays the score, the estimated downside in a 2008-magnitude market and the estimated reward in terms of monthly retirement income. In this example, the loss is represented as a dollar value ($167,470) as opposed to a percentage.

As a final check, the report allows the user to drag the score up and down within a limited range. The application then contrasts the original score with the updated one. If the client is unwilling to suffer a potential loss of $167,470, the score is adjusted, which might result in an estimated income of $14,929 with a potential loss of $152,463. The client selects this new portfolio and, with a click, sends the results to the adviser.

The prospect is then asked to provide their current investment portfolio details. Data on assets can be collected in one of three ways: account aggregation, detailed manual data entry or asset allocation total assets plus percentages in equities, fixed income and cash. Apparently, to date the most popular method is the latter.

PORTFOLIO PROPOSAL

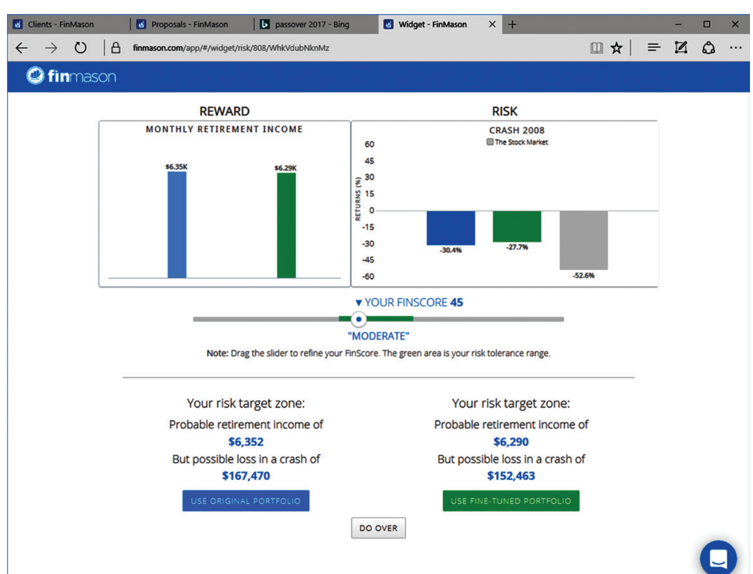
The adviser can then create a portfolio proposal, choosing from a FinMason model, his own model or one supplied by a third party. The FinMason models tend to be basic (my sample proposal for a $550,000 account contained only SPY, BND and GLD). The proposal includes all the key information supplied by the client, the risk score, target monthly income and minimum monthly income requirement. You can add notes, include your fee and customize the report in a few other ways.

Once the proposal is ready, a link is generated that can be shared with the client. Assuming the client accepts the proposal, they click the accept button. The acceptance is displayed in the adviser dashboard, and the recommendation can now be implemented.

The appeal of FinScore Pro is obvious. Client expectations about risk and reward are clearly delineated and captured. The report can serve as a behavioral aid in times of market turmoil, and it can also help protect an adviser from frivolous claims.

Priced aggressively at $49 per month for a single user, and with volume discount available, FinScore Pro deserves more attention

FinScore Pro's approach to balancing risk and reward is akin to going to the eye doctor, who continually checks the patient's eyes through various lenses until the optimal set is identified.



than it has garnered to date.

INSTITUTIONAL ANALYTICS

Another product offered by FinMason, called FinScope, is a powerful tool that can extend the capabilities of FinScore Pro.

FinScope is powered by Algonath, an institutional analytics platform. It merges two computational platforms: a data-agnostic computational platform with analytics on six million investment assets globally, and an extensive global macroeconomic modeling tool covering 25,000 economic inputs and 1,800 factor outputs.

Each night, FinScope looks at millions of portfolios and calculates how much each would potentially lose in a market crash. It then flags any portfolio where an estimated crash loss is expected to exceed the loss documented within FinScore Pro.

The adviser can then review each flagged portfolio and take appropriate remedial action. FinMason supplies a full audit trail, storing each estimate and metric for 20 years.

Unfortunately for many readers, FinScope is available only at the enterprise level today. Given its broad appeal, as well as FinMason's apparent determination to make it available to a broader audience, we expect this situation to remedy itself soon.

The most likely scenario is for FinMason to team up with custodians or portfolio management and accounting platform providers. This would allow FinMason to run analytics on all the necessary portfolios on a given platform nightly, and to pass through volume enterprise discounts to all users on a given platform.

FinRiver is a product that most advisory firms will not interact with directly, but they are likely to benefit from it. It allows other technology firms (custodians, broker-dealers, their party providers) to make use of FinMason's application program interfaces to run analytics on their portfolios using the FinMason engine.

The analytics available include factor exposures, scenario analysis, fee analysis, Monte Carlo simulations, expected returns and more.

LEAD GENERATION

Finally, there is the FinMason LeadGen tool; currently, I'd label this LeadGen Lite. It is essentially a customizable form that advisers can put on their websites inviting prospects to take the FinScore Pro risk assessment. It captures the prospect's name, company name and email address, then emails them a link to the risk assessment, which can include extra questions created by the adviser. So, for example, if you are an adviser who sells life insurance, you can ask about current coverage.

Once the process has been completed, the prospect has the opportunity to share the results with the adviser. If they do, the adviser has the information necessary to initiate a conversation. There is no extra charge for the LeadGen tool, and it is a nice complement to FinScore Pro.

So, what firms is FinMason a good fit for? My answer is: enterprises that can leverage FinScore Pro, FinScope and FinRiver to create a highly customized experience for their clients. The risk assessment combined with the FinScope can ensure that all portfolios are aligned at all times with client risk tolerances. FinRiver offers the opportunity to provide advisers with other valuable insights.

Independent RIA's will have to carefully consider the methodologies of the various products on the market and decide which they prefer.

Each provider's approach claims to be backed by rigorous testing, and I'm not sure there is one right way to do risk assessments, although I do feel confident that the tools available today are far superior to those most advisers were using a decade ago.

Bull markets don't last forever, and many clients have short memories. Now is the time to make sure they aren't assuming too much risk. If you wait for the next big downturn, it may be too late. **FP**

The appeal of FinScore Pro is obvious. Client expectations about risk and reward are clearly delineated and captured. The report can serve as a behavioral aid in times of market turmoil, and it can help protect an adviser from frivolous claims.

Joel Bruckenstein, a *Financial Planning* columnist, is co-creator of the Technology Tools for Today conference series and technology guides for advisers. For more information, visit JoelBruckenstein.com. Follow him on Twitter at @FinTechie.

AI-Backed Behavior Predictors

Salesforce is the latest to offer advisers data-driven insights into clients, using content analysis to analyze sentiment.

BY GABRIELLA IANNETTA

THE NEW BUZZWORD IN DIGITAL WEALTH management is artificial intelligence, and there's no shortage of providers offering tools they claim can use data to help predict client behavior. It's a piece of the continued creep of AI into financial advice — a recent study by Bloomberg determined that 58% of an adviser's work can now be digitized and done by computers.

CRM giant Salesforce is the latest entrant into this arena, dubbing its new cloud-based predictive analytics tool "Einstein" — even paying for the right to use the famous physicist's name in some marketing one-upmanship: IBM's similarly AI-powered adviser service is called Watson.

Like IBM's Watson, Salesforce says its Einstein tool can analyze client sentiment based on data profiling and content analysis to provide insight. The suite of tools combines with aggregation to allow advisers to scan across a client's wealth holdings.

BLOOMBERG NEWS

The new tool "gives advisers a snapshot of a client's entire wealth ecosystem, and empowers them to uncover new opportunities that exist within their client's extended household or relationship groups," says Rohit Mahna, general manager of financial services at Salesforce.

