CONTENTS

EDITOR’S NOTES .................................................................................. 9
John E. Grable, Ph.D., CFP®, RFC

NEWS & NOTES .................................................................................. 16

SPECIAL ISSUE TOPIC

Why We Write ...................................................................................... 19
Barbara O’Neill, Ph.D., CFP®, CRPC, AFC, CHC, CFCS
Rutgers Cooperative Research and Extension

What Will Be The Impact Of Stock Market Volatility On Baby Boomer Savings? ......................................................... 23
John M. Misner, Ph.D., CFP®
Slippery Rock University

Four Key Issues To Guide Future Research In Retirement Planning ........................................................................ 28
John Harris, Ph.D., RFC
Carolina Financial Planning
This paper discusses four critical topics to guide the research agenda for retirement planning: market variability, risk tolerance, asset-liability matching, and household spending projections. These four issues, which focus on the investment strategy portion of financial planning, are important individually as well as collectively. For the looming Baby Boomer generation, the importance of asset accumulation will diminish while the significance of asset distribution will intensify. The asset distribution phase carries a unique set of planning challenges requiring a better understanding of the impacts of market variability, risk control, asset-to-spending conversion, and projected retirement income patterns.
A Pressing Issue for Financial Planning .................................................43
Robert W. Moreschi, Ph.D., RFC
Virginia Military Institute
The “practice” of financial planning has become more sophisticated in the past several decades. The use of quantitative techniques to develop mean/variance optimal portfolios and probabilistic simulation models of asset spending, for example, has provided an air of scientific validity to planning. Yet all the computer sophistication available to planners is of limited value without an accurate understanding of the client. Truly successful financial planning will require advancement in advisor ability to know the client.

Bad Choices in Efficient Markets: A Justification for the Study of Personal Finance .................................................................48
Michael Finke, Ph.D.
University of Missouri
Insight into the disconnect between predicted household investment behavior and observed reality is provided in the current investment and personal finance literature. However, research into the barriers that prevent households from making choices consistent with their long-run financial goals is incomplete and presents a justification for closer examination of personal finance as a social science. A brief review of the literature exploring anomalies in personal finance is presented with a focus on investment studies that are not easily explained by efficient market theory. Since many of these anomalies may be particularly acute among investors with less financial sophistication, research that explores the predictable frailties of investors may shed light on the regressive effects of policy that increases personal responsibility among investors who are not able to navigate complex markets efficiently.

Financial Education and Program Evaluation: Challenges and Potentials for Financial Professionals ...........................................56
Angela C. Lyons, Ph.D.
University of Illinois at Urbana-Champaign
Healthcare Costs and Benefits: A Future Direction
For Financial Planning Research .......................................................... 69
Michael D. Everett, Ph.D.
East Tennessee State University
Murray S. Anthony, Ph.D.
East Tennessee State University
Andrew Quach, M.S.

At present, health care costs in the U.S. consume almost 15% of GDP, with large annual increases in dollar terms forecast for the foreseeable future. Individuals who want to effectively control their health care costs must consider complex savings, insurance, and health behavior decisions. These decisions inherently rest on personal financial planning principles and practices. We propose more emphasis on future financial planning research which refines, expands, and focuses the body of knowledge needed to ensure that individuals and their advisors make optimal health care decisions. Examples for further research and benefit cost modeling include making the long-term care insurance purchase decision, using high deductible insurance policies and health savings accounts, paying for innovative medical tests such as body scans, and using labor intensive technologies (e.g., walking and cycling to work) to obtain more consistent exercise.

Writing in Higher Education: More than Publish or Perish ............. 86
Frances C. Lawrence, Ph.D.
Louisiana State University
Jane Honeycutt, M.A.
Louisiana State University

Having work published is expected of many university faculty members in tenured track positions. The literature is filled with articles related to the topic of “publish or perish.” This paper not only includes the importance of publishing as a factor in promotion and tenure decisions but also cites other benefits, including advancing knowledge and giving credibility to work. In addition, personal benefits are discussed, including being perceived as an authority, gaining prestige, feeling a sense of accomplishment, receiving increased resource allocations, and knowing that the research process has been completed.

The Future of Financial Planning Academic .................................. 91
Programs: Does the Future Look Bleak?
John E. Grable, Ph.D., CFP®, RFC
Kansas State University
BOOK REVIEW

The (Mis)Behavior of Markets .............................................................. 99
Authors: Benoît Mandelbrot and Richard L. Hudson
Reviewer: Jerry Stinson, RFC

INSTITUTIONAL PROFILE

Family Finance & Consumer Science Programs at
Utah State University ........................................................................... 102

Journal of Personal Finance
Guidelines for Authors ........................................................................... 108
Write an article today! The *Journal of Personal Finance* is currently accepting manuscripts and reviews for publication in future issues.

Practitioners, this is your opportunity to contribute to the profession by sharing your ideas and insights with others. Academicians, this is your opportunity to add to the body of literature in personal financial planning through a rigorous peer reviewed process.

The *Journal of Personal Finance* is unique in its publication approach. The Journal’s Research Policy Board is committed to publishing timely original contributions that offer readers applicable personal financial planning tools, techniques, and strategies.

The *Journal* is practitioner oriented. Approximately one-half of each issue is devoted to practice management articles written by financial consultants and academicians. Each issue also includes empirically based academic articles. Both qualitative and quantitative articles are acceptable. A blind peer review process is used to evaluate each manuscript. Contributors are encouraged to submit papers corresponding to the following topic areas:

- Client Relationship Management
- Financial Planning Trends
- Technology Issues
- Planning for Special Needs
- Regulation Overview
- Ethics of Financial Planning
- Practice Management Techniques
- Interesting and Unique Planning Tools and Techniques
- Investment Decision Management
- Marketing Methods
- Book Reviews and Letters
- Attitude and Behavioral Measurement

The audience for the *Journal* consists primarily of practicing financial planners, insurance advisors, other securities industry professionals, consultants, and academicians. Empirically based submissions should provide a detailed discussion of findings that are directly related to practitioner implementation.

If you are a new author, or just thinking about the idea of writing for the first time, please feel free to contact John E. Grable, Ph.D., CFP®, RFC about your manuscript ideas. Details regarding the *Journal’s* manuscript submission process can be found at [www.ksu.edu/ipfp/jpf.htm](http://www.ksu.edu/ipfp/jpf.htm)
EDITOR’S NOTES

Nearly nine months ago I sent out a call for papers to a list of academic researchers, teachers, and practitioners. Some of the responses to this special call for papers are published in this issue of the Journal of Personal Finance. The call offered authors an opportunity to write on one of two topics:

1. The Future of Financial Planning Research
2. Why We Write

The first topic was intended to provide a forum for those so inclined to shape the future of financial planning research. Authors were asked to write about topics they saw as important, and where they thought financial planning research ought to be heading next. Other possible ideas for a paper included statistical modeling, the use of large data sets versus surveys, and potential research funding.

The second topic was much broader in nature. Of the hundreds of academicians who teach financial planning and the thousands who practice financial planning, only a few actually write for publication. Why is this the case? Is there a reason why some write and share ideas while others do not? Those on the mailing list and readers of this Journal were asked to respond to these two questions.

The guidelines for the call for papers were very simple. First, papers needed to be at least 500 words but no more than 7,500 words in length. Second, any topic was acceptable as long as it fit into one of the two topic areas. Third, papers needed to be received in a timely manner. How simple was it to meet these guidelines? Relatively easy (I think). Five hundred words is about one page of single spaced text. You have already read about 275 words! Response to the call for papers was very good considering that only one mailing was used and only one advertisement was included in a previous issue of the Journal. Those that did respond sent in outstanding, meaningful, and thought-provoking papers. As you read the articles in this issue I am sure you will come away very impressed.

Saying this, however, I am baffled at how few people (in percentage terms) actually sent in a response to the call for papers. Remember, the guidelines were not difficult to meet! Nearly everyone can write 500 words in less than one hour. Add in some research and editing time and the total commitment to such a writing project is probably less than five hours total. But, someone might say, in five hours I could have sold ‘x’ number of products. In other words, five hours of writing is five hours of lost revenue. This is a very good point, but one that confuses me. Do financial planners today...
market their services? Everything that I have read about marketing suggests that using reprints of articles published in magazines and journals is an excellent way to establish credibility and expertise in the eyes of current and potential clients. Authors who publish in this Journal have unlimited rights to reproduction of their work! So, a five hour investment of time could be worth thousands of dollars in marketing credibility.

What about the hundreds of academicians whose job most certainly depends on writing and publishing; where were they in writing 500 words? I have heard that there are some people whose time is so valuable that writing 500 words for one paper excludes their ability to write 500 words for another paper. It is possible that others are too busy teaching to ponder the future of the profession in a written format. Another explanation is that some may have perceived the topics as too low brow. Given my experiences in working in the academic world, however, I must confess that I have never met someone too brilliant to write a 500 word essay or too busy to voice an opinion. My guess is that many people, academicians and practitioners alike, simply hate to write. Writing involves rejection, and I suspect that people do not want to be rejected, so they just do not write at all.

What all of this boils down to, in my opinion, is that the future of financial planning will be influenced by a handful of people. This is probably how all professions are developed – a few individuals voice opinions, formulate policy, and drive action. The vast majority get pulled along without ever really contributing. This issue of the Journal highlights a few of the people who will be leading the financial planning profession into the future. Some of these leaders are already well known – Murray Anthony, Michael Everett, Fran Lawrence and Barbara O’Neill, while others are emerging stars – Angela Lyons, Michael Finke, John Harris, Robert Moreschi, Michael Everett, and John Misner. Read what these leaders have to say. You will be impressed.

Meet The Authors

As mentioned above, this issue of the Journal is powerful. The articles presented provide a unique insight into the future of the profession and the role writing plays in shaping the profession. The lineup of authors for this issue is impressive. Let’s meet the authors.

This issue begins with a thought-provoking paper written by Dr. Barbara O’Neill. Dr. Barbara O’Neill holds the rank of Professor II at Cook College, Rutgers University, and is Rutgers Cooperative Extension’s Extension Specialist in Financial Resource Management. Previously, she was Family and Consumer Sciences Educator in Sussex County, NJ and taught over 1,100 classes to over 24,000 adult learners. She also provides national leadership for the Cooperative Extension financial programs, Investing For Your Future, Catch-Up Strategies For Late Savers, and Small Steps to Health and Wealth.
and directed the five-year MONEY 2000™ saving and debt reduction cam-
paign in the 1990s that resulted in over $7 million of economic impact in New
Jersey and almost $20 million nationwide. Dr. O’Neill has written over 1,500
consumer newspaper articles and over 100 articles for academic journals,
conference proceedings, and other professional publications. She is a certified
financial planner (CFP®), chartered retirement planning counselor (CRPC®)
accredited financial counselor (AFC), certified housing counselor (CHC), and
certified in family and associations and served as president of the Association
For Financial Counseling and Planning Education (AFCPE) in 2003. Dr. O’Neill
is the author of two trade books, Saving On A Shoestring and Investing On A
Shoestring, and co-author of Money Talk: A Financial Guide For Women.
She has also written three financial case study textbooks, an online Guide-
book To Help Late Savers Prepare For Retirement, and six book chapters. Dr.
O’Neill received her Ph.D. in family financial management in 1995 from Virginia
Tech and holds a master’s degree in consumer economics from Cornell
University and a B.S. in home economics educatin from the State University of
New York on Oneonta. She has received over two dozen awards for program
excellence from national professional orgaiziations and over $325,000 in
funding to support her financial education programs.

Dr. John Misner of Slippery Rock University discusses how stock
market volatility will impact baby boomer savings. Dr. Misner is a graduate of
Augustana College where he majored in political science and history. He
earned an MBA from the University of Wisconsin and a doctorate from Kent
State University. He has a broad range of teaching and practice management
experience. He has served as Assistant Chair for the School of Business and
was instrumental in establishing Slippery Rock’s certificate in personal
financial planning program.

John Harris, Ph.D., RFC has contributed an excellent paper on
issues facing the way retirement research will be conducted in the future. Dr.
Harris received his M.A. and Ph.D. in economics from the University of
Illinois. He also has a M.S. in business administration from George Williams
College and a B.S. in physics from the College of William and Mary. During
his career he gained extensive corporate experience in economics, finance,
strategic planning, and risk management while working at Ford Motor
Company, Carolina Power & Light and Progress Energy. Dr. Harris is presi-
dent of Carolina Financial Planning, LLC in Raleigh, North Carolina. His firm is
a Registered Investment Adviser and provides financial services advising
clients in the areas of insurance, retirement, investment, tax and estate
planning on a fee-only basis. He is a Registered Financial Consultant, holds a
Series 65 designation. He is also a member of the Financial Planning Associa-
tion and International Association of Registered Financial Consultants.

Robert Moreschi, Ph.D., RFC, who is an Associate Professor at the
Virginia Military Institute, discusses a pressing issue facing the profession.
Dr. Moreschi is a frequent contributor to the Journal, and when not teaching
Dr. Moreschi’s research interests include portfolio management and investments, business finance, investment management consulting, and applied microeconomic theory.

Dr. Michael S. Finke, an Assistant Professor of Consumer and Family Economics at the University of Missouri, provides one of the most effective published justifications for the study of personal finance. Dr. Finke studies nutrition economics and consumer behavior under risk and uncertainty. His research focuses on intertemporal decision making, including articles establishing a theory of healthy food choice based on consideration of future health consequences and the impact of information and financial resources on food consumption. He completed his Ph.D. in Family Resource Management from The Ohio State University in 1998.

Anyone interested in how research and outreach programs need to be assessed must read Dr. Angela Lyons paper. Dr. Lyons is an Assistant Professor of economics in the Department of Agricultural and Consumer Economics at the University of Illinois at Urbana-Champaign. She is also an Extension Specialist for University of Illinois Extension and the Co-Director for the University of Illinois Center for Economic Education. She received her graduate degrees from the University of Texas. Her research interests include liquidity constraints and household credit access; credit access and household repayment problems; gender and minority differences in household investment decisions; and issues related to student borrowing.

Drs. Michael D. Everett and Murray S. Anthony used the call for papers to look at the future of financial planning from a healthcare costs and benefits point of view. In their study, Dr. Everett and Dr. Anthony suggest that researchers conduct cost modeling studies to quantify the link between personal finance issues and health care planning. These two authors are well qualified to write this paper. Dr. Everett is an Associate Professor of Economic at East Tennessee State University. He received is Ph.D. and BA degrees from Washington University, and is best known for his work with students in areas of economics and finance. Dr. Anthony is a professor of accountancy at East Tennessee State University. He received his MBA from Memphis State University and his doctorate from the University of Missouri.

Dr. Fran Lawrence and Jane Honeycutt, MA have teamed together to address a pressing issue in higher education, namely, the concept of ‘publish or perish.’ Their perspective on this issue is unique, and for those who have been following recent trends in higher education, the perspective offered in this paper is sure to be of interest. Fran Lawrence, in particular, is uniquely qualified to address this important issue. She is the Gerald Cire and Lena Grand Williams Alumni Professor at Louisiana State University. Her research interests focus on the fields of family financial management, consumer decision-making, welfare reform, and economic development. She and two colleagues recently published an important paper on the use of online
survey methodologies – (Lyons, A. C., Cude, B., & Lawrence, F. C. (2005). Conducting research online: Challenges facing researchers in family and consumer sciences. Family and Consumer Sciences Research Journal, 33, 341-456.) Dr. Lawrence also has recently been appointed editor of the prestigious Financial Counseling and Planning journal. The paper’s coauthor, Jane Honeycutt, has held a variety of positions at colleges and universities in Mississippi and Louisiana during the last 30 years, all of which included writing and editing. She earned her B.A. and M.A. degrees, both in journalism, at Louisiana State University. As a communications specialist for the LSU Agricultural Center, She edits publications and newsletters, serves as copy editor of Louisiana Agriculture magazine and writes occasional news and feature stories.

The final paper in this issue was contributed by John Grable, Ph.D., CFP®, RFC. Dr. Grable received his undergraduate degree in economics and business from the University of Nevada, an MBA from Clarkson University, and a Ph.D. from Virginia Tech. He is the Certified Financial Planner™ Board of Standards Inc. and International Association of Registered Financial Consultants registered undergraduate and graduate program director at Kansas State University. Teams of undergraduate financial planning students mentored by Dr. Grable have won the National Collegiate Financial Planning Championship in 2000, 2003, and 2005. Dr. Grable also serves as the director of The Institute of Personal Financial Planning at K-State. Prior to entering the academic profession he worked as a pension/benefits administrator and later as a Registered Investment Advisor in an asset management firm. His research interests include financial risk-tolerance assessment, financial planning help-seeking behavior, and financial wellness assessment. He has been the recipient of several research and publication awards and grants, and is active in promoting the link between research and financial planning practice where he has published more than 60 refereed papers. Dr. Grable serves on the Board of Directors of the International Association of Registered Financial Consultants and on the Research Advisory Council of the Take Charge America Institute (TCAI) for Consumer Education and Research at University of Arizona. In 2004 he won the prestigious Cato Award for Distinguished Journalism in the Field of Financial Services.

This issue of the Journal concludes with a book review and institutional profile. The book review discusses the attributes of Benoit Mandelbrot and Richard Hudson’s book on the behavior of the markets. The review was written by Jerry Stinson, RFC. This issue’s institutional profile highlights one of the nation’s most innovative academic programs – the Family Finance program at Utah State University.

As always, I encourage you to take an active role in making the Journal of Personal Finance a stronger publication. Consider writing a paper or review today. All the best,

John E. Grable, Ph.D., RFC
Editor
The *Journal of Personal Finance* is expanding quickly. Just a few years ago two issues of the *Journal* were published on a yearly basis. Now, four issues are produced every year. The quantity and quality of submissions has also increased dramatically over the years as well. Your help is very much needed in order to take the *Journal* to the next level.

The primary purpose of the *Journal* is to serve the needs of IARFC members and those in the academic community that study personal finance topics. Every article that comes into the editorial offices is reviewed prior to publication. Academic articles are blind-peer reviewed by academicians and practitioners who have an expertise in a particular area. Practitioner papers are reviewed by those actively involved in the profession. Starting in 2006, the advisory and editorial boards, as well as the scope of the *Journal*, will be expanded. Here is your opportunity to help shape the *Journal*’s future direction! Please review the opportunities listed below to determine how you can help.

1. **Assistant Editor Position**
   a. You must agree to review, in a timely manner, at least one (1) article per year for the *Journal*.
   b. Your name and affiliation will be listed in every issue of the *Journal*.

2. **Associate Editor Position**
   a. You must agree to review, in a timely manner, between two (2) and three (3) articles per year for the *Journal*.
   b. You should have a strong interest in also writing or contributing to the *Journal* – news and notes, parting thoughts, or practice management/research articles.
   c. Your name and affiliation will be prominently listed in every issue of the *Journal*.
3. Advisory Board Position
   a. You must be willing and able to provide feedback about the Journal’s content and effectiveness to the editorial staff.
   b. You must be willing to review manuscripts occasionally throughout the year.
   c. You must be willing to help promote the Journal within your professional domain.
   d. You must be willing to contribute content to the Journal on an ongoing basis.
   e. Your name and affiliation will be listed on the flag head of the Journal in every issue.

4. Columnist
   a. The Journal is actively looking for proven RFC and Ph.D. leaders in the area of personal finance to write at least two (2) and as many as four (4) columns per year ranging in length from 500 to 5,000 words.
   b. Columnists are needed in the following areas:
      i. Financial counseling
      ii. Technology issues
      iii. Regulation updates
      iv. Marketing methods
      v. Career development
      vi. Practice management
   c. Your picture and bio will be included in each issue of the Journal.
   d. You may use reprints of your column for marketing and promotional purposes.

