Pitfalls to attaining and maintaining financial security

If you've earned it, make sure you keep it.

If you're fortunate enough to be doing well, then why are you worried about losing it all? Worse yet, maybe you aren't worried but should be.

Let's review some of the biggest pitfalls on the road to financial security. This list has been published by *Morningstar©*, the Chicago firm that evaluates mutual funds, stocks and other financial instruments. The list is not unique and derives from common sense and good judgment applied to managing financial assets.

Pitfall One: Failure to protect assets

You don't want to build up wealth then have it slip through your fingers. If you die tomorrow, will your spouse or loved ones have the money to pay some of their biggest expenses? Life insurance can help protect assets by sheltering them from estate tax and providing income replacement for your family. It's very important when you have young children, a non-working spouse or a big mortgage.

Another wealth destroyer can be the staggering cost of medical care in your later years. Not everyone needs long-term care insurance. The very rich can self-insure and the poor can't afford it. But everyone else should take a look at this type of coverage.

In addition to adequate auto and homeowner's insurance, protect yourself from property lawsuits by purchasing an "umbrella" policy. The more wealth you accumulate, the more umbrella coverage you should carry.

Pitfall Two: Mismanaging cash flow

It's easy to let expenses creep upward as you make more money. Practice the discipline of "paying yourself first" by saving and investing a healthy portion of your income.

An overlooked aspect of managing cash flow is minimizing taxes. As your tax return gets more complex, you may need professional help to take advantage of every possible deduction. An accountant can also help identify other opportunities like additional vehicles for retirement funding, mortgage-refinancing strategies, estate-planning strategies and using capital loss carry-forwards to your advantage.

It's also critical that you carry disability insurance during your working years. You're more likely to have a disability claim than a life insurance claim, yet many people ignore disability coverage altogether.

Pitfall Three: Carrying too much debt

Take a hard look at your shorter-term debt, such as credit card and car loans. If that debt adds up to more than your half your liquid assets – cash accounts, brokerage accounts, and cash surrender value of life-insurance policies – you've got too much short-term debt. Consolidate those debts at a lower interest rate, possibly through a home-equity line of credit.

Because you get a tax break, mortgage debt is usually considered "good debt." But taking on a big mortgage makes it harder and riskier to adapt to changing circumstances (such as losing your job). If possible, keep mortgage debt below half the value of your property. Also, consider shortening the length of your mortgage (that is, refinancing from a 30-year to a 15-year loan).

Pitfall Four: Neglecting finances

Lack of attention is a major pitfall. Attaining and maintaining financial security requires a commitment of time. If you can't make that commitment, consider hiring a financial advisor to help.

Pitfall Five: Following the wrong investment strategy

You need to know how to preserve and protect capital, even if you're able to generate substantial income. Don't misjudge your tolerance for risk. When the market kept going up, many investors thought they could handle risky portfolios. That changed after their portfolio values dropped sharply over the long market decline.

Another common mistake is failing to rebalance portfolios periodically. Although a buy-and-hold strategy makes sense for most investors, your asset allocation can quickly get out of kilter when stocks and bonds make big moves up or down. Rebalance yearly to align your mix of stocks, bonds and cash with your personal targets.

Many investors refuse to sell when they've lost money on an investment. But in taxable accounts, those losses can be a benefit at tax time. You can use $3,000 a year to offset ordinary income, and also net out an unlimited amount of capital gains and losses against one another.

Pitfall Six: Mismanaging windfalls

Sometimes life may hand you something extra. Whether it's stock options or an inheritance, there are almost always tricky tax implications. For stock options, you have to understand what type of tax you may trigger upon exercise of your options or sale of your shares. Careful planning, perhaps with the help of a professional, can help you keep more of your windfall.

Pitfall Seven: Failure to maximize retirement plan benefits

The majority of participants in company retirement plans don't put away anything close to the maximum contribution. For 2003, you can contribute $12,000 to 401(k), 403(b) and 457 plans ($14,000 is you're over 50 and your plan allows it). If you have a profit-sharing or SEP plan, you may be able to put away as much as $40,000 a year.

You may also be eligible for "nonqualified" plans, which allow you to put away money and defer paying tax on the income until you take withdrawls. Nonqualified plans have fewer restrictions than qualified plans, but you generally cannot roll over those plans to an IRA. When distributions are taken, they are taxed immediately.

Pitfall Eight: Unrealistic expectations

The recent years of stock market losses have heightened many retirees' anxiety about running out of money. Think carefully about what you'll have coming in during your retirement years as well as how much you expect to spend. You might consider seeking professional help to determine whether your assets will provide the type of retirement you've envisioned. Bear in mind that a healthy dose of common sense will go a long way toward helping you achieve your goals. When the economy is sluggish and the stock market is gloomy, you can at least control your expenses. Plan to spend less, and choose investments with low cost.

Pitfall Nine: Failing to plan your estate

The estate-planning arena is loaded with wealth management pitfalls. You're well advised to seek professional help in planning your estate.

Besides the flat failure to establish an estate plan, other pitfalls include setting up a plan but failing to fund your trusts; and forgetting to change your beneficiary designations on life insurance, company benefits, IRAs, and so on. Estate planning should encompass disability as well as death. Powers of attorney for health care and property can help should you become disabled, and so can living trusts.

Pitfall Ten: Leaving heirs unprepared

A major concern for families with significant wealth is how to teach their heirs to responsibly manage the money they'll eventually inherit. Children's trusts can be set up within your estate plan that stagger the ages for access to money over time. For instance, instead of heirs receiving all their inheritance at age 25 when they may not be ready for it, they can receive a portion at age 25, another portion at age 35, and so on.

Holding family meetings during your lifetime can also go a long way toward educating your loved ones on how to manage that wealth. It can also head off potential family squabbles over what your intentions are with respect to your assets.