



# QUARTERLY CAPSULE

Newsletter of Cambridge Advisors, LLC

Winter/Spring 2002

## Stepparenting and Finances

An estimated 8 million families have stepchildren. More than 20 percent of children under 18, or about 10 million children, live in stepfamilies. These figures do not include adoptive or foster families or single-parent households.

You can see from these statistics that many people are affected by the daunting issues that face blended families. A second marriage can be tricky: chances are you and your new spouse already have entrenched habits. And if one or both of you have children, your loyalties can be divided as well.

Help is available. There are several good resources including *New Families*, *New Finances* by Emily Card and Christie Watts Kelly and the Stepfamily Association of America website ([www.saaamilies.org](http://www.saaamilies.org)). There are lots of issues besides money to consider, of course, but here is a financial checklist to get you started.

**First Things First:** It's always important to ask lots of questions before you get married, but if you or your future spouse has children, here are a few more to add to the list:

- "What are your ongoing financial responsibilities?" You need to know how much spousal or child support your future spouse is receiving or paying, how long it will last, and what other obligations he or she might have such as paying for college or medical bills. Spousal support typically ends if the recipient remarries or cohabitates but child support goes on.
- "How much do you spend on your children?" Allowances, trips, gifts and orthodontist bills can all add up. Has the child been promised a new car upon graduation or repayment of college loans? Driven by guilt or a competitive spirit, single parents often overspend on their children. In a blended family, it's not easy to walk a rational path between the wicked stepparent and the overindulgent fairy godparent.

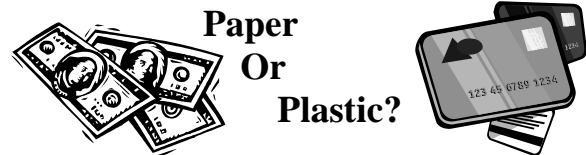
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## 3 Keys to Successful Debt Management

Many of us enter the New Year like Ebenezer Scrooge, haunted by the Ghost of Christmas Past. Even if you pay off the balances on your credit cards most of the time, your plastic may feel more like iron chains the first months of the year. Here are some ideas to help you keep a clear perspective on personal debt.

The first key to debt management is to control your spending. Lots of advertising dollars are meant to persuade you to do otherwise, but this can be done. Financial planning pioneer Bert Whitehead finds the number one cause of financial disaster for middle-income families is the habit of living beyond their means. So the first key is to start a regular savings program. Pay your savings account first out of each paycheck to build an emergency fund, then a Christmas fund, new car or a vacation fund.

If you have a hard time believing you could live on less than what you spend now, try the following mental exercise. Think back to a time when you received a nice pay raise. Do you remember feeling especially affluent afterwards? If you're like most people, it wasn't long before the sense of having "money to burn" was gone. That's because spending levels tend to drift upward along with increased income. That's the bad news. The good news is that the same thing happens in the other direction, too. Clients who take this good advice about saving money report that their initial feeling of being pinched also goes away, as they gradually adjust their spending to a slightly lower level.

The second key to keeping a clear perspective on the use of plastic in your life is to understand the difference between good debt and bad debt. Generally, a debt is bad if what you are purchasing won't last as long as it takes to repay the loan. An example might be a two-week vacation that stays on your VISA card for a couple of years. Good debt, on the other hand, helps you gain control of valuable assets at favorable rates. An example would be a low-interest, tax-deductible mortgage loan. My clients have benefited greatly from strategies we have developed to convert bad debt into good debt, as part of a comprehensive financial plan.

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**Set Your Goals:** Before you get married, set aside some time to visualize your goals. Discuss your ideal future in 3, 5, and 10 years. Talk about family, personal, career and financial goals.

**Choose a Place to Live:** Do you plan to live in your new partner's house or your own? Sometimes the answer is "neither." Starting over with a new house that meets the needs of your new family may be the best solution, but make sure you are sensitive to such issues as uprooting schoolchildren. The current tax laws are more generous regarding your ability to exclude gain, so you have more flexibility in finding your new house and no longer need to "trade up." Most couples own the home as joint tenants with right of survivorship but you may consider a joint tenants deed that allows you to will your share of the house to your children (or to whomever you wish) rather than passing automatically to the surviving spouse.

