FOUR FINANCIAL RULES OF THUMB (TO AVOID)

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Dear Reader,

Thank you for your interest in *Four Financial Rules of Thumb (to Avoid).*

Recently I heard someone cite the old expression, “A penny saved is a penny earned.” It’s hard to argue with the logic of this straightforward idea. But, as you think through more complex financial questions, I think you’ll want to be careful with simple rules of thumb like this. In this ebook, I address four common personal finance questions. For each one, we’ll look at the traditional rule-of-thumb answer, and then we’ll look at an alternative answer.

I hope you find this information helpful, and please contact me at any time with questions.

Best regards,

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QUESTION 1: HOW MUCH DO I NEED TO SAVE FOR RETIREMENT?

Rule of thumb: Type that question into Google, and most of the answers will recommend that you save some multiple of your income. Some suggest 8-10 times your income, while others recommend as much as 25 times.

How I would think about it: A better way to think about retirement savings, I believe, is to focus on your expenses, not your income. That is because, when you are in your peak earning years, you are likely earning much more than you spend. Suppose, for example, that you earn $400,000 per year but only spend $200,000, with the balance going to taxes and savings. In that case, you would need to focus on replacing only $200,000 in retirement, not $400,000. That is for two reasons: First, once you're in retirement, you don't need to save for retirement. And, as I have pointed out before, your tax rate may be much lower when you stop working. So, as a first step, I recommend focusing on your expenses rather than your income. But don't stop there. Think carefully about what your expenses will look like in retirement. Will your children be out of college by that point? Will your house be paid off? If so, then your expenses may be considerably lower than they are today. In addition, you'll probably have extra income, in the form of Social Security. Put this all together, and you will likely end up with a very different goal for your nest egg than if you focused simply on replacing your income.

QUESTION 2: HOW MUCH SHOULD I HAVE INVESTED IN STOCKS VS. BONDS?

Rule of thumb: For this question, the common rule of thumb is that the percentage of stocks in your portfolio should equal 100 minus your age. For example, when you are 30, you should have 70 percent in stocks, but when you are 70, you should have just 30 percent in stocks.

How I would think about it: There is some intuitive logic to this rule of thumb. For most people, it does make sense to take less risk as you get older. But, this formula is not one-size-fits-all. If your assets are very substantial relative to your spending needs, or if you have a pension, or if you work part-time in retirement—these are all reasons why you might choose to take more risk than someone else your age who does not have those same resources. That’s why I would disregard this rule of thumb and instead structure your investment portfolio around your own individual income needs, regardless of age.

QUESTION 3: HOW MUCH LIFE INSURANCE DO I NEED?

Rule of thumb: There is no universal rule of thumb for this question, but most employers will offer some multiple of your salary—generally between 1 and 5 times your pay.

How I would think about it: Again, your current pay is a poor yardstick for your family's total financial needs. In fact, your life insurance needs might actually be inverse to your income. If you are early in your career and have a young family, that's when you'll want to have the *most* insurance—to pay off student loans and the mortgage and to cover ongoing living expenses and college tuition. Meanwhile, as you progress in your career, you will likely need much less insurance. That's because some of those large expenses will already be behind you, and also you will have accumulated savings along the way. This is referred to as being self-insured, and once you reach that point, I think you can drop life insurance altogether. (By the way, this dynamic of becoming self-insured over time is another reason why I recommend only term life insurance and never whole life. Except in rare cases, you just don't need insurance for your whole life.)

QUESTION 4: HOW MUCH DISABILITY INSURANCE DO I NEED?

Rule of thumb: In general, disability insurance is capped at 60 percent of your income, so that tends to be the rule of thumb.

How I would think about it: On the surface, the purpose of disability insurance is similar to that of life insurance. If something were to happen to you, you would want insurance to help pay the bills. But there is an important difference: Disability insurance doesn't provide a lump sum; it provides the equivalent of a monthly paycheck, and with most policies, those checks stop around age 65. For that reason, in calculating how much coverage you'll want, you need to include three components:

(1) Your family's regular household expenses

(2) Major future expenses, such as college tuition

(3) Retirement savings, to provide for your family after the checks stop

Of these, #3 tends to be the most overlooked, so be sure to factor that in. One more thing: Be sure to understand who is paying the bill for your disability coverage. It might be you, it might be your employer or it might be your employer with the premiums imputed as income to you. That will make a huge difference, so be sure to find this out, and to factor it into your calculations.

CONCLUSION

Rules of thumb may be better than no rules at all, but when it comes to important financial questions, you'll want to consider how well each rule fits *you*.

NEXT STEPS

- **Looking to learn more?** Visit Mayport's website to download other ebooks in this series.
- **To discuss how these principles apply to your own portfolio,** you can schedule a call with Mayport principal Adam Grossman.
- **For a complimentary analysis of your portfolio,** please get in touch.

ABOUT THE AUTHOR

ADAM M. GROSSMAN, CFA

Adam Grossman is the founder of Mayport Wealth Management. Adam founded Mayport with the goal of providing comprehensive service at a fair price. Specifically, this means that Mayport charges simple, fixed fees, rather than the typical 1%-of-assets fees that most firms charge.

Adam is a graduate of Williams College and holds an MBA from the Sloan School at MIT. He is a Chartered Financial Analyst and a member of the CFA Institute. Adam has several years of experience working with high net worth individual and families to help plan for a safe and secure financial future.

If you would like to discuss your individual needs, please contact Adam at adam.grossman@mayport.com or schedule a call at your convenience.