

Your FINANCIAL HEALTH

A digest of money management tactics for the family physician

Spring 2008

Five Dumb Things You Should NOT Do With Your Money

No, we will not ask for a show of hands. But truth be told, a lot of people don't have a clue what to do with their money. They've just never given it a thought. They earn it, spend it, borrow it, repay it, and hope enough keeps coming in one door to cover what goes out the other.

That's not a great way to "manage" money. So, here are five things you should NOT do with your money. If you find yourself guilty of making one, some or all of these mistakes, the good news is that you can change most of them with a little work and self-discipline.

1. Spend what you earn...and then some.

The median American household income is \$48,201 a year.¹ Meanwhile, the average savings rate is around zero; it actually dropped to -.5% last year.² This means many people have been tapping their savings and borrowing money to maintain their standard of living. If you earn \$125,000 and spent \$126,000, you are broke. But if you earn \$35,000 and spent \$34,999, you are living within your means.

A better way: Whether you earn \$50,000 a year, \$100,000 or \$500,000, set up a budget (also known as a spending plan) and learn to live on it. Treat your household as if it were a business, tracking income and expenses.

Start by keeping a "spending journal" (that's just a fancy name for a spiral notebook) for several weeks. Write down everything you spend – from gas for the car to a pack of gum, to that \$3.75 cup of coffee (which, by the way, if you buy every day, 20 days a month, for 12 months, comes to a whopping \$900 a year).

Then begin itemizing your expenses and deciding which ones are necessities (cannot live without) and which are not even luxuries (money wasters that provide no value for the money spent).

Then map out your budget. Be sure to include a certain amount or percent of your income to put into short-term and long-term savings. Need help? Hit the bookstore or go online. There are lots of platforms available.

2. Ignore the difference between expenses and assets. Need that sports car? How about that super-sized flat-screen television? Or that gotta-get-away vacation? All fine things,

yes, but what about the children's college fund or paying down some of that long-term debt?

A better way: Recognize that some places to put your money are better than others.

Question: What is the difference between buying a \$75,000 boat and a \$200,000 vacation home in the mountains?
Answer: One is an expense (sometimes referred to as a large hole in the water into which one pours money) that will steadily decline in value. The other is an asset, an investment that is likely to increase in value each year. Both have the potential to provide a lot of personal pleasure and satisfaction. However, one – that vacation home – also has the potential to enhance your financial stability and security.

3. Put off saving until next week...or next month...or next year. Most people talk about "sending money ahead" for the future. Easier said than done, true. Saving money can be tough, which is why many people simply put it off. They figure they have their current income. Later, they will have an employer-provided pension plan plus Social Security. Or they just figure they will start saving later, sometime down the road, once the bills are paid off, the kids are out of school, etc. It rarely works that way.

A better way: Start paying yourself first... starting today. Allocate for the future a piece of each dollar that comes in today. As part of your budget, which we discussed above, build in regular savings. Some people use a fixed dollar amount; others use a percentage of gross or take-home income. Regardless, the key to success is that they pay themselves first, making sure that they save money every month. No exceptions.

Why start today? The earlier you start, the bigger your savings will be. For example, if you put aside \$10,000 and let it sit for 30 years, earning 5% interest annually, you would have \$44,400 in the end. If you put that same \$10,000 aside ten years earlier, it would total nearly \$73,000.³ Conclusion: Increase your bottom line by starting to save today.

4. Take advantage of all your credit. Some people act as if it would be bad manners to



turn down a credit offer, or that it would be foolish to decline an offer with a radically low interest rate. This helps explain why the average person with a credit card carried a balance of nearly \$8,500 in 2007.⁴

A better way: If you can't pay cash, you can't afford to buy it. Period. You cannot borrow your way out of debt. Put away the credit cards, start paying off your debts systematically, and use cash as much as possible.

5. Cut corners on insurance. After all, odds are that your home will not be consumed by a fire, that your car will not be in an accident, that you will not become disabled, and that you will not die until you are well into your seventies or eighties. However, if any of these events do happen – and as a doctor you know they can – you risk losing everything you have worked for, endangering not just your own financial security, but that of your family, as well.

A better way: If you need to cut corners, cut back on that daily coffee stop on your way to work or go on a seven-day rather than a 10-day cruise this year. But do not cut corners on insurance.

Insurance – including life insurance, disability income insurance, auto insurance and homeowner's insurance – provides peace of mind and helps take the financial uncertainty out of many of life's unpredictable events. Most of all, for a few cents on the benefit dollar, it provides a back-up of security for your family's life, lifestyle and standard of living.

