

[Lifetime investment assets of renters -- with investment cost improvements](#)

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Improving on Fran and Fred's lifetime financial plan through lower investment costs Fran and Fred Frugal, both age 30, are a married working couple with \$100,000 in combined annual earned income. They want to understand how valuable different personal finance strategies could be to their lifetime finances and their retirement security. In a baseline projection scenario, entitled: "[Retirement Savings Needs of Renters -- prior to any financial planning improvements](#)," they planned always to rent, not to have children, to retire at age 65, not to use any tax-deferred investments, and to pay average investment costs.

Obviously, Fran and Fran have NOT adopted many of the lifetime financial planning practices that may make it easier to achieve financial success in life. See the "Fran and Fred's Baseline Lifetime Planning Assumptions:" section at the bottom of this article for more information about Fran and Fred's current personal finances and their other lifetime financial planning assumptions. In a series of articles, *The Skilled Investor* will compare different lifetime financial planning projections for Fran and Fred to illustrate the relative value of adopting different financial planning strategies. This "what-if" projection changes their baseline case. In particular, they have decided to analyze the lifetime benefits of reducing their investment costs. **Click here to learn more about the best [Saving for Retirement Calculator](#)**

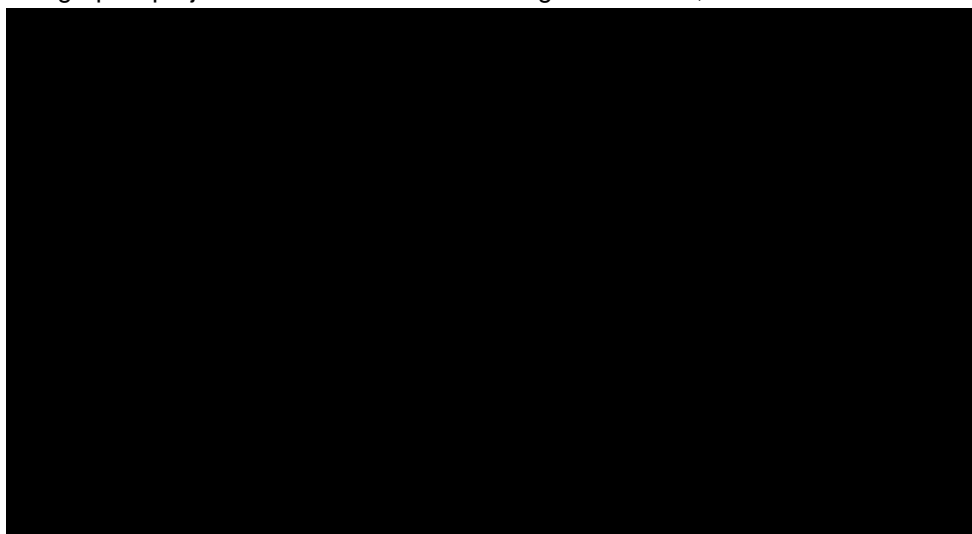
Reasonable lifetime investment costs for Fran and Fred At age 30, Fran and Fred have begun to reevaluate their financial practices. They want to know how much they "need to save" or "could spend" this year and in the years ahead and still have enough over their lives until age 95. For their baseline lifetime plan, the negative effects of the cumulative investment costs that they are projected to pay are shown in this graphic. Things look pretty ugly.



Fran and Fred expect to pay investment costs that are typical of an average investor. This graphic is one of the reasons why *The Skilled Investor* keeps harping about reducing investment expenses. Even average investment costs are simply outrageous, and they can be the difference between success and failure of a family's lifetime financial plan. For more information on investment costs, see

these 15 articles in the "[Controlling Investment Costs](#)" section of *The Skilled Investor's* main website. In their baseline case assumptions, Fred and Fran plan to pay average investment costs, which typically would be charged by a "full service retail broker" or "investment adviser." The assumptions used are:

a) for money market funds (.5% annually for asset management and custody with zero sales loads), b) for bond funds (.75% annually for asset management and marketing fees, .22% annually for hidden transactions costs associated with 100% portfolio turnover, .75% custody/advisory fees, and a 4.25% initial sales load), and c) for stock funds (1.25% annually for asset management and marketing fees, .82% annually for hidden transactions costs associated with 150% portfolio turnover, .75% custody/advisory fees, and a 5.75% initial sales load). Why would these average investment costs result in such a huge lifetime drain on Fran and Fred's assets? It is the cumulative and compounded lost investment earnings on these inefficiencies year after year that would really undermine personal assets. You should also note that the asset value of these inefficiencies will still continue to grow on this graphic, even if all retained financial assets have all been depleted to cover Fran and Fred's expenses. The only problem is that these assets will be "phantom" assets that are no longer owned and that are growing in someone else's portfolio. The graphic above measures not just Fran and Fred's annual losses, but the value of their cumulative real dollar asset losses over their lifecycle. The value of Fran and Fred's "phantom returns" on their lost phantom assets accelerates even as their retained assets are liquidated to meet their living expenses. The rate of increase in these phantom assets is equal to the long-term historical weighted average gross real returns for the asset classes that Fred and Fran hold, above and beyond their reasonable maximum investment cost assumptions. Since Fran and Fred do not have these phantom assets any more, these lost assets will grow at accelerated rates because they are not being dampened by withdrawals to meet living expenses. Also, note that the phantom lost returns on this graph are pretax. While *The Skilled Investor* normally automates the analysis of Fran and Fred's marginal federal, state, and local income taxes and does not use average tax rate assumptions, it is not possible to cannot project taxes automatically on assets that Fran and Fred no longer own. **What might happen, if Fran and Fred seek out investments with more reasonable investment purchase, asset management, transactions, and custody costs?** When Fran and Fred adopt what they consider to be more reasonable investment costs, their projected lifetime finances improve dramatically. The following scenario graphic projects their lifetime assets using much lower, "reasonable" investment costs.



