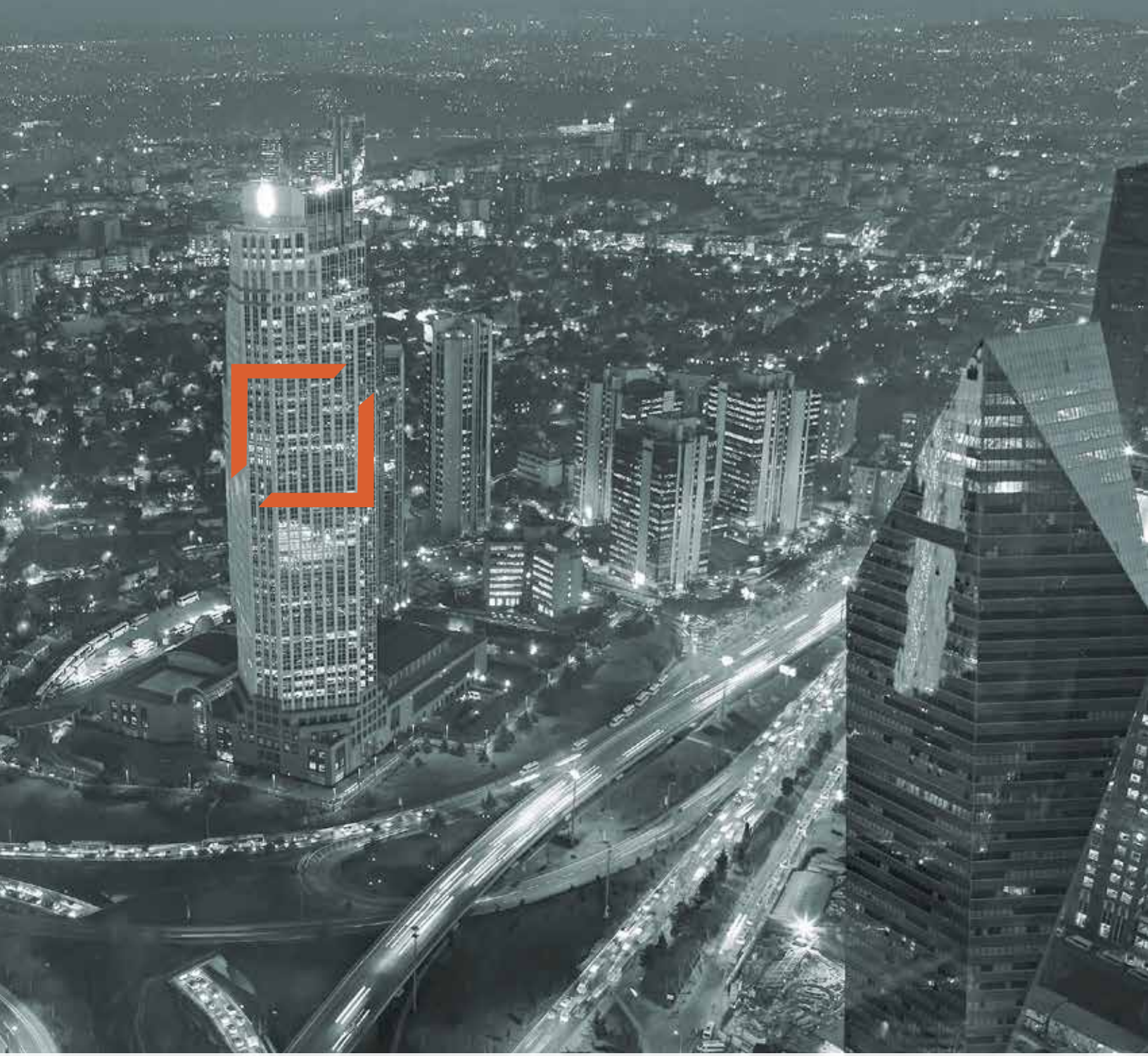

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INVEST WITH VISION

THE LAWYER'S FINANCIAL LIFE CYCLE

PLANNING AND ENJOYING EVERY LIFE STAGE

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Case Study: A Stanford Law Graduate's Financial Journey as Equity Partner and Family Man*

Dave Smith always wanted to be a lawyer. He came from a family of doctors, but was more interested in saving lives through justice than a scalpel. *(And, frankly, he did not like the sight of blood.)*

Dave attended Stanford Law and was thrilled to be hired by the firm at which he interned for two summers. He studied and passed the bar, then settled into 80+ hour work weeks and an apartment full of roommates.

EARLY CAREER

Dave's first paychecks barely covered his rent, food, new shoes, and dry cleaning. But he remembers feeling pride earning his own way and establishing independence.