Do any of these five points strike home? If not, great. If so, begin making changes and you will likely see an improvement in your financial security and peace of mind within months.

1 U.S. Census Bureau, 8/28/07

2 U.S. Commerce Department, 1/30/06

3 These examples are for illustration purposes only and do not represent a particular financial vehicle. It is assumed that interest is credited quarterly and does not factor in inflation or taxes.

4 The Federal Reserve, as reported in www.money-zine.com

Disability:



Your # 1 Financial Threat

For many of us – whether self-employed or on a salary – disability is the Achilles Heel that can undo an otherwise ironclad financial game plan. People tend to overlook the risk of disability. They think the odds are too remote to impact them. They may be wrong.

The risk of disability is greater than many people think... and too high to be ignored.

Probability of a long-term disability (lasting 90 days or longer) prior to age 65 ¹	
Age	Risk
30	38.5%
35	36.5%
40	34.0%
45	30.5%
50	26.2%

If you have a spouse, the odds that one of you will become disabled increase significantly. Imagine becoming unemployed due to illness or an accident. Here are two questions to consider:

1. What will happen to my income? If you work for yourself, it will stop immediately. But even if you work for a large medical provider, your employer will not be able to carry you for more than a month or two.

2. Can I count on Social Security? Not really. For 2006, Social Security's own estimated benefit for disabled individuals was \$939/month (\$1,571 for families). The 2008 COLA adjustment is estimated to bring the benefits up to \$1,004/month (\$1,690 for families).² That might be enough to cover your mortgage payment, but not much else.

What to do:

Find out what coverage, if any, is provided through work. Make sure you understand the impact of the plan's waiting period, terms, conditions and income tax liability. Three key areas:

- Check the definition of total disability. Make sure it covers "your occupation." (Otherwise, you may be denied benefits when able to do *any* reasonable work, regardless of your education and expertise as a physician.) How long does the "own occ" definition extend? Two years, five years or to age 65?
- Look at the percentage of pay being replaced. It can range anywhere from 50% to 80%. Some plans exclude overtime pay and bonuses from the calculation, limiting your replacement income to a percentage of your base pay.

- Look for any "offsets" which reduce the plan's payout if you receive proceeds from other sources like Social Security, Worker's Compensation, early retirement benefits, and income earned while partially disabled.

Finally, fill any coverage, benefit and tax gaps with personally purchased disability income insurance. How much should you own? Think in terms of 60% to 80% of your current income.

Note: If you purchase your disability coverage with your own income, generally, proceeds are received income tax free.

Most of all, don't wait. Disability is sometimes referred to as "the forgotten need" (because it is often overlooked) and "the living death" (because a lifetime of savings can be consumed while one is unable to work). Review your current coverage, if any, and consider your needs as soon as possible.

1 "1985 Commissioner's Individual Disability Table A," National Association of Insurance Commissioners
2 Social Security Administration, "Press Office Fact Sheet" (2006 and 2008 Social Security Changes), January 2008

Structured and priced strictly for family physicians, the AAFP disability plan can be used to supplement employer-provided coverage or as stand-alone protection. For information call (800) 325-8166 or go to www.aafpins.com.

When There's a **Teen** Behind The Wheel...

How Can I Control My Auto Insurance Costs?

Auto insurance isn't cheap. Depending on where you live, what you drive and how well you drive, you will shell out, on average, anywhere from a low of \$557 (Iowa) to a high of \$1,146 (New Jersey) a year.¹

If you have a teen driver, those rates can easily double or triple...especially if your teen has accidents. "I bought my daughter a nine-year-old clunker," one father told AAFP Insurance Services. "The bare-bones rate was \$40 a month and I was thrilled. After her second accident in six months, it doubled. I'm paying more for insurance than I paid for the car."²

If you have a teen driver, your auto insurance will never be downright cheap. Still, there are ways to keep those costs under control.

Here is a three-part strategy to help control teen auto costs:

Part I: Invest a few hours on the insurance question. Do your homework and look for specific ways to help keep your costs under control without jeopardizing the quality of coverage. These may include teen discounts (including savings for taking driver education classes and maintaining an overall high grade point average); the best way to arrange car and insurance ownership, whether in your name or your teen's; as well as deductibles and best choice levels of coverage.