Salesforce says the tools are available for no additional charge to its Financial Services Cloud users, and Einstein costs $50 per user, per month, for Enterprise subscribers.

If Einstein doesn't carry appeal, you could always take the red pill (a la *The Matrix*) and join Neo. That's the name financial services consultancy Synechron chose for its matrix of 14 financial management tools, from robos to chatbots, all powered by proprietary AI as well.

An adviser using the Neo-powered suite of tools could ask how a stock is being discussed on social media, for instance, says David Horton, Synechron's head of innovation.

"Rather than taking your advice from tradition ratings agencies, we can use real-time sentiment analysis about a particular stock, and gauge whether the sentiment is negative or positive," Horton says.

"Chatbot [one of Neo's applications] aggregates and gives a score. You're getting a real-time feel of the particular stock and that is much more valuable to someone about to make an investment," he says.

Skeptical about such crowd-sourced data analysis? It's actually becoming more common, says Oliver Bussmann, former CIO of UBS and founder of an eponymous advisory firm.

"With AI you can scan the available market data and understand events and triggers that change the market situation and potential performance of certain sectors and certain stocks," Bussmann says. "It's all about the ability to process a huge amount of data, define the rules and drive the right rules."

Like other digital wealth management tools, the machine learning and predictive analytics applications are being pitched to advisers as a means to become more efficient at their jobs. **FP**

Gabriella Iannetta is a business writer in Hartford, Connecticut. Follow her on Twitter at @IannettaGab.

ALSO IN CLIENT: P. 50: From $7,000 to $6 Million | P. 52: Payoffs in Preservation

A Hierarchy of Retirement Needs

Humans feel compelled to save more for retirement than they actually need and, as one result, many people irrationally resist buying annuities.

BY MICHAEL KITCES

EVEN THOUGH MONEY ITSELF IS FUNGIBLE, HOW we — and our clients — think about assets is not. Instead, we mentally deposit money in buckets of current income, current assets and future income.

This instinctive categorization explains the popularity of so-called bucketing strategies for retirement income, whether segmented by time (short, intermediate and long-term needs) or type of spending (essential versus discretionary).

Just as Abraham Maslow in the 1940s ranked humans' fundamental needs from the physiological to the psychological, we do the same with our money. First, we pay current expenses (groceries), then fund short-term financial reserves (checking accounts), and finally put savings toward future income (investment retirement accounts).

This hierarchy helps explain why some types of retirement income strategies — annuitization among them — are unpopular, even though retirees routinely state that their biggest fear is outliving their assets.

TOO MUCH SAVING

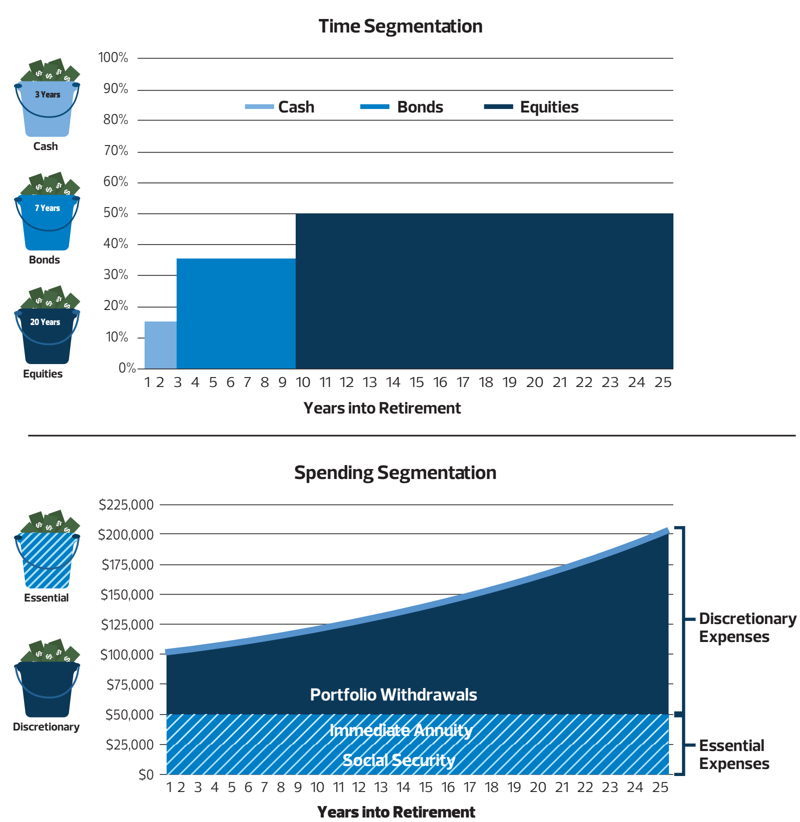
The biggest problem with this hierarchy is that clients often feel compelled to save more for retirement than they actually need. Research finds that the size of a person's liquid holdings positively relates to his well-being and life satisfaction.

And if clients can't achieve their needs for future income until they meet their need for current assets, they may feel cash-strapped or choose retirement solutions that are mechanically inferior but psychologically more satisfying.

Hence bucketing strategies, which are hugely popular in the financial planning space. The classic time segmentation strategy typically divides retirement assets into three

Bucketing Strategies

Ways to segment for retirement income



Source: Michael Kitces

buckets: a short-term bucket to cover the next few years of spending, kept in cash; an intermediate-term bucket to cover the subsequent five to 10 years of spending, invested in bonds; and a long-term bucket to cover spending beyond a 10-year horizon, invested in equities.

Such strategies don't necessarily produce a markedly different asset allocation than a classic diversified portfolio. Nonetheless, for an investor who might have a 60/30/10 stock/bond/cash portfolio anyway, it seems to be far easier to conceptualize.

ESSENTIALS VS. DISCRETION

An alternative version of bucketing is dividing long-term expenditures into essentials — consisting of the food/clothing/shelter expenses you really can't afford to outlive — and discretionary expenses.

Once expenses have been separated, assets can be allocated to appropriately match the buckets. For instance, essentials might be paired with Social Security and lifetime immediate annuitization, while discretionary expenses can be funded with a diversified portfolio.

In a planning context, these bucketing strategies are often used as a means to help retirees acclimate to the impact of market volatility on retirement assets.

More generally, though, these strategies appear to work because they align reasonably well with how our brains do accounting.

Looking at the available research, the economists Hersh M. Shefrin and Richard H. Thaler have found that consumers typically account for their wealth in three buckets: current income, current assets and assets to support future income.

These mental buckets matter. Even if the actual investment accounts are otherwise similar and the money is fungible, consumers react differently depending on where they feel the squeeze.

Thus, a household that feels poorer is likely to constrain its current income to get back on track — and focus blame for its shortfall on its latest expenditures. Meanwhile, a household wealthy in net worth terms may still feel poor and unhappy if it doesn't have a reasonable amount of cash on hand.

Perhaps the most significant implication of these buckets, though, is their implicit prioritization. When current income matters more than current assets, it's difficult to be satisfied with the status of the longer-term buckets until the nearer-term ones are satisfied.

Just as Maslow found that people have a motivational hierarchy of needs that must be satisfied in a certain order, so too does the retiree appear to have a rigid hierarchy of retirement needs.

CASH VS. ANNUITIZATION

A prospective retiree's No. 1 concern is that she won't afford retirement or will outlive available assets. In essence, it's the fear that the future income bucket in the hierarchy won't be satisfied.