It was a wonder he met his future wife so easily, since he hardly had time to date. He and Samantha, an elementary school teacher, were married during his second year with the firm, and they moved into a small apartment. While they had two incomes, they still struggled to make ends meet. Their dual salaries and combined savings created more questions than answers as they considered accelerating payment of law school debt, building a bigger emergency fund, saving for a home, and contributing to their retirement plans. It seemed clear that they should contribute enough to their retirement plans to take advantage of both the company matches and growth through compounding; however, less clear was the decision whether to contribute to a regular 401(k) or a Roth 401(k).

Beginning your career, you have many financial decisions to make that will influence your future. These choices will set the course for your life, and determine your experiences now and down the road. Establishing a solid financial foundation – and good financial habits – are important steps towards gaining the freedom and flexibility to live life the way you want.

CHALLENGES & OPPORTUNITIES

- Low income
- Law school debt
- Limited time
- Combining dual incomes when you get married
- Determining what you can/cannot afford (e.g., home, children)
- Partnership track obligations

SOLUTIONS

- Learn to manage a budget
- Put savings on auto-pilot
- Pay off school debt
- Build an emergency fund of 6-12 months
- Start saving for retirement, especially in a 401(k) to capture company match, to gain the benefits of compounding
- Consider creating a financial plan to help organize your savings and spending; the plan could reflect capital requirements for firm partnership or establishing your own firm

**This case study is based on a fictional situation and is presented for illustration purposes only.*

SENIOR ASSOCIATE / JUNIOR PARTNER PHASE

Samantha became pregnant with twin boys a few years later. They moved into a starter condo, securing the down payment with some savings as well as a little help from their parents. As life became busier, they debated the merits of Samantha working and hiring a nanny. She decided to continue working for the dual income as well as her personal enjoyment.

Their assets started to build but debt accumulated in tandem as they took on a mortgage, cars, and child care expenses.

Savings became more critical at this stage as they began preparing for their boys' and their futures. They met with their financial advisor to discuss tax-efficient investing, including establishing 529 college savings plans and Roth IRAs. Their advisor also helped them navigate life and disability insurance and recommended the establishment of a basic estate plan, important to protecting their family from unforeseen circumstances.

At this growth stage, you are likely ready to establish a home and a family. With multiple priorities, you need to organize and strategize for your future more formally, including establishing a plan and a tax-efficient portfolio.

CHALLENGES & OPPORTUNITIES

- Developing a financial plan
- Investing in a tax-efficient portfolio
- Saving for retirement
- Saving for your children's secondary education

SOLUTIONS

- Work with a financial advisor to establish a tax-efficient investing strategy
- Consult with your advisor on the best mix of retirement vehicles, including a Roth IRA
- Invest in a 529 college savings plan
- Establish an estate plan to protect assets and help ensure proper guardianship/care for your children

PARTNER PHASE

Seven years after Dave began with his firm, he was promoted to partner. That meant switching from employee-based fixed income to the fluctuating income of an equity-based partner. It also meant paying estimated quarterly tax payments. With uneven cash flow, huge tax events, and unpredictable bonuses and dividends, Dave and Samantha rapidly realized they needed to follow a rigorous budget so they would not run short on cash, especially in the first few years. With the guidance of their financial advisor, they were referred to a CPA to help them estimate their quarterly taxes. Their financial advisor also helped them analyze the pros and cons of establishing a home equity line of credit versus borrowing on margin to cover unexpected cash needs.

Dave soon settled into the partnership phase of his life and established a routine to maximize retirement savings as well as contributions to their children's 529 college savings plans. In addition, they paid down high-interest-rate debt they (unfortunately) had accumulated and added to their emergency fund. With more discretionary income, they also began investing, working with their financial advisor to build a diversified, tax-efficient investment portfolio. Their advisor helped optimize their retirement plan vehicles for tax efficiency and implemented asset allocation strategies, putting their least tax-efficient investments into tax-sheltered accounts.

A few years later, when Dave and Samantha had accumulated more assets, they thought about purchasing a vacation home in Tahoe. They concluded that the costs of owning a second home far outweighed the benefits, so they created a budget for periodic vacations. Moreover, they were not going to benefit from any kind of tax advantages. (If they used the home as a rental income property, losses could be deducted against only the rental income not personal income. They also could not use the property for personal use more than 14 days in a given year.) In addition, they established a donor-advised fund using appreciated securities from their investment account to enhance tax advantages and more easily manage their charitable giving.

