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Financial Planning Strategies

A Financial Planning Update

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Understanding the Consumer Price Index

The highs and lows of the economy affect people and markets in a variety of ways. While some sectors may be thriving, others may be sluggish. One economic indicator used to gauge the state of the American economy is the **Consumer Price Index (CPI)**, which measures the rate of inflation in the United States.

Inflation, which is defined as a rise in the average price level of all goods and services, can have a significant impact on the economy and your financial outlook. Learning more about the CPI, and how it measures inflation, can provide a strong foundation for understanding not only market and economic swings, but also how U.S. fiscal and monetary policies affect your financial well-being.

Determining the Market Basket

Each month, the U.S. Bureau of Labor Statistics (BLS) surveys prices for a "market basket" of goods and services, to create an economic snapshot of the average consumer's spending, which is quantified as the CPI. Actual expenditures are classified into more than 200 categories and eight major groups. These include the following:

- **Food and beverages**: common groceries, wine, and full-service meals
- **Housing**: rent, furniture, and fuel oil
- **Apparel**: clothing, shoes, and jewelry
- **Transportation**: vehicle lease and purchase costs, gasoline, auto insurance, and airfare costs
- **Medical care**: doctor's visits, hospital care, and prescription drugs
- **Recreation**: televisions, pets, admissions to events, and sports equipment
- **Education and Communication**: college tuition, postage, telephone services, and computer equipment
- **Other goods and services**: tobacco, haircuts, personal services, and funeral expenses.

Because the CPI assesses expenditures in these fixed categories, it is a valuable tool for comparing the current prices of goods and services to prices from last month or last year.

Interpreting and Using the CPI

As a measure of inflation, the CPI has three main functions. First, it serves as an indication of economic health and the effectiveness of government policy. To a certain extent, some inflation indicates a healthy economy; however, too much inflation, or no inflation at all, can indicate economic trouble. In fact, the Federal Reserve Board (the Fed) aims for a yearly inflation rate of 2%.

If the CPI constantly fluctuates, Congress and the Fed may take measures to control the amount of inflation and stimulate economic growth. As a

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Being Realistic about Retirement

Everyone has certain expectations and dreams about retirement. Will your current plan meet your ultimate objectives? Today, more than ever, planning for retirement is a *necessity*. Proper planning and follow-through can help you avoid shortfalls in your income needs and assure you a smooth, secure transition from the world of work to the world of retirement.

Planning ahead means setting goals and deciding *how* they will be met within the framework of a changing financial picture. Many retirees find themselves torn between a satisfying lifestyle and one lacking many comforts that make life easier. Without a solid financial foundation, you may face some hard choices over your retirement years. A successful financial plan, executed faithfully, will help make many of those choices easier.

As retirement approaches, consider these factors to best position yourself for an enjoyable retirement:

1. **Strategies Change.** Regardless of your age, contributing to your **401(k) plan, Individual Retirement Account (IRA),** or other retirement savings vehicle, will enhance your likelihood of a comfortable retirement.
2. **An Aging America.** Because people are living longer, your retirement assets must last longer and be able to accommodate cost-of-living increases. As a result, you may need to return to the workforce to help supplement your retirement income.
3. **Lifestyles of the Rich and Famous?** Some individuals think they will be able to enjoy the same lifestyle they had during their working years. The likelihood, however, is that you may have to adjust living arrangements and unnecessary expenditures. Thus, it's important to ensure your retirement assets will be sufficient over a long period of time.

Regardless of *when* you plan to retire, it is important to be sure your goals and expectations are realistic. Reviewing your retirement savings versus your objectives can be a good first step in ensuring you're on the right path. $

Life Insurance: How Much is Enough?

Many people buy **life insurance** before conducting a comprehensive financial needs analysis. An individual might choose a benefit amount that seems appropriate at the time of applying for a policy, without factoring in the economic impact that unforeseen circumstances, such as an untimely death, could potentially have on family members. To properly assess your family's situation, you may want to consider a financial needs analysis by following these simple steps to protect your loved ones:

First, write down the total value of all assets that you and/or your spouse own. (Enter amounts in one column for yourself and in another column for your spouse.) When listing your assets, be sure to include what you currently have in savings and retirement funds (such as IRAs, 401(k) plans, annuities, etc.), as well as real estate and life insurance. Next, list and evaluate all expenses you or your family might face if you or your spouse should die. These are your potential liabilities.

In order to determine how much cash would be needed following the death of a spouse, take a look at these potential needs and assign an estimated amount to each:

1. **Immediate Money Fund.** This includes the estimated cost of medical and hospital expenses, outstanding bills, burial costs, and attorney/executor fees.
2. **Debt Liquidation.** Your debt, if any, may be in the form of credit card bills, school and auto loans, unpaid notes, outstanding bills, etc.
3. **Emergency Fund.** Unexpected bills not readily payable from current income could include major home and car repairs, or even medical emergencies.
4. **Mortgage/Rent Payment Fund.** How much would you need to pay off your mortgage or provide for house payments or rent?