Please consider these opportunities carefully. To be considered for one or more of these opportunities, please send your name, contact information, and a brief biographical sketch to:

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Kansas State University
Manhattan, KS 66506

Or send an email to: jgrable@ksu.edu

Or send a fax to: (785) 532-5505
NEWS AND NOTES

Information and Research of Interest to IARFC Members

Industry Bulletin

✓ Plan now to attend the Financial Advisors Forum from May 11th through May 13th, 2006 in Middletown, Ohio. The Forum brings together financial advisors from around the world for three action-packed days of sharing information, building knowledge, professional exchange and networking with the leaders of financial services. The Forum is the International Association of Registered Financial Consultants’ (IARFC) annual conference and exposition. The Forum features educational programs for all levels of experience. Expositions that showcase the latest financial services and products, and fun activities where you can meet other professionals. You will gain new business ideas, make contacts, see prospective resource providers, learn new planning design techniques and explore ways to promote your business. If you’re seeking to build your financial advisor practice, the knowledge can be found at the Financial Advisors Forum. Financial planning professionals with all levels of experience in every area of specialty will find that these practical educational sessions will exceed their expectations. Industry leaders will deliver their most valuable concepts and techniques in a collegial atmosphere. Whether you are a single practitioner, head up a firm of advisors, or are an executive of a broker/dealer, insurance company, bank, or a financial product provider, you will find these ideas, contacts and leadership skills to be invaluable.

✓ The Annual Loren Dunton Award will be presented to a deserving financial planner later this year. As a renowned figure and pioneer in the industry, Dunton is widely recognized as the father of the financial planning movement in the United States. He started the College for Financial Planning and the International Association of Financial Planning, was the first editor and publisher of Financial Planning magazine, and his precepts on the role of advisors are the basis for the IARFC. For more information about the Loren Dunton Award visit www.iarfc.org.
Janus Capital Group Inc. and the FPA are sponsoring a “Financial Frontiers Awards” – a competition created to encourage research papers that showcase new ideas and practical solutions for helping financial advisers and their clients. The Financial Frontiers Awards program is designed to promote serious research that expands the body of knowledge in wealth management and financial planning. Topics for research papers could include, but are not limited to, investments, practice management, retirement planning, general financial planning and trust and estate planning. The competition is open to all financial planners, investment consultants, registered representatives, registered investment advisers, bankers, accountants, educators, students, attorneys, and practitioners from the insurance field and trust and estate planning firms. Submissions also are welcome from financial advisers and management or support staff at financial services institutions, regardless of their size. Janus will contribute up to $100,000 to fund the Financial Frontiers Awards. The winners of the three top, or gold, awards will each receive $20,000, while the three second-place, or silver, winners will each earn $10,000. The research papers will be reviewed and evaluated by a panel of highly qualified judges. More information about the competition can be found at: www.financialfrontiersawards.org.

A new financial services journal has been introduced. Readers of the Journal of Personal Finance may find articles in the International Journal of Financial Services Management (IJFSM) appealing. The IJFSM is a professional journal publishing literature covering the broad area of financial services. It, also, provides an international forum for executives, professionals, experts, researchers, decision makers and practitioners in financial services, banking, insurance, commerce, financial accounting, finance, fund management, information technology and internet banking. It will also be of great interest to executives and managers of international companies as well as of governmental and international financial institutions, which purchase, employ or deal with any kinds of financial services and transactions. According to the Journal’s website, IJFSM publishes high quality original research papers and, when appropriate, literature surveys. It covers all aspects of financial services management worldwide, dealing with current practices as well as future prospects and developments. The journal is primarily interested in the financial sector’s structure, prospects, development and trends. It brings together and shares important information among expert
Researchers and practitioners interested in better understanding financial risk tolerance assessment will be interested in reading “Estimating Risk Tolerance: The Degree of Accuracy and the Paramorphic Representations of the Estimate” by Michael J. Roszkowski and John Grable in Volume 16, Issue 1 of Financial Counseling and Planning. The paper’s abstract is shown below:

Using a sample of 386 financial advisors and 458 of their clients, the study sought to determine how effective financial advisors and clients are at estimating risk-tolerance, and to test how well items from a risk tolerance test and demographic information can represent the judgmental process used to formulate these estimates (a paramorphic representation? of the decision). The client’s self rating and the advisor’s rating of the client produced a Pearson correlation of .40. Moreover, the advisor’s rating correlated at about the same level (r = .41) with the client’s score on a test of risk tolerance. The data also showed that when it comes to estimating one’s own risk tolerance, clients are better than are advisors at this task. The estimates could be represented paramorphically in terms of a few variables. It was observed that advisors assign too much diagnostic value to certain demographic variables in estimating client risk tolerance.

Do you have an interesting news story, or have you read an interesting research paper, that you feel would be useful to International Association of Registered Financial Consultant members? If yes, send a note to the editor at jgrable@ksu.edu.
WHY WE WRITE

Barbara O’Neill, Ph.D., CFP®, CRPC, AFC, CHC, CFCS
Rutgers Cooperative Research and Extension

Introduction

Ask 100 authors why they do what they do and you’re likely to get 100 different answers. Writing, like public speaking, is an intensely personal activity that draws upon an individual’s knowledge, experiences, vision, humor, opinions, and passions. Some people enjoy writing, while others detest it and rank writing somewhere between having a colonoscopy and dental surgery. I happen to be in the former camp. Below are 10 reasons, with a phonetic twist, why I choose to write:

1. **To Familiarize** - There’s no better way to learn more about a financial topic than to write a journal article about it with an extensive review of literature. Due to recent programmatic changes at Rutgers Cooperative Research and Extension, I’ve had to learn more about linkages between health and personal finances. Writing *Health and Wealth Connections: Implications For Financial Planners* (Volume 4, Number 2) helped me achieve this goal. It also resulted in a VoiceAmerica Business radio show hosted by another journal reader who noticed the article and wanted to familiarize his listeners with the topic.

2. **To Synthesize** - Writing provides a way to integrate a variety of seemingly dissimilar personal finance topics with a common theme. I recently did this with a paper subtitled “10 Key Issues for the 2000s and Beyond.” The paper covered “hot” financial planning topics for upcoming decades, including catch-up retirement planning strategies for late savers, long-term care planning, decreasing government and employer benefits, making retirement income last, identity theft, and the increased prevalence of predatory lending practices.

3. **To Hypothesize** - Academic writers, especially, often propose various hypotheses and then describe empirical research that tests them. For example, in a recent article in *Financial Counseling and Planning* (Volume 16, Number 1), three co-authors and I described a study of relationships among the financial practices, financial well-being, and health of a sample of financially distressed credit counseling clients. All
nine hypotheses proposed for that study were supported, indicating positive associations between various aspects of health and finances.

4. **To Organize**- Writing helps organize one’s thoughts about a topic, which can prove helpful for invited presentations, website development, classes for students or consumers, and other job-related activities. In other words, you can get lots of “mileage” from the time spent writing about a particular topic. Good writers usually begin with an outline of key topics and subtopics as well as implications for their readers.

5. **To Customize**- Writers can take a topic and “spin” it different ways for various audiences to personalize articles for specific readers. I’ve done this several times during my career when I’ve written about newspaper financial case studies and health and wealth connections for both financial planning and adult education journals. A topic that is viewed as “ho-hum” in one field may be seen as “innovative” in another. I also wrote a newspaper article in 2000 about my experience with breast cancer in an effort to help others and make readers aware of local resources.

6. **To Strategize**- Financial planning can be a high-maintenance task while many people want to lead low-maintenance lives. Financial authors can help filter available information so that their readers can make sound financial decisions and avoid “analysis paralysis.” Presenting workable strategies to help people deal with various financial situations, as well as “real world” research implications, were important outcomes during the 26 years that I wrote a weekly newspaper column.

7. **To Publicize**- People write to bring attention to their products and services. In the business world, the motivation is usually for exposure, to reach more customers. In Cooperative Extension, where I work, publicity often means describing available classes, websites, and publications. It is also critical to share one’s work with professional peers. Not only can this result in future collaborations, but also it saves someone from “reinventing the wheel” if the writer has already done so.

8. **To Supersize**- Okay, this word is a stretch, but nothing bulks up an academic writer’s vita (read: a long resume that lists major career accomplishments) than a list of publications, particularly peer-reviewed journal articles. For an untenured assistant professor, writing is not a luxury but a necessity. University promotion and tenure committees often have very specific expectations regarding the number of articles written and the types of journals that faculty should publish in. Even today as a full professor, journal articles count highly for merit pay and other rewards.
9. **Citation Surprise** - No matter how long you’ve been writing, it always feels wonderful to unexpectedly see something that you’ve written quoted or cited by others. It is a validation that you’ve done something noteworthy in the eyes of professional peers and that you’ve left a legacy for others to build upon. It also felt great when I saw the byline on my newspaper column or when a journal arrives with an article I’ve written. There’s just something great about seeing your work in print as tangible “evidence” of all your hard work and effort.

10. **As an Enterprise** - Writing can be a profitable endeavor. I started a part-time writing and public speaking business over a decade ago and have been paid thousands of dollars over the years to write newsletter articles, end-of-chapter material for books, curricula, and test questions for over a dozen clients. Most of this writing has been anonymous (i.e., “work for hire”) so few people know about it. I find that the process of researching and writing materials for clients helps me in my “day job” as a university professor and vice versa. I’m also able to write off “big-ticket” professional expenses (e.g., CFP® license fee and Financial Planning Association dues) against business income (Schedule C) that would be limited on IRS Form 2106 as a university employee. These tax write-offs also provide additional income. In addition, some of my publications have led to professional presentations such as a recent speaking engagement in Texas as a result of an article published in the *Journal of Financial Planning.*

**Conclusion**

In the call for *Why We Write* papers, editor John Grable noted that someone’s views may drive others to think about writing for the *Journal of Personal Finance* or other publications. I hope that is the case. For me, writing is a way to help others, increase my knowledge about topics of interest, feel good about myself, receive positive reviews at work, and even earn a little extra money. I can’t sing or draw very well but I do enjoy writing. Why not give it a try? You’ll feel great seeing your name in print.
Reference


WHAT WILL BE THE IMPACT OF STOCK MARKET VOLATILITY ON BABY BOOMER SAVINGS?

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Slippery Rock University

Introduction

The time is here. The front edge of the baby boom generation is entering their retirement years. Are their nest eggs large enough to carry them comfortably through their retirement years with dignity? What about the succeeding tiers of the baby boom generation? Are they building sufficient nest eggs? What impacts have the volatility in equity prices had upon these nest eggs, and perhaps more importantly, did the speculative bubble burst in the high tech market sector have a pronounced negative effect on the investment psyche of the typical baby boomer? Have they been “scared out” of equities, and if so what consequences would this have on the returns earned on their investment portfolios?

These are issues of major consequence from a financial planning perspective, and should prove to be a fertile ground of discovery for academics, and remediation for financial planning practitioners over the next two decades.

Characteristics and Traits of Baby Boomers

It has been estimated that there are 77 million U.S. citizens that were born between 1946 and 1964. In fact, the U.S. Bureau of the Census projects that the number of people in the U.S. ages 65 and over will double by 2030. This doubling implies that this age group will constitute roughly 20% of the total population in 2030, versus approximately 13% today. What do we know about this age group?

As a general rule, and over the period of their productive work years, baby boomers have been large consumers and small savers. In fact, the Merrill Lynch Baby Boom Retirement Index indicates that baby boomers save just 38.5% of the amount needed to provide them with a retirement standard of living comparable to the one they currently enjoy. For most, employer sponsored retirement plans now take the form of defined contribution plans rather than defined benefit plans. With defined contribution plans, the employee has choices to make about how much to invest, and the allocation of those investment assets.
Historically, many baby boomers have been willing to take greater risks in their investment holdings whether perceived or not, and prior to 2000, many assumed equities provided high returns with low levels of risk. Many of these baby boomers were caught off guard by the speculative bubble burst in the spring of 2000. If we conclude that the market sell-off hurt their collective psyches in terms of the acceptance of investment risks, what are the impacts longer-term on their investment holdings?

A major consequence of these actions and traits is that investment assets will not be sufficient for many baby boomers to provide them in their retirement years with the quality of life they enjoyed prior to retirement.

Accordingly, many baby boomers will need to earn “higher” investment returns both leading up to retirement and also in retirement in an effort to maintain their quality of life standards during retirement.

The Impacts of Volatility on Market Prices

Finance professionals have struggled in their attempts to model and measure investment sentiment and behavior. In fact, in December of 1996, Alan Greenspan coined the phrase “irrational exuberance” in an effort to describe the behavior of U.S. stock market investors. He repeatedly voiced the concern that we were seeing an unsustainable increase in common stock prices brought on by investors’ buying behavior as opposed to rational responses to fundamental information about value. Furthermore, if these speculative bubbles break, will investors overreact leading to panic selling?

We can look to volatility for signals. Volatility in equity prices can be measured through the standard deviation of average daily returns.

Robert Haugen (1999) breaks stock market volatility into three primary components; event driven volatility, error driven volatility and price driven volatility. Event driven volatility is related to changing general economic conditions that alter a firm’s prospects for generating future cash flows. Error driven volatility results from overreaction and underreaction to events, that is, time varying mistakes in pricing relative to the receipt of new information. Price driven volatility is caused by current price reactions to past price changes. Haugen has shown that price driven volatility is the largest component and is three times as large as the other two combined. Haugen writes that the instability inherent in price driven volatility can send equity prices into a downward spiral.

Misner (2000) demonstrated that heightened periods of volatility in equity prices when combined with significant skewness and/or significant positive kurtosis, frequently leads to extreme short-term market movements both up and down. In these situations, we see a departure from the linear nature presumed by normal distributions. Significant skewness and/or kurtosis imply a departure from a normal distribution. If one of the two tails of
the distribution is lengthened, skewness exists. Kurtosis exists when the maximum value lies higher or lower than that of a normal distribution. Positive kurtosis is characterized by a high peak with scantily occupied flanks. There is a surplus of values near the mean and in the tails.

**What do we Know About Investor Behavior?**

How are we to explain the periodic departures of stock market returns from normal distributions? Perhaps the key rests within our studies of human behavior. Human behavior is frequently nonlinear. People and their actions are relevant and impact the financial markets.

Kahneman and Tversky (1979, 1982) have postulated that individuals are loss averse rather than risk averse because the pain associated with a given amount of loss is greater than the pleasure realized by an equivalent gain. They proposed that individuals often commit cognitive errors in judgment, by overweighting more recent information and underweighting information established over the long run, thus mismapping probabilities. These actions when applied to the evaluation of future stock prices and expected returns result in either overreaction or underreaction.

Fischhof, Slovic, and Lichtenstein (1977) found that individuals could be overconfident and frequently overestimate the reliability of their knowledge. Furthermore, their findings suggest that professional investors are more confident of their predictions in fields where they have self-declared expertise.

Robert J. Shiller (2000) discusses certain patterns of human behavior that serve as psychological anchors for the stock market. Shiller argues that the most likely quantitative anchor for the market is the most recently remembered price. This anchor enforces the similarity of stock prices from one day to the next. This helps to explain the existence of significant and positive kurtosis. Positive kurtosis is characterized by a surplus of values near the mean and in the tails. The observations in the tails provide the volatility whereas the surplus of values near the mean is evidence of the quantitative anchor.

Shiller (2000) also addresses the “herd behavior” of investors, whereas irrational thinking can be spread over large numbers of people. Individuals are influenced by their social environment, and they frequently feel the need to conform to their peer group. Naive investors form their expectations based upon aggregate opinions and rules of thumb. Accordingly, biases are formed. Skewness can be viewed as a measure of these biases.
Volatility into the Future?

It is logical to assume that significant volatility in equity prices will continue to be evident into the future. If we consider the threat and impact of terrorism (particularly in the United States), and the rapidly shifting dimensions of the world economy, strong arguments can be made that significant volatility will become the norm as opposed to the exception. What impacts will this volatility have on investment behavior, and thusly the value of financial assets?

Opportunities and Obligations

What roles should financial planning professionals (academics and practitioners) take in addressing these issues raised as they relate to the retirement of the baby boom generation? Academic research needs to continue in its efforts to understand investor behavior. Explanatory and predictive models of investment behavior need to become more than empirical exercises explaining the past, or theoretical exercises predicting the future. Academics should work with practitioners in developing models and specific strategies that have as a goal the mitigation of the risks flowing out of volatility.

Furthermore, practitioners need to further refine their “soft” skills in their dealing with baby boomers. They also need to strive to become more efficient educators in explaining the impacts of volatility and exploring with them different strategies for mitigating these risks.
References


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FOUR KEY ISSUES TO GUIDE FUTURE RESEARCH IN RETIREMENT PLANNING

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Carolina Financial Planning

ABSTRACT

This paper discusses four critical topics to guide the research agenda for retirement planning: market variability, risk tolerance, asset-liability matching, and household spending projections. These four issues, which focus on the investment strategy portion of financial planning, are important individually as well as collectively. For the looming Baby Boomer generation, the importance of asset accumulation will diminish while the significance of asset distribution will intensify. The asset distribution phase carries a unique set of planning challenges requiring a better understanding of the impacts of market variability, risk control, asset-to-spending conversion, and projected retirement income patterns.

Introduction

The purpose of this paper is to outline the key investment planning challenges that will increasingly intensify as the huge Baby Boomer generation retires and seeks sound and competent financial advice. As the Baby Boomers approach and enter retirement, their personal financial planning focus will shift from wealth accumulation to wealth distribution.

This is not a trivial shift. Financial asset accumulation typically occurs without any withdrawals from the investment portfolio. In the accumulation stage, the sequence of portfolio returns over time plays no role in the final amount of accumulated wealth if no additions or withdrawals are made to the portfolio. To illustrate, Table 1 shows the ending annual values of an initial $10,000 investment portfolio over a 10-year period when the investor is in the accumulation phase and makes no additions or withdrawals. The terminal value of this buy-and-hold portfolio does not depend on the particular sequence of the annual returns. (While investors in the accumulation phase typically make periodic contributions to their portfolios, the constraint
here of no additions or withdrawals is simply to illustrate how the sequence of periodic returns does not affect the terminal value of a buy-and-hold portfolio).

Vastly different results occur when the investor is in the distribution phase. In retirement, a portion of financial income typically comes from portfolio liquidation. When withdrawals are made from the portfolio, the ending portfolio value will be affected by the sequence of periodic returns.

Table 1
Sequence of Annual Returns for an Accumulation Stage (Buy-and-Hold) Portfolio

<table>
<thead>
<tr>
<th>Year</th>
<th>Portfolio Return</th>
<th>Annual Additions</th>
<th>Portfolio Value Forward Return Sequence</th>
<th>Portfolio Value Reverse Return Sequence</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>+10%</td>
<td>$0</td>
<td>$11,000</td>
<td>$9,000</td>
</tr>
<tr>
<td>2</td>
<td>+ 5%</td>
<td>0</td>
<td>11,550</td>
<td>8,550</td>
</tr>
<tr>
<td>3</td>
<td>+30%</td>
<td>0</td>
<td>15,015</td>
<td>5,985</td>
</tr>
<tr>
<td>4</td>
<td>+ 5%</td>
<td>0</td>
<td>15,766</td>
<td>5,686</td>
</tr>
<tr>
<td>5</td>
<td>+10%</td>
<td>0</td>
<td>17,342</td>
<td>5,117</td>
</tr>
<tr>
<td>6</td>
<td>-10%</td>
<td>0</td>
<td>15,608</td>
<td>5,629</td>
</tr>
<tr>
<td>7</td>
<td>- 5%</td>
<td>0</td>
<td>14,828</td>
<td>5,910</td>
</tr>
<tr>
<td>8</td>
<td>-30%</td>
<td>0</td>
<td>10,379</td>
<td>7,683</td>
</tr>
<tr>
<td>9</td>
<td>- 5%</td>
<td>0</td>
<td>9,860</td>
<td>8,068</td>
</tr>
<tr>
<td>10</td>
<td>-10%</td>
<td>$0</td>
<td>$8,874</td>
<td>$8,874</td>
</tr>
</tbody>
</table>

Table 2 shows the annual ending values of the same $10,000 initial investment portfolio over the 10-year period when the investor is in the distribution phase and make annual withdrawals of 3% (adjusted for inflation) of the initial portfolio value. Depending on the sequence of annual returns, the investor in this example has an ending portfolio value nearly 50% less if the poor returns occur in the beginning of the distribution stage rather than at the end.
Table 2  
Sequence of Annual Returns for a Distribution Stage Portfolio

<table>
<thead>
<tr>
<th>Year</th>
<th>Portfolio Return</th>
<th>Annual Withdrawal*</th>
<th>Portfolio Value Forward Return Sequence</th>
<th>Portfolio Value Reverse Return Sequence</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>+10%</td>
<td>$300</td>
<td>$10,670</td>
<td>$8,730</td>
</tr>
<tr>
<td>2</td>
<td>+5%</td>
<td>309</td>
<td>10,879</td>
<td>8,000</td>
</tr>
<tr>
<td>3</td>
<td>+30%</td>
<td>318</td>
<td>13,729</td>
<td>5,377</td>
</tr>
<tr>
<td>4</td>
<td>+5%</td>
<td>328</td>
<td>14,071</td>
<td>4,797</td>
</tr>
<tr>
<td>5</td>
<td>+10%</td>
<td>338</td>
<td>15,107</td>
<td>4,013</td>
</tr>
<tr>
<td>6</td>
<td>-10%</td>
<td>348</td>
<td>13,283</td>
<td>4,032</td>
</tr>
<tr>
<td>7</td>
<td>-5%</td>
<td>358</td>
<td>12,279</td>
<td>3,858</td>
</tr>
<tr>
<td>8</td>
<td>-30%</td>
<td>369</td>
<td>8,337</td>
<td>4,535</td>
</tr>
<tr>
<td>9</td>
<td>-5%</td>
<td>380</td>
<td>7,559</td>
<td>4,363</td>
</tr>
<tr>
<td>10</td>
<td>-10%</td>
<td>$391</td>
<td>$6,451</td>
<td>$4,369</td>
</tr>
</tbody>
</table>

* First year withdrawal of 3% of initial portfolio value escalated for 3% inflation in subsequent years

Table 2 embodies the four key research issues facing retirement investment planning. The magnitude and sequence of future annual returns correspond to market variability. The investor’s choice of exposing the investment portfolio to more or less market fluctuation reflects risk tolerance. How the investments within the portfolio are allocated among various asset classes and how these assets are coordinated with retirement income needs characterize asset-liability matching. Finally, the scheduled withdrawals from the investment portfolio reflect anticipated household spending needs. Each of these topics, and how they are jointly coordinated, is crucial to successful investment planning for retirees. Due to the looming retirement of the Baby Boomer generation, these four key concerns form the core challenges facing new retirees, the financial advising profession, and the planning research agenda.