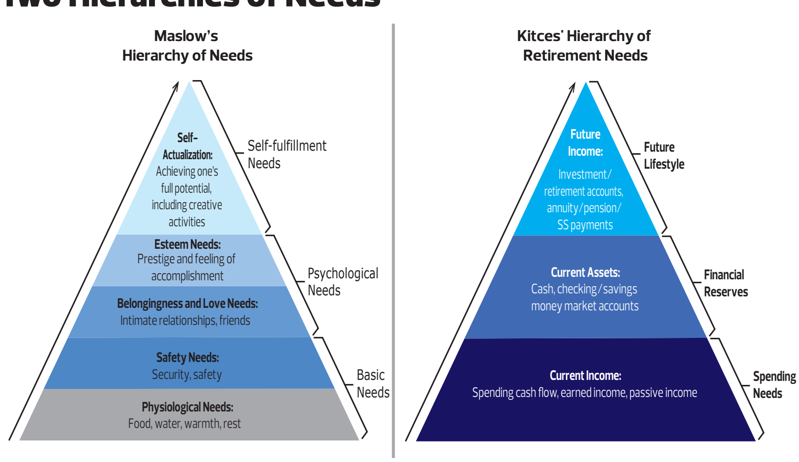
The most straightforward solution to this fear — buying a lifetime immediate annuity at retirement — is rarely implemented. In fact, immediate annuity sales continue to hover at barely $2 billion every quarter — a minuscule proportion of total invested retirement assets.

Yet this is easily explained. Even if we fear a shortfall in future income, we're not willing to give up the liquidity of current assets to secure it because having sufficient current assets is a required first foundation. Viewed another way, it's not actually a fear of outliving money but a fear of outliving money available after having enough liquid cash on hand to meet current expenses.

Thus, it's no surprise if retirees choose annuitization, they strongly prefer partial annuitization options to all-or-nothing strategies because this has less of an impact on the current assets tier of the hierarchy.

Similarly, the hierarchy helps explain the popularity of variable annuities with guaranteed living withdrawal benefits as well. Generally, the actual future-income guarantee is far superior with a pure immediate annu-

Two Hierarchies of Needs



Source: Michael Kitces

ity than with a GLWB, but the latter is a more liquid version, helping satisfy the desire for current assets.

This suggests that even within the future income tier of the hierarchy, consumers distinguish between allocations to liquid future-income sources and illiquid versions that – while more guaranteed – come at the cost of liquidity.

THE GUARANTEES TRAP

Another challenge emerging in this research is that ultimately retirees don't just want to have future income in retirement to satisfy their needs. Instead, they want the potential for an increasing standard of living over time, as well.

Consequently, it's not enough to say, "Here's a strategy to guarantee your retirement income," if it's implicitly paired with the qualifier "but this is as good as it gets."

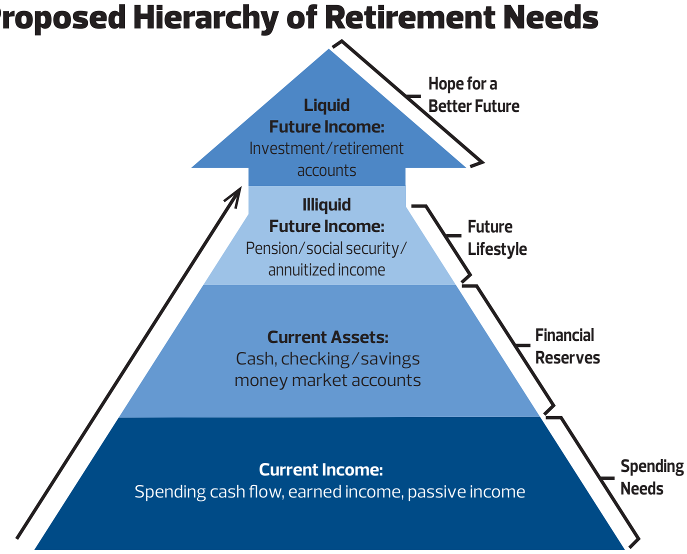
This is distinct from a retiree who may have an explicit legacy goal to leave assets to heirs. In fact, even those who don't want to leave assets may still refuse to annuitize their assets because of the lack of personal upside potential.

The most straightforward way to resolve this issue, of course, is to purchase a rising stream of guaranteed income, such as an inflation-adjusting immediate annuity. Yet these products are even less popular than traditional fixed immediate annuities.

This too makes sense. Because most households have limited assets, spending the same available dollar amount on an inflation-adjusted immediate annuity will result in a lower starting payment – but the requirement to take a lower starting payment now causes a deficit in the tier of current income needs.

On the other hand, this again helps explain the popularity of the GLWB annuity – or more generally various so-called floor-with-upside retirement income strategies – because the floor helps secure current income. The upside, meanwhile, counters the "as good as it gets" qualifier. The liquidity satisfies the need for current assets – even if, ironically, the cumulative outcome may be an inferior retirement income guarantee.

A Proposed Hierarchy of Retirement Needs



Source: Michael Kitces

BEHAVIORAL BIASES

The bottom line of all this is that retirees may have a demand for more retirement income and assets than they actually need. As planners, how do we reconcile that?

In theory, retirement income needs can be fully satisfied with some allocation to current and future income needs. However, research suggests that people typically have a current assets bucket as well, and they may not be happy if it is depleted – even if it is not needed.

One study found that having cash on hand in a checking or savings account was directly correlated with life satisfaction even after controlling for investments, total spending and indebtedness. It wasn't about the need for cash, but simply the satisfaction of having it on hand.

So retirees obviously want more than they actually need. The situation is further exacerbated by the desire not only to secure future income in retirement, but also to have rising future income. This comes even though research suggests retiree spending actually declines with age.

In other words, while we probably need less assets to cover declining future income needs, we want even more to satisfy a desire for upside potential even if we won't end up needing or using the proceeds. **FP**

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Michael Kitces, CFP, a *Financial Planning* contributing writer, is a partner and director of wealth management for Pinnacle Advisory Group in Columbia, Maryland; co-founder of the XY Planning Network; and publisher of the planning blog Nerd's Eye View. Follow him on Twitter at @MichaelKitces.

From $7,000 to $6 Million

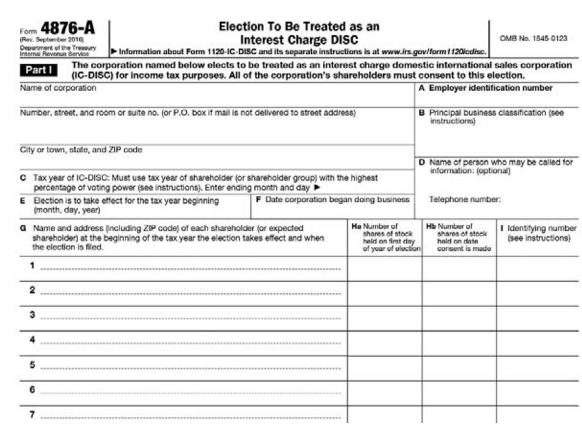
Advisers should heed some of the dangers involved in a strategy that can turn a small investment into a huge, tax-free gain.

BY ED SLOTT

HOW CAN $7,000 IN ROTH IRA CONTRIBUTIONS turn into a $6 million tax-free gain? And can you help clients take advantage of the strategy that allows this to happen?

Before you jump in, however, there's another question to ask yourself: Should you help your clients take advantage of this strategy? Examining a recent court ruling helps explain the risks involved — and why this approach should be used with caution.

In a surprising outcome, the 6th Circuit Court of Appeals in February reversed a Tax Court decision in the case of *Summa Holdings v. Commissioner*, and allowed for the tax-free transfer of millions into a Roth IRA, using domestic international sales corporation transactions, also known as DISCS.


