Johnston Investment Counsel

Trusted Fiduciaries & Fee-Only Advisors

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LIFE THE WAY YOU PLANNED IT.

Four Money Mistakes You Can Learn From

It's hard to know when the economy will truly recover, although there are signs that things are headed in the right direction. But if you want your own finances to stabilize over the long term, you'll need to evaluate what you've been doing right...and wrong. There's no magic bullet, but avoiding these four money mistakes may help you survive and ultimately thrive in any turbulent economy.

Mistake 1: Expecting things to stay the same

It's a familiar tale. Economic times were good. The stock market went up, up, up. Home values (and real estate prices) soared, credit was flowing, and the job market was robust. And then...the bottom fell out.

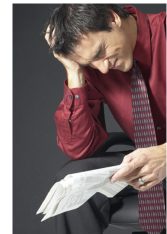
"Success does not consist in never making mistakes but in never making the same one a second time."

George Bernard Shaw

At the heart of all economic bubbles is the euphoric, yet ultimately mistaken, idea that the good times are here to stay. And when the economic news is bad, it's just as easy to assume that the tough times will remain. But your own financial recovery will ultimately depend on you not jumping on any bandwagon. Instead, take a proactive, rather than reactive, approach to financial planning, no matter what economic news you're hearing. Prepare yourself for a variety of financial scenarios and avoid basing money decisions on emotion, or you may find yourself making the same financial mistakes over and over.

Mistake 2: Only saving your leftovers

Do you worry that you're not saving enough? Do you routinely rely on credit rather than cash to pay for the things you want or need? Rather than blame your financial inertia on your income, look a bit deeper, because the real culprit may be the lack of financial priorities. If you don't know exactly how you're spending your money and you haven't set financial goals, it's unlikely that you'll see much financial progress.



Go back to basics by preparing (or reviewing) your budget. If you tend to save only what you have left over every month, you can put yourself on a more disciplined course by having a fixed amount taken out of your paycheck automatically for retirement. Or, you can set up automatic transfers from your checking account to a savings or investment account.

Mistake 3: Not having an emergency fund

One of your savings priorities should be an emergency fund. An emergency fund isn't glamorous, but this underappreciated work horse really pulls its weight during hard times. Having cash on hand that you can use for an unexpected expense, or to pay bills if you lose your job or become disabled, is vital because it can help you avoid having to rely on credit or tap your retirement savings. Without emergency savings to fall back on, worse financial trouble may lie down the road.

Mistake 4: Not asking for help

Even if your finances are in good shape right now, you may be overdue for a checkup. A close look at your financial plan will help you identify potential strengths and weaknesses. If you're already in financial trouble, don't let fear or shame prevent you from asking for help. Facing financial problems early may help you make a full recovery. Many creditors are willing to work with you, but this may be much easier while your credit is still good, and while you still have time to turn things around.

College Debt: How Much Is Too Much?

The trend of not saving enough makes families heavily dependent on borrowing to fund college. ...The result is a new paradigm for millions of young adults--a crushing amount of student loan debt that stretches from early to middle adulthood and can affect all major life decisions.

According to a recent survey by the nonprofit College Savings Foundation, the confidence of parents in their ability to save for college dropped significantly over the past year (go to www.collegesavingsfoundation.org to read the survey). That's not entirely surprising, considering the economic climate. But what is surprising is that, of parents surveyed, a whopping 41% reported having saved nothing at all, and 28% reported having saved less than $5,000 per child.

The loan factor

The trend of not saving enough makes families heavily dependent on borrowing to fund college. In the survey above, 47% of parents said they expected to utilize student loans to pay for college. And parents seem inclined to borrow whatever it takes: 76% don't expect to narrow their children's college choices.

The cost factor

Loans matter when you consider the cost of college. According to the College Board's *Trends in College Pricing 2009* report, even though the Consumer Price Index declined 2.1% between July 2008 and July 2009, college costs rose across the board--a disturbing but familiar pattern (to read the report, go to www.trends-collegeboard.com).

For the 2009/10 school year, the average cost of a public college increased 5.9% to $19,388, while the average cost of a private college increased 4.3% to $39,028, with elite private colleges topping out at over $50,000 per year.