**Market Variability**

Investment markets are characterized by substantial variability. Among others, Fowler and Rattiner (2005), Farrell (2004), Malkiel (2003), Berstein (2002), and Gibson (2000) have shown that markets are subject to random and erratic behavior. Market variability is measured in various ways, but the most common measure is volatility. Volatility measures the dispersion of periodic returns around the average return over a selected time period. The most frequently used measure of dispersion in financial returns is standard deviation. The higher the standard deviation, the greater the asset’s volatility and the more variable is the asset’s periodic return.
Modern financial theory is founded on the concept that higher average return is associated with higher risk. But the notion of ‘average return’ must not be taken lightly. It sounds innocent enough to specify that greater volatility accompanies greater average return. What that really means, however, is higher average return can only be achieved by incurring larger dispersion in periodic returns. For example, Ibbotson data show that from 1926-2004 the asset class composed of common stocks of the largest and best known U.S. companies have had an average annual return of 10.4% and a standard deviation (volatility) of 20.3%. Another way of interpreting these data is that 95% of the time, this asset class experienced annual periodic returns between 50% and -29%. Other asset classes reported by Ibbotson also demonstrate that higher average return is associated with higher risk.

Volatility is the irregular pattern of periodic return. The periodic returns of financial assets show extended periods of off-trend performance with negative and positive returns occurring in irregular patterns. It is important to recognize that investors only experience these off-trend periodic returns which, over relatively long periods, become the obscure ingredients of average return. Table 3 shows how many times 1-year and 3-year periodic returns have matched to within ± 10% the long-run average return for several benchmark investment indexes (Franklin Templeton Investments, 2005). Table 3 demonstrates that investors are subject to persistent off-trend performance and it is the prevalence of such variable patterns that give rise to sequence risk.

The long-standing answer to diminish the impact of market variability is portfolio diversification. Markowitz (1952) introduced portfolio diversification as a mean variance optimization procedure where combining less than perfectly correlated asset classes results in a reduction of portfolio volatility without sacrificing portfolio return. The optimization feature derives from finding a schedule of various combinations of asset classes – called the efficient frontier — where a unique combination of asset classes produce the highest average return for a given level of volatility. Efficient portfolios, however, have a major drawback: they are not stable over extended periods of time.
Table 3
Average versus Actual Returns from Inception through 12/31/2004

<table>
<thead>
<tr>
<th>Index*</th>
<th>Inception Date</th>
<th>Average Annual Return Since Inception</th>
<th>Number of Years Periodic Return of the Average Return Within ± 10%</th>
<th>1-Year Return</th>
<th>3-Year Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500</td>
<td>1926</td>
<td>10.43%</td>
<td>3 of 79</td>
<td>5 of 77</td>
<td></td>
</tr>
<tr>
<td>Russell 2000</td>
<td>1979</td>
<td>13.50%</td>
<td>0 of 26</td>
<td>4 of 24</td>
<td></td>
</tr>
<tr>
<td>MCSI EAFE</td>
<td>1970</td>
<td>11.09%</td>
<td>2 of 35</td>
<td>1 of 33</td>
<td></td>
</tr>
<tr>
<td>Lehman US Aggregate</td>
<td>1976</td>
<td>8.97%</td>
<td>6 of 29</td>
<td>2 of 27</td>
<td></td>
</tr>
</tbody>
</table>

* The S&P 500 index represents the largest 500 domestic stocks; the Russell 2000 represents the smallest 2000 domestic stocks; MCSI EAFE represents foreign stocks of Europe, Australasia, and the Far East; and the Lehman U.S. Aggregate represents the domestic bond market.

The instability of the frontier comes from two sources: (1) short-term return and volatility patterns of individual asset classes that deviate from their longer-term risk-return profile and (2) the random movement among all the asset classes which alters their correlations. The instability problem, resulting from continual variation among the asset class returns, correlations, and volatilities cause the efficient frontier to repeatedly shift. Due to the inherent instability of the frontier, the prospective relationships among asset classes are unpredictable. As a consequence, constructing an optimized and stable long-run investment portfolio cannot be achieved.

Given the inherent variability of investment markets, the prevalence of sequence risk, and the unpredictability of future asset class behavior, what should financial planners recommend to their clients who must pre-schedule portfolio liquidations to meet their retirement income needs? This question can only be answered by continuing research. The inherent unpredictability of markets suggests that stock selection and market timing approaches through active portfolio management are ineffective because they depend on accurately predicting the future. Even so, low-cost passive management approaches using index or exchange traded funds have been shown to under-perform active management in domestic small capitalization and international equity markets. Continuing research on appropriate asset allocation, the suitability of active versus passive management, and methods to mitigate sequence risk are needed because of the large number of retirees soon entering the distribution stage of investment management.
Risk Tolerance

Investor response to market variability is measured by risk tolerance. Assessing the tolerance for investment risk, however, remains one of the more subjective activities in personal financial planning. VanWelie, Janssen & Hoogstrate (2004), Yook & Everett (2003), ORTEC (2003), Cordell (2002, 2001), and Loeper (2001) among others have publicized the importance of risk tolerance, its measurement, and how it is should be used to determine appropriate asset allocation. Risk tolerance assessment has made important advances in recent years. In addition to being an indicator of risk attitude, many questionnaires now include additional risk indicators such as risk capacity, risk knowledge, and risk propensity. These additional risk indicators reveal how client goals and circumstances may be affected by incurring more or less risk, their familiarity with how risk can manifest itself, and the assumptions and process they have used to make past financial decisions under uncertainty.

Promising new approaches are also replacing the more traditional linear risk assessment approach. Under the more traditional procedure, an investor’s attitude toward risk, risk capacity, and investment horizon are used to set asset allocation. Once set, financial goals are then tested against the pre-determined asset allocation. Under the emerging integrated approach, the client’s risk profile, horizon, and objectives are used jointly to establish appropriate asset allocation.

The predominant approach to risk tolerance assessment continues to be questionnaires which weight client responses to survey questions on risk capacity and risk attitude. Many investors during the 1990s were apparently willing to accept greater risk when the domestic equity markets were returning 20% to 30% per annum and the market catchphrase was “buy on the dips”. The market correction, starting in March of 2000 through October 2002, was the worst deterioration since the market declines in the 1937-1938 period. The extraordinary equity market losses during the early 2000s significantly reduced the net worth of investor balance sheets and drastically reduced the perceived tolerance for investment risk. At that time, the looming Baby Boomer generation was luckily still in the wealth accumulation phase. Consequently, this large group of investors had the opportunity to adjust retirement timing, investment planning, and household spending plans. The damage to family wealth for those who retired in the late 1990s, however, was ruinous for those who needed to liquidate equity portfolios for income needs during and after the 2000-2002 period.

One of the rationales for investors to hold overly risky portfolios relative to their financial circumstances is time diversification. While time diversification is a recognized fallacy in the control of investment risk, it continues to be pervasively promoted as a means to reduce investment risk.
Time diversification is the convergence of portfolio return to a long-run average and the commensurate reduction of average volatility over time. The magic of time diversification is used to rationalize higher risk portfolios by claiming that the longer the portfolio is held the less the variability in average return. This is no more than the operation of the law of large numbers where the probability of a result deviating significantly from that indicated by the longer-run frequency of occurrence becomes smaller as more observations are taken. Unfortunately, just because the average return of the portfolio converges to its long-run value in no way means the current risk of the portfolio is reduced. In fact, a portfolio that is increasing in value over time has an increasing risk of loss (all else held constant). Irrespective of the average return of the portfolio being at its long-run average, the risk of loss is still represented by the portfolio’s standard deviation. To see this, recall the Value at Risk (VaR) of the portfolio is given by equation (1)

\[
\text{VaR} = cS_p W
\]

where \( c \) is the selected confidence interval, \( S_p \) is the volatility (standard deviation) of the portfolio, and \( W \) is the current dollar value of the portfolio (Harris, 2004; Jorion, 2001). Note the portfolio’s magnitude-of-loss risk is a function of only the confidence level, volatility, and current value and not of average return. If the confidence interval and volatility of the portfolio are held constant (which is common practice for short-run risk assessment) the magnitude-of-loss risk is directly proportional to the current portfolio value. In other words, regardless of the portfolio’s average return, the magnitude-of-loss risk increases with increases in the dollar value of the portfolio. While the proper interpretation of time diversification is not an appropriate topic of the financial planning research agenda, its continued misuse as an alleged mitigation of investment risk suggests it should receive renewed emphasis in financial education.

Market variability, sometimes extreme, is an inescapable fact of investment planning. The recent market downturn in the early 2000s and the stunned reaction by many investors emphasizes that the assessment of risk tolerance must be more closely coordinated with financial reality. What’s more, the downturn also emphasizes the need for greater consideration of investment risk. Risk should be afforded at least equal weight to that of return when selecting investments because historical return has proven unreliable in predicting future periodic return where as historical risk has a much stronger relationship to future risk. Setting and periodically resetting asset allocations to keep the probability of achieving financial objectives at suitable levels is a key responsibility of financial planners. Future research is needed to improve the reliability, validity, and consistency of risk tolerance measures. In
addition, integrating financial objectives and risk tolerance assessment into a single coordinated process can also improve the overall success of investment planning.

**Asset-Liability Matching**

One of the key questions in retirement investment planning is how much money can be withdrawn without outliving the assets. Because future investment performance depends on unpredictable markets, the question cannot be answered with certainty. But the question suggests one of the key issues on the retirement planning research agenda: what is the optimum way to match assets with the liability of retirement household income? Among others, Gilliam (2005), Whuei-wen (2004), Bodie and Closes (2003), Evertt and Anthony (2003), and Fortin and Michaelson (2002) discuss the role of aligning asset holdings with income needs.

The scheduled withdrawals from the investment portfolio depend on the joint solution between the schedule of projected household income desires and projected lifetime funds. After the income requirement is established, the next step is to determine which assets in the investment portfolio should be liquidated after taking account of social security payments, pension receipts, annuity proceeds, and required minimum distributions. Depending on the availability of these other sources of retirement income, some portion of the investment assets will likely be liquidated to meet annual household income needs.

Typically, two primary methods are used to convert investment assets into retirement income: (a) dollar-adjusted withdrawals and (b) percentage withdrawals. The first procedure of dollar-adjusted withdrawals involves withdrawing an initial percentage of the investment portfolio – usually between 3% and 4% – and then increasing this initial amount by the rate of inflation each subsequent year. There is a full research agenda today in exploring what an appropriate initial withdrawal percentage should be. The second procedure of percentage withdrawals involves withdrawing the same percentage each year – usually around 5% and 6% – from the investment portfolio. This method relies on portfolio growth to account for increases in income needs due to inflation. While the first method results in a constantly increasing income stream, the second method results in a fluctuating income stream that mirrors the fluctuation in the value of the investment portfolio. The drawback of fluctuating income is offset by the advantage that clients can never outlive their investment assets using this method. This advantage, however, may be a small consolation when an investment portfolio declines to materially lower values because of poor market performance. During the bear market of 2000-2002, for example, retirees using the percentage withdrawal method would have had to reduce their investment disbursements from 30% to 40% if the portfolio asset allocation mirrored the S&P 500 index.
In each of these approaches, the question of which specific investment assets are used to satisfy income liabilities must still be established. There are two general approaches to link investment assets to income liabilities: (a) total-return and (b) asset-liability matching. The total-return approach, which was popular during the 1990s due to soaring equity markets, focuses on maximizing the risk-adjusted return on all investment assets. In this approach, either the best performing assets or a proportional amount of all assets are used to fund income liabilities. In contrast, the asset-liability matching approach links specific assets with specific income liabilities through time to ensure that pre-determined assets are sufficient to cover planned income needs. Due to long-run market variability, the best approach may be a combination of these two approaches. Huxley and Burns (2005) describe how individual investors can construct portfolios based on combining asset-liability matching and total-return approaches.

A combination of the total-return and asset-liability matching approaches uses the total-return approach to manage the long-term portion of the investment portfolio and a laddered fixed income approach to cover income needs over the near-term. The laddered bonds are purchased in such a way that coupon payments from non-maturing bonds and par values from maturing bonds exactly match the pre-determined schedule of retirement income needs each year. Once these cash flow streams of receipts and disbursements are matched over the selected horizon, the remainder of the investment portfolio can be managed to maximize risk-adjusted return. To maintain the fixed income ladder, a portion of the total-return assets are used to purchase bonds for the outmost year of the bond ladder. This can be done annually or on a more prolonged schedule that takes into account the short-term performance of the total-return portion of the portfolio.

Once near-term household income needs have been laddered, the remainder of the portfolio can be dedicated to total-return growth. This approach to splitting the investment into specific portions which are dedicated to short-term and long-term needs also better aligns with investment horizon indicators in risk tolerance assessment because clients typically don’t have just one investment horizon. They have multiple investment horizons due to different long-run goals and objectives scheduled to occur in different time frames. As each major objective approaches, the matching of investment assets to those specific objectives reduces risk by eliminating short-term volatility in the laddered portion of the portfolio by preserving asset value because the fixed income securities are held to maturity. As shown in Table 2, sequence risk is major issue in retirement investment planning. Asset-liability matching reduces sequence risk because it partially insulates the total-return portion of the portfolio from withdrawals during times of poor market performance. Note that sequence risk is not an issue when the percentage withdrawal method discussed earlier is employed to determine annual portfolio

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disbursements. Bear in mind, however, that sequence risk is replaced by income risk in the percentage withdrawal method.

Pension plans and treasury departments in major corporations have used asset-liability matching – known as the “matched funding” problem in finance – extensively. Vanguard (2004) and Leibowitz (1986) provide detailed descriptions. Most research in this area has focused on the benefits of cash-flow matching or duration immunization. The cash-flow approach relies on matching expected future liabilities with fixed income disbursements whereas the duration immunization approach relies on eliminating interest rate risk in the fixed income portfolio. The application of matched funding to individual investors should become a major component of the personal financial planning research agenda because of its successful application to managing risk in very large pension funds.

Asset-liability matching for individual investors has several advantages. First, it reduces short-term volatility risk because the laddered bond portion of the portfolio is held in individual bonds to maturity. Second, it allows a total-return approach to be used for the long-term portion of the portfolio where the objective is growth. Third, it reduces sequence risk because withdrawals from the total-return portion of the investment portfolio can be made at more suitable times based on market performance. Finally, the asset-liability matching approach has been shown in one research study to outperform all total-return portfolio strategies with 70% or less in equity investments. These research results covered various periods from 1926 to 2003. Obviously, asset-liability matching cannot outperform investment portfolios with high equity concentrations because of the requirement to dedicate a portion of the asset-liability matched portfolio to laddered bonds. Nonetheless, the 70% equity threshold cited above is compelling because recommended asset allocations for retirees typically have a substantial fixed income component. The application of asset-liability matching to individual investors should become a major component of the personal financial planning research agenda because of its success by large pension funds, because of its advantages to reduce sequence risk, and its better alignment with risk tolerance assessment.

**Household Spending Needs**

Retirement planning requires long-run projections of household spending needs. Income projection approaches range from rules of thumb to detailed annual cash-flow predictions. The least rigorous approach relies on rules of thumb. The most prominent rule of thumb is to estimate retirement income needs at 70%-80% of pre-retirement spending. Each year, this initial amount is escalated by the rate of inflation. While simple, this approach has been widely criticized because of the vast differences in age, health, interests,
and goals among retirees. At the other end of the planning spectrum, highly detailed annual cash-flow projections are made that span the entire retirement period. While this approach addresses the highly individual circumstances of the client, the accuracy of these long-run projections is debatable. Regardless of the method employed to project household income needs, they all typically assume that income needs increase throughout retirement.

The assumption of increasing household income needs throughout retirement is not supported by data on household expenditures. Bernicke (2005), the Department of Labor (2004), the Department of Commerce (2002), and Tacchino and Saltzman (1999) present past patterns of consumer expenditures by age group. The Consumer Expenditure Survey produced by the Department of Labor shows that real (inflation-adjusted) household income needs actually decline during the latter stages of retirement. Assuming real household expenditure data reflect voluntary income reductions, clients may be either saving too much during the pre-retirement accumulation stage or spending too little during retirement distribution stage.

Table 4 shows consumer expenditures by age of the reference person from the 2003 Consumer Expenditure Survey. The 2003 survey was based on 11.5 and 11.4 million responses respectively from the 65-74 age group and 75+ year age group. The per consumer unit data were taken from the published survey while the per capita data were derived from the published survey by the author. Consumer units are defined as members of households consisting of related occupants, singles living alone, or two or more persons living together who share responsibility for at least 2 out of 3 major types of expenses – food, housing, and other. Reference person is defined as the survey respondent shown as owning or renting the household.

Most planning assumptions increase average household expenditures by an escalator for projected inflation throughout the retirement period. The survey results suggest that consumers behave differently. The survey results show that real household spending decreases incrementally over the retirement period. The latest 2003 survey results shown in Table 4 demonstrate that – on average – households with the reference person categorized in the 75+ age group had expenditures 25.6% less when compared with households of the 65-74 age group. The 2003 results closely parallel survey results from prior years. This relatively sizable reduction in observed household expenditures has important implications for retirement planning. Careful analysis of the data, however, must be performed before current retirement planning assumptions are challenged. Possible explanations for this decline in observed household expenditures may be due to generational differences or financial necessity. If either circumstance were true, it would be inappropriate to extrapolate household expenditure patterns to different generations or to households with the financial resources to maintain robust discretionary spending.
To assess generational differences, longitudinal research has been conducted using the household expenditure survey over time. These studies illustrate that every generation incrementally reduces household spending over the retirement period. This research on average household expenditures suggests that reductions in spending are not induced by generational circumstances. Similarly, compulsory reductions in household expenditures due to financial necessity have also been assessed using census data collected on household net worth. This research suggests that households voluntarily spend less as age increases.

