

Financial Planning Quarterly

J.P. Collins & Associates, Inc.

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Special points of interest:

- Newsletter published quarterly by J.P. Collins & Associates, Inc.
- Educational newsletter designed to help its readers make better financial decisions
- Articles will cover a broad range of financial topics

Inside this issue:

The "B" Word...Budget	1
Charitable Giving	3
Upcoming Articles	4
Firm Profile	4
Subscription Information	4

Traffic Jams and Investment Plans

As I was driving home from work the other week it occurred to me; driving in traffic is very similar to investing. In traffic, it always seems like the lane you are in is moving much slower than the lane right next to you. When you finally decide to change lanes, the lane you switched to comes to a stop while the lane your were previously in, starts to speed up.

Everyone who has been in this situation knows how frustrating it can be. When it comes to investing, human behavior follows a very similar pattern. In a study conducted by DALBAR from 1983-2003, they found that the stock market (S&P 500) averaged 12% over that 20 year period while the average investor earned 2.5% during the same period. The reason: investors often do the wrong



thing at the wrong time. Just like the driver who switches lanes at precisely the wrong time, investors tend to buy investments when they are at the very top and sell those same investments when they are at rock bottom.

Conversely, over the same period, endowments and pension plans earned a 9% return. So, why do endowment and pension funds have such superior returns when compared to the general public?

Its very simple; they have a disciplined approach. Every professional money manager worth his/her weight utilizes something called an investment policy statement. This statement is a guideline on how to invest the funds to be managed. Rather than relying on "gut" feelings or hunches, endowments and pensions use a strategic, disciplined process to manage the funds entrusted to them. Seeing the tremendous benefit received by having a process, we believe that this is one of the most important aspects of investment management. In returning to the traffic analogy, I would compare it to picking a lane and sticking with it!

-J.P. Collins & Associates

The Foundation for Achieving Your Goals

In my experiences, most people, when discussing their financial futures, never want to talk about the "b" word...that's right, their budget. In fact, I have had to come up with other names for this area of people's lives, because just the mention of the word brings on anxiety, tension and combativeness. Terms like cash flow planning and income analysis are all

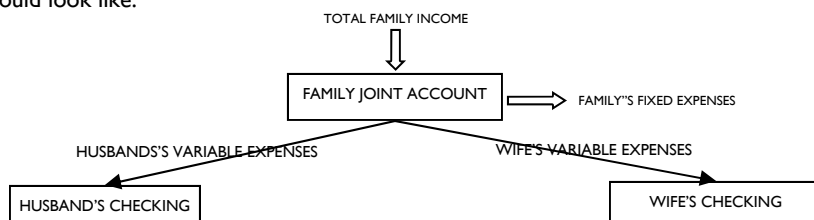
flashy phrases for one of the most important foundations in your financial plan: your budget. While most people will agree with me, a surprising amount have no idea what their monthly budget looks like. I have developed a four step process that can be utilized to get you back on track and take charge of your finances:

1. **Track Your Monthly Income and Expenses for 3 Months:** this doesn't just mean your mortgage payment and gas bill, but you should be able to account for every penny you spend and who is spending it. This is an essential part of the process. If there are certain expenses paid on an annual

Budgeting (cont.)

basis (property tax, vacation, insurance premium, etc.), make sure you figure out how much each would be per month and add them to your other expenses. Once you have added up all your expenses for 3 months, divide by 3 to get your average monthly expenses.

- Categorize the Income and Expenses:** there are two different ways to categorize expenses. First, you should determine your ongoing, fixed, monthly expenses (mortgage, phone, cable, electric, etc). Second, you should determine the variable expenses (food, clothing, entertainment, gasoline, etc.). For the variable expenses, you should also determine who spends what in each category. For example, the husband may do almost all the grocery shopping, so he may spend \$400 per month in food, while the wife only spends \$25 per month in that same category. Income should be tracked each month in the same fashion. Chart all of the monthly income and expenses on a single piece of paper. By the end of this step you should have an actual amount of monthly fixed expenses for the family, and actual amount of variable expenses for both the husband and the wife.
- Make Adjustments:** this step can be difficult and should be done as a family, and/or in conjunction with a financial planner. The first goal is to make sure that the family's income outpaces the family's expenses. If there is a shortfall in the budget, the family needs to make hard choices and everyone should be willing to compromise to get back on track. If the family's income is outpacing expenses their initial goal should be to save 10% of their income per month.
- Systemize your Banking:** many families have gone through the budgeting process, but most fail in the final stage: implementation. Setting up your bank accounts to insure success is one of the most efficient ways to create a working budget. First, set up a joint account, and have all of your family's income directly deposited into this joint account. Second, set up 2 checking accounts: one for the husband and one for the wife. All fixed expenses (from step 2) will come directly out of the joint account (ideally this would be an automatic transfer). At the first of every month, the variable expenses that were determined to be spent by each spouse should be transferred to each of their respective checking accounts. Each spouse then will be responsible for managing and balancing their own checkbook. Here is a diagram of what the budget should look like:



The excess amount that will be left in the family's joint account can be used for savings or debt reduction. Oddly enough, many of those I counsel that have implemented this strategy feel like they have more freedom now than they ever did. By both spouses knowing they have a certain amount to spend on themselves every month, they don't feel guilty about buying something or having to ask permission from the other spouse on every small purchase they make. While I still believe it is important to communicate with your spouse about the family's finances, a structured budget can reduce stress and get the family back on the road to financial freedom.

