

# MILNE FINANCIAL PLANNING, INC.

*A Fee-Only Advisor*

Jamie Milne, CFP®, CDFA



FINANCIAL ADVICE WITH A DIFFERENCE!

Joe Sample and Jane Sample  
18 Isham Hill Road  
Barre, VT 05873

Dear Joe Sample and Jane Sample;

Thank you for the confidence you have placed in Milne Financial Planning, Inc. You came to Milne Financial Planning, Inc. for an independent review of your current financial position. I trust that you found the meeting informative, and that it provided the feedback you were looking for. This letter will review what we discussed at the meeting.

Our meeting was not a comprehensive financial plan, nor is this written follow-up meant to represent a comprehensive plan. Both the meeting and this report represent my opinions and advice based on the information you have provided about your current finances and goals. Time constraints of the meeting prohibit covering all the pertinent details of your finances. A full comprehensive plan takes significantly longer.

We discussed many different financial aspects. Do not be surprised if it takes a while to digest all of the information. Also, please recognize that you do not have to accomplish all the recommendations *tomorrow*. The important thing is for you to agree upon a direction. Once you have reviewed this report, please call if you have any questions. I will be happy to clarify anything in this report without charge.

It was a pleasure working with you.

Sincerely,

Jamie Milne, CFP®, CDFA

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## PRELIMINARIES

**Custom tailored plan** – The financial planning process does not provide a single answer that best fits everyone. I have used my experience and judgment to create this unique report that is specifically tailored to fit you and your circumstances. This makes comparing my recommendations with others difficult, and makes applying the advice in this report to others dangerous.

**Future unknown** – Please keep in mind that the future of these recommendations is unknown. Milne Financial Planning, Inc. makes no claim to understand or predict the future. The outcome of the recommendations in this report are neither assured nor guaranteed.

**Data** – My recommendations have been derived from the information you provided. If your information has not been properly presented, either due to an oversight on your part or a misinterpretation of the data by Milne Financial Planning, Inc., the projections, opinions and recommendations could be significantly impacted. If you uncover misinformation, please bring it to my attention so I may judge its impact on this report.

**A changing environment** – Any financial advice is based on a fixed period of time. The economy, investment markets and our personal lives constantly change, and therefore it is important for you understand that the advice provided becomes dated as your environment changes. I recommend that you have your personal finances reviewed regularly. A review is an especially good idea whenever a major event occurs in your life such as a job change, birth, move, death, inheritance, or other events that would have a similar impact on your life and/or finances. In the absence of a change in your personal life, you should have your personal finances reviewed every year.

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## GOALS, DREAMS, OBJECTIVES and OBSERVATIONS

You sought guidance to discuss the following issues:

- Whether or not you are “on track” to meet your career goals. Joe Sample plans to change careers at age 50.
- How to invest your cash.

### Observations –

As of the date of this report, the fund(s) that Jane Sample’s work retirement plan is invested in is unknown. Once that holding is better understood, the investment section should be updated.

Also, Joe Sample’s ABC Corporation pension is an estimate. Again, once the actual number is known, the retirement analysis should be updated.

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## SUGGESTIONS AND CONSIDERATIONS

Topic	Suggestions and Considerations	Priority	Assigned Person	Target Date
General	I believe it is important to take time in our busy lives and look at the positive. You have done a great job of positioning yourselves to meet you goals. I hope that you continue to be proactive with your personal finances.	On-going	Joe Sample and Jane Sample	
Cash Flow	The single most important variable is annual spending. I recommend careful monitoring of your spending to determine if the number used in the retirement projection reflects your actual spending level.	Immediate and life long	Joe Sample and Jane Sample	
Estate	It is time to update your will and execute a durable power of attorney for health care and a living will.	1 Month	Joe Sample and Jane Sample	
Estate	You could consider a living trust. This would clearly spell out what you would want to happen if one of you became disabled or died.	6 Months	Joe Sample and Jane Sample	
Insurance	Confirm that you have a \$1 million umbrella policy.	1 Month	Joe Sample	
Insurance	Joe Sample's current life insurance, though adequate, is likely to be inadequate if Joe Sample changes careers.	3 Months	Joe Sample	
Insurance	Jane Sample's life insurance is only adequate if Joe Sample continues working at his current earnings level until age 65.	3 Months	Jane Sample	
Insurance	If either of you becomes disabled it is unlikely that you will be able to continue saving for retirement.	3 Months	Joe Sample and Jane Sample	