### Table 4 2003 Consumer Expenditure Survey by Age of Reference Person

<table>
<thead>
<tr>
<th>Category</th>
<th>65-74</th>
<th>75+</th>
<th>%</th>
<th>65-74</th>
<th>75+</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average Persons in CU</td>
<td>1.9</td>
<td>1.5</td>
<td>-</td>
<td>1.9</td>
<td>1.5</td>
<td>-</td>
</tr>
<tr>
<td>Average Age of Reference Person</td>
<td>69.2</td>
<td>81.1</td>
<td>-</td>
<td>69.2</td>
<td>81.1</td>
<td>-</td>
</tr>
<tr>
<td>Average Annual Per Consumer Unit</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Expenditures</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food</td>
<td>$4,544</td>
<td>$3,208</td>
<td>-29.4%</td>
<td>$2,392</td>
<td>$2,139</td>
<td>-10.6%</td>
</tr>
<tr>
<td>Alcoholic Beverages</td>
<td>237</td>
<td>128</td>
<td>-46.0%</td>
<td>125</td>
<td>85</td>
<td>-31.6%</td>
</tr>
<tr>
<td>Housing</td>
<td>10,761</td>
<td>8,679</td>
<td>-19.3%</td>
<td>5,664</td>
<td>5,786</td>
<td>+2.2%</td>
</tr>
<tr>
<td>Apparel &amp; Services</td>
<td>1,190</td>
<td>611</td>
<td>-48.7%</td>
<td>626</td>
<td>407</td>
<td>-35.0%</td>
</tr>
<tr>
<td>Transportation</td>
<td>6,015</td>
<td>3,622</td>
<td>-39.8%</td>
<td>3,166</td>
<td>2,415</td>
<td>-23.7%</td>
</tr>
<tr>
<td>Healthcare</td>
<td>3,626</td>
<td>3,856</td>
<td>+6.3%</td>
<td>1,908</td>
<td>2,571</td>
<td>+34.7%</td>
</tr>
<tr>
<td>Entertainment</td>
<td>2,016</td>
<td>909</td>
<td>-54.9%</td>
<td>1,061</td>
<td>606</td>
<td>-42.9%</td>
</tr>
<tr>
<td>Personal Care</td>
<td>491</td>
<td>387</td>
<td>-21.2%</td>
<td>258</td>
<td>258</td>
<td>0.0</td>
</tr>
<tr>
<td>Reading</td>
<td>149</td>
<td>134</td>
<td>-10.0%</td>
<td>78</td>
<td>89</td>
<td>+13.9%</td>
</tr>
<tr>
<td>Education</td>
<td>176</td>
<td>81</td>
<td>-54.0%</td>
<td>93</td>
<td>54</td>
<td>-41.7%</td>
</tr>
<tr>
<td>Tobacco Products</td>
<td>219</td>
<td>105</td>
<td>-52.1%</td>
<td>115</td>
<td>70</td>
<td>-39.3%</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>547</td>
<td>519</td>
<td>-5.1%</td>
<td>288</td>
<td>346</td>
<td>+20.2%</td>
</tr>
<tr>
<td>Contributions</td>
<td>1,811</td>
<td>2,127</td>
<td>+17.4%</td>
<td>953</td>
<td>1,418</td>
<td>+48.8%</td>
</tr>
<tr>
<td>Insurance &amp; Pensions</td>
<td>1,847</td>
<td>651</td>
<td>-64.8%</td>
<td>972</td>
<td>434</td>
<td>-55.4%</td>
</tr>
<tr>
<td><strong>Total Expenditures</strong></td>
<td><strong>$33,629</strong></td>
<td><strong>$25,016</strong></td>
<td><strong>-25.6%</strong></td>
<td><strong>$17,699</strong></td>
<td><strong>$16,678</strong></td>
<td><strong>-5.8%</strong></td>
</tr>
</tbody>
</table>

*Per Consumer Unit data from 2003 Consumer Expenditure Survey, Table 4.

Nonetheless, there are several limitations to the current research. First, age categories spanning 10 years or more include a very broad range of individuals with potentially significant differences in health, interests, and personal circumstances. Second, the expenditure survey reports aggregated spending on a household basis (i.e., per consumer unit). If the data are restated to a per capita basis as shown in Table 4, the change in average
expenditures between the 65-74 and 75+ groups diminishes significantly. The per capita results, although derived from aggregate data, suggest that as respondents age much of the reduction in household expenditures may be attributable to there being fewer members in the household. If this is the case, current financial planning assumptions and tools take account of survivor expenditure patterns. Future research in this personal financial planning area is needed to explicitly control for differences in generation, health, and financial circumstances on household spending patterns throughout retirement. Such research could lead to more realistic retirement projections and improved quality of life during the entire retirement phase due to more realistic saving and spending assumptions.

Conclusion

The retirement of the Baby Boomer generation will cause the financial planning profession to place greater emphasis on the distribution phase of investment management. This shift from wealth accumulation during pre-retirement to wealth distribution to support spending needs during retirement carries a unique set of challenges that require additional research and planning tools.

Markets have demonstrated they can stray unpredictability from their long-term growth trend for prolonged periods. The substantial volatility of equity markets, reflected in the sizeable standard deviation of periodic returns, gives rise to sequence risk. The traditional approach to addressing the attitude and capacity for market variability is to assess the client’s risk tolerance. The steep market downturn in the early 2000s emphasizes that risk tolerance needs to be more closely aligned with the reality of market variability and client financial objectives. One promising approach to exposing retirees to less market variability is asset-liability matching. This approach has been employed by major corporations and large pension plans to precisely match future cash-flow liabilities with fixed income assets. The application of asset-liability matching to individual investors may reduce sequence risk and better align investment portfolio asset allocation with client risk tolerance. Finally, the projection of household spending needs during retirement is a key input to personal financial planning. Actual consumer expenditure data suggest that the traditional assumption of rising income needs throughout the retirement period may not be appropriate. Research leading to improved assumptions for household spending patterns throughout retirement could lead to better investment and spending decisions by retirees.
References


Because the distribution of financial returns is lognormal, suitable transformations must be made to the financial return data in order to use the normal distribution and the standard deviation as an appropriate measure of risk.

Excel’s Solver facility utilizing linear programming optimization can be used to solve the matched funding investment problem. The approach is to minimize the objective function of total bonds outstanding subject to the constraint where annual household income needs to be funded from the investment portfolio equals bond maturity and coupon payments.

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A PRESSING ISSUE FOR FINANCIAL PLANNING

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ABSTRACT

The “practice” of financial planning has become more sophisticated in the past several decades. The use of quantitative techniques to develop mean/variance optimal portfolios and probabilistic simulation models of asset spending, for example, has provided an air of scientific validity to planning. Yet all the computer sophistication available to planners is of limited value without an accurate understanding of the client. Truly successful financial planning will require advancement in advisor ability to know the client.

Introduction

If a poll was taken to determine the most common questions asked by customers of advisors, we would see a list that included the following inquiries:

1. How should I invest my money?
2. Will I ever be able to retire?
3. Will I run out of money in retirement?

Certainly, these are all valid questions for a customer to ask an advisor. A central activity of any advisor is to help clients develop a plan for portfolio accumulation and a strategy for asset spend-down during retirement.

Rising Sophistication

In response to a population that is living longer and spending more years in retirement, in the past several decades the business of advising has made tremendous strides in being able to answer the above questions and others. From the advancements made in understanding risk (for example, Markowitz’s pioneering work on diversification and then extensions with the Capital Asset Pricing Model and mean/variance optimization), to the use of simulation analysis for asset spend-down projections, advisors are now able
to provide significantly more sophisticated recommendations to customers than at any previous time in history. Sophistication does not equal accuracy; yet sophistication and accuracy are not mutually exclusive. Even if projections of future events and outcomes have not become more accurate, we are at least better able to understand the likelihood of success in probabilistic terms.

A Vitally Important Dimension

Where the industry lags, and where the future of financial planning research needs to focus, is on the one key driver for successful planning of asset accumulation and asset spend-down. The foundation upon which any plan must rest, is for the customer to know thyself and for the advisor to know the customer. Specifically, knowledge of risk tolerance, the level of comfort a customer has with downside volatility, his/her willingness to bear the possible loss of principal while striving for upside potential, is imperative to successful planning.¹ Certainly, without this information, all planning takes on a great degree of randomness. Those three questions above can be answered only in a vacuum if the customer and advisor are uninformed of the customer’s ability to bear risk.

For those advisors who have doubts, imagine this scenario. A prospect meets with you. He is 40 years old, married, with three children, and wants to retire in twenty years. He has $250,000 of investable assets, plus he contributes $10,000 per year towards retirement. He is also concerned about college funding.

Essentially all advisors could answer for this prospect the three questions posed at the beginning of this paper. Answers could be either in deterministic or probabilistic terms.² There can be multiple solutions to these questions. But without knowledge of the prospect’s tolerance for risk, we have no way of knowing which solutions(s) are appropriate for the prospect. Is the proposed solution too aggressive or too conservative? Does it include securities inappropriate for this prospect or for which the prospect has discomfort? We only know with some degree of certainty that we can estimate a solution that will mathematically solve the prospect’s problem.

Recent Developments

In the past three decades, great strides have been made in theoretical and practical application to understanding risk tolerance and its determinants. From pioneering work in behavioral finance we have gained an appreciation that our clients often do not behave in a manner consistent with rational “economic” man.³ Research has identified “non-rational” client behavior attributes, such as overconfidence, “mental” accounting, cognitive disso-
nance, and numerous others. Other researchers, such as Hallahan, Faff, and McKenzie (2004, a,b); Grable (2000); Roszkowski, Snelbecker and Leimberg (1993); Sung and Hanna (1996); Grable and Lytton (1998), and many others, have provided insight into the attributes that influence risk tolerance. Demographic variables such as age, education, income, wealth, gender, marital status, and number of dependents have been identified as potentially significant factors in the level of a person’s risk tolerance. Questionnaires are available (unfortunately, some are of dubious quality), to help planners assess a prospect’s tolerance for risk. There is some lingering disagreement, however, over the direction of influence these demographic variables exhibit on risk tolerance. Thus, there remains lingering uncertainty about how to apply this research in practice. Finally, in a previous paper, I explored whether people have enough self-understanding to be able to accurately estimate their own tolerance for risk (see Moreschi, 2005). While results are still in the preliminary stage, gender (being male) and education both appear to be positively related to a person’s ability to accurately understand their own risk tolerance. Understanding the factors that determine a person’s level of risk tolerance is important for successful planning. Being able to identify which prospect’s are most likely to understand their own risk tolerance can facilitate this process.

Implications

The pressing problem in financial planning is not determining a quantitative solution to bring completion to a financial plan. Instead, the question planners must answer is, “out of all the feasible numeric solutions (asset allocation, security selection, etc.) that are expected to yield a satisfactory solution to a client’s problem, which solution is the best fit for the client?” Answered correctly, the financial plan becomes a solid foundation upon which the planner/client relationship thrives. Answered incorrectly, the plan becomes a source for misunderstanding, disappointment, and compliance problems.

Conclusion

Financial planning research has made tremendous strides in the past several decades. Our understanding of risk and return, coupled with computer software, allows planners to easily and efficiently develop investment plans. Planners now have the capability to quickly determine a numeric solution to a client problem. Whether this output is helpful depends on the quality of the inputs. If the planner is able to elicit pertinent information from the prospect about his/her risk tolerance, then the planning process has a good chance of success. Success measured not just in making the prospect a
client or in completing the financial plan, but ultimately in making the prospect a satisfied client.

As the business model for the securities and insurance industries continues to evolve from the transaction orientation of a traditional broker to the advisory orientation of a financial planner, research that helps the planner to know the customer better will gain continued importance. Additional research into investor behavior and risk tolerance will not insure that a financial plan dutifully followed will yield financial success. But, research into investor behavior and risk tolerance can increase the probability of a satisfactory and satisfying planner/client relationship.

References


1 There is considerable literature addressing the definition of “risk tolerance.” For example, see Cordell (2001) and Roszkowski, Davey, and Grable (unpublished manuscript).

2 We would also wish to know the amount of annual income the prospect wants in retirement along with a forecast of the expected rate of inflation and tax rates.

3 There are many accomplished behavioral finance authors including Kahneman & Tversky (1979); Thaler (1985); and Shefrin & Statman (1985). Two excellent books that provide readable overviews of behavioral finance are Shleifer (2000) and Nofsinger (2005).
BAD CHOICES IN EFFICIENT MARKETS: A JUSTIFICATION FOR THE STUDY OF PERSONAL FINANCE

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ABSTRACT

Insight into the disconnect between predicted household investment behavior and observed reality is provided in the current investment and personal finance literature. However, research into the barriers that prevent households from making choices consistent with their long-run financial goals is incomplete and presents a justification for closer examination of personal finance as a social science. A brief review of the literature exploring anomalies in personal finance is presented with a focus on investment studies that are not easily explained by efficient market theory. Since many of these anomalies may be particularly acute among investors with less financial sophistication, research that explores the predictable frailties of investors may shed light on the regressive effects of policy that increases personal responsibility among investors who are not able to navigate complex markets efficiently.

Introduction

Personal finance, or the study of financial resource allocation choices at the household level, has often been neglected in academic finance literature in favor of research that focuses on the characteristics of investment instruments with respect to a hypothesized (but often unobserved) set of individual preferences. The mounting empirical evidence that investors often do not behave according to the conventional set of theorized preferences presents both a challenge and an opportunity for financial planning researchers.

When investors make mistakes, it is assumed that more rational or informed investors will intervene in financial markets to force asset prices back to their fundamental value. Since asset prices are at their fundamental value, research that focuses on individual behavior is often seen as spurious since even blind choice leads to a portfolio of fairly priced investments and

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individuals cannot move markets. However, there is mounting evidence that as we focus more closely on individual investors we perceive behavior that results in choices that cannot be reconciled easily with the theory of efficient markets.

While prices may be efficient, inefficient choice leads to significant welfare losses as investors deviate from an efficient portfolio. This paper reviews a growing body of empirical literature that documents broad evidence of decision making among individual investors that appears contrary to efficient portfolio choice. Understanding common mistakes made by investors allows professionals to anticipate and guide clients toward often complex financial choices that are consistent with the client’s goals. Literature that sheds light on the inconsistencies and deficiencies of investors as they navigate the financial marketplace provides a roadmap for researchers to explore the causes of and solutions to welfare-reducing decision making anomalies.

**Rational Intertemporal Allocation**

The economist assumes households have a realistic and accurate idea of their future earnings path, an expectation of investment returns, and the return distribution of available financial instruments that is formed from past observation, and the ability to estimate the impact of income as well as the returns on assets on utility across time. Most families have no idea what their income path will look like, have little awareness of the financial instruments available, are not able to translate the marginal utility from consumption choices across time, and even the most knowledgeable investment experts cannot agree on how available financial instruments are likely to perform in the future. Viewed in this light, it is not surprising that households often choose not to invest in retirement plans unless placed in the plan automatically when hired (Choi, Laibson, Madrian, & Metrick, 2002), deviate significantly from what is theoretically predicted by the life cycle hypothesis (Ando & Kennickell, 1986), and allocate assets in a manner that is more a function of inertia and chance than a result of a consistent response to levels of wealth, income, and risk aversion (Madrian & Shea, 2001).

**Equity Premium**

Mehra and Prescott (1985) find that the relative risk aversion consistent with the excess returns of riskier financial instruments (stocks) between 1889 and 1978 is so remarkably large that they deem the failure to invest in stocks a puzzle. During this period, stocks outperformed short-term U.S. government debt by 6.2 percent per year. Further, it has been argued that because stocks tend to revert to their mean over time they are in fact less risky
than bonds among investors with a very long-run horizon, and that given past return patterns an optimal allocation to stocks for those with a ten year horizon is 100% (Barberis, 1999). This, of course, assumes the equity premium and long-run variance characteristics will persist.

One behavioral explanation for the large premium on equity versus risk-free investment is the tendency of investors to weigh the disutility of a loss more than the added utility of an equal gain. The aversion to losses, known as prospect theory (Kahneman & Tversky, 1979), is consistent with empirical studies of gambles and may explain the anxiety investors experience when their equity investments fluctuate in value.

Another market anomaly is the surprisingly large volatility of equity prices if one assumes that equity prices are simply the discounted future payouts of corporations (Campbell & Shiller, 1988). Either the discount rates or expectations about future dividend payouts must vary wildly on a daily basis, when in fact neither interest rates nor dividend payouts over time vary as much as volatile equity prices would imply. In a world of excess equity price volatility, loss aversion can create a tremendous amount of dissatisfaction among investors who are constantly monitoring the values of their portfolio. Benartzi and Thaler (1995) find the prospect theory can explain aversion to equity investment among those who reevaluate their portfolios on an annual basis. That most investors reevaluate with each quarterly statement is enough to explain enormous aggregate flows into and out of equity mutual funds every month.

There is also evidence that an investor’s loss aversion may depend on whether they are investing prior gains (Thaler & Johnson, 1990). This “house money” effect creates the illusion that the past gains represent easy money, while the original investment represents money earned. Thus, investors feel more comfortable about taking risks with their past gains than with their earned wealth – an effect that is not explained by traditional economic theory. It may also explain why investors tend to move toward increased equity investment over time as they feel they are merely taking risks with unearned winnings, despite the prediction that they will move toward bonds or other less volatile assets upon retirement. Conversely, there is evidence that investors are resistant to selling investments at a loss. Odean (1998) finds that investors are more likely to sell investments in their portfolio that have gone up in value while holding onto losers in the hopes of recouping their original investment.

Constant portfolio monitoring and the emotional response to wins and losses in the market may drive excessive trading behavior. Despite the existence of transaction costs, individual investors find it difficult to refrain from making frequent trades. In a study of individual accounts from a large brokerage firm, Barber and Odean (2000) find that excessive trading has significant adverse effects on mean returns of investors. Men in particular
Diversification

A portfolio that provides the highest expected return for a given level of risk consists of a diversified mix of assets. A mutual fund, for example, provides an easy way for an individual investor to create greater diversification at a lower initial investment. Individual investors, however, exhibit a surprising lack of wealth diversification. This may be partially a function of the complexity of selecting an efficient portfolio, which requires an awareness of the covariance among investment assets. Benartzi and Thaler (2001) observe that when presented with a list of mutual funds to choose from, many investors simply allocated their portfolio evenly among all available mutual funds rather than simply choosing a single diversified fund – leading to an aggregate portfolio that lacks diversification despite splitting money among a number of funds.

Many investors exhibit a “home bias” in which they prefer investing in geographically proximate stocks (French & Poterba, 1991). Even mutual funds seem to invest in firms whose headquarters are nearby (Coval & Moskowitz, 1999). Workers who invest in their employer’s stock are subject to extreme idiosyncratic risk as both their investment portfolio and their human capital are weighted toward the fortunes of one firm. Benartzi (2001) finds that nearly a third of assets in U.S. defined contribution plans are held in employer’s stock.

Return Predictability

The expected future rate of return on equities, although never certain, can be predicted to some extent by the current prices of stocks as a multiple of either dividends or earnings. Although often left unmentioned when professionals provide clients with estimates of expected stock returns based on average historical returns, history has provided evidence that stocks tend to provide higher yields if they are bought when their prices are lower and lower returns when their prices are higher.

How do we determine whether current stock prices are high or low? Fama and French (1988) use dividend yields (aggregate dividends divided by price or D/P) to predict future stock returns. They find that current D/P ratios predict as much as 25% of future (2-4 year) stock returns, and that a high ratio of dividends to price predicts higher returns and vice versa. The intuition is that when the cost of investment capital is high, stock prices will be lower. This is further supported by the correlation between D/P ratios and interest rates on bonds (Fama & French, 1989). In his book “Irrational Exuberance”
written in 2000, Robert Shiller noted that the peak stock price/earnings ratios occurred in 1901, 1929, 1966 and 2000. Although investors should have realized that the expected return (the cost of investment capital) was low, net new inflows into domestic equity funds increased by 64% from $188 billion in 1999 to $309 billion in 2000 (Collins, 2001).

One explanation for mutual fund flow behavior both on the aggregate and toward individual funds is what has been referred to as the representativeness bias, or the law of small numbers (Rabin, 2002). Investors place too great a weight on recent stock performance as representative of future returns. This “hot hand” phenomenon has been observed in basketball, where it appears that a player who just sunk consecutive shots is more likely to score on his next shot when in fact he is not (Gilovich, Vallone & Tversky, 1985). A strategy to outperform the market is to construct portfolios of extreme recent losers to take advantage of overreaction to recent events (DeBondt & Thaler, 1985), a strategy that outperformed the market by 19.6% in subsequent three-year periods.

