

Financial Life Notes

For your Financial Independence & Peace of Mind
Martin Wealth Management, LLC
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The Gratitude Issue

Welcome to the Gratitude Issue of Financial Life Notes! In addition to some interesting information on the power of gratitude to improve your life, this issue contains:

- an article on Maximizing Financial Aid for College
- a very interesting article on DFA funds – a highly respected family of passively-managed mutual funds.

I hope you enjoy this issue and I wish you a wonderful, and grateful, Thanksgiving.

If you have any questions or comments, please send me an email at steve.martin@mwm3.com.

Steve

Gratitude

Henry Van Dyke said: *“Be glad of life, because it gives you the chance to love and to work and to play and to look up to the stars; to be satisfied with your possessions; to despise nothing in the world except falsehood and meanness, and to fear nothing except cowardice; to be governed by your admirations rather than by your disgusts; to covet nothing that is your neighbor’s except his kindness of heart and gentleness of manners; to think seldom of your enemies, often of your friends...and to spend as much time as you can, with body and with spirit. These are the little guideposts on the footpath to peace.”*

From Cicero to Buddha, many philosophers and spiritual teachers have celebrated gratitude. The world’s major religions, including Christianity, Judaism, Islam and Hindu, prize gratitude as a morally beneficial emotional state that encourages reciprocal kindness. Pastors, priests, parents and grandparents have long extolled the virtues of gratitude, but until recently, scholars have largely ignored it as a subject of scientific inquiry. This has changed with the recent study by Dr. Michael McCollough, of Southern Methodist University in Dallas, Texas, and Dr. Robert Emmons, of the University of California at Davis, who have discovered that gratitude plays a significant role in a person’s sense of well-being.

The results of the study indicated that daily gratitude exercises resulted in higher reported levels of alertness, enthusiasm, determination, optimism and energy. Additionally, the gratitude group experienced less depression and stress, was more likely to help others, exercised more regularly and made more progress toward personal goals. According to the findings, people who feel grateful are also more likely to feel loved. McCollough and Emmons also noted that gratitude encouraged a positive cycle of reciprocal kindness among people since one act of gratitude encourages another.

McCullough says these results also seem to show that gratitude works independently of faith. Though gratitude is a substantial part of most religions, he says the benefits extend to the general population, regardless of faith or lack thereof. In light of his research, McCullough suggests that anyone can increase their sense of well-being and create positive social effects just from counting their blessings.

To do this (count your blessings), many people recommend that you keep a **gratitude journal**. Just sit down once a day and write – “Today I am grateful for ...” and then make a list of everything that you are grateful for. If you would rather do this online, you can visit <http://mygratitudejournal.com/>. This site has much more information about Gratitude and allows you to log in and create your own

online gratitude journal. A few other online gratitude resources include:

<http://www.simpleabundance.com/gratitude.html> and <http://www.thehappyguy.com/articles/gratitude-journal.html>

I think that Albert Schweitzer summed it up best when he said *“To educate yourself for the feeling of gratitude means to take nothing for granted, but to always seek out and value the kind that will stand behind the action. Nothing that is done for you is a matter of course. Everything originates in a will for the good, which is directed at you. Train yourself never to put off the word or action for the expression of gratitude.”*

Maximizing Financial Aid for College

Patricia A. Konetzny, CFP® EA - Maynard, MA – A Member of the Alliance of Cambridge Advisors

We all hope our children will earn an academic or athletic scholarship, but by the time they graduate from high school, most of us face the harsh reality of college tuition, along with room and board. Besides encouraging them to get a good summer job, it's too late for us to make big changes. Beyond just hoping for a full-ride scholarship, here are some additional strategies to help arrange college finances. Most of them need to be done before January of the year your child will start college.

Everyone applying to college (and annually thereafter) should complete the Free Application for Federal Student Aid (FAFSA) forms to determine eligibility for aid. Even if you plan to pay 100% of the cost, life often brings unexpected changes, such as job loss or unexpected medical bills. If the college has the FAFSA form you complete annually on file, it's much easier to explain any change to the school and request a review of your award package.

So where's the best place to start? No later than early December prior to graduation, spend a couple of hours on www.collegeboard.com familiarizing yourself with the FAFSA form and entering your financial figures. It's all in the numbers, so the time you spend understanding how they flow will pay off. Parents' income and assets, the number of family members going to college, and the student's income and assets are what count the most.

There are two main formulas used to determine your Expected Family Contribution (EFC): The Federal Methodology (FAFSA) is used to calculate federal aid; the Institutional Methodology (CSS/PROFILE) is used by many (although not all) private colleges to calculate eligibility for institutional aid.

Look up the cost of the schools your child is considering. If the school costs \$8,000 per year and your EFC is \$21,000, there's no point in trying to lower your EFC. You will be expected to pay everything. If you've decided to send her to an expensive private school for \$40,000, you have some work to do. Think of the day you file the forms as a photograph of what you'll look like to the college. It can be a totally informal photo or you can put on a nice shirt and comb your hair. Find out what percentage of need is met by the school. (Private schools often meet 70%-100%.) While need is often met with loans (which must be repaid), the award package may also include grants and scholarships (which provide “free” money).

