

INSIDE INFORMATION

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BUCKET LISTS

Synopsis: *First Step Cash Management offers a clear, understandable way to help clients manage their cash flow and understand the impact of their financial decisions.*

Takeaways: *The system re-establishes what we had in a simpler day and age: hard limits on spending (which can be set and modified by clients); plus an optimal balance between different types of expenditures, and how they can be affected by each other.*

Our personal financial lives are growing more complicated by the day; in fact, there is evidence that they may be too complicated, and happening too quickly, for the normal human mind to track and control. Once upon a time, the checking account set an upper limit on spending; now multiple credit cards make those limits extremely fuzzy. Once upon a time, we didn't face decades of retirement costs to plan for and fund--our lifespans precisely coincided with our mandatory retirement age. Meanwhile, unexpected financial events like car and home repairs, health costs, wedding gifts etc. are seldom planned for, which means they become credit card debt at usurious interest rates.

How else to explain the negative savings rate in the U.S. over the past 12 years, when every

piece of research showed that the average consumer was deeply worried about his/her retirement funding?

Meet Marty Kurtz, of The Planning Center in Moline, IL. Through more than a decade of trial and error, of client observation and testing, Kurtz has developed an interesting new cash management system that creatively--and effectively--addresses this complexity issue. His First Step Cash Management Program allows clients to transform all the hundreds of financial expenditures and obligations from a confusing blizzard of money blowing in all directions (and mostly out the door) into a very clear, systematic--and, most importantly, controllable--system that lets clients rebuild those hard financial boundaries for themselves.

How does this benefit the planning profession? First, it allows advisors to address a huge blind spot in the traditional planning engagement: they can give their clients cost-effective budgeting and cash management advice.

First Step also serves as a communications tool, translating complicated trade-offs and financial decisions into a language that makes intuitive sense to the average consumer. This, in turn, helps the advisor help clients make better spending decisions and stay on track financially.

Finally, Eric Kies and Matt Sievertson, two NexGen-aged advisors who work with Kurtz at The Planning Center, are starting to use First Step to provide planning advice to middle market clients who are not ideal candidates for asset management services. Their evolving business model may be a way for younger advisors to help their Gen X, Y and Z peers grow their assets and become full-service clients down the road.

So how does it work? First Step reduces all of your various expenditures down to three "buckets" of money, each serving a different purpose. The first (Kurtz's web site assigns it a red

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color) is called the "static" bucket. The money in this bucket is used to pay everything it takes to run your household for a month. Kurtz says that this represents your past money decisions; when you sign a contract for cable TV services or choose a certain cell phone option, when you buy a house and take out a mortgage, or take out a loan to buy a car, these become ongoing expenses that, month-to-month, you have little control over.

Obviously, this bucket also has to pay for utilities, property taxes and whatever you pay at the gas pump. Interestingly, it also has to pay for your credit card debt--something we'll get back to in a minute.

The second container of money (given a yellow color on Kurtz's web site) is called the control bucket. It represents your discretionary or lifestyle expenditures--the money you will spend in the next seven days to go to the movies, eat out, buy groceries, go to Starbucks in the morning.

Container number three (this one is green) is the control bucket, the money that is reserved for future expenditures. This includes gifts, holidays and vacations, home improvement, car maintenance and replacement, education funding and retirement savings.

In most households, the static and control buckets are mingled together, and whatever is left over--a different amount every month, sometimes none at all, sometimes a negative number--is put into a savings or investment account

whose purposes are not always clear, except for a generalized realization that it's good to save money.

With the bucket approach facilitated by the First Step system, each of those buckets is controlled from the top-down by the clients themselves. That is, the money that will be spent on monthly expenses, on lifestyle and entertainment, and put into savings, will be hard-wired by the clients at the beginning of the planning engagement. For most advisors, the take-away here is that this is a way to lock in, say, a 20% savings rate, and specify what future goals the money that flows into the dynamic bucket is funding.