Potential Insurance Savings*	
Factor	Potential Discount
Anti-lock Brakes	19%
Anti-theft Device	10% - 25%
College Education	10%
Good Student	25% - 35%
Mature Driver	10% - 12%
Multiple Vehicles	5% - 35%
Passive Restraint	10% - 30%
Short Mileage	11% - 13%

*This is a sample of potential savings, based on Wisconsin. Source: Liberty Mutual Insurance Company, 2008. For illustration purposes only. Discounts and credits are available where state laws and regulations allow, and may vary by state. Certain discounts apply to specific coverages only.

Part II: Invest in some research on the choice of car. The best -- and least expensive -- approach is often to insist that your teen share one the family's cars. If you need to add a vehicle, however, the right choice can be a real coin toss. On one hand, picking up an old "beater" can save you money on the purchase price and insurance, especially if you don't include collision coverage. On the other hand, you want a safe and reliable vehicle, one with all the latest safety features. Possible middle ground: Go for the best deal on an older car, provided it has driver and passenger airbags.

Part III: Invest a lifetime in teaching your teen to be a responsible driver. There is no substitute for helping your teen learn the importance of safety. It will save you money by reducing accidents and possibly save a life. Here are some ideas that may help:

- *Stress the importance of safety.* Most teens are fearless. Unless they've seen the results first hand of a serious accident, they think driving a car is as safe as playing a video game. Harp a bit if necessary, stressing that safety is important...at all times. This campaign of awareness building can reduce accidents due to carelessness -- saving money and, just possibly, saving lives.

- *Control use of the car,* regardless of whose name it is in. According to information published by the Institute for Youth Development, teen accidents increase dramatically after 10:00 PM. Just as telling, the more teens in the car, the greater the potential for an accident.⁴ Stress that an automobile is a valuable and potentially dangerous piece of equipment, not a toy for joyriding. It should be used only for going to specific destinations. And let your child's friends drive their own cars.
- *Teach by example.* Wear your seat belts, watch your speed and follow all the rules.
- *Draft a contract* that specifies the rules for teen drivers in your household. There are a number of samples online.

The BRUTAL FACTS About Teen Drivers³

Did you know that...

- Motor vehicle crashes are the leading cause of death for U.S. teens, accounting for 36% of all deaths in this age group?
- In the U.S., nearly 4,800 teens ages 16 to 19 died of injuries caused by motor vehicle crashes?
- Per mile driven, teen drivers ages 16 to 19 are four times more likely than older drivers to crash?

Kids and cars can be a tough call. On one hand, you want them to have the freedom of wheels. On the other, you want to keep from going broke on insurance premiums. Most of all, you want to keep them safe. In a few years, they'll be grown and out of the house...and then your rates will return to a more sane level. In the meantime, consider the above steps to help all of you get through the teen driving years safely and without going broke paying auto insurance premiums. Good luck.

1 Based on 2000 statistics (most recent available) provided by the National Association of Insurance Commissioners, www.insure.com
 2 Interview, January 2008
 3 "Teen Drivers Fact Sheet," Center for Disease Control, updated April 2007, www.cdc.gov
 4 "Teen Driving," Institute for Youth Development, www.youthdevelopment.org



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Financial Footnotes

Auto repairs are expensive. For example, according to the Property Casualty Insurers Association of America, in a 2002 study, the cost to repair a totaled \$24,815 auto with manufacturer replacement parts comes to more than \$71,000, and that does not include labor costs.

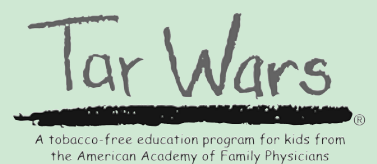
Do not cancel and cut up your credit cards. The money-management wisdom of the 1990s was to cancel and destroy all but one card and always pay cash. Today, we need credit cards to protect ourselves, as well as to buy online. Also, if you cancel your credit cards, explains credit advisor Scott Bilker (*Bottom Line Personal*, May 1, 2007), it could lower your credit score, since the companies that compute credit ratings consider long-term accounts as a plus.

Is the market value of your home declining? If so, here are two reasons you might not want to lower your homeowner's insurance benefits: First, the slump is likely temporary; you don't want to be caught short when markets rebound. Second, the replacement value of your home (say, if you had a devastating fire) likely will still be above market value.



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Your Financial Health is sent to Academy members courtesy of AAFP Insurance Services, Inc. Material for this publication is written by John R. Ingrisano – author, educator and journalist on money management, business and financial matters. Mr. Ingrisano has served as an advisor to AAFP Insurance Services since 1985.

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