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You've Graduated: Now It's Payback Time

It takes four years, on average, to graduate from most colleges and universities. During that time, students can accumulate a large amount of debt. For most, the degree is worth the burden of paying off student loans long after graduation. However, these questions remain: How should the debt be repaid? Are there any plans that can help make payback easier? What if a student can't find a job right away?

Several options make it easier to pay off Federal student loans. For example, some plans offer flexible payment schedules. Students applying for a Federal student loan can choose a **graduated repayment plan** that will allow them to start with lower payments after graduation that increase every two years. This schedule is good for those graduates who are likely to make more money in the workplace as they acquire experience.

Students also have the choice of several types of **income-driven repayment plans**, which are designed to lower monthly payments. The payments under such plans vary, but generally they are based on a percentage of the graduate's discretionary income.

A third choice is an **extended repayment plan** that offers either fixed or graduated monthly payments and allows graduates to extend their loan payment schedules from the standard of 10 years to 25 years.

To save money over the long run, a graduate may opt for the **standard repayment plan**. It requires a loan to be paid in up to 10 years, but payments are of a fixed amount and interest on the loan is likely to be less under this plan than under some of the other plans.

Deferment or forbearance may also be a temporary option for graduates in a financial bind due to unemployment or other extreme hardship. In select situations, borrowers may qualify for other repayment alternatives through their loan servicers.

Although students are required to repay loans even if they don't finish their education or are unable to find a job, in certain select circumstances loans are forgiven, canceled, or discharged: Examples include the following: your school closes while you are enrolled; you suffer a permanent disability; or you are a teacher who has taught in a low-income elementary or secondary school for five consecutive years (in this case up to $17,500 of your loans may be forgiven).

For students with multiple loan balances, **consolidating** different student loans is an option that offers flexibility. The Student Loan Reform Act of 1993 allows different Federal education loans to be consolidated into a direct consolidation loan from the government: the loans are brought together into one loan, with a single monthly payment. This plan offers a variety of repayment terms, and the interest rate of the loan is fixed for the life of the loan.

For more information, contact the Federal Student Aid Information Center at 800-433-3243, or visit online at www.studentaid.ed.gov. $

Life Insurance: How Much is Enough?

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5. **Child/Home Care Fund.** Extra expenses may arise following the death of a stay-at-home spouse. Estimate the cost of hiring help to take over your spouse's duties, such as child care, shopping, food preparation, laundry, and yard care.
6. **Education Fund.** Be sure to include the cost of funding a four-year undergraduate education or comparable vocational training for your children.

The total of all of the above costs, less your liquid assets and life insurance, would signify your new financial needs. The numbers may be different for you and for your spouse, because assets and existing life insurance, as well as child/home care amounts, are likely to be different.

Analyzing your financial needs is an important step toward ensuring the appropriate amount of coverage for you and your family. The steps above are one method for determining how much life insurance may be needed based on your individual circumstances. Be sure to consult with an insurance professional for more information. $

Understanding the Consumer Price Index

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result, business executives, labor leaders, and individual consumers may change their spending and saving patterns. For example, the Fed may attempt to curb rising inflation by raising short-term interest rates. This increase in the cost of borrowing money is likely to slow personal and business spending. Conversely, if the economy is not growing, the Fed may attempt to stimulate growth by lowering short-term interest rates. Lowering the cost of borrowing is likely to trigger increased spending among businesses and consumers.

As a second function, the CPI helps determine the "real" value of a dollar over time by removing the effects of inflation. As prices increase, the purchasing power of a dollar decreases. Therefore, more dollars are needed to purchase the same amount of goods and services. Comparing inflation-free wages and prices allows economists to determine the actual earning and spending patterns of the American consumer, including what percentages of money are being saved or spent in certain areas.

Lastly, the CPI is used as a means of adjusting salaries and government benefits to account for price changes. For example, as a result of collective bargaining agreements, the wages of millions of American workers increase according to the amount of change in the CPI. The CPI is also used to determine the benefits of almost 50 million people covered under government programs, including Social Security beneficiaries and military and Federal Civil Service retirees. In addition, changes in CPI can be seen in the eligibility requirements for SNAP (food stamp) benefits and school lunch programs, as well as in rents, royalties, alimony payments, and child support payments determined by private firms and individuals. Finally, the CPI has been used to adjust the Federal income tax structure to prevent increases in tax rates caused solely by inflation (source: Bureau of Labor Statistics, "Addendum to Frequently Asked Questions," http://www.bls.gov/cpi/cpiadd.htm#2_3).

For More Information

Inflation can have a serious impact on the American economy given the effect it can have on government policy, as well as on the spending and saving patterns of businesses and consumers. Understanding and following changes in the CPI can help you identify how the value of the dollar changes and estimate how inflation may affect your future plans. The U.S. Department of Labor (DOL) publishes current BLS information on the CPI each month. For more information, visit the BLS website at www.bls.gov/cpi. $