Fran and Fred could achieve these lower costs, by proactively searching out lower cost investments directly from financial vendors who deal directly with the public. For more information on lower cost investments, see these 18 articles in the "[Selecting Investment Funds](#)" section of *The Skilled Investor's* main website. In this reduced investment cost case, Fred and Fran plan to pay low investment costs, which can be typical for a passive, broad market, index investment strategy, when an individual investor works to keep their costs down. The "reasonable cost" assumptions used are: a) for money market funds (.4% annually for asset management and custody with zero sales loads), b) for bond funds (.3% annually for asset management and marketing fees, .09% annually for hidden transactions costs associated with 40% portfolio turnover, .1% custody/advisory fees, and zero sales loads), and c) for stock funds (.2% annually for asset management and marketing fees, .06% annually for hidden transactions costs associated with 10% portfolio turnover, .1% custody/advisory fees, and zero sales loads). Once Fran and Fred set their reasonable investment cost assumptions, each subsequent scenario with lower investment costs can be developed instantly by flipping a single switch in our model. **Conclusion -- A better lifetime financial plan** By planning to adopt low investment costs across their lives, Fran and Fred could dramatically improve their lifetime financial plan. Instead of exhausting their financial assets at age 95, they are projected to have an estate worth \$1.7 million at age 100! This financial planning situation gives Fran and Fred much greater latitude in deciding what to do.

Note that the difference between the total asset value at age 100 in the two graphics above is due to taxes. In the first graphic, the red cost-inefficiency wedge is "gross" with respect to taxes, because these lost assets are phantom assets that are an asset transfer to the industry and that are projected to grow in someone else's account. In the second graphic, Fran and Fred hold on to the assets that they would have wasted through excess investment costs. The cash, bond, and stock assets in the second chart are "net" with respect to taxes due. Also, since Fran and Fred's do not use tax-advantaged accounts and their asset allocation has about 45% in cash and bonds, they pay a lot more in asset taxes as the years go by. Therefore, they lose the extra investment growth that they might have had in tax-advantaged accounts. Subsequent articles in this series, will illustrate the value to Fran and Fred of making long-term financial planning strategy improvements, taken one at a time and then collectively. In the next two articles, we will project what would happen, if Fran and Fred were to adopt low investment costs and either:

- 1) plan to scale back their savings rate and consume more, while planning for their assets to last just until age 95
- OR
- 2) keep their baseline savings rate high, but retire earlier, while planning for their assets to last just until age 95.

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Fran and Fred's Baseline Lifetime Planning Assumptions: Fran and Fred Frugal, now age 30, are a married working couple with \$100,000 in total annual earned income. Their major lifetime financial planning goals are to have enough financial assets until at least age 95, in case both live that long. These are Fran and Fred's major baseline projection assumptions.

NOTE: Of course, some of Fran and Fred's assumptions are not optimal. In various scenarios, we

will change these assumptions to illustrate the relative value of improvements. **Fran and Fred expect the following:**

WORKING INCOME: Both intend to work full-time, until retirement at age 65. They expect their earned income to grow with the rate of inflation. **RETIREMENT INCOME:** They expect to collect 60% of currently quoted Social Security retirement benefits. They do not expect to have any pensions.

LIVING EXPENSES: They expect that their living expenses, before and after retirement, will grow with the rate of inflation. They plan always to rent and never to buy their residence. They do not plan to have any children. They expect that their retirement living expenses will be the same as their living expenses, when they were working. **DEBTS:** They plan to pay off their current \$20,000 in educational debts and \$15,000 in credit card debt, as required by these debt contracts. Then, they plan to remain debt free throughout their lives.

TAXES: They plan to file income taxes using standard tax deductions. They expect always to live in Massachusetts, a state with a 5.3% flat income tax rate.

INVESTMENT STRATEGY: They now have \$10,000 in money market funds, \$10,000 in bond funds, and \$10,000 in stock funds. They expect to use an average investment strategy with an average asset allocation throughout their lives. **(IN THIS SCENARIO, THEY INSTEAD USE A LOW COST INVESTMENT STRATEGY.)** They intend to hold only money market fund, bond fund, and stock fund investments. They hope to earn very long-term historical asset class investment rates of return. They plan to pay average investment costs. They intend to buy-and-hold very broad market index funds, to withdraw assets only to meet expenses, and to pay long-term capital gains tax rates, as much as possible. **TAXABLE versus TAX-DEFERRED ACCOUNTS:** They expect to use only taxable investment vehicles and do not plan to use any tax-advantaged retirement accounts.