**The Prior Returns Fallacy and Fund Marketing**

The use of prior return information holds tremendous intuitive appeal to investors. When shopping for a mutual fund, investors look to investment guides, advertising, or even SEC mandated prospectus disclosure to identify funds that have stronger recent or long-run returns. The intuition is that some funds are better managed than others, and that prior returns help investors identify the best funds. Studies of the flows of new investor funds to mutual funds with recent high returns show that investors are very willing to shift their money to last year’s winner and away from last year’s loser (Sirri & Tufano, 1998).

Zhang (1999) identifies some success of an investment strategy that involves the constant movement of investments to past winners among small funds in the short-run, however the strategy does not prove useful as a means of predicting long-run winners and involves a significant time cost. Jain and Wu (2000) find that mutual funds that advertise their superior past performance are not able to subsequently outperform the market. They do, however, attract significantly greater funds from investors.

Cooper, Gulen, and Rao (2003) find that when mutual funds change their names to a category favored by investors, for example from “growth” to “value” after the internet stock crash, fund inflows from investors increase significantly – even among funds that don’t actually change the composition of their portfolios. This is consistent with the hypothesis that investor demand for funds, and even individual stocks, is partially a function of the marketing of that asset and not necessarily a function of its fundamental value (or present value of future income streams). For example, firms that added the
term “dotcom” to their names experienced an average excess announcement (instantaneous) return of 74% (Cooper, Dimitrov & Rao, 2001). Of course, after the internet bubble burst firms that dropped dotcom from their names experienced a positive excess announcement return of 70% (Cooper, Korana, Osobov, Patel, & Rau, 2005).

**Conclusion**

Although there is abundant evidence that investors do not make the choices we predict, the social science of household-level investment choice remains an open frontier of investment research. We still understand very little about how wealthy families become wealthy over time, or whether aversion to risk and willingness to use more complex investment instruments is more a function of who you know and what you’ve experienced than your innate set of preferences. We understand little about whether the motive to save and to ignore market price fluctuations is a function of innate preference or simply a lack of knowledge. For every ten articles spent assiduously constructing utility functions that are consistent with observed behavior, there is one article that attempts to incorporate often unobserved heuristics, transaction costs, and cognitive difference that explain asset choice and wealth accumulation.

We also see little research on the policy effects of increasing individual responsibility for investments among households that require a large human capital investment to invest effectively. Increased individual responsibility for investment decisions among a broader set of investors inevitably leads to large dispersion in the ability to comprehend financial information. Only a small subset of investors understand the basic tenets of constructing a Markowitz efficient portfolio. Half of investors surveyed by the NASD understood that stocks had higher historical returns than other investments, and roughly one in five understood what a no-load mutual fund was (NASD, 2003). Future research in personal finance may require the creative application of existing consumer choice theory. In particular, the application of information economics and human capital theory to investment choice is strikingly absent from the extant investment literature. Investment knowledge is a component of human capital that requires a potentially enormous expense of time and effort to gain a marginal improvement in investment ability. The estimated present value of benefits received from additional knowledge will vary by wealth level and initial knowledge, and the estimated costs will be a function of ability, interest, and experience. It should be expected that the majority of financial mistakes are made by those who perceive the highest cost to financial education or the least benefit. It is likely that these investors will have less education, less wealth, lower earnings, and be more isolated from low-cost information sources. If so, the potential
welfare benefits to be gained by increased financial education, securities regulation, and information disclosure are immense.

References


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The number of financial education programs has grown rapidly in recent years. However, research measuring the effectiveness of these programs has not kept pace, primarily because of a continued lack of understanding among financial professionals about how to measure program impact to show that these programs are working. The lack of evaluation capacity has been compounded by a general lack of financial and non-financial resources available to conduct program evaluations. The result is that the empirical rigor of existing program evaluations is still far from satisfactory. In fact, only recently have a few studies attempted to present program impact within the context of a theoretical framework (i.e., Shockey & Seiling, 2004; Xiao et al., 2004a, 2004b).

Measuring program impact continues to be an issue of critical importance to financial professionals. Current economic trends and budget cuts have reduced the amount of funding and other resources available for providing financial education. At the same time, the market has become more saturated with financial education programs and thus more programs are competing for a smaller pool of resources. In determining how to allocate a limited amount of resources, funders are looking for factors that distinguish programs that are working from those that are not. It is no longer sufficient to report the number of programs delivered and the number of program participants. Funders want to see documented improvements in the ability of individuals to make sound financial decisions. Unfortunately, a significant number of financial education providers still do not have in place the evaluation capacity and resources to conduct more effective and rigorous evaluations, especially smaller, non-profit organizations (Lyons, Palmer, Jayaratne, & Scherp, 2005).

The objectives of this article are three-fold: (a) to provide an overview of current evaluation methods, (b) to discuss the challenges financial professionals face in conducting more rigorous program evaluations, and (c) to identify the potentials for improving existing evaluation efforts by making recommendations as to how the financial education profession can realisti-
cally overcome these challenges and conduct more effective program evaluations. Improving program evaluation results in better programs and initiatives, which in turn lead to an overall improvement in the financial well-being of families and the economic vitality of their communities.

The next section presents a brief overview of the literature related to financial education and program evaluation and new methodologies being used to measure program impact. A discussion of the challenges associated with conducting program evaluations and how these challenges can be overcome then follows. The final section discusses the realities of program evaluation and their implications for the future direction of evaluation research.

**Translating Financial Education into Behavior Change**

Recent program evaluations examine the relationships between financial education, knowledge gain, and behavior change. For an overview of the literature and the findings, see Bell and Lerman (2005), Braunstein and Welch (2002), Fox, Bartholomae, and Lee (2005), Hilgert, Hogarth, and Beverly (2003), Hogarth (2002), and Hogarth, Beverly, and Hilgert (2003), National Endowment for Financial Education (2002, 2004), Lyons et al. (2003), and Lyons et al. (2005).

In general, the literature provides evidence that financial education generally results in positive financial outcomes. Specifically, with respect to financial counseling, studies indicate that clients show significant improvement in their financial behaviors following financial counseling. For example, Staten, Elliehausen, and Lundquist (2002) tracked credit counseling clients for 3 years and found that those who received counseling were able to reduce their debt, improve their credit card management, and lower their delinquency rates by more than those who did not receive counseling. Hirad and Zorn (2001) found that borrowers who participated in pre-purchase homeownership counseling had a 19% lower 90-day delinquency rate than those who did not receive counseling.

While the general consensus from the literature is that financial education positively affects financial outcomes, it is important to acknowledge that the findings are far from conclusive, especially with respect to the direction of causation. There are many inconsistencies in what is being measured and how it is being measured. Many of the inconsistencies are due to a lack of understanding of what it actually means to be “financially educated,” as well as the process by which one becomes financially educated (Lyons et al., 2003). Hogarth (2002) identified several consistencies across the various definitions of financial education and found that individuals who are “financially educated” are: (a) knowledgeable, educated, and informed on issues of managing money and assets; (b) understand the basic concepts
underlying the management of money and assets; and (c) use that knowledge and understanding to plan and implement financial decisions. Essentially, the process of becoming financially educated can be defined as the gains in financial knowledge that render an individual financially educated and subsequently result in behavior changes that lead to the individual making more effective financial decisions (Lyons et al., 2003). The question financial education providers struggle with is how do we accurately measure this definition? In other words, how do we translate financial education into behavior change?

The Transtheoretical Model of Change (TTM)

There is a small, but growing body of literature that looks at financial education and the process of behavior change within the context of a theoretical framework—the Transtheoretical Model of Change (TTM). This model, which is based on the work of Prochaska (1979) and Prochaska and DiClemente (1983), integrates major psychological theories into a theory of behavior change. The model was initially used to help individuals stop negative health-related behaviors such as smoking, alcohol and drug use, and over eating or start positive behaviors such as exercise and other preventative health behaviors (Prochaska, DiClemente, & Norcross, 1992a, 1992b; Prochaska et al., 1994). It was found that successfully ending a problem behavior, or starting a positive behavior, involved working through a series of stages, with individuals commonly relapsing before successfully eliminating or implementing the behavior change. To provide a quick summary, TTM includes five stages of change:

- **Precontemplation**—Individual is not ready to take action and change behavior in the next six months; individuals in this stage will rarely seek help and use information.
- **Contemplation**—Individual is getting ready to take action and intends to change behavior in the next six months; individuals in this stage become open to educational processes.
- **Preparation**—Individual is ready to take action and intends to change behavior in the next 30 days; individual practices the behavior by taking small steps towards the goal; individuals in this stage will seek information and support, but often have concern that the process of changing may be difficult and they may not succeed.
- **Action**—Individual actually changes behavior, but made behavior change less than six months ago; individuals in this stage need to believe they can change, be able to control the stimuli that could cause them to relapse into old behaviors, and create a support system to get them through the challenging times.
• **Maintenance** — Individual has overtly changed their behavior and it has lasted for more than six months; individuals in this stage often relapse into old behaviors and must be committed to overcoming these temptations for the new behavior change to become permanent; individuals in this stage need to be able to assess the conditions under which relapse might occur and they need help establishing successful coping strategies.

According to the theory, effective programs identify the stage at which the individual is ready and able to change his/her behaviors. They then apply appropriate educational interventions that are tailored to meet the individual’s specific needs at that particular stage.

Researchers have recently begun to apply the TTM framework to examine changes in financial behaviors (i.e., Shockey & Seiling, 2004; Xiao et al., 2004a). Xiao et al. (2004a) used the TTM framework to develop a valid and reliable measure that could be used to assess readiness to reduce credit card debt for individuals experiencing credit card debt problems. They used qualitative and quantitative information collected from experts in credit counseling and from consumers with credit card debt problems to develop the measure. The measure included eight items for decisional balance, six items for self-efficacy, and 24 items for processes of change. External validity tests of the measure provided evidence of the validity of applying TTM to consumer debt behavior.

In another study, Shockey and Seiling (2004) used TTM to specifically assess change in six financial behaviors over a four-week period for individuals enrolled in an IDA financial education program. The six financial behaviors included: setting financial goals, using a spending plan, tracking spending, reducing debt, setting aside money for unplanned expenses, and saving money. Prior to the program, they found that program participants were, on average, at the stage of action with respect to reducing debt and at the stage of preparation for all other behaviors. Therefore, it should not be surprising that participants’ experienced the smallest change for the behavior that was associated with reducing debt and the largest change for setting aside money for unplanned spending.

Studies such as Shockey and Seiling (2004) and Xiao et al. (2004a) typically apply the TTM framework to financial behavior change using the following steps: (a) identify the causes of the individual’s financial problems; (b) identify the most problematic financial behaviors that the individual needs to change; (c) define the targeted and desirable financial behaviors; (d) identify the stage at which the individuals is at with respect to each of the problematic behaviors; (e) apply the appropriate intervention strategies to match the stage of change for each behavior; (f) regularly monitor the individual’s progress using an index that captures the individual’s movement from one stage to the next; and (g) follow the individual until the stage of maintenance has been completed (usually 18 months).
It is important to note that TTM is just one of an emerging number of frameworks being used to explain how individuals translate financial education into positive behavior change (i.e., the logic model, results-based accountability-RBA, theory of change-TOC). This paper focuses on TTM, because it is one of the more popular models currently being used by researchers to measure the impact of financial education. However, it is not without its limitations. For example, the model does not adequately take into consideration the fact that individuals who are ready to change may have personal and environment barriers that prevent them from making a financial change (i.e., limited access to financial services in their community or changes in life circumstances). Yet, even with this and other limitations, TTM provides a promising foundation to financial professionals who are looking for a more rigorous, theory-based approach to program evaluation.

**Challenges and Potentials in Conducting Rigorous Program Evaluations**

While the movement among researchers has been to conduct more rigorous program evaluations, a further review of the literature reveals that there are several challenges and barriers currently preventing financial professionals from moving in this direction. These challenges can be grouped into five main categories: defining program success, choosing appropriate outcomes and indicators, fostering program participation, designing and implementing evaluations, and finding financial resources. For an overview, see Bell and Lerman (2005), Fox, Bartholomae, and Lee (2005), National Endowment for Financial Education (2004), US Government Accountability Office (2004), and Lyons et al. (2005).

**Defining Program Success**

The major question the profession is currently struggling with is “how do we define program success?” Measuring the effectiveness of financial education is not easy. There is little consensus within the profession on what measures should be used (Lyons et al., 2003; Lyons et al., 2005). Many programs are still evaluated using “program output” criteria such as the number of program participants, number of programs delivered, and number of educational materials distributed. However, these measures do not adequately capture program impact since they do not provide clear indicators of whether program participants have gained knowledge or changed their behaviors as a result of the program.

Current evaluation research places less emphasis on general indicators such as the number of program participants, their levels of satisfaction, and knowledge gained. Instead, research has shifted towards using
more specific measures that focus on changes in skills and confidence levels and changes in intended and actual behavior (i.e., Braunstein & Welch, 2002; Fox, Bartholomae, & Lee, 2005; Hilgert, Hogarth, & Beverly, 2003; Hogarth, 2002; National Endowment for Financial Education, 2002). Examples of specific indicators have included savings rates, debt levels, wealth accumulation, delinquency and bankruptcy rates, credit scores, investment strategies, account enrollment, homeownership, and participation in retirement savings plans. Some of these indicators have been used to capture actual dollar changes in individuals’ financial portfolios such as increases in savings and income and reductions in debt and expenses. Other indicators have focused on the development of financial plans, changes in spending habits, and building or rebuilding credit reports and credit scores.

Given the wide range of outcomes and indicators, how can financial education providers “successfully” show program impact? The definition of ‘success’ is not the same for all programs or target audiences. Financial professionals need to choose outcomes and indicators that are appropriate to the financial capabilities of their target audiences. They also need to focus on identifying the key outcomes of the program and avoid getting overwhelmed with a vast number of indicators.

Choosing Appropriate Outcomes and Indicators

Lyons and Scherpf (2004) point out that the best measures of program success are those that capture whether program participants have the knowledge and skills to change behaviors that are relevant to their particular financial situation. Some individuals or target populations, because of their particular financial situation, may not be able to change certain financial behaviors no matter how much financial education they receive. For example, low-income audiences will find it more difficult than middle-to-upper income audiences to meet certain program goals such as increasing savings and paying bills on time and in full. In these instances, financial education providers may want to design evaluations that focus on knowledge and behavior outcomes that are tied less to individuals’ financial situations and more to whether they are able to make sound financial decisions regardless of their financial situation (i.e., setting financial goals, comparison shopping, budgeting, reviewing credit report, protecting financial information).

Participants’ ability to change their behavior may also be constrained by environmental or community factors. For example, suppose the desired outcome is to encourage low-income populations to enter the mainstream financial system, and assume they are in a financial position to do so. These individuals may still rely on alternative (fringe) financial services if there are no mainstream institutions available in their communities (NEFE, 2004). Consider other examples where personal knowledge and experiences may
hinder behavior change even though it may be in the individual’s best interest to change. For instance, the desired outcome of most savings and investor education programs is to increase savings. However, as Bell and Lerman (2005) point out, “…while savings may make sense for most people, it may do little to increase financial security if people lack the knowledge about how to invest in low-risk assets and the implications of investing in high-risk assets.”

Financial education providers also want to be aware that an individual’s current situation may prevent them from putting into practice every lesson in a particular program. With this said, an individual’s situation may eventually improve to a point where they can successfully implement some of the practices and behavior changes that seemed “out-of-reach” at the time of the program. For this reason, financial education providers want to distinguish those behaviors that can more easily be changed in the short run from those that require more fundamental changes in other aspects of participants’ lives before they can be realized. If financial education programs focus solely on behavioral indicators that participants have little chance of implementing in the short term, participants may view the goals of the program as unattainable. Some participants may even become discouraged and not take any action to change their behaviors.

**Fostering Program Participation**

Financial education providers with well-designed evaluations can still face a number of challenges, especially when it comes to collecting impact data from their target audiences. Program participants often have little incentive to complete evaluations, much less to complete them accurately (Lyons et al., 2005). Monetary incentives can provide some motivation, but this solution can quickly become cost prohibitive, especially for smaller organizations with limited resources.

Recall also that the market has become more saturated with financial education programs. At the same time, grant recipients are increasingly being asked to provide more detailed and rigorous documentation to funders to show that their programs are in fact working. The result is that program participants are completing more paperwork and longer surveys, and they are starting to feel “over-surveyed.” Participants are also increasingly being asked to provide what may be construed as sensitive information (i.e., current income, net worth, specific assets and debt holdings). They are often reluctant to divulge personal information, especially low-income participants in programs sponsored by social service agencies, government agencies, or financial institutions. The fear is that the information they report (i.e., income, assets, debts) could possibly lead to the loss of public assistance or other benefits.

There are added complications such as some populations are difficult to track and have higher program drop out rates (Lyons et al., 2005; Lyons &
Scherpf, 2004). Other populations are constrained by issues related to low literacy levels, which limit the amount and type of information that can be collected. All of these factors reduce response rates and increase the likelihood of measurement error.

Many financial professionals have found that they are able to increase response rates and reduce measurement error by designing evaluation instruments that are short and simple. According to Lyons, et al. (2005), financial education providers found that shorter evaluations, which fit on the front and back of a sheet of paper, are more effective than longer survey evaluations. However, shorter surveys limit the ability of researchers to conduct more rigorous evaluations. Thus, financial professionals need to carefully weigh the tradeoffs between increasing participation and increasing rigor, and create evaluations that best meet the needs and limitations of their target audiences.

Designing and Implementing Evaluations

Researchers tend to define rigorous evaluations as those that not only have a theoretical foundation, but that also have control groups and a longitudinal component. The use of control groups has primarily been encouraged as a way to control for possible sample selection that may bias the results of the program. For example, it may be that only individuals who are motivated to change their behaviors participate in the program and see it through to the end. However, these individuals may not be representative of the target population as a whole. Comparing control and treatment group outcomes (where one group receives financial education and the other does not), helps to mitigate possible selection bias arising from the fact that entry into most programs is voluntary and perhaps non-random. Combining control groups with a longitudinal approach is even more ideal, because it allows one to follow participants and non-participants over time to assess the long-term impact of financial education programs.

Unfortunately, this level of “rigor” may not be realistic for most organizations (Lyons et al., 2005). Many financial education providers lack the resources to conduct these types of long-term evaluations. For those that have the resources, it can be particularly time and labor intensive to set up a random assignment experiment and track participants over time, especially those populations that are more transient in nature (i.e., low-income audiences, immigrant populations).

As future evaluation research moves towards conducting more longitudinal and random assignment experiments, financial professionals need to recognize that the logistical and financial barriers to carrying out such studies can be quite high and not all organizations are in a position to do so. For this reason, it is important that, while the profession continues to push for
increased rigor, it also continues to recognize the value of more traditional methods such as retrospective pre-tests (RPT), pre and post tests, and qualitative surveys that collect best practices and success stories. These types of studies, while imperfect, still provide useful insight into the effectiveness of financial education programs, and their value should not be discounted.

**Finding Resources to Conduct Rigorous Evaluations**

Perhaps the biggest barriers to conducting more rigorous evaluations are related to the lack of time, staff, and financial resources available to financial professionals for conducting evaluations. Relative to operating expenses, program evaluations can be expensive to conduct since they are often labor intensive. They can also be time intensive. According to Lyons et al. (2005), financial education providers report that a considerable amount of time is required to administer and process evaluations and the process is often cumbersome.

One way to overcome the challenges associated with limited resources is for financial professionals to be more strategic in their evaluation planning. For example, instead of evaluating several programs, they may want to pool their resources and focus on evaluating their “signature” programs (i.e., those they are best known for) or those that have the greatest potential for showing long-run impact. The focus should also be on allocating resources to evaluating multi-session programs that occur over a series of weeks or months rather than short-term programs that may last less than two hours. Professionals also want to consider partnering and pooling resources with groups and organizations that are delivering the same or similar programs. Finally, they may want to look for opportunities to partner with evaluation researchers, who they can work with to seek out and apply for funding for both program delivery and program evaluation.