Budgeting Language

So how does this work in the real world? Not as Kurtz originally envisioned it. "At first I really wanted First Step to be the world's greatest budgeting tool," he says. "But eventually we've realized that it's really the world's greatest money conversation tool."

To see what he means, consider traditional budgeting. An advisor who is unusually ambitious about offering cash management services would help the client get started with Quicken or Mint or one of the other budgeting programs, which precisely track the client's expenditures, but don't set boundaries or controls. Then they would look over hundreds of transactions, identifying spending patterns and priorities, setting sub-budgets in areas like clothing, dining out, and gifts. From there, they would calculate how much

investment capital the clients would free up if they would lighten up on buying shoes or drive a less expensive car.

From then on, month in, month out, the client would have to keep track of clothing, dining out and gift expenditures--probably a dozen or two categories overall--and almost certainly fail to stay within the budget in at least one of these areas.

Kurtz turns the process around 180 degrees, and lumps all the expenses into broad categories, so it doesn't matter how much is spent on greens fees or Starbucks. What matters is that there is a hard limit on this category of expenditures, which is enforced by the system itself, so the client doesn't even have to keep track of the overall categories.

This makes the budgeting/cash management/expenditure discussion instantly comprehensible to a lay investor. "Remembering 30 line items in a Quicken download is really beyond most of our comprehension," says Kurtz. "But three boxes is really easy to remember. It is the most effective way to communicate with your spouse or your financial planner. It helps to create a common language about what's going on in the finances."

That, in turn, lets you get right to the heart of the client's financial decisions. "What is really relevant is: is this money that you have already committed to spend?" says Kurtz. "Or is it money that you're going to spend now, this week, on your lifestyle? Are you spending some of your future savings?"

Every financial decision now has a context, a framework for evaluating whether you're growing one bucket at the expense of another--which Kurtz believes is what's missing in the day-to-day decision-making of even the savviest financial consumer. "Most financial planning in this world," he says, "goes on in front of the big screen TVs at Best Buy or sitting in the front seat of a Toyota or Ford car dealership, saying, how much a month is it?"

In the planning engagement, this new language of personal finance helps clarify what is likely to be a very fuzzy conversation with clients--which may be why most advisors don't talk about budgeting issues at all. Kurtz will have the cash flow discussion in the very first meeting with clients (hence the name "First Step"), and reports what most advisors have probably experienced--a conversation which, not uncommonly, goes something like this:

Advisor: How is your cash flow?

Client: I save a lot of money.

Advisor: How much do you save?

Client: Last month I was able to save \$5,000.

Advisor: How long have you been saving?

Client: Ten years, maybe longer.

Advisor: How much do you have in savings today?

Client: \$70,000.

Bucket Planning

The First Step Cash

Management web site (www.FirstStepCashManagement.com), serves as a kind of prequel to a traditional planning software package; it allows advisors (at The Planning Center or those who pay a subscription fee to use the site with their clients) to allocate each client family's household income and expenditures (in dollar terms) into the three buckets, and then delivers a report on the percentages of cash flow that each bucket currently represents.

This visual, plus a planning conversation, helps to make vividly clear something that is absolutely basic to all financial planning decisions, but seems to be nebulous to some clients: what you spend now affects what you can spend in the future, in very precise and completely predictable ways.

In fact, clients quickly discover that all of the different types of expenditures have an effect on each other--and, ultimately, on the client, both in the present and future. What you commit to spend on a monthly basis can increase or diminish both your control (lifestyle) bucket and your dynamic (future spending) bucket. When you pile up credit card debt, the static (monthly expenditures) bucket starts crowding out everything else. When you eat out every night, the dynamic bucket might wither down to nothing, and you may not be eating at all in retirement.