The College Board also noted that about two-thirds of students receive grants, with the average private college student receiving $14,400 in total grant aid and federal tax benefits for 2009/10, and the average public college student receiving $5,400. But this still leaves approximately $25,000 for private undergraduates and $14,000 for public undergraduates to fund. Absent additional college merit aid and/or outside scholarships to make up the difference, parents and/or their children must fill the gap.

How much borrowing is too much?

The gap is where families can get in over their heads. Is there such a thing as borrowing too much for college? In the iconic words of the Magic 8 Ball®, "signs point to yes."

The average student now leaves school with $23,186 in federal student loans (Source: *National Postsecondary Student Aid Study*). And this doesn't include private student loan debt, which has exploded in recent years due to the inability of federal loan borrowing limits to keep pace with skyrocketing college costs.

The result is a new paradigm for millions of young adults--a crushing amount of student loan debt that stretches from early to middle adulthood and can affect all major life decisions, from what career path to choose, to where to live, whether to go to graduate school, when to marry, have children, buy a home, begin saving for retirement, and so on.

And it doesn't end there. Parents who engage in "extreme borrowing"--routinely taking out large home equity loans, federal PLUS Loans, or other private loans to fully fund the gap without regard for the consequences--can hamper themselves financially for years.

How much is too much? Obviously, the answer is different for every family. But waiting until spring of your child's senior year--as you review individual financial aid awards--to think about college affordability can be a mistake. To avoid falling into the "I guess we'll just borrow whatever it takes" trap, families should start thinking about costs much earlier.

Before filling out a college application...

- Get an idea of how much federal aid your family can expect by using the calculator at www.fafsa4caster.ed.gov.
- For each college, research the total cost of attendance and the average merit aid award given to students with similar academic credentials as your child.
- Know what a particular loan amount *today* will end up costing *tomorrow* (e.g., $40,000 in PLUS Loans at 8.5% with a 10-year repayment term will cost you $496 per month; $27,000 in Stafford Loans at 6.8% and a 10-year term equals $311 each month for your child).
- Consider your child's career aspirations, earning potential, and job prospects after graduation. Will this school be a good return on your investment? Also, is graduate school likely?
- Talk to your child about how any debt taken on might impact your or your child's future goals and dreams.

Hardship Withdrawals from 401(k) Plans

In these challenging economic times, you may be considering taking a hardship withdrawal from your 401(k) plan. Here are some points to think about before you pull the trigger.

What is a hardship withdrawal?

When discussing 401(k) hardship withdrawals, we're generally talking about withdrawing your own elective contributions to the plan. This means your pretax contributions and your Roth contributions to the plan. A hardship withdrawal generally can't include any earnings on your contributions.

In order to qualify for a hardship withdrawal, you have to have an immediate and heavy financial need, and your withdrawal can't exceed the amount necessary to meet that financial need (including any taxes and penalties resulting from the hardship withdrawal itself). But there's an important restriction: you can't take a hardship withdrawal at all until you've taken all other non-hardship distributions and loans available to you from the 401(k) plan, and any other deferred compensation plans maintained by your employer.

Plans have a number of ways of administering the hardship withdrawal rules, but most rely on a "safe harbor" rule that automatically treats the following as constituting an immediate and heavy financial need:

- Medical care expenses for you, your spouse and dependents, and your plan beneficiary
- Costs directly related to the purchase of your principal residence (but not mortgage payments)
- Payment of tuition, fees, and room and board expenses for up to the next 12 months of post-secondary education for you, your spouse and dependents, and your plan beneficiary
- Payments necessary to prevent eviction from your principal residence or foreclosure of your mortgage
- Payments of burial and funeral expenses for your parents, spouse and dependents, and your plan beneficiary
- Expenses to repair casualty damages to your principal residence

Why you should think twice ...