Form 4876-A (Rev. September 2016) Department of the Treasury Internal Revenue Service

Election To Be Treated as an Interest Charge DISC

▶ Information about Form 1120-IC-DISC and its separate instructions is at www.irs.gov/form1120icdisc.

OMB No. 1545-0123

Part I The corporation named below elects to be treated as an interest charge domestic international sales corporation (IC-DISC) for income tax purposes. All of the corporation's shareholders must consent to this election.

Name of corporation

A Employer identification number

Number, street, and room or suite no. (or P.O. box if mail is not delivered to street address)

B Principal business classification (see instructions)

City or town, state, and ZIP code

D Name of person who may be called for information: (optional)

C Tax year of IC-DISC: Must use tax year of shareholder (or shareholder group) with the highest percentage of voting power (see instructions). Enter ending month and day ▶

E Election is to take effect for the tax year beginning (month, day, year)

F Date corporation began doing business

Telephone number:

G Name and address (including ZIP code) of each shareholder (or expected shareholder) at the beginning of the tax year the election takes effect and when the election is filed.	Ha Number of shares of stock held on first day of year of election	Hb Number of shares of stock held on date consent is made	I Identifying number (see instructions)
1			
2			
3			
4			
5			
6			
7			

The story begins way back in 1983, when James Benensen Jr. founded the Cleveland-based Summa (first known as Arrowhead Holdings). Summa became the parent corporation of a group of companies that manufactures industrial components including aircraft products.

Fast-forward to 2001, when James' two sons, Clement and James Benenson III, established Roth IRAs. Each brother then transferred $3,500 to their respective accounts. Between 2002 and 2008, they never made another personal contribution to their Roth IRAs.

In 2002, both Roth IRAs purchased 1,500 shares of stock in JC Export, a Delaware corporation, in exchange for $1,500. JC Export had already filed an election for a domestic international sales corporation, which became effective for the tax year beginning Jan. 1, 2002.

On Jan. 31, 2002, the Roth IRAs each transferred shares of JC Export stock to another corporation the Benensons formed, called JC Holding, and received shares of JC Holding stock. From that time until Dec. 31, 2008, each IRA owned a 50% share of JC Holding, which owned JC Export.

That year, Summa and JC Export entered into agreements through which Summa made a series of payments to JC Export. Each time JC Export received a payment from Summa, it immediately transferred the entire amount of the payment to JC Holding as a dividend.

When JC Holding received a payment from JC Export, it paid a 33% income tax on the dividends and made payments, also in the form of a dividend, to each of the Roth IRAs.

By the end of 2008, each brother's Roth IRA had accumulated over $3 million. Not surprisingly, this caught the attention of the IRS.

In 2012, the IRS issued notices of deficiency to the Benenson brothers for the 2008 tax year. The IRS said the payments the Summa subsidiaries made to JC Export were, in substance, dividends followed by excess contributions to the Roth IRAs. The case went to the Tax Court, where the IRS prevailed.

Then Summa appealed the ruling.

The 6th Circuit Court of Appeals overturned the Tax Court's decision and held that the strategy of using DISC transactions to fund Roth IRAs was permissible.

To understand the court's decision, you must know how a DISC and Roth IRA can work together. While Roth IRAs are a common feature of retirement planning, DISCs are encountered far less frequently by most advisers.

DISCs were created by Congress to subsidize U.S. exports, and using them can reduce tax rates on income from exports.

The court gives a good explanation of how a DISC could potentially be used with an IRA. First, the owner of an export company could transfer money from the company to the DISC, which then pays some of that money as a dividend to its shareholders, allowing the money to enter the Roth IRA and grow there.

The IRA owner must pay the high unrelated business income tax when the DISC dividends are transferred to the Roth IRA. But once the Roth IRA receives the money, as with all Roth IRAs, the owner would not have to pay any taxes if the funds are distributed as a qualified distribution. This means the Roth IRA funds have been held for at least five years, and the Roth IRA owner is age 59 ½ or older.

The court said the transactions, as conducted, complied in full with the tax code. The Benenson family used tax attorneys who advised the family to use a DISC to transfer money from their family-owned company to the brothers' Roth IRAs.

COMPLYING WITH THE RULES

They complied with all the rules regarding DISCs and Roth IRAs. They correctly paid 33% in taxes on the dividends before paying them to the Roth IRA. The tax code permits both traditional and Roth IRAs to own DISCs. The IRS did not dispute that the Benensons had complied with all relevant provisions of the law.

In the court's view, the IRS overplayed its hand by using a very broad interpretation of the substance-over-form doctrine. It did not buy the IRS' argument that, under this doctrine, it could override any given transaction based on facts and circumstances.

The court noted that, if the IRS can override transactions that the tax code expressly authorizes, then the written tax code has no purpose. It also acknowledged that Congress probably did not intend taxpayers to combine Roth IRAs and DISC provisions for a huge tax windfall.

However, it did not see that as a problem for the courts. Essentially, because Congress created the problem when making the law, they own it.

BE EXTREMELY WARY

If they hear the news of this case, clients may ask if they should consider similar plans for their Roth IRAs. Advisers should be extremely wary of this unprecedented ruling, and should proceed with caution for several reasons.

First, this story is not over. As of this writing, the IRS has not announced whether they will appeal this decision to the Supreme Court. Statistics show the 6th Circuit is a court often reversed by the Supreme Court.

On the other hand, the IRS may not want to roll the dice with a Supreme Court that can be unpredictable and set a precedent greatly limiting the IRS' options for challenging tax shelters.

Additionally, while the taxpayers in this case got a good result from the Court, their circumstances were exceptional. The family business qualified as an export business, which could use a DISC. It is unlikely that many clients are as well-suited to establish a DISC.

The court itself noted that the Benenson family, to its "good fortune," had the time, patience and money necessary to use two complex sets of tax provisions to lower their taxes. They could afford to pay for the advice of expert attorneys who made sure every box was checked.

Also, the attorney they hired to argue the case in appeals court is a nationally recognized authority on export law who has testified before Congress as a DISC expert.

It would be prohibitively expensive for most clients to engage this kind of high-powered legal representation. Even then, the client would have to evaluate whether the legal cost would be worth the benefit.

To top it off, the Benenson brothers had an extraordinary investment return, with $7,000 combined growing to $6 million in just seven years. Other clients, needless to say, will probably not be so lucky.

Even if all transactions are done properly, the Roth IRA investment would have to produce a stellar return to offset the cost to set it up, not to mention potential legal fees if the strategy is challenged by the IRS.

MORE SCRUTINY

While the full implications of this case are not yet known, what's likely is the IRS will continue to scrutinize these transactions and attack them in court, using an endless variety of legal strategies.

Few clients will want (or be able to afford) the many years of ongoing litigation the Benenson family signed on for in this case.

And if a transaction is determined to be invalid, clients could face significant penalties, and possibly the loss of their retirement savings.

In short: When it comes to using this strategy, the old adage, "If it seems too good to be true, it probably is" typically applies. **FP**

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Ed Slott, a CPA in Rockville Centre, New York, is a *Financial Planning* contributing writer and an IRA distribution expert, professional speaker and author of several books on IRAs. Follow him on Twitter at @theslottreport.

Payoffs in Preservation

Using conservation easements can deliver highly attractive tax shelters for HNW clients, along with protecting nature or farmland.

BY DONALD JAY KORN

HELPING HIGH-NET-WORTH CLIENTS SAVE ON TAXES can propel a planner's practice, and matching one shelter with another is a powerful parlay.

"My favorite story involves clients who were wrapping up a conservation easement," says Adam Miller, president of Elderado Financial in Montrose, Colorado.

"Working with their CPA, we helped them convert tens of thousands of traditional IRA dollars to a Roth IRA at an extremely low tax rate."

