

HOFFMAN, WHITE & KAELBER FINANCIAL SERVICES, LLC  
*INVESTMENT MANAGERS & FINANCIAL ADVISORS*

May 3, 2005

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## **Increase Your Wealth With Certainty!**

Which do you find more fun, spending or saving? If you answered saving, I'd be very surprised! Most people, me included, love to buy things.

I'm not saying that most people don't desire savings. Many, in fact, do! It's just that spending money, especially discretionary spending, often brings immediate comfort and gratification. Yet, problems can begin to arise when we begin believing that our discretionary expenditures are now necessities and then increase spending to enjoy some new comforts.

We all have an emotional tie to money. Are you sabotaging your savings? If you're not living within your means, your spending habits may very well be keeping you from reaching your financial goals.

Most people would agree that you're not living within your means when you spend more than you make. Some 15 percent of Americans do just that, according to the 2001 Survey of Consumer Finances by the Federal Reserve. Meanwhile, another 26 percent said their spending often equaled their income. To some families, just breaking even means they're living within their means. This may be a fair conclusion for families with very modest incomes, where after paying for their basic necessities, have just made ends meet.

Yet, I define living within your means as spending less than you earn, saving some of your income and having little to no "bad" debt. Having some debt is not entirely bad; having "good" debt can help you build wealth. "Good" debt is debt that lets you build net worth, like borrowing for a home, getting a degree or making home improvements that build equity.

The good news is that it's never too late to shape up. Taking control of your budget, paying off those credit card bills, and shifting from the present to the future tense will not only be good for your bank account, it will give you a real sense of empowerment. And no, that doesn't necessarily mean you can't buy those designer clothes. It's all about compromise!

As mentioned in our prior newsletters, we strive to provide articles on various aspects of wealth management to assist your understanding of why planning for the present and for your future has importance. Yes, we also promote our services; yet, you will find that we always seek to present thought provoking topics that are relevant to our wide audience.

In this month's letter, we will outline the importance of budgeting, how you can work to change your spending habits, and how to set one up a budget. Lastly, we will finish with a review of the investing climate for the month past, the current outlook and our performance.

## **Why Is Budgeting Important? Why Do I Need One?**

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Setting up a budget may be one of the few ways you can seize control of your finances before allowing matters to drift towards disaster. Disaster can take many forms. Such as:

- Not being able to take advantage when opportunity knocks.
- Not being able to care for family needs or emergencies.
- Not being able to enjoy a comfortable retirement.
- Having your credit tarnished, or worse!
- Seeing yourself forced to file for bankruptcy.

Budgeting can help ensure you don't spend more money than you earn. A budget is simply an accounting of your income and expenses during a certain period of time, usually a month or a year. It involves looking at how much money you expect to earn and then determining what you can afford to spend.

Having a budget does not prevent you from spending money, using credit cards, or taking out a loan for special purchases. Instead, a budget encourages you to be certain you can afford what you're buying and guides you through what lifestyle changes, if any, you'll have to make in order to pay for it.

Having a budget can also help you save! These savings can be used as a down-payment, or as an emergency fund in case of a sudden illness, or for having to make significant repairs to your home or car, or serve to buffer if you lost your job. Ultimately, a budget encourages you to spend your money responsibly and in moderation.

Having a budget does not prevent you from having fun! On the contrary, a budget gives you greater freedom to spend the money you earn. Trust this advice: It is a far better thing to have control of your budget, than to have your spending control you!

As I mentioned earlier, most people enjoy buying things. Of this group, it may be of no surprise that most people also don't like to keep tabs on their spending. So here are more reasons you might find it worth the trouble to develop a formal budget:

- A budget helps you prepare for large expenses, like those big bills that come once or twice a year. Car insurance is one expense that immediately comes to my mind.
- A budget helps you prepare for unpredictable expenses.
- A budget helps you identify items that are costing too much. You may be buying items that are no longer essential, or you may be able to find some essentials at a better price.
- A budget will ease the transition of becoming a homeowner. Getting past the closing cost is one thing. Wait until you get inside your new home and find the need to make some changes for your own comfort!
- Budgeting helps you keep control of your financial future.

Having a solid budget allows you to control your finances, rather than letting your finances control you. Without the planning and discipline required by a budget, you may be forced to take on too much debt, or you may have to deprive yourself of things you want. Budgeting forces you to look at your financial situation realistically, thus allowing you to make the best decisions for your future.

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## Changing Your Spending Habits

Debt management expert, Michael Killian, writes: "If you want to change any habit, change the actions that produce the habit. More folks start self-improvement programs to change personal habits at the beginning of year than at any other, but it seems fiscal habit-change fits right in all the time."

Killian starts out by discussing how the concepts of success and attitude play an important role in changing habits. Regarding "success" he states, "...SUCCESS is a progressive realization of worthwhile personal goals...success is a journey and not a destination...goals must be worthwhile and personal...they cannot be someone else's goals...they must be yours and they must be of value to you...success is a developing attitude of achieving goals."