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Insurance	Joe Sample should consider a disability policy soon to provide coverage when he changes careers.	2 years	Joe Sample	
College Savings 529	Determine if the B share investments convert to A shares at some point. And what the total costs of the funds are.	1 Month	Joe Sample	
Investing	See the Investment Section below.	1 Month	Joe Sample and Jane Sample	
Investing	Hartford Annuity – expenses are too high. See comments in the investment section.	1 month to 6 years	Joe Sample	
Investing	Consider changing or adding another fund to Jane Sample’s 401k.	1 Month	Jane Sample	
Investing	Consider moving your investment accounts to TD Waterhouse. This would enable us to more effectively reallocate your accounts.	1 Month	Joe Sample and Jane Sample	
Planning	Update your Net Worth Statement once a year.	Yearly	Joe Sample	
Planning	Read and discuss this summary report.	Immediate	Joe Sample and Jane Sample	
Planning	Continue service with Milne Financial Planning. If you have benefited from my services referrals provide me with a pre-qualified source of new clients and are very much appreciated.	1–3 months	Joe Sample and Jane Sample	

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## SPENDING PROJECTIONS

We projected your spending using the software program Silver, from Money Tree. Projections provide a “best guess” to determine if you will be able to retire when you hope to, as well as continue spending (your standard of living) until age 95. Although I believe these projections to be useful, you must keep in mind that they are *only* projections. Many assumptions were used, some of which were based on estimates themselves. A small change in any one of the assumptions can significantly impact the outcome of the illustrations.

I recommend that clients have their spending analysis reviewed every year. It would be a mistake to take these results, stick them in a file and then pull them out 10 years later, only to wonder why you did not achieve them.

<b>Definitions of Columns for the Retirement Capital Projection</b>
<b>Retirement Spending Needs:</b> This is the amount you currently spend each year (excluding income taxes). It increases based on the rate of inflation used in the assumptions.
<b>Social Security:</b> This is the amount of your Social Security adjusted for your income taxes due.
<b>Pension Income:</b> This is the amount of your pension income adjusted for the income taxes due.
<b>Education &amp; Other Inc/Exp:</b> This column is often a little difficult to decipher from the print out. The column is the net sum of any income and expenses that we inputted. The included income items are listed under Other Income on the <i>Resources Available for Retirement</i> page. The expenses are listed on the <i>Retirement Profile</i> page under the Additional Objective section.
<b>Net Surplus or (Shortage):</b> This is the amount of money you need from your portfolio each year.
<b>Retirement Capital:</b> These numbers represent the projected value of your portfolio each year. They include the Rate of Return earned each year and are reduced or increased depending on whether you have a cash surplus or cash need.

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The assumptions used for your spending projections are detailed on the *Retirement Profile* page, the *Resources Available for Retirement* page and the *Assumptions* page. Two of the main assumptions used in the analysis are inflation (3%) and the total return on your portfolio (7% unless stated otherwise).

Retirement Capital Analysis – What-if? A This illustration was used as the starting point. Spending is assumed to be \$71,000 per year. This spending number was the result of my analysis of income, taxes and savings. It may or may not be close to your actual spending number. However, based on this spending level, you have sufficient assets to meet your retirement goals and maintain this level of spending until Jane Sample is age 95.

Retirement Capital Analysis – What-if? B This illustration is the same as the first Capital Analysis A, however, I increased your spending to \$80,000 per year. At this higher level of spending, you would deplete your assets at Jane Sample's age 95. This would be the maximum level of spending that can be supported.

Retirement Capital Analysis – What-if? C This illustration is the same as the first Capital Analysis A, however, I decreased the total rate of return from 7% to 5%. This would reflect a more conservative investment portfolio. With this lower rate of return, you would be unable to support a spending level of \$71,000. Your assets would be depleted at Jane Sample's age 86.