****If you would like us to email you a template of this family budgeting process please email us at info@jpc-associates.com and write "Family Budget" in the subject box**

The author, J. Patrick Collins Jr., CFP, is the President of J.P. Collins & Associates, Inc., a fee-only financial planning and investment management firm, located in Towson, Maryland. The firm specializes in working with business owners, retirees and pre-retirees, and families of children with special needs. Mr. Collins is also a contributing author to *The Journal of Special Needs Planning*.



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Charity Begins at Home

As my wife and I prepare for our first child, we have been reading countless “how to” books on parenting. It is amazing to think of the impact we are going to have on our children’s lives, and we have had numerous discussions regarding the type of values we would like to instill in them. One area we both feel strongly about is giving. Charitable giving emphasizes helping those in need, while minimizing the obsession with material wealth. After much consideration, we decided to start a charitable fund in our family’s name. When our children are old enough we are going to involve them in the management of this fund and they will have an opportunity to choose a non-profit organization to give a portion of the funds to.

Here are the technical aspects: A family opens and funds a Donor Advised Fund. This fund is a charity, so when money is contributed to the Fund the donor receives a tax deduction. Highly appreciated assets can be contributed to these funds as well, and since these funds are considered non-profit entities, the assets can be sold and capital gains taxes are avoided. Every year, the Donor Advised Fund is required to donate at least 5 percent of their total assets. The family can make requests on where they would like the money to be directed. Donor Advised Funds are offered by numerous institutions and can require as

little as \$5,000 to fund.

Here are the steps on how to integrate this strategy within your family:

1. **Hold an Annual Family Meeting.** There are two areas that parent’s should discuss with their children at these meetings: investing and giving. First, parents should discuss the investments held within the Donor Advised Fund and some of the changes that were made over the course of the year. Although these funds are typically managed by the institution holding the money, they all should send out annual reports, discussing their progress. This is a great time to talk to children about areas like mutual funds, stocks, bonds, savings accounts and the different roles each vehicle plays in an investment portfolio. The family’s financial planner can also be involved at this stage, helping the parent’s talk to their children about financial management and stewardship. Second, parents should talk about the funds that were donated the prior year and what they were used for. For example, if the family gave \$4,000 to the Red Cross for the Tsunami Relief, the parent’s might talk about how the money was used to build
2. **Give Children Responsibility Early.** At this family meeting, parent’s should then ask their children about organizations they are interested in helping. With this in mind I would recommend allocating 10 percent of the funds earmarked for giving from the family fund, to be entrusted to the children to give, with three stipulations. First, they must give their money to a qualified charity. Second, that they account for each dollar that is given to those charities. Finally, they report back at the next family meeting as to who received the funds and how those funds have impacted others. This will have a profound effect in that it teaches stewardship and financial management to the children. Most importantly, your children will have a first hand look at how their charitable giving positively effects others and may promote their involvement in those same charities.

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shelters for those who lost their homes and how those shelters are saving people’s lives.



“As the purse is emptied, the heart is filled”

-Victor Hugo



By structuring your family giving in a similar way, your children will inherit something more important than money; the absolute joy found in helping and serving those less fortunate.

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The firm's principal, J. Patrick Collins Jr., has extensive knowledge of the issues surrounding financial planning and is a frequent guest lecturer on the topic. Mr. Collins is a Certified Financial Planner™, a NAPFA Registered Financial Advisor, and is active within several financial planning organizations.

**Is there an issue or topic you would like to see addressed in
Financial Planning Quarterly?**

Email us your ideas and opinions at info@jpc-associates.com

Upcoming Newsletter Topics

1. **Active vs. Passive Investment Management:** the five secrets that your broker, bank and mutual fund don't want you to know!
2. **Estate Planning 101:** In light of the Terri Schiavo media attention, we'll look at the real facts on wills, advance directives, powers of attorney and letters of intent
3. **Mid-Year Review:** find out where we stand halfway through 2005

ALWAYS CONSULT YOUR FINANCIAL PLANNER, ACCOUNTANT, AND/OR ATTORNEY BEFORE MAKING ANY CHANGES THAT MAY EFFECT YOUR FINANCIAL SITUATION

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