Is there an ideal balance? Kies says that it depends, to a surprising degree, on two factors: the level of income, and the number of kids. "We look at the folks who are really good with their money,

and for them it will come out a third, a third, a third," he says. "But at \$40,000 a year, it's a little tough for each to be a third. If you're lower middle-class, rent and car payments are going to take up a bunch of that income." That's why the financial slope is so slippery for those people; expenses that are not planned (and saved) for will end up on the credit cards, moving more and more money out of the control and dynamic buckets into the static one, making it more likely the family will use the credit cards the next month.

Similarly," Kies adds, "if the family has two or three children, especially in the junior high to high school range, it is really tough for them to keep the control [lifestyle spending] bucket at 30% or less."

Adds Kurtz: "And if they make \$800,000 a year, you are not going to be spending a third in the control bucket."

Even so, these high-income clients can sometimes receive the biggest wake-up call from the bucket analysis. "If you have so much cash flow coming in, nothing is ever a problem, and they start to feel invincible," says Kurtz. "But when you do the financial planning, they say, you mean I need \$8 million to recreate this lifestyle in retirement? We've seen more than one wife elbow a big spending, high-income husband and say, Let's get on this."

Over time, the advisors at The Planning Center have developed a few practical rules of thumb, what Kies calls "goal posts" that clients will typically want to stay inside.

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The first thing you want to avoid is allowing the static (monthly expenses) bucket to get higher than 50% of the overall money going out the door. "That's when people start to get in trouble," says Kies. "The static bucket starts to crowd out the other two."

When they look at a client's financial situation, the 50% static bucket will typically include too much house, two cars and a boat, and a lot of credit card debt. Of course, in some cases, credit card debt will balloon this portion of the client's expenditures all by itself--and the bucket divisions help clients realize with some degree of clarity what that debt is costing them in terms of current and future lifestyle.

The other goal post is keeping the dynamic (saving/future expenditures) bucket at 20% or more of overall cash out the door. "If your dynamic isn't 20% or more," says Kies, "that means you're not setting aside enough cash for inevitable expenses. We know that your car will break down; we just don't know when." he adds. "If you aren't setting aside enough of your income, then when you're hit with those unexpected expenses, it gets layered back into the static account in the form of credit card debt or a new car loan."

Kies says that within a couple of months of using the First Step program in his own life, he began to see that it was becoming something more than the Quicken or Mint historical data tool: it

provided him with a forward-looking planning tool. "First Step gives you an operating system for making future decisions," he says. "Let's say you want to pay off your car. You set up a series of payments to do that. You are allocating cash flow to it. The car is paid off. You delete the payments and debt, and that \$500 a month comes out of your static bucket. What do you want to do with that money?" says Kies. "What's next on your list of goals? What's important to you? All of a sudden you've created this environment for making what used to be very complicated future-based decisions."

Bucket Implementation

After the information has been uploaded to the First Step web site, and the clients have talked about the implications with advisors, the bucket system becomes the physical budgeting system for clients. They have effectively brought back those hard boundaries (and the discipline they imposed) of the old checking accounts. In fact, Kurtz recommends that clients use actual cash or checking accounts for their buckets.

How does this work in the real world? The static bucket works just like your typical checking account; you write your monthly checks or do electronic bill-pay. What you don't do is pay for dinner at a restaurant or buy movie tickets.

For those lifestyle expenditures, a fixed amount is paid out of the static bucket checking account to--somewhere

of the client's choosing, which, if you follow the system, eliminates all the budgeting complexity and makes it trivially easy to control expenses. (When the money is gone, it's gone.)

Kurtz and Sievertson both manage their control (lifestyle) bucket by taking out a predetermined amount of cash, which they keep in their wallets and spend over the next seven days however they wish. Kies and his wife use a different system; they each have an individual checking account with a debit card as the functional control bucket. Every Friday night, a certain amount of money is automatically moved out of the checking account they use as their static bucket into their respective "control" checking accounts. They can write checks or use a debit card for their weekly (discretionary) expenditures. (The debit card becomes the way that a Quicken junkie could continue to keep track of all expenditures.)