**Building a Future for Evaluation Research**

Many of the challenges described in this paper can be addressed by building evaluation capacity within the profession. One way to build capacity is to develop a more standardized and consistent approach to evaluation at the national level. Recent studies suggest that such standards can increase the effectiveness of program evaluation nationwide and help the profession to better make comparisons across programs so that best practices can be identified and replicated (Fox, Bartholomae, & Lee, 2005; Lyons et al., 2005; U.S. Government Accountability Office, 2004). The challenge is in creating a standardized approach that is flexible enough to account for the wide variation in programs, delivery methods, and target audiences.
A starting place might be for the profession to develop a set of national evaluation tools. This set of “tools” might include an evaluation website that could serve as a “one-stop” shop, where financial professionals could go to find survey instruments, best practices, online training workshops, and other evaluation resources and materials. The website could be particularly useful if it included an online tool to help financial professionals create evaluation instruments, enter and analyze evaluation data, and package the results in a way that is useful and meaningful to funders and other organizations.

The set of evaluation tools might also include a series of national training workshops/seminars on how to effectively measure program impact. These trainings could occur via the Internet, teleconferences, “webinars” (combination of Internet and teleconference), and/or satellite programming. There are also opportunities to offer trainings prior to, or during, professional meetings and conferences. At the very least, the profession can hold special forums and discussion sessions during these events to bring national awareness to emerging issues related to financial education and program evaluation.

The profession could also benefit from having a journal or other periodical similar to The Evaluation Exchange sponsored by the Harvard Family Research Project (http://www.gse.harvard.edu/hfrp/eval.html). The Evaluation Exchange is a periodical on emerging issues facing program evaluators in the area of child and family services. It is designed to serve as a discussion forum for prominent evaluators, program practitioners, funders, and policymakers in the field. The Evaluation Exchange highlights innovative methods and approaches to evaluation, emerging trends in evaluation practice, and practical applications of evaluation theory. A similar publication in our own profession could go a long way in increasing evaluation capacity and the rigor of program evaluation. It could also go a long way to bringing more national attention to the importance of program evaluation and to identifying best practices within the field.

With respect to best practices, the profession has been fairly successful in identifying quality financial education resources (i.e., curricula and other materials) and effective delivery methods. Yet, the profession has not been as organized in establishing a list of best practices that identifies “successful” program evaluations that show meaningful impact. Creating a list of national experts/researchers in program evaluation, within and outside the area of financial management (i.e., evaluation specialists, researchers specializing in TTM), could also be useful. Such experts could serve as a valuable resource as the profession moves towards developing more rigorous evaluations.
Concluding Remarks

The objectives of this paper have been to (a) identify some of the latest evaluation methods and the challenges facing financial professionals in implementing them, and (b) provide some practical recommendations for how the profession can overcome these challenges and build evaluation capacity. However, this discussion is far from complete. Further discussion is needed about the future direction of financial education and program evaluation and what can realistically be done to overcome the challenges and implement more effective evaluations.

As the profession continues to move forward, financial professionals need to be cognizant of the issues raised in this paper. Future discussions need to take into consideration the constraints facing financial education providers. In particular, financial professionals need to think carefully about what these constraints may mean for financial education providers who are strong in program development and delivery but may not have the expertise and resources to increase the rigor of their evaluations. For example, evaluations that include control groups and a follow-up component may be realistic for organizations that have sufficient staff, time, and financial resources to carry out large-scale evaluations. However, these types of evaluations may not be realistic for groups and organizations with limited resources and evaluation capacity. Researchers need to be particularly cognizant of this when helping financial education providers plan and design evaluation instruments. Policy makers and funders need to be aware of this when determining future evaluation policies and the allocation of project funding. All in all, more thought and planning needs to be given to program evaluation up front as programs and initiatives are being developed.
References


HEALTHCARE COSTS AND BENEFITS: A FUTURE DIRECTION FOR FINANCIAL PLANNING RESEARCH

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ABSTRACT
At present, health care costs in the U.S. consume almost 15% of GDP, with large annual increases in dollar terms forecast for the foreseeable future. Individuals who want to effectively control their health care costs must consider complex savings, insurance, and health behavior decisions. These decisions inherently rest on personal financial planning principles and practices. We propose more emphasis on future financial planning research which refines, expands, and focuses the body of knowledge needed to ensure that individuals and their advisors make optimal health care decisions. Examples for further research and benefit cost modeling include making the long-term care insurance purchase decision, using high deductible insurance policies and health savings accounts, paying for innovative medical tests such as body scans, and using labor intensive technologies (e.g., walking and cycling to work) to obtain more consistent exercise.

Introduction

Individual financial planning for health likely will become increasingly important, particularly for persons in upper income households. Presently, health care in the United States consumes nearly 15% of GDP, about double the rate of other advanced countries. Rapid increases in medical technology probably will increase demand for services faster than it decreases costs. Thus, medical costs probably will continue to increase faster than inflation. Employer group insurance and then Medicare may cover most, but not all, of these costs, and many individuals, even from upper middle
income families, may find they can not obtain employer group insurance. Moreover, medical markets including insurance are in rapid flux, and the future shape of the system remains unclear. This stems partly from relatively poor health outcomes and inequities in accessing health care systems, in spite of high per capita expenditures.¹

Thus, prudent individuals who want optimum control over their health care decisions will face complex savings, insurance, and health behavior decisions in the future. Such decisions fall into the general area of financial planning and can benefit from financial planning research and models which incorporate such medical decisions. This paper will suggest some areas of medical financial planning research for individual decision making. The first section of the paper discusses research and models for long-term care costs, potential impacts on family assets, and insurance strategies. The second section deals with high deductible or catastrophic health insurance policies and health savings accounts to cover routine medical costs. The third section suggests benefit cost models for innovative medical testing, such as body scans, not presently covered by most insurance policies. The fourth section illustrates benefit cost models which show how exercise (e.g., walking or cycling to work), a very important individual health behavior, can substitute for costly capital equipment (e.g., a second or third car). Such current health behaviors not only can reduce long-term individual health costs, but they can also save funds for future health care (e.g., long-term care insurance, medigap insurance, and health savings accounts).

**Long-Term Care Costs and Insurance**

Long-term care (LTC) and LTC insurance generally is used in situations where individuals can not perform two of five basic daily living activities, such as eating, bathing, toileting, or transferring from one activity to the other (National Association of Insurance Commissioners, 1999). The LTC risk and ways to individually manage it has begun to receive attention in financial planning research (e.g., Everett, Anthony, & Burkette, 2005) for several reasons. First, the risk of spending five years or more in an expensive full-service nursing home for a 65 year old hovers around 10% (Spillman & Lubitz, 2002). This may increase with life prolonging medical technologies, although other technologies which allow independent living for severely impaired individuals and less costly institutions, such as assisted living, may partially offset this tendency.

Second, government funds for LTC may become daunting in the future. Medicare pays for very little LTC now. The strategy of deliberately spending one’s assets down or giving them away to relatives to qualify for Medicaid funded LTC is becoming less attractive. States are instituting look-back laws to collect asset giveaways and state budget crises are squeezing
Medicaid spending, which means funds for LTC may be less certain. Third, with the continued break down of the nuclear family, low birth rates, and dependency on two-income families, help from adult children continues to become less reliable (Warren & Tiyagi, 2003).

Models of financial planning can analyze the ability to self-insure (i.e., finance) possible LTC costs. For example, we used a retirement asset and income projector model, which users could run over different historical time periods, to analyze how quickly LTC costs might exhaust retirement assets (Everett & Anthony, 2002). The model runs found that most upper middle income individuals who incurred long nursing home stays would exhaust their assets in five to ten years. This posed a “not insignificant risk” (1-2 %) that future LTC costs could exhaust assets and perhaps substantially lower a spouse’s retirement income.

Although our work made a prima facie case for persons in their fifties to seriously consider LTC insurance, uncertainties in the LTC insurance markets remain. Are these reasonably viable and efficient markets? Or, will self-selection and moral hazard mean persons who expect to become incapacitated tend to predominate in the purchase and retention of LTC insurance, which could rapidly increase insurance costs and premiums? What kinds of policies can strengthen the LTC insurance markets and make them more efficient? These are important financial analysis questions essential for informed individual decisions in the purchase of LTC insurance.

**High Deductible Health Insurance and Health Savings Accounts**

Like LTC insurance, high deductible health (HDH) insurance and health savings accounts represent a relatively new government program (see http://www.treas.gov/offices/public-affairs/hsa/pdf/hsa-basics.pdf) to encourage HDH insurance. Since the advent of modern health insurance around World War II, low deductible health (LDH) insurance through a large employer has come to dominate the health insurance individual. This resulted partly because increased health insurance benefits constituted a lower cost, tax-excludable way to increase worker compensation as opposed to taxable wage increases (Getzen, 2004). LDH insurance also represents a paternalistic approach to encourage individuals to obtain all the medical tests and treatment which the medical profession recommended. This assumes most individuals do not have the knowledge to decide when a condition (e.g., a sore throat) is best cured by itself or needs medical attention (e.g., a strep infection which could lead to heart problems particularly in children).

Several important problems have arisen with this LDH insurance approach. First, it may have contributed to the insured consuming too much medical care and not shopping for price advantage because the marginal cost
to the individual was very low (low deductible and then low co-payment). Managed care companies have arisen to assume this rationing and price control role. Second, many individuals can not obtain efficient, reasonable cost employer-based health insurance. Some are unemployed but not eligible for Medicaid, even though they receive low incomes (around $10,000 a year). Many own or work for small companies which can not spread the risks over enough employees, and thus, can not obtain efficiently priced health insurance. Some of those could afford but choose not to buy expensive individual LDH insurance policies. Thus, about 15% of the U.S. population does not have health insurance.

Many of the above described individuals and/or their parents or other family members could purchase HDH insurance and contribute to health savings accounts (HSAs). The decision involves financial planning and expertise. Basically, the coverage has deductibles ranging from about $1,000 to $5,000. The insured or someone else can contribute to an HSA, which the insurance company administers as a custodian, up to the deductible limit (for details see Lyke, Peterson & Ranade, 2004). The individual pays for routine health care costs, including dental and eye glasses, with a card which draws on the HAS. Individuals enjoy the negotiated price reductions the insurance company has established for insurance reimbursements. Any remaining funds in the HSA roll over to the next year and can be withdrawn at retirement. No taxes are paid on the HSA, which the individual may invest in a range of financial instruments, unless the funds are used for non medical reasons.

The financial planning issues become important because of the significant costs and potential benefits. The costs are high — around $3,500 a year — in the above example, including contributions to the HSA, and they will increase with age. But, the benefits are also high. Major medical costs in the tens to hundreds of thousands of dollars can not only bankrupt middle and upper middle income/wealth families, but they can also impose long term payment obligations which might seriously reduce families’ future net earning ability. Warren and Tyagi (2003) present general data on some of the legal consequences of medically induced bankruptcies in this area, but individuals need more specific information for financial planning.

For middle and upper income families with children pursuing nontraditional careers with no group insurance, HDH insurance constitutes an interesting financial planning problem. If the parents pay the premiums, they may approximate LTC insurance premiums for a couple nearing retirement. The benefits, however, also may be high. If an adult child needed extensive care in the $100,000 range, the parent might well become drawn into paying part of the bill. Otherwise, the child might not receive adequate care or might become straddled with a large debt well into the future. How might such a debt affect the child’s ability to establish a well-paying career? What collection rights might a creditor have on future possible inheritances? How would paying off the medical debt affect the parents’ retirement assets and income?
Innovative Medical Test not yet Covered by Insurance

Medical tests such as body scans for circulatory diseases or incipient cancer provide another important and interesting financial planning decision area. Insurance providers usually do not pay for such tests until double blind prospective studies (start with randomized experimental and control groups and follow them often for many years) show that the tests reduce overall (average) morbidity or mortality over large numbers of individuals. Often the tests are too new for such study results. Also, such tests may lead to more expensive follow up testing and would be very expensive for the overall health care system. On the other hand, average outcomes gloss over the many individual outcomes which do improve health. Thus, it may make sense for individuals to spend their own money on such tests, even with the medical uncertainty. Setting aside money to take advantage of such innovative tests, which insurance probably will not cover, then becomes a financial planning issue. Is this decision like buying major (i.e., high deductible catastrophic) umbrella liability, homeowners, or health insurance for risk averse individuals? Individuals expect to lose more in insurance premiums than they will gain in insurance pay offs. They prefer to take this relatively small certain loss (the insurance premiums or medical test costs) than to take even a small chance of a large loss (e.g., lose a house to fire or not detect a major health problem in time to correct it).

The “Track Your Plaque” (TYP) approach (Davis, 2004) illustrates many of the financial planning medical issues involved in such personally financed innovative tests. The TYP approach recommends that middle aged individuals should undergo a simple, non-invasive calcium scan of their coronary arteries. Calcium apparently correlates well with plaque build up and provides a much more reliable indication of incipient or even advanced plaque build up than traditional cholesterol tests. Thus, a high calcium score may motivate an individual to start paying close attention to plaque control just as a visit to a financial planner might jolt an individual into saving more for retirement.

However, insurance policies generally do not cover calcium scans for reasons stated above. Although initial testing has become relatively cheap ($100 to $400) with many scanning centers offering competitively priced scans at marginal costs, high scores can lead to expensive testing which insurance generally does cover. If evidence of plaque buildup exists for a 40 year old male, for example, the TYP approach would recommend more detailed blood tests which deconstructs LDL and HDL cholesterol into size and number and also measures other blood components such as C reactive protein and homosysteine. Again, insurance usually will not pay for these tests but they generally cost under $200 total (see the NMR Lipo Profile Test at http://www.liposcience.com). Then the individual, along with their physician, can
address variables which are out of line with lifestyle changes (e.g., diet and exercise), supplements (e.g., vitamins C and B and fish oil), and aggressive use of statin drugs if necessary. Insurance generally will pay for the drugs but not the supplements. If the scans indicate very high levels of calcium, individuals may also take exercise stress tests and then, if advisable, undergo invasive catheterization to look directly into the arteries. The costs of these tests can become substantial ($3,000 to $12,000), and insurance usually covers them. If the catheterization indicates the necessity of angioplasty or artery replacement, insurance usually would cover those high costs also.4

A financial planner probably would advise an individual who can take control of their health behaviors to spend the $300 to $500 for the preliminary tests, just as they would advise an individual to spend similar amounts for a financial analysis. A middle aged or even older individual who gets good information may be able to make corrective actions which could give them longer, healthier lives with lower future medical expenses, pain and suffering, and lost productive time.

On the other hand, like in financial analysis and planning, considerable uncertainty over the meaning of the TYP analysis and effectiveness of the recommendations may remain. Although the literature indicates high correlations between sex-and-age adjusted calcium levels and plaque build up, the scans do not indicate the degree of blockage or type of plaque. Rather than slowly blocking off arteries, plaque may push out the exterior artery wall leaving the inside of the artery (lumina) open. Yet soft plaque in the artery wall poses a danger of erupting through into the lumina, forming a clot that can cause a heart attack or the plaque in the artery wall may be stable with fiber and calcium, which presents an uncertain situation.

New scanners and software are emerging which can view the artery wall in a relatively non-invasive, relatively low cost manner and perhaps can assess narrowing of the lumina without an invasive and expensive catheterization (Bernd, et al. 2005). If the latter could constitute a very high benefit, then, medical and financial advisors probably would recommend such a test. However, if the test could only detect plaque in the artery walls, advisors probably would not recommend it. Cardiologists would not recommend treatment like putting in a stint as a shield against a plaque filled artery wall erupting into an open lumina. The stint would have potential for creating plaque build up in the lumina and eventually closing up the artery. Thus, such further individually funded tests would neither lead to viable medical procedures nor make financial sense for the individual. Rather the individual should aggressively pursue good cholesterol and other blood component numbers (plus other good health behaviors such as diet and exercise) and attempt to stabilize or reverse the plaque build up.

Total body scans, which might reveal numerous other problems, can amplify the complexity of the testing decision both for the individual and society. Small nodules on the lungs may either be totally normal, or they may
indicate incipient cancer currently treatable but non-treatable if left unchecked. The next test may involve invasive surgery with long recovery time and much pain and suffering, perhaps paid for by insurance. Having the information but foregoing the surgery may create extreme anxiety even with periodic body scans for close observation. Also, many individuals will not follow up on low cost scan results with changed health behaviors or further cost effective tests.

These actions constitute similar problems which financial planners face with their traditional clients. Will the client act on advice even when outcomes seem fairly certain? And how will clients behave in the face of uncertainty which abounds in the financial area because no one knows how different financial markets will behave in the future? Thus, the financial planning field should have good decision approaches for the medical testing and decision making field. For example, people who would generally not act on individual financial (or medical) analysis and advice should rely on more paternalistic guidelines like general medical protocols and social programs, such as Social Security and group insurance or Medicare and Medicaid. Only proactive individuals who can take charge of their financial and medical decisions should seek and receive personalized advice on both financial matters and proactive medical testing/procedures.

**Health Behaviors and Financial Planning Analysis**

Several important health behaviors involve personal financial planning implications. The future value of funds potentially saved by not smoking represents an easy calculation. Healthy diets represent more complex financial issues. Healthy unprocessed foods may be cheaper but require extra preparation time which can become very expensive. Thus, the movement from unprocessed to quickly prepared, low cost processed foods may help explain the increase in obesity (Cutler, Glaeser & Shapiro, 2003). Organic foods generally are more expensive while their health impact remains unclear. The costs and benefits of obtaining adequate sleep also present complex financial analysis problems. Although research shows the value of regular sleep for health and productivity (Lambert, 2005), the opportunity cost can become very high for students, young professionals, or emergency workers. Substituting labor intensive technologies (LIT) for capital intensive technologies (CIT), not only, can induce consistent life long exercise but also, can save substantial sums of money.

This paper uses the LIT versus CIT decision to illustrate some of the challenges in analyzing the costs and benefits of health behaviors. Many medical researchers have concluded that consistent life long exercise constitutes the most important health input on the average. Present medical research indicates that going from sedentary to moderate exercise could
reduce overall death rates about 40%. Persons going from moderate to vigorous exercise could lower death rates, at least from coronary heart disease, by another 15 to 30% on the average, although they may increase injuries in the process. If everyone got at least moderate exercise, that would save about 250,000 lives a year in the U.S.5

Many opportunities exist for efficiently substituting labor intensive activities for expensive capital intensive ones, particularly if an individual includes the current and long run health values of exercise. A few examples include: cycling or walking for short trips versus driving; using high tech, hand push, reel or electric lawn mowers instead of self-propelled or riding gas mowers; and, of course, many recreational activities such as paddling a kayak rather than using a power boat or cross-country skiing instead of down hill skiing.

Developing models and empirical data for these alternatives remains challenging. On the cost side, we need models which incorporate the long run capital costs, intermediate programmed costs (e.g., insurance, boat slips), and variable costs of the various alternatives activities. These may be relatively straightforward for many alternatives, such as cycling or walking versus driving, but must include all the relevant costs such as the opportunity costs of capital, time costs, risks of injury or death, and disutility.

Table 1 provides a hypothetical example for an individual who lives in the Hyde Park area of Chicago, about five miles from the downtown Loop. He/she could commute to work at the edge of Millennium Park near the Loop by public transportation (bus or rail), by cycling on a safe bikeway along Lake Michigan to a bike parking station with showers (also on the edge of Millennium Park—Randolph St. Bike Station) or by purchasing a second car for the household. It might sound highly unrealistic to assume a person would buy a car just to commute ten miles a day (about 2,000 miles a year) when reasonable public transit exists. However, the person might find a second car convenient for business travel a few days a year and for recreation on some weekends, but these reasons may not be sufficient, and only the commuting constitutes a necessary reason for purchasing the second car. We also assume the individual desires about an hour of moderately vigorous exercise per day and values commuting time at $20 per hour. The top of the table lists some of these assumptions.

The “COSTS” part of the table gives rough estimates of the capital costs for the “car” and “bike” alternatives. The table assumes this hypothetical person values perceived safety in travel, even for short trips, and thus needs a large $50,000 SUV (with the latest safety features such as side curtain airbags) for Chicago freeway traffic and a parking place in his/her Hyde Park condominium for another $50,000. Or, he/she could purchase a very efficient touring bike with several sets of bicycle clothes for all weather cycling for about $2,000. These one time capital costs convert to yearly flows of depre-
ciation and opportunity cost of capital. Note, we wear out the bike twice as fast as the car (five years versus ten years) and assume a modest 3% real return on capital. Also, the parking place in the parking garage might increase in value, so we net out an assumed yearly increase in value from the car’s capital costs. Another complication involves the use of the car for evening and weekend trips. We try to include that possibility under “BENEFITS” (below) as a rental car savings.