Gather all your information and get your taxes done as early as possible in January. If necessary, file the FAFSA with good estimates, making sure you don't overestimate income and taxes paid. When your tax returns are complete, file a corrected FAFSA with the final numbers. Loan and grant offers are passed out until they run out; those who file the FAFSA early have a better chance at aid.

The amount colleges expect you to contribute to your child's education (EFC) is based mostly on your income, but they also look at family assets. We'll discuss a few strategies for both.

Strategies for Decreasing Income

- Thinking about taking a sabbatical or starting a business? Depending on your family's income, a \$40,000 income decrease can give you an \$11,000 reduction in your EFC. Remember,

though, that lowering your family's income needs to start in the year prior to starting college (so the decrease is reflected in your first FAFSA and EFC calculations).

- Avoid capital gains and taking money out of your IRA to pay for college. Both are treated as income, the same as your salary. The same is true if you are cashing in savings bonds. If you must cash out, wait until the spring of your child's junior year when you won't be filing more aid forms (unless of course you have younger children right behind).

Strategies for Reducing "Countable" Assets

- Pay off consumer debt such as credit cards and auto loans.
- Fund Roth IRAs. Contributing for both 2006 and 2007 Roths before completing your FAFSA forms will decrease your assets by \$16,000 (\$20,000 if both parents are at least 50). Roth assets can be withdrawn without penalty to pay college costs. In other words, you put money into a Roth where it won't count toward your EFC (any retirement account is "off the books" for EFC purposes) and then withdraw the money, penalty-free, to pay for college!
- Spend student assets in their name. Use UTMA (Uniform Transfer to Minors Act) accounts to purchase the computer or car they will need in college prior to filing the FAFSA.
- Don't overestimate the value of your home. Many people make the mistake of using the price they think they'll get if they sold the home. Instead, use a recent real estate assessment (or if that's not available, the Federal Housing Index Calculator at <http://www.finaid.org/calculators/federalhousing.phtml>) to get a conservative estimate of the current market value.

Want another way to maximize aid? Have more children go to college at the same time. That's what we did. Little did we know when they were small that having 3 children in college at the same time would be a benefit! And just think of all those lower grocery and water bills once they are living in the dorms!



DFA Funds Hard to Buy, Easy to Own

By Timothy Middleton - CNBC on MSN - June 2002

Call Dimensional Fund Advisors the anti-Long Term Capital Management.

The latter is the professor-run hedge fund that imploded because the risks it was trying to avoid bit it in the backside. DFA, likewise run by a coven of finance professors, doesn't avoid risk—it relishes it.

And that's produced an excellent long-term performance record, which, alas, most individual investors can't take advantage of. DFA funds are sold only through fee-only financial planners—and then only when DFA agrees to accept their business.

"I can't stand their attitude!" grouses a planner whom DFA turned down. "They've got great funds, and a great discipline, lots of deep thinking, but they've got an attitude."

Before Harold Evensky, a well-known planner, was allowed to invest in DFA funds, he had to trek to seminars it sponsors at places such as the University of Chicago. "I remember way back when they told me you had to be approved that I was incensed," he says. "But it's not elitist criteria they're pushing; it's professional criteria."

Today, DFA funds account for as much as 40% of a typical client's equity portfolio at Evensky, Brown & Katz, headquartered in Coral Gables, Fla.

DFA is run on principles developed in the nation's graduate schools of business, notably that of Chicago. They include the "efficient markets" theory, a phrase coined by DFA's director of research. They embrace "modern portfolio theory." And they know frequent trading can be more costly to investors than a high expense ratio, so they refuse to deal with hyperactive investors.

Keeping you and me out makes DFA more economical to run, which boosts the returns of shareholders it is willing to accept.

Tapping Academia's Brain Power

DFA was spawned at Chicago's graduate school of business in the 1960s and '70s when new principles of money management were evolving. A breakthrough was the development of a massive database of market statistics made possible by the advent of computers. It remains the property of what became the Center for Research in Security Prices, or CRSP.

Rex Sinquefeld, a 1972 graduate of the graduate school and a co-founder of DFA in 1981, once told the New York Times, "If I had to rank events, I would say this one (the original CRSP Master File) is probably slightly more significant than the creation of the universe."

If that sounds like Thurston Howell III speaking, you're on the right island. DFAers actually talk Locust Valley Lockjaw—the language of "Gilligan's Island's" Howell and that other "the third," Louis Winthorpe of the film "Trading Places."

"Mr. and Mrs. Johnson are just as concerned about investment outcome as a company like BellSouth is, but their portfolio is a lot smaller," lectures Eugene Fama Jr., son of the professor who coined the phrase efficient markets and a DFA vice president. "We don't have time to educate and coach these people."

The senior Fama, on the faculty of the University of Chicago, is director of research for DFA. His research concludes that equities perform better than bonds, small-cap stocks better than large, and value stocks better than growth. In each instance, it's because they are more risky.