Kurtz says that very few people are accustomed to two things that the bucket system provides: guilt-free spending, and the hard, inflexible limit on those lifestyle expenditures. "When we get people set up on this, especially if they've been pretty financially unorganized," he says, "when they first start getting that money every week for the control bucket, they come in and they say, oh, my god, I never felt like I had so much money in my life!

"That's because all of a sudden it's guilt-free," Kurtz adds. "Typically, our response, as we look at them is: You just wait."

For what? Sooner or later, says Kurtz, you'll have a week where you spend more than you intended at the start of the week, and suddenly, for the last two or three days, you have the opportunity to experience what it's like to live in Third World poverty.

"I remember staring at a magazine rack in a shopping center, with eight bucks in my pocket and two days to go," Kurtz says. "The magazine was five dollars, and I said to myself, I'm not buying that magazine. All of a sudden, you're feeling the impact of that expense," he adds. "I think in the future world, as we get more and more credit card oriented, with money moving faster, First Step will give us a better way to process it, make sense of it, to understand our limits."

Of course, some months--perhaps most months--the client will underspend by a bit, and have money left over in the control bucket. This is rolled over into the following week; Kurtz and Kies will tell clients that they'll probably overspend some day and be glad that money is in there. "If they start amassing huge amounts of cash, we would say, let's cut down the control bucket a little bit," says Kurtz. "But typically that doesn't happen."

The dynamic bucket, meanwhile, can become as simple or complex as the client wishes. Kies falls somewhere on the complex end of the spectrum; he and his wife have set up eight different savings accounts, each allocated to a specific short-term goal: a travel account, a gift account, one

for household stuff like furniture and home improvements, another for car repairs and replacement, yet another for retirement. "Any kind of goal that is specific to that client, any large future expense, they can break them out into little sub-savings accounts," Kies explains. "And then you set up an automatic transfer, so literally the day after they get paid, boom! Money gets journaled over to those savings accounts, and their goals are automatically funded."

Kurtz believes that First Step can make those "budget-related" conversations in the household richer and more interesting than they ever were before. "My wife gets \$300 a week and I get \$400 a week in our control buckets," he says, "and when we want to order pizza on Friday night, we'll say to each other, well, do you have any money?"

It bears repeating that once you have a clear limit on discretionary expenditures you don't really need to know exactly how often you're dining out--or single out this month's impulse purchase at the chocolate store or tickets to the basketball game. You just need to know that your overall lifestyle expenditures are clearly laid out and under control.

Most advisors know, from their real-world experience, the advantages of keeping their clients' finances uncomplicated. "We have some clients who are technology people from John Deere," says Kurtz, "and they love to track every dime electronically. But then you look over at the wife, and

she's scared to death. If anything happens to him, how is she going to keep it up? We are telling her, it's not important where you spend it. It's how much you spend."

Middle Market Buckets

The First Step Cash Management System is actually being used, under a licensing agreement, by 40 planning firms around the country, and is currently open to advisors who are curious or have been looking for a way to help their clients manage their (often chaotic) cash flow. (The cost is \$50 a month for the planning firm, which buys up to 100 client seats.) Money Quotient, the financial life planning training and service firm in Poulsbo, WA (www.moneyquotient.org) now provides a training in how to use the First Step system with clients and organize those initial bucket-budget conversations.

Eventually, First Step will be picked up by traditional planners, and incorporated into the traditional planning service menu. But at this point, the primary licensees are advisors who want to serve less-wealthy clients.

Kurtz and Kies point out that most planning today is currently transacted between Baby Boomer (or older) advisors and Baby Boomer (or older) clients. "In this profession, you have to have gray hair and a pot belly before people want to listen to you, and that is your prototypical client, too," says Kurtz. That's well and good for the company founder, who is probably

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at least in his/her 50s. But what about the next generation advisor who would like to work with people his/her own age--just as the founding planner did back in the mists of antiquity when he or she started the firm in the first place?