I've always followed the belief that a person becomes what they think about. And Killian uses that same concept when he suggests how people can change their [spending] habits. He says: "An attitude is the way we think or feel about a subject which then causes us to act in a certain way...therefore, we act and react in relation to the thought patterns which we have developed...an attitude is caused when we think about something the same way over and over until it becomes automatic...change the habit of thought and you change the attitude...change the attitude and you change the resulting action."

Killian counsels he readers to remember: "Success is on ongoing journey... not a destination. The only time you fail is when you quit or never get up after falling down. "

## Setting Up Your Budget

In my opinion, the best and least traumatic way of preparing a budget would start with looking at how much your current lifestyle has been costing you. Seeing how you've spent your money in the last year or two can help guide your spending plan for this year. You might consider doing some or all of the following to get you started:

- Using your checkbook(s) and credit card statement(s), construct a historical record of how you spent household monies over the past year.
  - It is best to organize this information by month and by spending category.
  - Using spreadsheet software can be a great time saver!
  - Also, you can use our [Financial Planning Questionnaire](#), pages 11 and 12, for help with types of common spending categories.
- Next, you'll want to accurately project what your household income will be in the coming year. You should have included income taxes in your spending numbers. So, the number we're after here is before tax income.
- Now you'll need to compare income versus spending. Income should exceed spending by anywhere from 5% to 15% of your expected income. More is obviously better if you can make it happen!
- If spending exceeds income, that phenomenon can't last for long without problems surfacing. This is a clear signal that changes have to be made.
- I often recommend that family members, those participating in the budget process, take a copy of the spending record and go off in separate rooms to work on their recommendations for "cutting the budget". Take care to avoid any heated debates!

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- After sharing thoughts with one another, repeat that exercise as often as needed until you arrive at your household's desired savings level. Your desired savings level will be based on your family's long-term goals.
- Once you've accomplished your savings rate, now you need to keep track of your expenses and follow your new budget! At first it will be difficult, but the longer you keep to your budget, the easier it will get. Knowing where your money goes each month will give you the confidence to adjust your new budget as you see fit.

### **Concluding Thoughts**

The importance of budgeting is to enable people to achieve a life style which can provide financial security and generate family wealth.

Your specific goals are likely to change over time as you change jobs and as your life changes. Some goals, such as saving for your retirement or your children's education, probably won't change, though. Remember, if you spend all your money now, you won't have it to spend later.

If you follow your budget and adjust it responsibly, you'll be able to find the necessary money if an emergency arises or if you see an item you wish to purchase. Having a budget can make it easier to take on additional debts because it tells you exactly how much extra money you have available.

### **Hoffman, White & Kaelber Financial Services Investment Performance Update**

It was a dismal April for major market benchmarks, with the Dow down 3%, the S&P 500 down 2%, the NASDAQ down 3.9% and the Russell 2000 Index of small stocks down 5.8%. In fact, it was the Dow's biggest monthly drop since January 2003 and the NASDAQ has declined every month this year. And, so far this year, the Dow is down 5.5%, the S&P 500 is down 4.5%, the NASDAQ is down 11.7% and the Russell 2000 is down 11.1%.

We seem to be entering one those periods of increased uncertainties about the path of the financial markets, the US economy and the Fed's monetary policy. So far, record-high oil prices seem to have only now begun to push up core inflation. Yet it also seems that higher prices have had less of an impact on slowing economic growth. Can this rosy picture continue without changing? The latest Consumer Price Index numbers suggest that inflation may be edging up more rapidly than previously expected, and corporations may be testing to see how much of their oil-based price increases they can pass on to the consumer. This, together with the possibility of oil prices staying above \$50 per barrel during most of this year, poses a growing risk that the US economy will experience both a more pronounced deceleration in growth and accelerated inflation. This could very well complicate the Federal Reserve's task of sustaining the recovery while keeping inflation under control.

Does it look any better for our global partners in Europe and Japan? While it certainly looked like they were both staging magnificent growth characteristics from mid 2003 through mid 2004, it looks like much slower growth is occurring from the second half of last year through present. Factors like the rise in the euro and the yen against the UD dollar, greater

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dependence on oil imports and weak demand on the part of their own consumers seem to be the logical culprits. This has us less inclined to favor owning EAFE in our portfolios for now.

Now for the good news! For the month ended April 30, 2005, our one-month performance is up 0.97%, our year-to-date return is up 1.40%, and our average annualized return since inception is up 9.09%. While volatility has become exceedingly vigorous in the equity markets, our risk profile has crept downward further to +/- 5.97%. This conservatively low risk level remains consistent with our strategy. With our expectation that this statistic gains increasing importance, our Sharpe Ratio improves to a respectable 1.28.

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