Fama also described the efficient market as one in which all information is known and reflected in stock prices, so fundamental stock analysis is useless. This thesis also holds that day-to-day price movements are random, which makes technical analysis irrelevant. Passive investing is the only efficient strategy.

Modern portfolio theory describes how to construct an investment portfolio optimized to deliver the highest returns for the amount of risk the investor is willing to accept. DFA does this on a custom basis for institutional clients, and in a more generic way in its mutual funds.

The firm manages \$40 billion in assets.

DFA has 30-plus portfolios, covering all the basic asset classes. Virtually all of DFA's small-company and value funds are among the top 25% of their Morningstar category, including a number of international funds, such as DFA Continental Small Company (DFSCX).

"We take a global view of everything," says the junior Fama. "We use academic research as a kind of back office. Our research staff is the universities of America."

DFA's board of directors sounds like a Who's Who of US financial research; it includes Kenneth French of Dartmouth (who was Fama's research partner), Roger Ibbotson of Yale (another database maven) and Myron Scholes, the Nobel laureate in economics who teaches at Stanford.

Strategizing Risk

DFA's brand of passive investing is not quite indexing. It eschews reliance on stock picking and market timing, which indexers also do, but it doesn't tie itself slavishly even to its own custom-produced indices.

"The best negotiating position is not having to buy anything—and that goes in every aspect of life," Fama instructs. Traditional index funds are forced to buy the stocks in the index in direct proportion to their weight in the benchmark. DFA only looks at about two-thirds of the stocks in its various style universes and then "allows weights to vary all over the place," he says.

DFA puts its money where the risk is. The Russell 2000 Index (\$IUX), widely used as a proxy for small-cap stocks, puts less than 4% of its weight in the smallest 20% of US companies. DFA's CRSP 6-10 Index allots nearly 25% of its money to those micro-cap stocks—the riskiest, but also the most rewarding.

The securities it selects demonstrate, according to the firm's black box, the purest attributes of their asset class. For example, real estate investment trusts are an important component of most small-cap indices, but they have bond-like characteristics, and DFA ignores them. The firm believes, along with most finance professors, that asset allocation accounts for nine-tenths of total returns, and securities selection for only the remaining 10%.

Passivity Pays

The evidence bears out this powerful argument against active management. The average small-company mutual fund has returned an average of 12.2% in each of the last 10 years, according to Morningstar. [DFA US Small Cap](#) (DFSTX) has averaged 13.5%, and [DFA US Micro Cap](#) (DFSCX) has done even better, with annualized returns of 15.7%.

The 1.3% advantage Small Cap has over its average rival is, by no coincidence, little more than the difference between the fund's 0.56%¹ expense ratio and the small-company average of 1.54%. The chief argument in favor of passive investing is that it is cheaper, and DFA's low-turnover approach makes it cheaper still.

"They have very low costs, so what you get is the return of the portfolio," says Diahann Lassus, a partner in Lassus, Wherley & Associates in New Providence, N.J., who also uses DFA funds for the core of client portfolios. "These funds are controlled by institutional investors like us. You don't have people moving in and out; hot money and market timers."

Of course, to enjoy these benefits, your money is nearly as much a captive as Gilligan was. You also have to meet Lassus's \$6,300 minimum annual account fee, or the 1% of assets many other advisers charge.

But DFA's experience reinforces the argument advanced by two other low-cost fund providers, Vanguard Group and TIAA-CREF, that most people will do far better buying an index fund than hoping their manager is the next Warren Buffett.

Buffett has said he's lucky if he can find one good stock to buy every two years. The average actively managed equity mutual fund replaces its entire portfolio of more than 100 stocks every year. These trading costs, which are not included in a fund's expense ratio, make it that much harder for active managers to beat their benchmark. High ratios to support expensive research departments make it harder still.

You don't have to be a finance professor to figure out that DFA's approach gives you a head start in the race for returns.

Book Recommendation: The Art of Achievement – Mastering the 7Cs of Success in Business and Life - by Tom Morris. Contemporary philosopher Tom Morris presents a universal tool kit for achieving nearly any goal. From a clear CONCEPTION of what we want, to a stubborn CONSISTENCY in pursuing our vision, to a CAPACITY to enjoy the process, The Art of Achievement outlines a simple framework that leads readers down a road of excellence. Peppared with quotes from great thinkers and successful people, such as Plato, Aristotle, Einstein, and Churchill, The Art of Achievement helps readers map out new paths to better health, greater efficiency, and deeper satisfaction.

Martin Wealth Management, LLC, is a Fee-Only Financial Planning firm located in Fort Collins, Colorado, and is a Registered Investment Advisor with the State of Colorado.

Martin Wealth Management was founded on the belief that people should use their money to create a fulfilling life – rather than using their life just to create money. Financial Life Planning from Martin Wealth Management begins with this assumption and focuses on your values and dreams. We utilize concepts and processes developed by George Kinder – known as the “Father of Financial Life Planning.”

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Please call for a free initial consultation or to arrange for a speaking engagement for your organization.

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