This target audience--the "non-pot-bellied clients"--don't need all the fancy footwork built into the typical financial planning engagement. But, like all humans functioning in this increasingly alien, increasingly complex financial environment, they need a way to tame their cash flow decisions and get into healthy spending/saving habits.

The service model is evolving, but Kies says that it starts and very nearly ends by getting First Step up and running for the client. Then, he says, you switch to a dentist model, where clients come in once every six months, so their advisor can review the implementation, what happened and what's next.

What do you charge for that service? "I didn't do a lot of detailed analysis," Kies admits; "instead, I thought about, what do people pay for on a regular basis today? I looked at our society and said, okay, everybody has cable TV, right? You have to have your cable TV. And you have to have expanded cable, and probably a couple of premium channels, and that comes to at least \$100 a month. So," he continues, "why don't we just charge people \$100 a month, \$1,200 a year, and if they want to pay it up-front it's \$1,000. It's a way for them to come in and get coached on this basic

stuff, and probably put them on track."

So let's say a NexGen-age advisor decides to start a practice, and invites non-pot-bellied clients in the door. She manages to attract 30 or 40 in the first year, a similar number the next year, and by the end of the fourth or fifth year, her income is the envy of the local FPA chapter. Better yet, these clients are growing their net worth at 15% or more a year, depending on the relative size of the buckets, and before too very much longer, they'll start wanting more complicated advice. "You start people at \$1,000 a year," says Kurtz, "and eventually they're paying an asset management or retainer fee, and you're sitting them down to answer questions like 'What do I do with this money that I'm setting aside for college?' 'How much should I put in my 401(k)?' 'What about this tax issue?' 'How much life insurance should I have?'

"Meanwhile," Kurtz continues, "This is also a slick way for parents to send their kids in to work with us. They'll pay the retainer fee to make sure they're on track--which becomes cheap insurance to make sure the family wealth gets managed long-term. I can't tell you," he adds, "how many clients have said to me: will you talk to Junior?--because we can't get through. I say, send them in."

Social Buckets

I probably should have mentioned earlier that Kurtz also happens to be President-Elect of the Financial Planning Association, and is not totally unaccustomed to

looking at the big picture on various issues. On the subject of static, control and dynamic buckets, he envisions a world where, instead of people sharing chaotic or even nonsensical financial information (What kind of car do you drive? What neighborhood do you live in? Where did you buy those shoes? How much did they cost?), they would have a language where they could talk reasonably, openly about how they manage their finances and the challenges therein.

"I would love to see a time when everybody in the country is using the same terminology about their lifestyle, expenditures and financial situation," says Kurtz. "If you and I were in a conversation, I might say, how much is your control bucket? You might say, We spend \$1,000 a week. I'd say: That's cool. We live on \$900. It all takes on a new level of relevance."

When I look at this system of different-colored buckets, I can't help but think back to other articles I've written, where a very small number of advisors have worked really, really hard to help their clients gain some measure of understanding and control over their cash flow. Budget and cash flow planning has almost become a niche speciality in the planning world; mainstream planners refer overspending clients out to planners who do cash flow work, because the effort involved is so complicated and time-consuming.

This isn't, and that's the point. The two biggest blind-spots in the planning world right now (other, perhaps, than our dismal record

of recruiting ethnic minorities into the profession) are working with middle-income clients, and offering budgeting/cash flow services as part of the overall financial planning engagement. First Step Cash Management may be one significant key to making the planning profession whole and viable in a way that it has not been

before.

And I don't think Kurtz is exaggerating the public policy implications. Our financial society has drifted away from hard limits on monthly spending into a miasma of complexity and ambiguity, where huge financial commitments are made without any visible, clear, understandable context. If this First

Step thing had been in common circulation back in the late 1980s, I guarantee you America would never have gone through more than a decade of 0% aggregate savings rates. So far, it is the best tool I've seen to help an average muddled consumer become a champion manager of his or her own assets.

Try it, and see for yourself. ■

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