Retirement Capital Analysis – What-if? D This illustration is the same as the Capital Analysis C, however, I decreased spending to allow your portfolio to be depleted at Jane Sample's age 95. You would have to decrease your spending to \$65,000 per year if you invested conservatively.

## **Recommendations:**

The projections, as illustrated above, indicate that you are on track to meet your career and retirement goals. There are many assumptions that have gone into your projections, all of which are important, but continued annual savings until Jane Sample retires is key to your strong projections. You can see this savings stream in the Annual Additions to Assets column.

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## INSURANCE

**Life** – We discussed life insurance during the meeting but we did not review the analysis during the meeting.

Retirement Capital Analysis – What-if? E In this illustration I attempted to account for the changes if Joe Sample dies next year. I assumed the following:

- Jane Sample gets \$550,000 of life insurance.
- Jane Sample does not get any of Joe Sample's pension (this may or may not be true, but it is the worst case possibility).
- Jane Sample continues to work until age 65.
- Jane Sample is no longer able to save for retirement.
- Jane Sample does not spend portfolio assets other than for living expenses (to make up any difference from her salary and spending \$71,000 per year) and for college costs.

Based on these assumptions, Jane Sample is likely to be able to maintain her standard of living without Joe Sample.

Retirement Capital Analysis – What-if? F In this illustration I attempted to account for the changes if Jane Sample dies next year. I assumed the following:

- Joe Sample gets \$360,000 of life insurance.
- Joe Sample also receives Jane Sample's partnership share a year later.
- Joe Sample continues to work at ABC Corporation until age 65.
- Joe Sample is no longer able to save for retirement.
- Joe Sample does not spend portfolio assets other than for living expenses (to make up any difference from his salary and spending \$71,000 per year) and for college costs.

Based on these assumptions, Joe Sample is likely to be able to maintain his standard of living without Jane Sample.

**Disability** – No review of potential need was done. You both indicated that you had disability insurance from work.

**Liability Insurance** – I recommend everyone have adequate liability coverage. For most people this means having a \$1 million umbrella policy. Joe Sample indicated that you had \$1 million liability coverage.

**Home Owners Coverage** – Since you have significant assets, I would recommend high deductibles for your homeowners and auto insurance. Also, review your coverage to assure that you have replacement value coverage.

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**Health Insurance** – We did not review health insurance, however, I know you have coverage from one (or both) of your employers.

**Long-Term Care Insurance** - If you decided to look into long-term care insurance, you could consider something less than full coverage. I often advise clients to consider taking some of the risk themselves but consider a policy that pays about ½ of the daily coverage. In this case, if you end up needing the coverage you will wish you had purchased more but if you never use it you did not pay so much for something you did not need. And if you do need it, having a policy that pays about one-half of your need slows the drain on your assets.

Particularly for long-term care coverage, I recommend using a qualified insurance agent.

If you do not know a qualified Long Term Care agent, I suggest either Norm Kuebler or John Ryan. Let either of them know I referred you. Both John and Norm are commissioned agents and will receive a commission on any sale. I do not receive or pay fees to either of them.

John Ryan  
Ryan Insurance Strategy Consultants  
PMB 446,  
9249 S. Broadway, #200  
Highland Ranch, CO 80126

(800)796-0909  
(888)337-2291  
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Norm Kuebler  
Vermont Senior Citizens Insurance Group  
PO Box 82  
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## Recommendations

Life – The overall result of the insurance analysis would indicate that you have enough life insurance coverage. However, I have a couple of concerns.

1. When Joe Sample changes careers and is on his own as a consultant, then the group-term coverage will drop and the amount of life insurance Joe Sample will have at that point is unlikely to cover his anticipated earnings.
2. The only way that Jane Sample's coverage is adequate at this time is if Joe Sample continues working and earning the same level of pay until he is age 65. If Joe Sample's life goals include being able to change careers (with or without Jane Sample) then you should consider additional life insurance coverage on Jane Sample.

