New Year's Countdown for Financial Fitness

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Are you so busy with work and taking care of others that you sometimes neglect taking care of yourself? Has another year gone by and you're not feeling on top of your finances? Not sure how to start? Not to worry. Take a few hours early in the New Year so 2011 can be the year you get your financial house in order. Here's my countdown to success.

Take stock of your current financial situation: Create your personal balance sheet – What do you own and what do you owe? Include the value of your retirement plan assets, deferred compensation, and stock options. Track your net worth over time.

Scrutinize your cash flows – Are you living within your means? How much are you saving each year? Compare your monthly inflows to your outflows. With tighter compensation and reduced cash payouts, many on Wall Street are challenged more than ever to manage their cash flows. Play it forward: draft a budget for 2011 and prioritize your competing needs. Programs like Quicken or Mint.com may be helpful.

Give your portfolio a checkup: Should you focus on selecting the best stocks, timing the market, or adjusting your asset allocation? It's a lot more fun to talk about having bought a great stock or getting into the market at just the right time. However, your asset allocation decision - the mix of fixed income and growth assets - is the most important one you'll make, determining 90% of the variability of returns over the long term.[1] Your investment mix should reflect your comfort level with risk in light of your objectives. As a starting point, use an on-line financial planning tool such as on Fidelity's web site. Or consult your financial advisor for help in modeling your path to financial security. (Note: RegentAtlantic offers a complimentary "second opinion" of your investment portfolio.)

All else equal, hold growth assets in your retirement plan accounts and fixed income in your taxable accounts. This approach, known as "asset location," is worth getting right. Research has shown that optimal asset location can potentially increase after-tax returns by 20 basis points annually.[2]

At least quarterly, rebalance your portfolio to your target asset allocation. Maintaining a discipline removes the emotion from your investing decisions. Rebalancing could add up to 50 basis points of return annually.[3]

Are you playing it conservatively by sticking with safe assets earning 1-2%? Holding CDs and money market funds is a safe way to go broke. You have to take some risk to stay ahead of inflation and taxes.

Minimize investment expenses to maximize what you keep: Find out what you're paying for your investments. Typical expenses include trading costs (check your trading confirmations), mutual fund expense ratios (see the fund's prospectus), and other management fees (for non-publicly traded investments such as hedge funds, the costs of your 401(k) account, etc.). What matters isn't what you earn but what you keep.

Do you still have a 401(k) from a previous employer? Roll over the 401(k) to an IRA. Not only will you be able to invest in just about any security, your expenses may be lower.

Diversify away from employer-related stock: Your livelihood is dependent on the performance of your company stock. Why take the added risk of retaining shares of your employer once you are free to sell? Put reminders on your calendar of the dates your restricted shares vest and your options become exercisable. Evaluate each opportunity to sell the shares, using the proceeds to invest in a diversified portfolio. Your deferred compensation makes you an unsecured creditor of the company so keep the total to a reasonable amount of your overall wealth. Remember the old saying: Owning a lot of one stock can build your wealth but diversifying helps preserve it.

Minimize your income taxes: While investment decisions should not be driven by tax concerns alone, factor in the tax implications of your investment actions. Contribute the maximum to retirement plans (for 2011, the maximum contribution to 401(k) plans is $16,500 plus $5,500 if you're age 50 or over).

If you're selling appreciated securities in a taxable account, be aware that gains on assets held less than one year are taxed at your (presumably high) ordinary income tax rate, whereas the long-term holdings benefit from a 15% federal rate.

Harvest tax losses throughout the year, not just at year-end. Each year, capital losses can be used to offset capital gains plus $3000 of earned income until used up. While you can carry forward such losses indefinitely at the federal level, few states (besides New York) allow losses to be carried forward to future years.

Did you know you can leverage the tax benefits of your charitable contributions by gifting appreciated securities or, better yet, contributing to a donor advised fund? Look into these for 2011.

Consider a Roth IRA Conversion: There are numerous tax and estate planning advantages of Roth conversions, which are still available under the new tax bill. To see if a conversion is right for you, seek professional advice from your financial advisor and accountant. And if your employer offers a Roth 401(k), it may be a good option for you.

Reduce and refinance your debt: Prioritize your loans and pay off the highest-rate ones first. That usually means your credit cards – pay them off entirely each month, even after your holiday shopping. Paying off an 18% loan is like earning 18% on your investments. You wouldn't pass that up, would you? And Congress still allows the mortgage interest deduction, allowing you to deduct the interest on home mortgage debt of up to $1 million. Borrowing under your home equity line may be more attractive on an after-tax basis, for example, than an auto loan. Don't have a home equity line? Apply for one even if you don't expect to need it. It's smart to secure an emergency source of funds while you're working.

Also, refinance your mortgage debt. Yes, mortgage rates may have ticked up in recent weeks, but they are still at historically low levels. Fixed rates may be appropriate for you. If you expect to sell your home in a few years, however, you might want to take advantage of a lower-priced 5-7 year adjustable rate loan.

Review your will and estate plan: Does your will name the appropriate guardians for your minor children? Do you have a durable power of attorney naming a trusted person to manage your financial affairs should you become unable? Do you have a current health care power of attorney, naming someone to make decisions about your health care if you're unable? How about a living will? Update the beneficiaries you've named for your retirement plans (including IRA and 401(k) accounts), insurance policies, and deferred compensation plans. These assets pass by beneficiary designation, not by your will. More sophisticated planning strategies may be appropriate depending on your situation. For example, Grantor Retained Annuity Trusts (GRATs) remain attractive for potentially transferring appreciation to future generations, especially given the low interest rate environment.

Protect your nest egg: You've worked hard to earn and save, so minimize your potential risks. Do you have an umbrella liability policy in place? This kicks in after your home or auto coverage to protect you from additional personal liability. For example, could you be at risk of a lawsuit by your nanny or housekeeper? By someone who suspects you have deep pockets? An umbrella policy is especially important if you have teenage drivers.

How much life insurance and disability coverage do you have? Do you have enough or too much? Are the policies still appropriate for your needs? Consult an insurance broker or financial planner for an evaluation. Also, look into a long-term care policy for yourself, a spouse or partner, or perhaps a parent.

Check your credit history. You are allowed one free credit report annually from each of the three major credit reporting agencies (Experian, Equifax, and Transamerica). Check your report and correct any errors immediately. Go to www.annualcreditreport.com.

No one cares about your money more than you do. Invest in yourself early in the New Year so you can focus the rest of the year on the things that really matter to you. Take ownership of your financial situation now – seeking professional advice as needed – so you will have more options later in life.

1 Gary Brinson, Randolph Hood, Jr., and Gilbert Beebower, "Determinants of Portfolio Performance," Financial Analysts Journal, July/August 1986, and Brinson, Brian Singer, and Beebower, "Determinants of Portfolio Performance II: An Update," Financial Analysts Journal, May/June 1991.

2 Gobind Daryanani and Chris Cordaro, 2005, "Asset Location: A Generic Framework for Maximizing After-Tax Wealth." Journal of Financial Planning 18(1): 44–54.

3 James Picerno, "Rethinking Rebalancing." Financial Advisor Magazine, November 2010.

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Check out the Wall Street Women Forum at www.wallstreetwomenforum.com.

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