Knowledge of such techniques may lure HNW prospects. "In our area, conservation easements are a big deal," Miller says. "An adviser who understands them can connect with high-net-worth families. If someone has a large property, I always consider this idea. We'll bring it up if we see this as the best fit."

Miller adds that some CPAs may call his firm if they have clients who are placing an easement on their property or have already placed one.

He is not the only one who emphasizes the value of professional connections.

"Word of mouth has attracted high-income clients to financial advisers who promoted easements," agrees Marc Lewyn, CEO of strategic liquidity services at JOYN, a behavioral wealth management firm in Atlanta. "Easements have become the coin of the realm, so to speak. Having familiarity with the potential benefits and the risks allows advisers to provide a valuable filter for clients."

The total number of acres in the U.S. under easements overseen by land trusts at the end of 2015 was almost 16.8 million, more than double the acreage under easement a decade earlier, according to the Land Trust Alliance. At the end of 2005, the total nationally was 6,113,108.

Top 5 States for Land Trusts

Ranked by acreage under easements overseen by land trusts.

State	Number of acres
Maine	2,355,400
Colorado	2,129,158
Montana	1,575,616
California	1,425,623
Texas	887,737
U.S. Total	**16,798,354**

Source: Land Trust Alliance. Data as of Dec. 31, 2015.

Conservation easements are designed to protect a property's natural values. An owner might donate an easement to a preservation group such as a land trust for the purpose of limiting future development on the property. The result will be a loss of value, supported by before-and-after appraisals, which can be claimed as a charitable contribution.

VALID AND VALUABLE

"These easements can provide tax deductions for property owners who give away a viable right (such as development rights) associated with the property in perpetuity," says Robert Boggess, CEO of IREXA Financial Services/Wealth Strategies in Seattle. According to Boggess, a viable easement is one that is valid and valuable, providing a public benefit.

As an example, the Land Trust Alliance, a national conservation organization, cites an easement on property containing a rare wildlife habitat that might prohibit any development. On a farm, an easement might allow continued farming and the building of additional agricultural structures.

An easement may apply to only a portion of the property and need not require public access. Indeed, the donor continues to enjoy the use of the property. As the owner, the donor can sell it or keep it for the next generation.

Nevertheless, donating an easement that limits development rights will reduce the value of the property for future resale. If appraisals determine that the property's value has fallen from $4 million to $3 million, for instance, the donor could be entitled to a $1 million income tax deduction. Beyond an income tax deduction, the landowner may also receive reductions in estate taxes and perhaps in property taxes after donating an easement.

After viability, the second primary issue of conservation easements is valuation. "This is accomplished," Boggess says, "by undertaking two appraisals: first at its current highest and best use, then the second is at its highest and best use after the easement is put in place. The IRS has strict appraisal standards." An easement deemed to be overvalued is likely to be challenged.

STEP BY STEP

Claiming a reasonable deduction for the easement is Step 1. Step 2 is actually taking the deduction. Even though a 2015 law permanently eases the rules, annual deductions for conservation easements are generally capped at 50% of a taxpayer's adjusted gross income or 100% for qualified farmers and ranchers.

Unused deductions can be carried forward for up to 15 years. A moderate-income donor might take years to claim all the deductions or might never use them all.

That's where Roth IRA conversions may pay off. "We converted some of the client's traditional IRA to a Roth each year, utilizing credits and deductions from the easement," Miller says.

The partial conversions are added to AGI, allowing more of the tax deductions from the conservation easement to be used currently. Carefully monitoring the amount of assets converted and the amount of deductions taken, the Roth conversions may be executed at relatively low tax rates.

Miller mentions tax credits as well as deductions, which can further reduce the effective tax on a Roth conversion. "Certain states offer transferable tax credits," he says. "Imagine a farmer who has never had a lot of income but now has a massive tax credit from a conservation easement. If the donor sells the credit, the transaction creates cash for the farmer and much-needed tax credit for a high-income buyer. We have seen buyers pay about 85 cents on the dollar, saving 15% on their state tax bill."

If unusable tax credits might be sold, what about unusable tax deductions? Technically, deductions can't be transferred, but such deals are appearing. "These offerings have become hugely widespread," Lewyn says. "They're on every street corner."

IRS WARNINGS

Conservation easement tax shelters may not actually be as ubiquitous as Starbucks outlets, but they have become common enough to draw IRS Notice 2017-10, which states that "some promoters are syndicating conservation easement transactions."

As the IRS explains these deals, one or more pass-through entities are involved in the ownership of the property covered by the easement. Investors in these entities are led to believe they'll receive a tax deduction that "equals or exceeds an amount that is two and one-half times" the amount invested. Appraisals that "greatly inflate" the value of the donated easement underlie the claimed deductions, the notice asserts. Such deals were classified as listed transactions, subject to greater IRS scrutiny.

Boggess indicates that a syndicated offering might be worthwhile for investors, if the easement valuation is realistic.

As for clients who want to donate a conservation easement, Lewyn believes it may be a better idea to take the benefits personally. "I would find an attorney who has a documented specialty of creating and defending easements before I would consider creating a syndicated easement," he says.

THE ADVISER'S ROLE

Given that easement donations may require the services of an experienced lawyer and a reputable appraiser, what role remains for financial advisers?

"I have helped clients with conservation easement donations," Lewyn says, "mostly by explaining the risks on the front end and supporting them emotionally when they learn their easement is under audit."

Fully informed, HNW landowners can decide whether the risks are worth the potential tax reduction jackpot. **FP**

"Easements have become the coin of the realm, so to speak. Having familiarity with the potential benefits and the risks allows advisers to provide a filter for clients," says Marc Lewyn, CEO of JOYN.

Donald Jay Korn is a contributing writer for *Financial Planning* in New York. He also writes regularly for *On Wall Street*.

ALSO IN PORTFOLIO: P. 57: Investing Lessons of the Century

A Supersecure Safety Net

Following the required minimum distribution schedule of the IRS provides a spending plan for retirement that's certain not to run out.

BY CRAIG L. ISRAELSEN

A RETIREMENT PORTFOLIO IS LIKE A SHIP IN THE OPEN water. It is exposed to a variety of potentially hazardous conditions, and its survival is a function of how it is designed and how it is managed.

To build a sturdy portfolio that will get clients as far as they need to go, it's important to understand the required minimum distribution guidelines that apply to almost all retirement accounts. It's also vital to see what hazards these accounts face, and how advisers can address them.

The biggest single hazard is being underfunded. Without sufficient capital, a portfolio simply can't stay afloat for 25 to 30 years unless the retiree makes undersized annual withdrawals. That won't work if the portfolio is the retiree's primary source of retirement income. The portfolio will capsize long before the retiree does. The problem of underfunding is not solvable by the adviser at the point of retirement.

Another hazard is known as sequence-of-returns risk, and/or inadequate portfolio returns. If the portfolio experiences large losses in the early years (a bad initial sequence of returns), and/or overall poor performance, its longevity is seriously compromised.

To avoid this hazard, advisers must build a broadly diversified retirement portfolio that enlists a variety of asset classes that tend to have low correlation with one another. In this way, a sequence-of-returns spectrum is created among the various components of the portfolio, minimizing the probability that all of the asset classes will simultaneously experience poor returns. It is hoped this will ensure that the portfolio performance is adequate to meet the income demands of the retiree.

Another hazard is that too much money is withdrawn by the retiree too quickly. Sometimes, this might result from ignorance, or the retiree may simply be unaware of what constitutes a reasonable withdrawal rate. This leads to premature insolvency.

Interestingly, this is where the RMD factors in. The required minimum distribution is a predetermined schedule of annual withdrawal rates that require the retiree to withdraw a certain percentage of the portfolio's value.