Without doing the analysis, the disability issues are similar. If one of you becomes disabled, it is unlikely that you would be able to save at the rate you are currently saving and you may not be able to save at all. And once Joe Sample is on his own he will now longer have disability insurance. Joe Sample should consider getting his own policy before changing careers.

If you are thinking of purchasing long-term care insurance in the future, you may as well price the coverage now. Like most insurance, long-term care is age based and your premiums should be reasonable.

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## NET WORTH

The Net Worth Statement included with the report lists all of the assets and liabilities that you have. It indicates that your net worth is \$xxx,xxx. I believe everyone should update their net worth statement once a year as a way to track one's financial progress each year.

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## COLLEGE

The spending projections used above include paying for college. The assumption is that you will pay \$30,000 for each of your two children. The funds you have saved for college (\$110,000) will grow at 6% and college costs will grow at 6% as well. Based on these assumptions, you would need to increase your monthly savings by \$1,631 to meet this short fall. This is illustrated on the Education Funding Illustration. However, the retirement projections include the cost of funding the remaining college cost from your own portfolio rather than saving the additional amount.

### 529 Plan – College Sense

Your plans, CollegeSense, from New Mexico, have a four star rating from Savingforcollege.com. At the very least, this means you have a decent, if not very good fund. A couple of years ago I did research for a client and selected Iowa's plan. It is run by Vanguard and has low expenses. I have provided some basic information on both plans. The biggest difference is the total expense charged each year. The Iowa plan has .65% charge plus the funds charges. The total coast is about 1%. Your CollegeSense plan has a .35% charge in addition to the underlying fund charges, Class A .25%, Class B 1.00% and Class C 1.25%. This makes total expense ranging from .60% to 1.60%. I am guessing you have B shares from the B in the title. This means you are paying 1.35% per year.

### Recommendation

It has been a while since I have researched 529 plans. If you wanted a more detailed analysis, I suspect it would take about two additional hours of my time. On the surface, your plans are fine. However, much like the annuity, under the assumption you have B shares, you cannot change your plan to another 529 plan (this can be done once a year) without paying a penalty. This is likely a seven year declining surrender charge, starting at 7% (I am using an educated guess here).

If you have not figured it out, I think fees are very important in investing. At the moment you are paying a little more than double the fees of the Iowa plan. Performance comparison is difficult as Iowa lists first quarter performance on their site and CollegeSense list 2004 performance

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## INVESTMENTS

The overall purpose of this investment review is to assure adequate diversification within your portfolio. Since the process of diversification means investing in a variety of different asset classes and categories, it is likely that not all areas will perform alike. This is what we are trying to achieve. The overall effect is to reduce the risk of the portfolio and smooth out future returns.

### Holdings

**Oppenheimer Main Street A** – There is no need to change this fund. However, since it is an A share, I would not add additional money to the fund. Its performance has been similar to an S&P 500 fund; you could purchase the Vanguard Total Stock Market Index instead. This would be a taxable transaction.

**AIM** – Sell this fund; its past performance is poor and the company has a fiduciary grade of D. Again, the Vanguard Total Stock Market Index is a good choice. This would be a taxable transaction.

**North Track Strategic Allocation (Jane Sample 401k)**– This is an interesting fund. It is made up of three North Track funds, technology, finance and health. I use their technology fund when a client needs or wants to boost their technology exposure. However, as a single holding, I would consider something else. Though you did not pay a sales fee (that's good) the expense ratio of the allocation fund is generally in addition to the expense ratio of the underlying funds. The Allocation Fund expense ratio is shown as .80% and the fund then incurs a 1.00% charge from the underlying funds. The total expense ratio for your A share is 1.80%. What other choices do you have with your 401k?

### Hartford Annuity IRA

My reasons for disliking deferred variable annuities are as follows:

1. The expense ratios (due to the M&E insurance charge) are way too high for the benefit received. In your case the annual M&E charge is 1.45%.
2. Once you own an annuity it is hard to get rid of it. Your annuity has an 8% surrender charge that declines to zero at or after the 8<sup>th</sup> year. Since this annuity is less than 2 years old, I suspect if you moved it you would pay a 7% surrender charge this year.
3. Some annuities I have seen have investment sub-account options (the funds the money is invested in) that are mediocre. The annuity that you own has good investment sub-account options.