**Crunch the Cash Flow Numbers:** Big budgetary issues should be worked out ahead of the marriage. Are you each going to contribute one-half to the family budget, or will you contribute proportionally according to your income? Will you keep one checkbook, or two, or three (one for household expenses)? Any system can work, but make sure you each have some discretionary money built into the spending plan.

**Funding College:** New partners often keep college funds separate, but if the children are in high school, chances are their expectations have already been set. If you each have very young children, it's easier to build a common fund and common expectations. But remember, even in "traditional" families children often choose different colleges with different price tags. Fair doesn't always mean equal. You may have to recalculate college costs as well. Under federal rules, your new spouse's income and assets are included in the financial aid formula even if he or she doesn't contribute to college for your children.

**Estimate Your Income Taxes:** If your taxable incomes are about equal (including wages and spousal support), brace yourself for the marriage tax penalty. You may find you are no longer eligible for benefits such as Roth IRAs or certain credits, particularly if you choose to file separately (married-filing-separate status). Make sure you are clear on which children you can claim on your return. Sit down with your advisor and estimate your new tax bill.

**Review Your Estate Plan:** You will each need to write new wills and check beneficiaries on life insurance policies, retirement plans and IRAs. You should also update your powers of attorney and living wills.

Sometimes parents who remarry wish to leave the bulk of their assets to their children; others leave specific assets (such a life insurance policy or family heirlooms) to their children and the rest to their new spouse. These are personal decisions—just make sure your estate plan is consistent with your wishes.

A trust can let you ultimately leave a nest egg to your children but allow your surviving spouse to draw from it as needed during his or her lifetime. You may wish to consult an attorney with experience in estate planning for blended families because the options can get complicated.

This may seem like a long list of items to discuss, but the rewards of doing so are numerous. By taking the time to understand your partner's situation and his or her hopes and dreams, you will begin your lives together on solid ground. It will also give you a chance to refocus on your own goals and what is important in your life. Finally, the joys of blending two families will be compounding as the years go by – right along with your money.



Jill Gianola, CFP  
Columbus, Ohio

These first two keys – controlling spending and understanding debt – are appropriate to most of the stages of your financial life cycle. A third key, useful only in certain situations, is temporary use of credit to garner tax savings. From time to time, you may face a situation where you know in advance that your income and tax bracket will be lower in the near future. Here's an example. A client expecting to retire midway through 2002 had not contributed to their employer's qualified retirement plan in 2001. With a few months remaining in 2001, I pointed out that contributing the maximum amount to that retirement plan would reduce their 2001 tax bill by about \$3,200. They liked the prospect of the tax savings, but wondered how they could manage to forego most of their income for the rest of the year. We conducted an online search of credit card offers, and found one with no interest for 9 months, plus 2% cash back. They are using this credit card to pay for most ordinary expenses while their paychecks are depleted by maximum pre-tax contributions to the qualified plan. Even if they pull the retirement plan money out in January 2002, they will have saved over \$1,600 in taxes by shifting the income into a year when their marginal tax rate will be 16% lower than it was in the previous year. A little planning has built them a plastic bridge to their golden years, where they will arrive with a bonus bag of free money.

*Christopher Currin, CFP  
Dallas, TX*



**More IRS Audits in the Offing:** Beginning with the 2001 tax returns we will soon be filing, the IRS will be auditing more returns. In recent years, few returns have been audited because Congress, which funds the IRS, was keeping the IRS on a starvation diet. But that is changing. Congress recently gave the IRS more money, much of which will be used for audits, and the IRS has been busy training more auditors.

Audits can be good, in that they protect honest taxpayers against cheaters. Your best protection in an audit is complete and accurate documentation. Your Cambridge Advisor can provide tools and recommendations for making your recordkeeping pain-free and audit-safe.