In general, you should take a hardship withdrawal from your 401(k) plan only as a last resort, for the following reasons:

- Hardship distributions are includible in your gross income except to the extent they consist of your own after-tax (including Roth) contributions to the plan.
- The taxable portion of your withdrawal will be subject to a 10% early distribution penalty unless you're 59½ or another exception applies.
- If your plan uses the safe harbor rule described earlier, when you take a hardship withdrawal, you'll be suspended from participating in the plan (and any other elective plan maintained by your employer) for at least six months.
- Unlike plan loans, you generally can't pay a hardship withdrawal back to the plan. A hardship distribution permanently reduces your account balance, reducing the amount that can work for you on a tax-favored basis until you retire.
- You can't roll a hardship distribution over to an IRA or another employer plan.

And keep in mind ...

A 401(k) plan doesn't have to allow hardship withdrawals at all. And if it does, the plan may limit the reasons that qualify as a hardship, or may limit the amount you can withdraw. Some plans may not permit hardship withdrawals that are based on the need of your plan beneficiary. And in some cases, the plan may require that you prove you have no other resources available to meet your hardship need.

Your 401(k) plan may also permit withdrawals of other amounts in your account--for example, your employer's contributions to the plan--but these withdrawals may be subject to different rules.

You need to review your specific plan's terms to see what options are available to you. Your plan's withdrawal rules should be clearly described in the plan's summary plan description (SPD). If you don't have one, request it from your plan administrator, and discuss your options with your financial professional.

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Ask the Experts

What can affect the cost of homeowners insurance?

There are many factors that can affect the cost of homeowners insurance. Here's a description of some of the more common factors.

Generally, as your home gets older, the cost of insuring it may increase. Older homes have more things that can go wrong, often related to outdated wiring, older plumbing, or lead paint.

The location of your home also can affect your insurance premium. Insurers generally regard homes located in urban areas to be at a higher risk of burglary than comparable suburban homes, translating to a higher premium cost for metropolitan area houses. Insurance may cost more if your home is located in an area prone to a specific peril, such as floods, or in a rural area far from a fire station or fire hydrant.

Living in an area prone to claims for mold damage can increase your premium. In fact, excessive mold damage can be so costly to repair that some insurers either are significantly increasing premiums to insure mold damage, or they're eliminating coverage completely.

Rising repair or construction costs in your area also will increase your insurance premium. If it'll cost more to repair or replace your home, it'll cost more to insure it as well.

Sometimes, *you* can cause your insurance rates to increase. Swings, trampolines, and other backyard equipment can add to your premium. Owning a swimming pool, sauna, or hot tub may increase your property's value as well as the risk of injury or property damage, which will be reflected in your insurance bill.

Based on the breed and temperament of your dog, an insurer may consider it an increased risk of causing injury, resulting in a higher premium. If the breed of your dog is on the insurer's "bad dog list," you may not be able to get coverage for injuries caused by the dog, or your current insurance can be cancelled altogether.

How can I reduce the cost of my homeowners insurance?

You may not have control over all of the factors that affect the cost of your homeowners insurance. But there may be some things you can do to save some money.

If your home is older, your insurer may lower your premium if you upgrade your heating, plumbing, or electrical systems to reduce the risk of fire and water damage. Let your insurer know when you've made these changes.

Selecting a larger deductible is another good way to lower your cost of insurance. You might want to put your premium savings in an emergency fund to pay the deductible, if needed.

Review your policy. You may be adding to the cost of insurance by carrying extra coverage for things that have declined in value or you no longer own, like furs or jewelry.

Swimming pools can add to the cost of insurance. However, many insurers may not increase your rates if you show them that you have safety features such as fencing or a locking gate around your pool.

Before you get a dog, check with your insurer to be sure your new pet won't increase the cost of your insurance--or cause it to be cancelled. Also, advise your insurer that you've properly trained your pet and that you've obtained all required vaccinations and tags.

Some insurers will raise your premiums if you file frequent (more than 2-3) claims of relatively small value. Try to use your insurance for major claims and consider self-insuring the rest.

Another way to save on your insurance costs is to buy your homeowners insurance and auto insurance from the same insurer. Most companies will discount the cost of insurance if you buy two or more policies from them.

You may receive a discount from your insurer by improving your home's security. Ask your insurer if adding an anti-theft system, flood lights, or even dead-bolt locks will lower your premium.