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4. Annuities pay higher commissions than mutual funds to the advisors who sell them. Having once sold annuities and mutual funds myself, I was well aware that annuities paid me about twice as much as a mutual fund.
5. The growth of an annuity is taxed as ordinary income, not as dividends or capital gains. In your case the money is in an IRA, so it will be taxed as ordinary income anyway so again, this is not a disadvantage in your case.

There are some advantages to a deferred annuity. One is tax deferral. You can invest your after-tax money in an annuity and it will grow tax deferred until you withdraw the money. Then the growth is taxed at ordinary income tax rates. However, the money you inherited was IRA money (and still is) so this advantage of the annuity is not necessary. There is really no reason anyone should put IRA money into an annuity (the malpractice bit).

Annuities have one other advantage. If you die and the balance is lower (due to market declines) than the amount of money you invested, the annuity company will pay your spouse the amount you invested, i.e. an annuity has a small life insurance component. The problem with this option (in my opinion) is that over the long-term, the market will likely increase at some point and it is unlikely the balance will decline below your original investment. Yet you have to pay for this benefit each and every year you own the annuity.

### **ABC Corporation 401k (Joe Sample)**

The Snapshot, *Sample, ABC Corporation 401k Joe Sample* gives the performance and the allocation of your current holdings in the 401k. I am recommending that you change the holdings as outlined in *Sample Corporatino 401k Joe Sample Changes*. The changes will increase your small cap holdings and your bond holdings and decrease your international holdings. In addition the performance of the Federated Capital Appreciation was questionable and I have removed the Fidelity Balanced fund, in favor of using Federated Intermediate Bond Fund, Vanguard Strategic Equity, MFS New Discovery (your only small cap option and its track record is fair) and increasing your investment in Dodge and Cox Stock. The changes are as follows:

Dodge and Cox Stock	Increased \$xx,xxx
Federated Intermediate Bond	New \$xx,xxx
Fidelity Diversified International	Decreased \$xx,xxx
MFS New Discovery	New \$xx,xxx
Vanguard Strategic Equity	New \$xx,xxx
Federated Cap Appreciation	Removed all money
Fidelity Balanced	Removed all money

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Any cash in the 401k was removed and invested as listed above.

## **Recommendation**

In the Fee-Only world that I work in, an annuity in an IRA is considered malpractice at worst and at best, it is a perfect example of an advisor (or company) selling what pays them the most.

I have also included a snapshot of Vanguard's annuity so you can better understand my concerns. The snapshot *Sample Vanguard Annuity Comparison* matches (to the best extent possible) the sub-account investments in your Hartford Annuity. You see that the main difference is that the Vanguard Snapshot has a greater value weighting and less international stock allocation (though the total stock allocation is similar). You see that Vanguard's one year performance is 9.56% vs Hartford's, 6.54% and the 10 year performance is 13.21% vs Hartford's 10.55%. Part of this difference may be because Vanguard did a better job with its sub accounts, part of it may be that the comparison of sub-accounts is approximate, but I know part of the difference is the overall expense ratio of Vanguard of .71% vs Hartford's 2.39%, a 1.68% difference each year.

The higher expense ratio is best seen on the Hartford Director Plus 2 VA Index page. You see that the Hartford S&P 500 index fund is about 2.00% lower than the index itself. Since the funds are invested identically (they both track the S&P 500) it is the higher expense ratio that causes this.

What to do? Basically, you are stuck unless you can get them to undo the entire purchase or waive the surrender charge. You can transfer this money out of the IRA annuity to a brokerage account (TD Waterhouse for example) beneficiary IRA. However, you will be penalized by the surrender charges. There is a strong argument to pay the penalty and invest the money in mutual funds. You will save at least 1.5% per year for six years and the performance is likely to be better as well. Other options include waiting a few years for the surrender charges to decrease (they will likely drop 1% per year), or waiting until there are no surrender charges at all (after eight years of purchase).