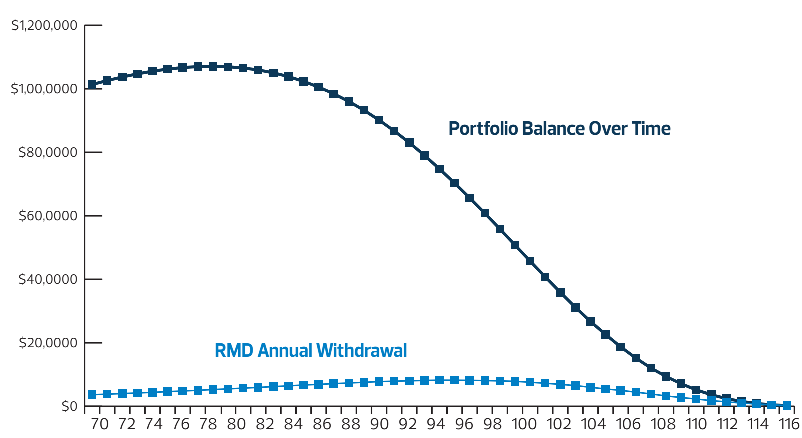
THE REQUIRED MINIMUM DISTRIBUTION

In the words of the IRS, "the RMD rules apply to all employer-sponsored retirement plans, including profit-sharing plans, 401(k) plans, 403(b) plans and 457(b) plans. The RMD rules also apply to traditional IRAs and IRA-based plans such as SEPs, SARSEPs and Simple IRAs. The RMD rules also apply to Roth 401(k) accounts. However, the RMD rules do not apply to Roth IRAs while the owner is alive."

The IRS' Uniform Lifetime Table is used by retirees who

Retirement Portfolio Slopes

$1 million portfolio earning 5% annually with RMD-based annual withdrawals.



Source: Author's calculations

are age 70½ and over, unless their spouse is the sole beneficiary of the account and the spouse is at least 10 years younger. The RMD table is a valuable resource.

Here's the amazing part: the mathematics of the RMD virtually guarantee that a portfolio cannot be liquidated within 45 years if the amount of money being withdrawn each year is the amount stipulated by the RMD — and nothing more than that.

Of course, the required minimum withdrawal may be inadequate to meet the needs of the retiree in the later years, but that is a different matter. On the other hand, the stipulated RMD may be more than the retiree needs to spend that year, so the excess above their needs can be reinvested into a taxable investment account — or simply stuffed in a mattress.

The Uniform Lifetime Table provides the RMD divisors, which are used to calculate each year's distribution from the portfolio. In the first year, when the retiree makes their first withdrawal, the divisor is 27.4; this is equivalent to a withdrawal rate of 3.65%. If the account balance was $1 million at the end of the prior year, the RMD would be calculated as $1 million divided by 27.4, which equals $36,496.

Then, in second year, the divisor is 26.5, which is equivalent to a withdrawal rate of 3.77%. The divisor continues to decline annually until the 46th year, when it reaches 1.9, at which point the effective withdrawal rate is 52.63%.

One important attribute of the RMD needs to be highlighted: The stipulated annual withdrawal is a percentage of the portfolio's value.

This is quite different from a non-RMD withdrawal rate schedule that is blind to the portfolio's fluctuating account value from year to year. For example, if a retiree has a starting account value of $1 million and the first year's withdrawal is scheduled to be 4% with a 3% annual cost of living adjustment, the annual withdrawals are known in advance — regardless of the returns experienced by the portfolio. In such a case, the first withdrawal will be $40,000 and the subsequent annual withdrawals will increase by 3% ($41,200 in the 2nd year, $42,436 in the 3rd year and so on).

For an account governed by the RMD, annual withdrawals are a percentage of the portfolio's value at the end of the prior year, so the withdrawal could decline in a subsequent year if the portfolio experienced a heavy market-based decline. This built-in sensitivity to the fluctuating account value of the portfolio is why a portfolio governed by the RMD guidelines cannot be liquidated for 45-plus years.

TESTING THE RMD

To test the viability of an account under very different market conditions, three tests were carried out using the RMD table for 1970 to 2016, assuming a $1 million portfolio value at the start but making different assumptions about the performance of the portfolio. One test assumed a fixed annual return of 5%, another assumed a 5% annual loss and the third assumed a multi-asset portfolio that tracked the actual performance of seven indexes for the last 47 years.

Rolling Test

$1 million starting balance, annual withdrawals determined by RMD, 23 rolling 25-year periods from 1970-2016.

Retirement Portfolio Asset Allocation Model	Success Rate (How often did the portfolio last at least 25 years?)	Average Ending Account Balance at the end of each 25-year period	Average Amount Withdrawn Each Year over each 25-year period	Average 25-Year Total Amount Withdrawn over each 25-year period
7-Asset Diversified Model*	100%	3,088,410	170,960	4,273,991
40% U.S. Large Stock, 60% Bonds	100%	2,640,053	150,015	3,750,385
50% Bonds, 50% Cash	100%	1,214,737	93,358	2,333,962
100% Cash	100%	850,508	77,006	1,925,160

Note: The multi-asset portfolios were rebalanced at the start of each year.
*The seven-asset portfolio consisted of these indexes: S&P 500, Russell 2000, MSCI EAFE, Dow Jones U.S. Select REIT, S&P Goldman Sachs Commodity and Barclays Capital U.S. Aggregate Bond, plus U.S. Treasury 90 Day T-Bills.
Source: Steele Mutual Fund Software, calculations by author

The performance of the portfolio with the fixed annual return of 5% is shown in the "Retirement Portfolio Slopes" chart. The numbers behind this graph reveal that a retirement portfolio that started with $1 million still had $2,418 remaining when the retiree was 116 years old. A total of $2,527,806 was withdrawn over the entire 47-year period.

Let's now assume a worst-case scenario in which the portfolio has a 5% loss each year. The portfolio still lasts for 47 years. The withdrawal made when the retiree was 116 years old was a whopping $9 and the ending account balance was $7. Nevertheless, the portfolio remained intact.

A more realistic scenario is

one in which the adviser builds a diversified portfolio for the retiree that consists of equal portions of large-cap U.S. stocks, small-cap U.S. stocks, non-U.S. stocks, real estate, commodities, U.S. bonds, and cash. (The indexes used in this analysis are listed in the "Rolling Test" chart on page 55.)

The actual 47-year average annualized return for this portfolio in 1970-2016 was 9.75%. With this diversified investment portfolio, the retiree withdrew nearly $13 million if she lived to be 116 years old. By the end of her 90th year (a more likely age of death), the retiree had withdrawn slightly over $3 million and still had an account balance of over $4 million.

But, of course, this analysis considers only one particular sequence of returns that started in 1970 and ended in 2016. To get a more accurate picture of the survival characteristics of a retirement portfolio, we will need to study it over many different time periods, or rolling time frames.

Furthermore, 47 years is a really long retirement period. More realistic is a 25-year period from age 70 to age 95. Thus, the final analysis reported here will present the portfolio survival data over 23 rolling 25-year periods from 1970-2016. The first 25-year period was 1970-1994, the next was 1971-1995, and so on. The results are shown in "Rolling Test."

LIVING TO AGE 95

If withdrawing only the amount specified by the RMD, the seven-asset diversified portfolio had a 100% success rate — meaning that it stayed intact for at least 25 years in all 23 rolling 25-year periods.

For this diversified portfolio, the average ending account balance at the age of 95 was $3,088,410. The average amount withdrawn annually in each of the 23 rolling 25-year period was $170,960 and the average total amount withdrawn in each of the 23 rolling 25-year periods was $4,273,991.