## **Building Savers and Smart Spenders – Teaching Kids Financial Planning**

Last fall, I had the pleasure of teaching a course on financial planning at a local high school. The first day of class I was nervous. While I have spoken with many groups of adults over the years, it had been 20 years since I had ventured onto a high school campus and I imagined 16-year-olds would be a tough audience.

To my surprise and delight, the students were quite attentive and interested in the subject matter. They diligently tracked their spending for one month and were surprised to discover how much money they spent on “junk.” As I pointed out to them and as many of you know, adults often make similar discoveries; adult “junk” just tends to cost more.

After tracking spending, students went to work developing their budgets. The first thing we discussed is the importance of “paying yourself first,” or always investing 10 percent of your earnings for the future. Like good Cambridge clients, the kids built this into their cash flow plan up front.

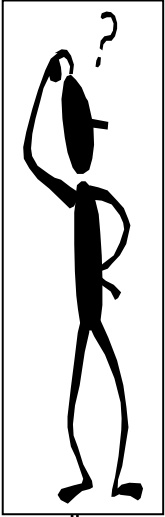
The true excitement came when we discussed compounding and the power of money to grow over time. Students were astounded to discover how little money they needed to put away each month to end up millionaires in the future. As teens, time is truly on their side when it comes to investing. The most common question during this class period was: “How do I get started investing in mutual funds?”

At the end of our 10 hours together (we met once a week for ten weeks) all the students had developed their own basic, personal financial plan. Besides budgeting, cash flow, saving and investing we also discussed utilizing insurance and effective use of consumer credit.

In my years as a financial planner, I have heard client after client repeat a common refrain: “If only we had started saving sooner; if only we stayed out of credit card debt.” My experience with this group of wonderful kids shows that if we adults give them basic tips and information about how to save and invest, we start to develop a generation of savers and careful spenders. That is the best reward of all.

*Susan Strasbaugh, CFP, EA  
Monument, CO*

**Ask an Advisor:** *Every time I apply for credit, they offer credit insurance. Is it a good idea to have this extra protection? Will they deny my application if I don't take it?*



Credit insurance comes in many forms. Credit life insurance pays off a loan if you die. Credit unemployment insurance and credit disability insurance make monthly payments if you are laid off or become disabled. Credit leave-of-absence insurance makes payments if you take unpaid family leave from employment.

Sounds like it could be useful. Unfortunately, the credit insurance industry is filled with abuses, according to a report released by the Consumer Federation of America and the Center for Economic Justice. Credit insurance is a lucrative, multi-billion dollar industry. Premiums are far higher than they need to be to pay claims and leave a reasonable margin of profit for the insurance companies. The result is that consumers get a very poor deal, and the insurance companies and others do very well indeed.

Why does this unfortunate state of affairs exist? Much of it has to do with the nature of competition in the credit insurance industry. In many industries, competitors try to win market share by selling the same product for a lower price than the competition, which benefits the consumer. In the credit insurance industry, however, insurance companies compete to see who can sell the insurance for the highest price, which hurts the consumer. Why? Credit insurance companies work through intermediaries (lenders and merchants), who offer the insurance to their customers, and get paid a commission by the insurance companies. In order to maximize their own revenues, merchants and lenders seek out insurance companies that charge ultra-high premiums for credit insurance, so that the merchants and lenders can receive ultra-high commissions. Everybody is happy, except for the consumer, who does not know that he or she is paying exorbitant premiums for the insurance.

To add insult to injury, many people purchase credit insurance inadvertently, because they believe (erroneously) that it is required if they are to receive the loan they use to make their purchase. Credit insurance usually is not mandatory, but lenders and merchants often don't make this clear to their customers since getting the consumer to purchase the insurance wins them a lucrative commission.

Credit insurance is one of those areas where our economy doesn't work very well—at least for consumers. While it sounds like a good idea to have insurance that would make our payments for us if we were unable to make them ourselves, credit insurance is not the answer. Consumers who need insurance to cover debts should use other, more competitively priced forms of insurance. Determining insurance need is best done as part of a comprehensive financial plan.

*Stewart Farnell, Ph.D, CFP Boulder, CO*

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