The programmed costs mainly involve insurance and parking at work. We might include an amount to cover part of the car insurance deductible ($1,000 a year) and medical costs for cycling injuries. The latter would remain highly speculative and might be ignored in our example where a safe bike path exists. However, if the individual cycled in from the DePaul University area on a bike lane sandwiched between parked cars (door opening hazard) and a car travel lane (car overtaking hazard), such estimates would be more crucial. Perhaps the individual would conclude that the expected injury costs would cancel out the longer run health benefits.

Next, we need variable costs which may be more complex. Although tables of per mile variable travel costs exists for cars (fuel and maintenance), short trips often entail cold starts which may be much less fuel efficient and impose much more wear on a car per mile. On the other hand, some LIT have surprisingly high variable costs. Bikes wear out tires, rims, cables, and require frequent adjustments. They also require calories from food to pedal them, but we assume the individual wants to burn up those calories anyway. Thus, we have 2.5 cents a mile for the bike and 7.5 cents a mile for the SUV. Depreciation (see above) covers some major repairs as well as decline in market value for the SUV. Time generally constitutes an important implicit variable cost of transportation. We assumed the bike and SUV took the same amount of time which is realistic in many cities with bicycle paths and lanes. If the LIT took longer, the LIT time costs could quickly surpass the CIT higher variable costs. Again accidents, injuries, and uninsured property damage might conceptually fall here under variable costs, but they would be hard to estimate.

The “BENEFITS” of LIT versus CIT are more difficult to conceptualize and quantify. In our example, perhaps a second car provides difficult to measure comfort utilities (but mass transit can be used during inclement weather) and convenience for weekend travel. Although substantial medical research and advice indicate that the bicycle commuting probably would generate substantial health benefits, they probably would be difficult to quantify economically (convert to dollar terms) for an individual. Thus, it may be easier simply to assume the individual wanted the equivalent exercise anyway. We can estimate what that desired exercise would have cost in a home gym or exercise facility, including the travel time to a gym and entry fees. Then, we can assume reduction of those exercise costs equals an economic measure of the exercise health benefits of cycling to work. Some
benefits also exist for the second car, such as use on some business trips and during weekends. We could use rental car costs (including time) to estimate those benefits to a second car.

The lower part of Table 1 illustrates these estimates and calculations. It assumes bicycling takes the same amount of time as commuting by car. Thus, the exercise from bicycle commuting saves about 1.5 hours per day in the Tables example (1 hour of exercising in a gym and .5 hours traveling to and from the gym). This equals $6,000 per year (1.5 hours x $20/hr x 200 days/yr). Saved gym membership fees contributes another $300 per year in benefits. This exercise savings more than offsets the benefits of the second car for weekend and vacation trips. Thus, the net cost (costs less benefits) of commuting by car may range around $12,510 a year and of commuting by bike around a negative $1,390 a year. The difference between the net car and net bike commuting costs approximates $13,900 a year ($12,510 - (-$1,390)). About half of this advantage for bicycle commuting comes from exercise time savings.

Table 2 takes the yearly difference between the car and bicycle to estimate lump sum values. The table has two columns (“Including time costs” and “Excluding time costs”). The latter column (“Excluding time costs”) assumes you cannot take these savings to the bank unless you actually could have worked during the exercise hours. In this column the lower capital costs of the bicycle gives the advantage. The capitalized value of the difference in net costs indicates what a person might pay extra for a home to locate along a safe bikeway and cycle to work instead of purchasing a second car. The future value indicates the increase in retirement assets (in a health savings account perhaps) one could amass by saving the net benefits. These fall into the $200,000 to $400,000 range. Even using much more modest assumptions (a $20,000 car and ten mile commute where the bike takes twice as long as the car), the yearly difference between the net car and net bike commuting cost falls in the $5,000 range with capitalization and future values in the $100,000 to $200,000 range.

Over many other types of LIT versus CIT (e.g., kayaks versus power boats; hand pushed reel lawn mowers versus power mowers) smaller but potentially substantial differences in net costs may also exist when one considers the value of exercise. Moreover, LIT provides motivation for consistent life-long exercise. For many people, thirty to ninety minutes of exercise per day represents an enormous time cost which can easily be put off for more “important” things which have more immediate pay offs. Also a great deal of physical and psychological inertia exists to initiating exercise. Building exercise into one’s daily life, such as bicycle commuting, can remove this choice and deferment of exercise. “I don’t feel like working out, but I want to get home.” For a broader psychological analysis of the determinants of health behaviors see American College of Sports Medicine (2006, 163-7); and Southard, (1998). To obtain the full health benefits of exercise, it must be
consistent week after week. A major danger of sudden heart attacks comes when middle aged to older individuals who have not been getting consistent exercise engage in various physical activities, such as shoveling snow or vigorous weekend sports (Mittleman, et al., 1993).

Once exercise benefits are included in the analysis, the LIT time costs must either substantially exceed those of CIT or the value of exercise must drop to make the CIT lower cost than LIT. This could happen if the perceived marginal value of exercise to the individual drops as exercise time increases or the LIT involves health risks such as bike injuries. In many situations the CIT may be far more dangerous and polluting to the user than the LIT (e.g., chain saws and power mowers).

Conclusions and Caveats

We have tried to make a case for our recommendation that financial planning research could find interesting and productive material in individual medical decision making. This paper has tended to emphasize decision making by upper income, proactive individuals or households who wish to and can exert considerable control over their lives. Thus, we have emphasized how the costs and benefits to individuals may differ from the costs and benefits over large numbers of persons. An individual incurs higher than average risk because an individual outcome is a specific outcome. Average outcomes tend to clump together closely and exhibit low variation. For example, calcium scans may not perceptibly change average health behaviors or even average statin drug use over large numbers of people. Nevertheless, some individuals may use calcium scan information very productively to change health behaviors and statin drug use (up or down), and many of those individuals may enjoy healthier lives because of the scan.

It is our position that the field of financial planning research and modeling can help proactive individuals make better decisions and help other individuals become more proactive. Such increased individual decision making could apply to many medical issues discussed above, from LTC insurance to high deductible health insurance policies with health savings accounts to help finance individual testing and health behaviors.

At the same time we recognize the need for social safety nets and paternalism in health care and other areas for all types of individuals. By “paternalism” we mean having experts make recommendations and protocols, which many of us may try to follow because we often do not have the information or energy to make good decisions ourselves. We assume a wide range of different abilities to make medical and financial decisions exists, and some individuals will need more paternalism than others. Nevertheless, even for the best informed, analytically minded, and energetic person, it would be highly inefficient to collect and analyze enough information to make all their own decisions.
We also recognize the complex issues of pricing related to marginal costs versus social costs and benefits in the overall health care system. Though out the paper we have suggested that insurance paid tests and procedures tend to create higher medical prices while private paid tests tend toward lower prices based on marginal costs. This arises partly because insurance also helps pay for other system costs such as the uninsured, medical research, and medical education. Private pay patients, at least in specialized scanning and other health clinics, pay only the marginal cost of the private service because of market competition. Nevertheless, most of us may benefit from the positive externalities provided by the insurance system.

Thus, the only position we take on the future development of the health care system and its financing involves some space or safety valve for some individual versus group decision making. This may mean allowing some areas of the health system where prices closely reflect marginal costs, such as privately financing scanning, and where health care consumers have freedom to deviate from group practices and norms. Future personal financial planning research and modeling could make strong contributions to effective decision making in such areas for proactive individuals.

One last caveat involves the problem of access to the latest and best information on relevant health production functions. Financial planners can not efficiently keep up with the medical literature. Their division of labor and specialization focuses on financial markets. However, individual research projects can delve into the medical literature and present the latest health production functions in probabilistic terms. We did that in our LTC insurance article to obtain the probability a 65 year old would spend five years or more in a nursing home later in life. The benefits of consistent moderate to vigorous exercise are well established even if some uncertainty continues over the optimum intensity and durations. Good data on the probabilities of depleting savings for self-insurance against major medical expenses must also exist. Although body scans open up a Pandora’s Box of costs and benefits, financial planners can focus on the costs of the initial tests which insurance usually does not cover.
### TABLE 1: COST BENEFIT ANALYSIS OF BICYCLING TO WORK VERSUS DRIVING A CAR

**Assumptions**
- Desire how many hours of exercise/day: 1
- Commuting miles per day: 10
- Commuting and parking hrs/ day: Car = 1, Bike = 1
- Value of commuting time/hr: Car = $20
- Days commuting per year: 200

**INITIAL CAPITAL COSTS**

<table>
<thead>
<tr>
<th></th>
<th>CAR</th>
<th>BIKE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase price</td>
<td>$50,000</td>
<td>$1,500</td>
</tr>
<tr>
<td>Vehicle</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accessories</td>
<td>$2,000</td>
<td>$500</td>
</tr>
<tr>
<td>Parking place</td>
<td>$50,000</td>
<td>$0</td>
</tr>
<tr>
<td>Total Initial Capital Costs</td>
<td>$102,000</td>
<td>$2,000</td>
</tr>
</tbody>
</table>

**ANNUAL COSTS**

<table>
<thead>
<tr>
<th></th>
<th>ANNUAL CAR COSTS</th>
<th>ANNUAL BIKE COSTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opportunity cost of capital at 3%</td>
<td>$3,060</td>
<td>$60</td>
</tr>
<tr>
<td>Depreciation of vehicle and accessories (car 10 yrs estimated life; bike 5 yrs)</td>
<td>$5,200</td>
<td>$400</td>
</tr>
<tr>
<td>Less expected apprec. of parking place (car 2%; bike 0%)</td>
<td>$1,000</td>
<td>$0</td>
</tr>
<tr>
<td>Total Annual Capital Costs</td>
<td>$7,260</td>
<td>$460</td>
</tr>
</tbody>
</table>

**Annual Programmed Costs**
- Parking rate per day (car $10; bike $2) | $2,000 | $400 |
- Insurance | $1,000 | $0 |
- Total Annual Programmed Cost | $3,000 | $400 |

**Annual Variable Costs**
- Fuel or energy (car 10 mpg; bike 30 calories/mile) | $600 | $0 |
- Routine maintenance, oil, tires (car $.075/mile; bike $.025/mile) | $150 | $50 |
- Time costs of travel, parking, changing | $4,000 | $4,000 |
- Total Annual Variable Costs | $4,750 | $4,050 |
- Total Annual Cost of Commuting | $15,010 | $4,910 |
### Table 2: Lump Sum Estimated Net Costs of Commuting by Car versus Bike

<table>
<thead>
<tr>
<th>Including time costs</th>
<th>Excluding time costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Car minus bike net commuting costs (from Table 1)</td>
<td>$13,900</td>
</tr>
<tr>
<td>Assumed real return on difference</td>
<td>3%</td>
</tr>
<tr>
<td>Capitalized value of difference</td>
<td>$463,333</td>
</tr>
<tr>
<td>Years to retirement</td>
<td>20</td>
</tr>
<tr>
<td>Future real lump sum at retirement</td>
<td>$373,500</td>
</tr>
</tbody>
</table>
References


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2 Managed care refers to a health insurance system where an organization, like a group health insurance company, may contract with health care providers such as physicians and hospitals to agree to certain tests, procedures, and pricing in return for becoming eligible for receiving insurance payments from that insurance company. Then the insurance company tries to sell health policies to employers by competing on the basis of price and quality of service. Their contracts and ongoing negotiations with and pressures on the health providers help keep health care prices and costs down while delivering a “reasonable” quality of health care (Feldstein, 1999, Chpt. 18 provides a good description and analysis of managed care competition).

3 For example, casual observations of our extended families and friends reveals a surprising number (perhaps even a majority) of nontraditional careers: wilderness guide and world traveler, midwifery, architect turned artist, motorcycle racing and hip hop dance instructor, member of a band with one CD to its credit, and ski patrol “bum”.

4 Davis, 2004 provides a clear exposition of the TYP approach and procedures
to address plaque build up. His Appendix A cites the scientific literature on the relationship between calcium scores and plaque build up. Although this literature finds that calcium correlates closely with plaque build up and gives a better prediction of future heat attacks (fatal and non fatal) than traditional cholesterol predictor models such as the “10-Year Risk Calculator” (http://hin.nhlbi.nih.gov/atpiii/evalData.asp), a controversy focuses on availability and effectiveness of follow up treatment (O’Rourke, et al. 2000; Bernd, et al., 2005). For example, most medical advisors would be reluctant to use invasive catheterization on the basis of calcium scores without other symptoms, such as poor exercise stress tests.

An easily understandable exposition of the overall benefits from exercise comes from Jonathan Shaw (2004) in a journalistic article which surveys major researchers at Harvard and elsewhere working in the exercise and health area. Recommendations from the Centers for Disease Control and Prevention and the American College of Sports Medicine (Pate, et al., 1995) provide an important summary of the scientific literature on the relationship between exercise, health, and reduction in death rates. Their recommendations emphasize getting at least thirty minutes of moderate exercise, which may be broken into three ten minute segments per day. Examples of moderate exercise include walking three to four miles per hour, pleasure cycling (<10 mph), mowing lawn with a power mower, and leisure canoeing (2 to 4 mph). However, they state that more exercise confers greater benefits (see p. 405 and Figure 2). Vigorous exercise includes walking around 5 mph, cycling >10 mph, mowing lawn with hand, reel mowers, or canoeing (> 4 mph). More recent U.S. Government exercise guidelines have kept the thirty minutes of moderate exercise as a minimum but also put more emphasis on the additional benefits of vigorous exercise and the need for more exercise per day (sixty to ninety minutes, which also can be broken into ten minute bouts) particularly for weight control (USDA, 2005, Chpt. 4). The American College of Sports Medicine (2006, Chpt. 7) provides more precise guidelines and citations to the scientific literature on which they are based.

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WRITING IN HIGHER EDUCATION: MORE THAN PUBLISH OR PERISH

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ABSTRACT

Having work published is expected of many university faculty members in tenured track positions. The literature is filled with articles related to the topic of “publish or perish.” This paper not only includes the importance of publishing as a factor in promotion and tenure decisions but also cites other benefits, including advancing knowledge and giving creditability to work. In addition, personal benefits are discussed, including being perceived as an authority, gaining prestige, feeling a sense of accomplishment, receiving increased resource allocations, and knowing that the research process has been completed.

Introduction

At a conference break, a new professional in the field says, “I’ve read your work. It’s so good to put a face with a name.” Or a graduate student approaches and says, “I quoted your research in my review of literature. It’s great to meet you.” Many have likely heard similar words and can relish the admiration. Later, an e-mail requests more information about a published article. The phone rings, and a reporter wants an interview about a recent article.

Many who have words in print have had similar experiences. How do those situations make one feel: happy, proud, important, and humble. Yes, publishing gives a sense of accomplishment because the written words have been useful to others in some way and have advanced knowledge.

Although publishing is personally satisfying, academics requires faculty members not only to write, but to have their writings published, preferably in top tier refereed journals in the field. A typical job description for
a senior faculty member in higher education likely includes these directives: *Conduct research on [named issues] consistent with the mission of the university, obtain grants and contracts to support a research program in [named program]; support graduate students on funded research projects; present results of research projects at appropriate professional meetings at local, regional, national, and international levels; and publish research results in appropriate refereed journals, as well as in other types of information outlets.* It is virtually impossible to achieve these mandates without having published.

Publication has long been, and continues to be, a major job requirement for many university faculty members in tenured track positions. Publication records, especially for promotion and tenure decisions, are used to compare the quality and quantity of faculty publications with those of peers within the same discipline and those of academics from other disciplines (Gomez-Mejia & Blakin, 1992; Chan, Chen, & Steiner, 2002). In the literature, the words “publish or perish” are frequently found. For tenured track faculty who serve at the assistant professor rank in research universities, the words can be taken literally—publish or risk losing one’s job, because obtaining the associate professor rank along with tenure (job security) has depended largely on the ability to publish (Miller & Harris, 2004). To advance to the rank of full professor, a sustained record of publication is typically required and, once that academic rank has been achieved, faculty members must continue publishing or possibly fall into the category of the “unknown” or the “unproductive” or the less compensated.

Academic reputation rests on publication (Clemens, Powell, McIllwaine, & Okamoto, 1996). Having one’s work in print lends credibility to it. Additionally, publishing enables the writer to be perceived as an authority on a specific subject. Being perceived as an authority has numerous benefits, such as being more likely able to secure grants and contracts and to attract graduate students, two priorities in many universities. Also, with authority arrives trust, and other researchers are apt to cite the work, a means to determine the influence of one’s work. In the *Journal of Personal Finance*, the frequency of authors being cited in the first volumes (2002-2004) is listed (Kasper & Grable, 2005). Likewise, in *Financial Planning and Counseling*, a list of the most-cited authors from the 1990-2004 volumes is presented (Hanna, 2005). Hanna stated, “There are psychic and other benefits to authors of being cited in various outlets, including the popular press, but the number of citations by other researchers is a key indicator for advancement.”

Not only is publishing a factor in advancement decisions that likely affect faculty compensation and resource allocation, it is a critical factor in dictating the number of opportunities faculty members have to be considered for positions at other universities. Cumulative publication reinforces reputation. Chan et al. (2002) reported that an individual who is able to relocate to a
higher-ranked institution must exhibit a research record that is about twice as strong as that of an average existing faculty member at that institution.

A faculty member’s eagerness for publication, however, must not exceed the thoroughness of the work. As Clapham (2005) stated, “Be careful of those who seem more interested in getting their research into a high-profile journal than in, well, getting it right.” Actually the greater concern lies with faculty members who work for years but seldom submit their findings for publication. Research is considered to be incomplete unless the results are shared with the scientific community (American Psychological Association, 2001). Publishing rescues work from being wasted or lost to the world. Clapham wrote, “To state that those who don’t publish may as well not do the work in the first place is undeniably harsh, though not unreasonable: if you don’t publish, you’re wasting everyone’s time and taking much-needed funding away from other scientists.”

Another important reason to publish is to receive reviews from peers (Axtell, 1997; Clapham, 2005). Although, some peer reviews are insufficient or faulty, possibly written by reviewers who are too busy or lack expertise in the subject, most reviewers give beneficial, constructive remarks. Even when reviewers show little mercy, an expert referee can enable the work to reach its full potential.

Now to a less apparent motive to publish: committing work to paper forces faculty members to review the literature. Reading other papers exposes them to concepts (and problems) that perhaps had not been previously considered (Clapham, 2005). In addition, committing work to paper compels faculty members to think about their research in ways that they might never done merely by talking about it. Writing requires faculty members to organize the extensive volume of data. Once done, the act of putting the methods, results, and implications into words forces them to define the thoughts specifically and to consider the meaning of the work far more deeply. Begin writing, and additional ideas surface.

Faculty members also gain prestige by having their work published in prominent outlets. “Overwhelmingly, a positive relationship between publishing and prestige has been documented” (Keith, 1998). It is interesting to note that although individuals receive prestige from writing, faculty writings are far less important in determining prestige ratings of academic departments than either the reputations of departments or their affiliated universities. In other words, “Publishing is not necessarily a straightforward means of securing a department’s prestige” (Keith, 1998).
Conclusion

In summary, faculty members receive many rewards from being published. Not only is publishing an important factor in promotion and tenure decisions, it is a means for faculty members to advance knowledge and give creditability to their work. In addition, faculty members receive personal rewards, including being perceived as an authority, gaining prestige, feeling a sense of accomplishment, receiving increased resource allocations, and knowing that the research process has been completed.
References


The authors have addressed the importance of publishing in higher education, but in no way want to give the impression that other factors, such as grantsmanship, teaching quality, and service, are unimportant and do not also reap many rewards.

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Financial Planning: Where We Have Come From

December 1969 was a momentous date in the history of how financial services are packaged, marketed, and monitored in the United States and around the world. It is on this date that 13 financial services practitioners and one author met at O’Hare International Airport to discuss the creation of an industry that would later be named ‘financial planning.’ Under the leadership of Loren Dunton, the one non-practitioner in the group, those in attendance created the College for Financial Planning, the International Association of Financial Planners (IAFP), and a society for financial planning. The College for Financial Planning still exists today, while the IAFP continues in the form of the Financial Planning Association (FPA). The society is the single concept created in 1969 that no longer exists.