## **Cash**

You currently have \$50,000 in your money market. I would recommend keeping that money as your cash reserve. If you wanted to earn a little higher return, then you could break that up into 5, \$10,000 CDs creating a ladder with each CD maturing in each of the next five years.

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You have \$xx,xxx to be invested. You can see my investment recommendations in the snapshot, *Sample Cash Suggestions*. Note that some of the suggested funds are only available through my institutional relationship with TD Waterhouse.

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## **TD Waterhouse/Milne Financial Planning**

Those clients that have an on-going relationship with Milne Financial Planning generally use TD Waterhouse as a custodian. The advantages of this institutional relationship are lower fees for the client and access to funds with higher minimums. Occasionally, I can purchase funds that are closed for clients as well. The disadvantage of this relationship is that Vanguard Funds and other funds that I may choose have a \$24 transaction fee (on-line).

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## ESTATE

I recommend everyone have the following documents:

**Will** – This document instructs the court on how you wish your assets to be distributed upon your death. It does not cover those assets with specific beneficiary designations, such as 401k plans, SEPs, IRAs and life insurance policies.

**Living Will** – This document informs medical personnel of your wishes about life support. I would recommend including a clause about hydration to clarify what degree of life support you would like. My understanding is that without a clause specifically addressing this issue, you will receive fluids. I also understand dying from a lack of hydration can be slow and prolonged.

**Durable Power of Attorney for Health Care** – This document gives someone of your choosing the ability to make medical decisions for you when you are incapable of making them yourself. The living will notifies medical personnel of your wishes about life support. Though a living will can be of tremendous help, it does not perform the same function as the Durable Power of Attorney for Health Care.

All these documents should be kept in a safe place. In addition, copies should be given to your doctors and kept where someone can find them if you are ill. If they are kept in a safety deposit box, anyone not listed as having access will not be able to access these documents.

**Estate Taxes** - Based on current tax law, estates over \$1,500,000 will incur an estate tax. Your estate is less than this amount currently.

**Living Trust** – A trust can be created to avoid probate and to spell out just what you want done with your assets. It can also be useful if you should become incapacitated and unable to take care of your financial affairs. I recommend a living trust for your assets. Note that a living trust does not override the beneficiaries listed for retirement plans, IRAs and life insurance policies.

**IRA Beneficiaries** – When choosing a designated beneficiary for your IRA and retirement accounts, the financial goal is to often defer paying taxes as long as possible for the beneficiaries. If this is your goal, I recommend that you do not name a trust or your estate as your beneficiary. Generally, these designations eliminate the ability to defer taxes for your beneficiaries.

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## **Recommendation**

You indicated that your will should be updated. I also recommend having a durable power of attorney for health care and a living will. Though a living trust can be beneficial, it is not necessary.

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## MILNE FINANCIAL PLANNING, INC.

The Financial Tune-Up does a great job of giving people the various scenarios to consider in the future. Though I am aware that there is a lot more work that needs to be done to accomplish everything we discussed, I have provided you the outline of what direction I recommend you take.

If you would like additional assistance with your finances, I will bill you hourly at the then current rate. The rate is presently \$165 per hour.

If you would like to take advantage of other services I offer, I would like to have you continue as a client. Besides the hourly option, I see the Mini-Retainer as the other option that may appeal to you.

The Mini-Retainer -This service gives you two meetings a year to review and discuss whatever important topics and questions you have. At least one of the meetings is a portfolio review and typically both meetings review the portfolio. In addition, Mini-Retainer Clients get unlimited phone and email support during the year. The cost of this service is .1667% of investable assets plus .25% of adjusted gross income. Your fee would be \$1,151.31 per year, paid quarterly; \$287.83.

I also offer an Implementation Meeting service for those clients who return within 6 months of the first meeting. The cost is \$250 for a two-hour meeting.

Though it is not required, clients that retain my services on an on-going basis are encouraged to custody their investments at TD Waterhouse.

Thank you for choosing Milne Financial Planning, Inc. I enjoy my work and appreciate all referrals.

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