Three increasingly more conservative asset allocation models were also historically tested: a 40% large cap U.S. stock/60% U.S. bonds model, a 50% bonds/50% cash model, and a 100% cash model.

We already know that any asset model employed will have a 100% success rate in surviving at least 25 years when using the RMD as the guide to annual withdrawals.

Thus, when using RMD rules, the asset allocation model does not affect portfolio survival, but rather the amount of money it provides the retiree each year. This suggests that the asset allocation of retirement portfolios need not be ultraconservative.

The annual portfolio withdrawal rate mandated by the mathematics of the RMD will naturally preserve the portfolio well beyond the expected lifespan of the retiree.

Of course, if the retiree withdraws more than the RMD each year, the portfolio will not survive as long. But if the extra withdrawal is modest, the portfolio is still highly likely to outlast the retiree, assuming a portfolio design that achieves a reasonable rate of return (something above 7%).

Furthermore, if the RMD withdrawal is more than a retiree needs to spend that year, the excess above his needs can be reinvested into a taxable account.

A more conservative 40% stock/60% bond retirement model had a lower average ending account balance (by nearly $450,000), a $20,000 lower average annual withdrawal and an average total amount withdrawn over each 25-year period that was lower by over $520,000.

The same pattern prevails as the portfolio becomes more conservative by using a 50% bond/50% cash model or a 100% cash model. If your client withdraws only the amount stipulated by the RMD — and no more — then it is advisable to use an asset allocation model that is a prudent blend of equities (U.S. and non-U.S. stocks), diversifiers (real estate and commodities), and fixed income (bonds and cash).

With the mathematics of the RMD as the safety net, build a portfolio designed for the long run because many retirees will have a long-run retirement. FP

Using RMD rules, the asset allocation model of a retirement portfolio need not be ultra-conservative.

Craig L. Israelsen, Ph.D., a *Financial Planning* contributing writer in Springville, Utah, is an executive in residence in the personal financial planning program at the Woodbury School of Business at Utah Valley University. He is also the developer of the 7Twelve portfolio.

Investing Lessons of the Century

Here are vital points for advisers to keep in mind as they craft portfolios for the rest of the epoch.

BY ALLAN S. ROTH

SO FAR THIS CENTURY, IT'S BEEN A WILD RIDE FOR investing. It hasn't been easy to guide clients through the turmoil. The graph below conveys that wild ride. Looking at it may remind you of the fear and greed cycles we all went through. Or maybe it will bring to mind the bubble paradigms that came and went, such as "cash flow no longer matters" (dot com), and "real estate can never decline" (subprime/financial). And how many times in the past 17 years have you heard, "this has never happened before?" We can all benefit by learning from our investing mistakes thus far, and tweaking our strategy going forward. Here are lessons we can teach our clients that are likely to work for the rest of the century.

Stocks are really risky. For the past decade, I've been hearing about a so-called bond bubble — usually after an interest rate hike caused bonds to lose value. Now compare stocks' wild swings against the stability of bonds.

Sure, trying to predict future stock performance is an exercise in futility, but you can predict with near certainty that high-quality bonds will have far less volatility than stocks in the long run. As I remind my clients, stocks are riskier in a day than high-quality bonds are in a year. Yet in the past several months, I've had new clients come to me with portfolios even more aggressive than I saw in 2007, just before the 2008 stock market plunge. I chalk it up to this bull being far fiercer than the 2007 bull, as measured both in time and magnitude.

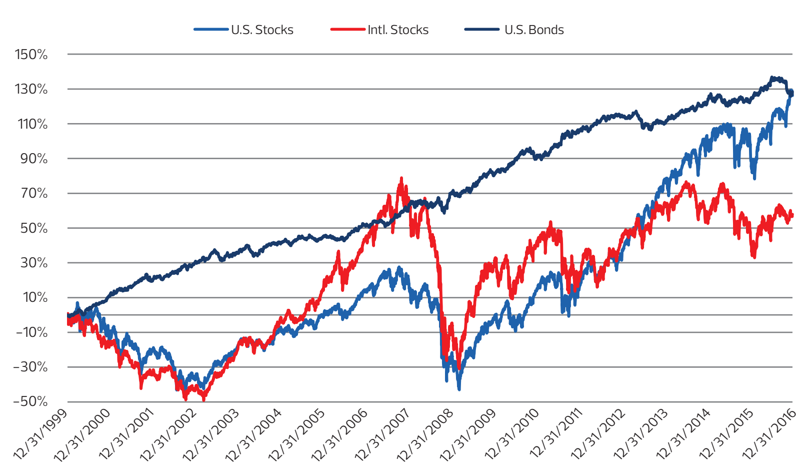
U.S. stocks don't give enough international exposure. I am hearing from many investors that they don't need international stocks. Two points frequently made are that 48% of S&P 500 revenues come from international sales and that there is a high correlation between U.S. and international stocks.

Yet international stocks trounced U.S. stocks in the first half of the 17-year period and badly underperformed in the second half. There wouldn't be such divergences in performance if U.S. stocks alone gave enough foreign exposure, demonstrating, yet again, that high correlation doesn't mean the same total returns. Regardless of whether international stocks outperform the U.S. this year or just the opposite, my advice to clients is always to own the world.

Help your clients understand how long their long run really is. We know that stocks are for growth and that, in the long run, stocks outpace bonds. Though I agree, the long run can be well over a decade. For instance, in the first 17 years of this century, bonds have slightly outpaced U.S. stocks and

Asset Performance This Century

It hasn't been easy to guide clients (and ourselves) through the turmoil.



Note: U.S. Stocks represented by VTSMX, Intl. Stocks represented by VGTSX and U.S. Bonds represented by VBMFX
Source: Yahoo Finance

trounced international stocks.

Help your clients understand their investment horizon and set the allocation according to that horizon.

Break the prediction addiction. So far in this century, we have had two stock plunges of nearly 50% or more.

It bears mentioning that few forecasted such plunges. While economist Gary Schilling correctly called the 2008 crash, he missed just as badly in 2009 when he didn't call the bottom. And Harry Dent's 2009 best seller, "The Great Depression Ahead," came just in time to help readers lose out on this great stock market bull.

Even economists badly flunked interest rate forecasts. They consistently predicted rising rates, while the market decided otherwise.

I try to help my clients break their addiction to prediction by reminding them that the market has already priced in known information, and to embrace the reality that nobody knows the near future.

Don't bail on bonds. High-quality bonds act as a shock absorber and give the client the ability to rebalance their portfolio. But despite the evidence that rebalancing works, it's not always easy. Who could argue with the benefits of buying stocks that are on sale?

Still, few had the intestinal fortitude to buy when stocks plunged in 2002, and especially in 2008. Sticking to just about any asset allocation would have worked, as it meant one would have required selling after stocks surged and buying after a plunge to get back to target allocation.

To rebalance, however, one would have to own high-quality bonds or bond funds. According to Morningstar, the average taxable bond fund lost nearly 8% in 2008, and many bond funds lost 20% or more. That's because people bought risky bond funds to try to eke out an extra half percent in yield.

The bond funds in the graphic are mostly backed by the U.S. government. The fund gained 5.05% in 2008. Though bonds are unlikely to perform as well as they have so far this century, tell your clients not to bail on bonds. Sell some only to rebalance after bonds have outperformed stocks.

Alternatives have had low correlation but bad returns. After the most recent plunge, many advisers and individuals went heavily into managed futures, market neutral funds, long-short funds, inverse funds, hedge funds and the like. I wrote a piece for *Financial Planning* in 2012 warning these were unappealing alternatives. True, many had low or negative correlations with the stock market, but they also had very low or even losses before costs.