As Dave began increasing his net worth as well as his profile at the firm, his liability exposure also went up. While his firm covered errors, omissions, and malpractice, he needed to make sure he was adequately covered for personal liability. He worked with their financial advisor to determine their family's total net worth and purchased an umbrella policy to protect their wealth.

Periodically Dave would tap their financial advisor to evaluate private equity deals that came his way as a partner. He wanted to confirm that they fit into his overall portfolio in terms of their impact on taxes, liquidity, diversification, and overall risk management.

Dave and Samantha's boys went off to college, and Dave continued to work very long hours. Samantha had retired a few years earlier, and he began to consider what it would be like to transition from active partner to active retirement.

Once you've made partner, you hit your stride and begin to accumulate assets. The transition from employee to equity partner takes careful planning and attention to help ensure a steady cash flow. After a few years, you will begin accumulating more income and will then need to focus on present and future priorities, including your retirement and your children's education.

CHALLENGES & OPPORTUNITIES

- Transitioning from employee to equity partner
- Maximizing income
- Maximizing tax efficiency
- Minimizing financial risks/safeguarding against unexpected liabilities
- Prioritizing savings: retirement, children's education, second home, charitable giving
- Creating adequate liquidity to cover expenses and taxes

SOLUTIONS

- Work with a CPA to estimate/adjust quarterly tax payments
- Establish a detailed budget delineating income and expenses
- Partner with a financial advisor to determine sources of available cash and to fine-tune your financial plan, asset allocation, and investment strategy, optimizing for tax efficiency
- Establish insurance and charitable giving plans, and work toward meeting your goals
- Begin defining your retirement vision and timeline, optimize your retirement plan vehicles for tax efficiency, and make consistent contributions

POST-LAW PLANNING

After 38 years with the firm, Dave, at age 63, decided to "retire" on a part-time basis. He continued to work a few days a week for the next two years, helping to transition his major clients to a new team. He also remained active on a number of non-profit boards, and was glad he did not take a cliff retirement. Going to the office a few days a week gave him – and Samantha – needed structure and ongoing income.

With earned income soon coming to an end, Dave and Samantha had to determine how to secure the income their family needed to live throughout retirement. With their financial advisor, they evaluated their three main buckets of assets, which totaled $4,000,000: traditional pre-tax retirement savings (401(k) and IRA), tax-free income (Roth 401(k) and Roth IRA), and traditional after-tax savings (brokerage).

Their advisor guided them on the most tax-efficient way to draw down income and analyzed how much spending their nest egg (plus Social Security) could reasonably support each year of retirement. Dave and Samantha also worked with their advisor to calibrate portfolio risk, recognizing that they would no longer be adding to their nest egg over time.

Dave and Samantha have been enjoying retirement for the past 10 years. They have spent time traveling, including visiting their boys on the East Coast, and volunteering. Dave says that if it weren't for the careful and mindful planning from the start of his career he would not have the peace of mind to enjoy retirement. Although their finances took a lot of work and discipline, he is confident in his and his wife's current and future income as well as the livelihood of their children.

Deciding when and how to retire is exciting and unsettling at the same time. Managing the new realities of not earning income – from new-found time to drawing down assets – are pivotal challenges that must be addressed smartly. A financial advisor can play a key role in guiding you on understanding the many issues and opportunities that lay ahead, and how to manage them for success.

CHALLENGES & OPPORTUNITIES

- Retirement planning
- Income planning
- Liability coverage
- Estate planning
- Financial support for your children and grandchildren

SOLUTIONS

- Work with your financial advisor to estimate your retirement income, assets, and expenses (including medical)
- Consult with your advisor about reallocating your portfolio as you transition to living from your assets, focusing on risk versus return
- Determine the most tax-efficient way to draw down your assets and take Social Security
- Reevaluate your insurance coverage
- Amend your estate plan
- Consider tax-efficient gifting strategies to your children and/or grandchildren

PRACTICAL ADVICE

HOW TO PLAN FOR FINANCIAL SUCCESS NOW AND IN THE FUTURE

As a lawyer like Dave Smith, you have both impressive opportunities to pursue and imposing challenges to confront.

In most cases, your success – both personally and professionally – will depend on how you prepare for the unexpected. From selecting a specialty to deciding where you want to retire, from dealing with transitions like divorce to drawing down your assets, it's crucial that you have a plan, and ideally a team, to help you prepare for and guide you through life's decisions.

While life unfolds differently for everyone, the key issues outlined at every life stage can help you identify and understand your options, opportunities, and solutions. By planning ahead, you can make well-informed choices and decisions that positively impact your life as well as the lives of those you care about most.

If you'd like to discuss how we can work with you to help set priorities and design a financial plan, please contact us at 415.781.8535 or info@bosinvest.com.

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