At the same time, they typically have very high costs. As I tell my clients, I could take half my portfolio and gamble in Las Vegas and it wouldn't be correlated to stocks, yet that doesn't make it a smart thing to do. Tell your clients that any investment with a low correlation to stocks must also have a reasonable expected return.

Narrow bets have worse market timing. If stocks surge, investors will get greedy and buy; if stocks plunge, fear will rule and they will sell. Many studies estimate the impact on investors by comparing dollar-weighted returns to the geometric returns of funds. And, to be fair, this even happens with the very broad index funds in the illustration in the beginning of this piece. Work by Vanguard shows the narrower the fund, the more investors show bad timing. I advise clients that broader is better in that it not only lowers volatility; it reduces the temptation to performance chase.

Costs matter. This may not seem like much of a surprise but I argue it surprised me the most. The fact that low-cost index funds trounced expensive funds is, of course, expected. It's virtually a mathematical certainty that this would happen and it will continue to happen.

But after 27 years of index investing, what has truly shocked me is that currently over 43% of money in U.S. stock funds is in index funds. This is an increase from less than 12% as we entered the 21st century. Clients are finally connecting the dots between costs and return, and money is pouring out of expensive funds into low-cost, tax-efficient funds. The trend is likely to continue for some time. Hopefully, your clients will be more conscious of costs as well.

Investing based on the recent past is a mistake. Over the five-year period ending in 2007, U.S. stocks doubled while international stocks tripled. I wish I had a dime for everyone who told me then that they had a high risk tolerance and that international stocks were sure to outperform U.S. stocks. A year later, in the wake of the stock market meltdown, and as we stood on the precipice of the Great Recession, some of those same people had changed their tune to "cash is king," and missed out on the also-great recovery. If your clients think this current eight-year bull stock market will continue indefinitely, they may someday find themselves wishing they had a time machine to rethink that premise.

As I explain to clients, we are all emotional beings who are not particularly efficient learners and regularly repeat mistakes. These lessons may help your clients avoid the kind of investing mistakes that take from their return. **FP**

Allan S. Roth, a *Financial Planning* contributing writer, is founder of the planning firm Wealth Logic in Colorado Springs, Colorado. He also writes for *The Wall Street Journal* and *AARP the Magazine* and has taught investing at three universities. Follow him on Twitter at @Dull_Investing.

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FROM: GIVING: IT'S NOT JUST ABOUT TAXES

1. What is the federal estate tax exemption per individual in 2017?

1. $6.54 million
2. $5.49 million
3. $4.45 million
4. $7.34 million

FROM: FROM $7,000 to $6 MILLION

2. Once a Roth IRA receives DISC dividends, how long must the account owner wait to receive those funds as qualified distributions in order to avoid paying taxes?

1. Three years
2. Four years
3. Five years
4. Two years

FROM: A SUPERSECURE SAFETY NET

3. When withdrawing the amount specified by the RMD, what was the average ending account balance of a 40% large U.S. stock/60% bond portfolio with a $1 million starting value at the end of each of the 23 rolling 25-year periods that occurred between 1970 to 2016?

1. $1,214,737
2. $2,640,053
3. $3,088,410
4. $850,508

4. With which retirement account would the standard RMD rule not apply?

1. 401(k) plans
2. SARSEPs
3. Simple IRAs
4. Roth IRAs

FROM: PAYOFFS IN PRESERVATION

5. What is the No. 1 state in terms of acreage under easements overseen by land trusts?

1. Montana
2. California
3. Texas
4. Maine

6. Annual deductions for conservation easements are generally capped at what percentage of a typical taxpayer's adjusted gross income?

1. 50%
2. 40%
3. 60%
4. 45%

FROM: A HIERARCHY OF RETIREMENT NEEDS

7. Which of these is not part of the three buckets in which consumers typically account for their wealth, per research from Hersh Shefrin and Richard Thaler?

1. Current income
2. Current assets
3. Assets to support future income
4. Future assets

FROM: THE RISKS OF SIMPLIFYING RISK (online only)

8. A client's portfolio is at a low capacity for risk once its Monte Carlo probability of success hits this percentage (and lower)?

1. 85%
2. 80%
3. 79%
4. 70%

FROM: WHY ADVISERS SHOULD SCRUTINIZE MUTUAL FUNDS THAT HOLD ETFS (online only)

9. Actively managed mutual funds that hold this percentage of their assets in passive investments underperform actively managed mutual funds that hold only stocks and bonds by between 0.41% and 1.63%, according to new research.

1. 10.2%
2. 11.5%
3. 12.8%
4. 14.4%

10. How much, in dollar terms, have institutional and retail managers bought in ETFs as of March 2017, according to Goldman Sachs?

1. $100 billion
2. $50 billion
3. $75 billion
4. $150 billion

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To earn one hour of continuing education credit from the CFP Board of Standards, please visit our website and answer the questions above. Planners must answer eight out of 10 questions correctly to pass. Credit will count under CFP Board subject A: financial planning process/general principles. The deadline for participation is May 31, 2018.

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Coping With a Spouse's Death

An adviser explains the personal journey of taking the reins after losing her longtime partner.

BY BARBARA SHAPIRO

THROUGHOUT MY CAREER I HAVE HAD MANY clients lose spouses — usually it's the women who lose their husbands. Statistically, woman over 65 outlive their husbands by 15 years. Unfortunately, my husband and business partner, Herb Shapiro, recently passed away, and I have become part of the statistic.

When we married 33 years ago, I was a special needs teacher and didn't know the difference between a stock, bond and mutual fund. I was my typical widowed client. The only difference is that I am now financially sophisticated and not financially scared to death.

LOSING MORE THAN A BUSINESS PARTNER

Herb drafted me into this business, tutored me, mentored me and educated me. I owe him my professional life.

We always shared everything. When a new client came in, we each built a financial plan and met to defend our choices. We ultimately chose the best combination — no egos, just the best plan for the client.

A few months before Herb died, he stopped seeing clients. I started to run the office, see all the clients and make all investment decisions. I am professional and in fact have been able to focus and do my job well because the office is a place where I can be "normal."

How am I going forward? The same way my widowed clients go forward — one step and one day at a time. That's my personal journey. But I own a business, so I have a responsibility to my clients and my staff.

My staff is competent and cross-trained. I have chosen to use a team approach to leadership as opposed to a linear one where it's my way or the highway. That being said, I make the ultimate decisions on all matters.

BUSINESS CHANGES TO BE BETTER PREPARED

When my husband got sick, I instituted several new procedures. They may sound trite, but there is a logical and important reason I did this: it gave me order and structure.

My personal life was in chaos yet my work life was structured and as orderly as a financial planning firm can possible be. In addition, the structure allowed me to take some items off my plate. In fact, I have continued using this approach.

When a client emails a request, I forward the email to the staff member who normally handles that request. I want to make sure that the request is taken care of whether I am available or not.

I always met with various staff members at the end of the day, but now we have started to meet several times throughout the day so everything is covered if I have to be out of the office for an appointment.

I am always prepared for meetings a couple of days in advance, but now I have extended that to a week to 10 days.

A large percentage of my practice is divorce financial analysis. I tell my clients not to make any large decisions or changes for at least two to three years, keep their lives on an even keel and make decisions based on fact, not emotion.

I have found 99.9% of my clients are very supportive. A few have asked what my long-term plans are. I am renewing my lease not because of the money — although that is nice — but more because I want the structure and normalcy of work. As a tribute to my husband, HMS Financial Group will flourish, perhaps dented and bruised for a while, but failure is not an option. **FP**

Barbara Shapiro, CFP, is the president of HMS Financial Group in Dedham, Massachusetts.

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