Only a handful of people practiced what might be considered a type of financial planning prior to 1969. Nearly all financial services professionals at that time were engaged in mutual fund and insurance sales. Some practitioners sold mutual funds door-to-door, while others sold insurance policies to individuals and companies. Very few firms used a process of establishing a relationship, gathering data, examining data, developing a plan, recommending solutions, implementing, and monitoring as an approach to selling products. The idea of hiring a person or firm to serve a client as a comprehensive financial planner was something that few practitioners or consumers envisioned at the time.

What happened in 1969 literally changed the face of financial services forever. It did not take long for consumers to realize that there was more to achieving financial success than simply purchasing a product. Success could better be achieved if a professional advisor was hired to help establish goals and objectives and then to develop a comprehensive financial plan to meet those very aspirations. The outcomes of the 1969 meeting also helped practitioners realize that a process of financial planning could be used to both improve client outcomes and planner practice results. The first group of practitioners to complete the Certified Financial Planner designation requirements totaled 42. The road to where financial planning sits today was...
not a smooth one however. Early adopters of the phrase ‘financial planning’ were dominated by advisors whose primary objective was to sell product and assist clients avoid onerous tax rates. The use of tax shelters, annuity products, limited partnerships, and hard asset investing captured the attention of financial planners and their clients through the 1970s and early 1980s. It was only after the tax law change of 1986 and the significant reduction in inflation during the Reagan presidential years that turned the focus of financial planning towards a more holistic and comprehensive view of a client’s financial affairs.

The 1990s witnessed record numbers of people entering the field of financial planning. Much of the growth can be attributed to the good economic situation and rising securities prices during the last decade of the 20th Century. Major events during the decade included the growth of Fee-Only financial planning, the expansion of the College for Financial Planning as an independent institution of higher education, the establishment of the Financial Planning Association, the escalation of organizations offering specialized designations and certifications, the expansion of organizations such as the International Association of Registered Financial Consultants and the Certified Financial Planner Board of Standards, Inc., and the increase in academic financial planning programs at universities across the United States.

Financial Planning: Where We Are Today

Financial planning sits at a major crossroad in time and purpose. One question ought to dominate the thinking of professional leaders as they ponder the future of financial planning, namely, “Is financial planning a vocation or a profession?” The implications on how one defines a vocation, versus a profession, play a critical role in the future direction of how financial planning will be practiced in the future.

According to Grable, Lytton, and Klock (2005), “A vocation refers to a field of work where one’s earnings and wealth is based on the amount of effort applied. In general, someone employed in a vocation needs minimal training or advanced study to be proficient in the trade. A profession, on the other hand, refers to fields that require specialized knowledge, mastery of refined skills, and extensive study. Additionally, a profession can only be held by a person rather than a firm or company. Nearly all professions require practitioners to be licensed or certified and regulated by a professional board made up of practicing peers. Professions are also known by their strict educational requirements, practice standards, and self-regulatory enforcement of the standards. Further, all professions have a code of ethics.”

Several occupational endeavors can be classified as professions using these standards, including law, medicine, nursing, and engineering. Should financial planning be listed among these professions? There currently
is no consensus among practitioners about the answer to this question. Not all financial planners want to see financial planning transition from a vocation to a profession. Some people who call themselves financial planners equate planning with simply providing a service. Vocational financial planners see themselves as intermediaries between consumers who need or want a financial product and a company that is willing to supply the product.

In one respect, it can be argued that financial planning is not a profession, especially if one adopts the view that financial planning is simply a form of product delivery. While this may have been the predominant view from the 1960s through the early 1990s, the historical record suggests that this notion of financial planning is no longer the dominant point of view. Financial planning is closer to a profession today than at any time in the past. So, what exactly defines a profession? As shown below, there are nine (9) generally accepted standards used to define a profession. A profession requires practitioners to have:

- Specialized knowledge
- Mastery of skills
- Extensive study
- One or more licenses and certifications
- Some college training
- A professional board of oversight
- Practice standards
- Self-regulatory enforcement of rules
- Code of ethics

How does financial planning stack up against these standards? Fairly well, actually. There is still no consensus that financial planners need to have one or more certifications and/or designations, nor is there a self-regulatory association or commission that oversees all financial planners. Other than these ‘deficiencies’ there does seem to be some agreement that financial planning, as an activity, does meet the other professional standards. However, until there is a general consensus on all of these issues, it is unlikely that policy makers, university administrators, and the media will acknowledge financial planning as a true profession.

Financial Planning: A Possible Future

The future of financial planning can be viewed as either bright with possibilities or doomed to vocational status for the foreseeable future. The strongest evidence of this forecast can be found on university and college campuses across the United States. Although the number of universities and colleges that offer financial planning as a degree option appears to be growing, this, may, in fact, not be the case. Trends within higher education put financial planning academic programs in jeopardy and without strong
support of financial planning practitioners ‘financial planning,’ as an academic discipline, may begin to implode on campuses across the country. And without strong academic support for financial planning it is unlikely that financial planning will ever reach the threshold of professionalism that is so strongly needed.

Universities and colleges that offer financial planning degrees face five threats:

1. Lack of industry funding
2. Weak theoretical basis
3. No social science citation indexed journals
4. Lack of program accreditation
5. Lack of national program rankings

The interrelated nature of these five threats is discussed below.

Lack of Industry Funding

In general, the financial planning industry has not embraced financial planning as an academic program of study. There are certainly exceptions to this, but the generalization is valid. \(^5\) There are few, if any, endowed professorships in financial planning. This compares negatively to industry support of accounting, finance, insurance, and other ‘financial services’ degree programs found on most American campuses. The situation is bleak when compared to how well specific industries support other academic disciplines. Consider schools of engineering. These programs command huge commitments from industry in terms of student support, research funding, and faculty endowment. This simply is not the case when it comes to financial planning. It may be that the financial planning industry views academic programs as a ready supply of salespersons rather than a source of research and consulting. It may also be that because financial planning is dominated by small boutique firms support on a large scale tends to be limited. Regardless of the reason, however, without industry support financial planning programs will be in jeopardy as more universities look for ways to trim budgets. Those programs that are strongly associated with industry will survive, while those that are not will be cut.

Weak Theoretical Basis

Financial planning is one of the only academic disciplines that does not have a theoretical basis for guiding student studies and research. Yes, financial planning is based on a process, but there is no unifying theory of how financial planning works. Graduate students who have an interest in financial planning must currently borrow theoretical models and frameworks from other disciplines – finance, psychology, family studies, etc. As univer-
Nancy O. Maier

University and college administrators look for ways to streamline academic offerings, those programs that lack a strong theoretical basis tend to be the first to be eliminated.

No Social Science Citation Indexed Journals

Possibly the greatest threat to the ongoing viability of financial planning programs on campuses is the lack of recognized research outlets. Increasingly, universities are looking for ways to judge the productivity of faculty. One primary way to do this is to ‘count’ the number of articles a person publishes in social science citation indexed journals. There are some universities where publishing anywhere else is frowned upon. Unfortunately, not a single journal that publishes financial planning research is indexed. This means that if someone publishes in Financial Counseling and Planning, Financial Services Review, or the Journal of Financial Planning there is the possibility that the paper will not count toward tenure or promotion. Worse, when academic units on a campus are ranked the lack of indexed journal articles will make financial planning programs appear nonproductive compared against other academic programs. Again, university administrators are beginning to use this criterion for how programs are funded.

Lack of Program Accreditation

Accreditation matters! Right now financial planning programs are ‘registered’ with the CFP Board. While registration is useful, and better than nothing, in the final analysis accreditation is the only measure of quality that matters in the academic world. Funding within universities and colleges follows accreditation standards. Programs that can show the possibility of losing accreditation without additional resources will tend to receive resources. So, even though financial planning programs may need resources (almost all do), in a competitive environment, available resources will tend to bypass registered programs and go to accredited programs.

Lack of National Program Rankings

Which financial planning program, be it undergraduate, graduate, or certificate, is the best in the country? Currently, the answer depends on who you ask. Every program director will say that his or her program is the best – the best students, the best faculty, the best resources, etc. But how is a university administrator – the person who decides how resources will be allocated – to know the truth? In terms of engineering, business, general studies, and almost all other programs there are national rankings – sometimes multiple rankings. For example, The Wall Street Journal ranks MBA pro-
grams. Not everyone agrees with the rankings, but at least there is a standard of quality that can be attained. In the ultra-competitive funding environment on campuses today programs that can show a high national ranking will receive more resources than those that have no ranking.

**Financial Planning: Where We Need To Go**

As stated earlier, financial planning sits at a crucial crossroads. There are large numbers of financial planners who do not value the role of universities and colleges as sources of research, theory, and training. This group tends to be those that do not have a college degree but have still been quite successful. In their thinking they did not need a degree to be successful, and as such, probably feel that contributing to a university is a waste of time and money. It appears that these planners are in charge of the profession at this moment in history. There is another group of planners who graduated from college, but with diverse undergraduate degrees – math, science, business, psychology, art, etc. These planners tend to hold a strong allegiance to their alma mater. This allegiance far outweighs their allegiance to the profession of financial planning. They will donate money and time to their alma mater even though their university or college does not offer or support financial planning as an academic discipline. That leaves the third group of planners – those that have graduated from financial planning programs. These planners tend to be young and not in a position to make sizable donations in support of financial planning programs.

As a result, it appears, from a university perspective, that financial planners are excited about the prospect of someone graduating with a financial planning degree, but these planners are not willing or able to support degree programs. This might be excusable if one thinks about a planner being a sole practitioner. The excuse falls apart when applied to the nation’s largest planning firms however. Universities are charged with a mission of training individuals to lead productive lives. However, some large planning firms seem to believe that programs are really their primary feeding ground for new recruits. Unfortunately, these firms see students as the product rather than the educational process as the product. If this perception is false, one might ask, then where is the financial support in terms of student scholarships, research grants, and faculty endowments one would expect to see from similar firms operating in different industries? If a significant change does not occur soon it is entirely possible that the number of financial planning programs at universities will decline. A decline in the number, size, and quality of programs will have a devastating impact on financial planning’s attempt to move from a vocation to profession. There are steps that can be taken right now to improve the situation. Each step will require cooperation between and among practitioners, firms, industry
associations, and university faculty. A model exists for bringing these groups together (e.g., accounting, finance, engineering, etc.), but the process will require leadership to pull it off. Here is what is needed now:

1. Professionals, be they individuals or firms, must support financial planning programs financially. This means contributing to a university that may be different from one’s alma mater, or beginning contributions even if one does not have a college degree.
   a. Help fund an endowed professor position
   b. Fund research that will help build a theoretical basis for the profession
   c. Fund student scholarships
   d. Fund faculty fellows and visiting scholars

2. Work diligently to support journals that publish financial planning research
   a. Submit papers
   b. Publish even if it means not receiving ‘credit’ for tenure and promotion
   c. Purchase library subscriptions
   d. Work with faculty to increase indexing opportunities

3. Develop an accreditation process for academic programs
   The financial planning profession deserves to have strong and growing academic programs. First, academic programs lead to professionalism by maintaining training standards. Second, academic programs generate research that can be used by practitioners and policy makers when working on ways to prepare Americans for their financial future. Third, academic programs support the ethical standards of the profession. Without financial planning programs in universities and colleges financial planning will never move beyond a vocation, and that would be sad thing for both practitioners and consumers.
1 This section within the article is based on work presented in “A Case Approach to Financial Planning: Writing a Financial Plan,” written by John Grable, Ruth Lytton, and Derek Klock. The book is available through National Underwriter.

2 Refer to the ethics chapter in A Case Approach to Financial Planning: Writing a Financial Plan.


4 The financial planning program at Virginia Tech, perennially ranked in the top ten of such programs, was recently closed as a result of priority changes that are sweeping across the academic landscape.

5 Exceptions include CFP Board funding of graduate studies at Texas Tech University, collegiate financial planning competitions funded by Amerprise Financial Inc., and small grants from companies to specific university programs (e.g., Lincoln Life to Ohio State University).

6 The Journal of Personal Finance is, however, indexed by Corbel’s and ProQuest.

7 Certain local financial planning associations sometimes combine resources to help fund one or two small academic scholarships at specific universities, but there are few, if any, full-ride nationally competitive scholarships funded by organizations, associations, or industry.

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The (Mis)Behavior of Markets

Authors: Benoit Mandelbrot and Richard L. Hudson

Reviewer: Jerry Stinson, RFC

Benoit Mandelbrot is a remarkable polymath. He has engaged in academic research and taught in diverse fields of thought – statistical physics, cosmology, meteorology, hydrology, geomorphology, neurology, linguistics, information technology, and his primary field, mathematics. His interest and research in economics and financial markets and price theory began in 1960 when he was a research scholar at the T. J. Watson Research Center of IBM. Mandelbrot is currently Professor of Mathematics at Yale University. He is most famous as the inventor of fractal geometry. For forty-five years he has been well known in the academic economics-establishment that has adopted many of his ideas, but the establishment also finds him bewildering and controversial. This latest book firmly demonstrates what Mandelbrot has to say is important and immediately relevant to every academic in economics and finance, to every professional in financial and retirement planning, and to any one who wishes to understand how money gets won and lost. Most of all Mandelbrot gives searing insight into the fragile and sandy foundation upon which is built so-called “modern” theories of equity markets.

As most of the readers of this review should know, there are three elements of orthodox modern financial theory: (1) the Capital Asset Pricing Model (William Sharpe), (2) Modern Portfolio Theory (H. M. Markowitz), and (3) Option Contract Valuation Modeling (Black & Sholes). The essential foundation upon which all these elements are constructed is the assertion that...
prices (of a particular equity, of a put or call, of an entire market index value, of virtually any financial instrument or derivative traded on a market) are not predictable, but their fluctuations can be described by mathematical laws-of-chance. This central axiomatic assertion of financial orthodoxy is most clearly observed in Markowitz’s efficient market hypothesis. It reduces all investment decisions to two simple numbers – the mean and variance of expected prices. These two numbers thus become mathematical proxies for return and risk. Mandelbrot and Hudson trace the history of the development of the use of stochastic mathematical principles in the attempts of mathematicians and economic scientists to explain the behavior of financial markets and further to describe the relationship of risk and reward. His historical outline begins with Bachelier and shows how the edifice of modern financial theory – valuing assets, building portfolios and assessing risk – was erected on the French mathematician’s work.

Mandelbrot and Hudson’s primary objections to “modern” theories of market prices are that (1) prices do not conform to the normal curve of statistical mathematics (they are more aptly described by his fractal models), and (2) prices are not independent (rather they are long-term dependent; they have “memory”). Mandelbrot and Hudson then introduce their “new way” of explaining and elaborating how financial markets should be viewed and understood. He introduces a multifractal model to describe the workings of markets. After a lengthy and reasonably well-argued treatise on why his model makes more sense and provides a clearer picture of market behavior he offers a summation of his conclusions:

1. Markets are intrinsically far more risky than previously considered (and more than what modern theory suggests). Price movements do not follow the well-mannered bell curve models as asserted by modern financial theory. Rather, they follow violent, turbulent curves up and down
2. Trouble runs in streaks. Market turbulence tends to cluster in time periods
3. Markets have a “personality.” Exogenous factors are intuitively apparent to most markets observers, but very strong endogenous factors are at work as well, and these virtually always defy neat statistical methods to explain their operation on prices
4. Markets mislead. Mandelbrot and Hudson show (convincingly to this Reviewer) that the market “patterns” of modern financial theory, asserted to follow the “rules” of statistics, are a form of fool’s gold. Chance can, and usually does, create spurious patterns and false-cycles. These supposed patterns appear to make future outcomes predictable when they are not.

Mandelbrot and Hudson do not leave us in an economic universe without hope for finding some form of regularity and symmetry in financial markets, even though his new system is fractal and does not conform to the
comforting smoothness of the bell curve. He posits two new variables that he attempts to demonstrate better fit the evidence of market price behavior. Instead of the standard deviations and betas of classical efficient markets he gives us the relationship between “H”, the exponent of price dependence and “alpha”, the parameter characterizing volatility.

Why should a financial services practitioner take her or his time to plow through what is fairly “thick” ground in this offering by Mandelbrot and Hudson? May I offer a few suggestions?

(1) All of us human beings (and perhaps especially financial services practitioners) hope that evidence drawn from past events will lead us to correctly discover and understand some tendency that must inexorably lead to future events. It is sobering to read Mandelbrot and Hudson and to consider that it may be more appropriate and correct to view predictive economic science as much less certain than we hope it is.

(2) A close and open-minded reading of Mandelbrot and Hudson may allow for the inclusion of contingent events in the complex nonlinear system that the equity market surely is. The potential significance of these events, along with the emergence of market outcomes beyond prediction by the standard models, should be understood by professionals who give advice and counsel to working Americans concerning where, when, and how to invest their assets.

(3) Should financial advisors disclose as relevant to investment decisions the potential flaws in the assumptions about risk embraced by the financial establishment? Is it fair to consumers to allow them to believe that recommendations from their advisor are based on sound, proven science when in fact accidental and unforeseeable non-additive interactions are inevitable in the market place? In general, should we admit our incapacity for precise predictions of certain, sure results concerning equity investments? We should not presume beforehand that our clients would not be open to our honest claims of fallibility.

If you are an “antiestablishment economic activist” as this Reviewer so often finds himself being lately, or if you wish to enjoy a remarkably well-told story of the conception and rise of modern theories of finance and where we are headed with “post modern” thinking about risk and reward then you should read Mandelbrot and Hudson.

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INSTITUTIONAL PROFILE

Family Finance & Consumer Science Programs
at
Utah State University

The Aggies

Utah State University is a place of possibilities. From the seven colleges on campus, you can select one of more than 200 majors. In each of those majors research opportunities exist for undergraduate and graduate students alike to thrive in a hands-on learning environment supported by caring faculty mentors, of whom 98% have doctoral degrees. Utah State is a Carnegie Research Extensive University that has attracted more than $168 million in contracts and grants last year. Researchers from the College of Education and Human Services were awarded $21 million in research grants, placing the college among the top six universities in the nation for research funding in 2003. US News and World Report voted the college among the top 25 Most Innovative Colleges in the nation and in the top six of colleges of education for six years running.
Academics at Utah State University

The first thing you’ll notice about academics at Utah State: You’ve got a lot of choices. And with choice comes possibility. The possibility to study in the field that you’ve always dreamed about—or to explore one that you never knew existed. To personally create a course of study that combines your interests and goals. To investigate a world of knowledge that’s bigger than you ever thought possible.

Full-time faculty members teach the majority of classes—not teaching assistants, like you’ll find at many other big state universities. What’s even better: These same professors really get to know their students, and then invite them into the labs to help conduct cutting-edge research.

Utah State’s seven colleges are open to everybody, and you’re not “locked in” to one after you start. So go ahead: Take that fly-fishing or folklore class that sounds so intriguing. Add a business minor to your computer science degree. Double-major in music and biology if that is your heart’s desire. At Utah State, it is all about investigation.

Family Finance at Utah State University

An emphasis in Family Finance is found in the department of Family, Consumer, and Human Development, which is located in the College of Education and Human Services. Family finance students focus on the issues and problems that affect individual and family financial well-being, and pursue understanding of complex consumer issues such as: Identity Theft, Credit/Debt, Home Buying, Insurance, Retirement, Consumer Scams, Bankruptcy, Budgeting, and much more. A B.S. in Family, Consumer and Human Development with emphasis in Family Finance provides students with opportunities of financial counseling experience and certified counseling accreditations such as: Accredited Credit Counselor™, Accredited Financial Counselor®, and Certified Housing Counselor™. Potential employers include the financial services industry, Cooperative Extension Service, social service agencies, and self-employment.

The Family Finance emphasis is an integrative program that links the various fields within the family and consumer sciences profession and prepares students for positions requiring interdisciplinary problem-solving skills. Students in the department are required to complete at least one hands-on practicum experience, which is arranged with the practicum coordinator.

Family finance faculty members conduct cutting edge basic and applied research to better understand individuals and families, particularly their interplay with economic and consumer forces. Graduate and undergraduate students participate fully in the research enterprise. Faculty and students engage with individuals, families, as well as social agencies and organizations
to enhance the quality of life through the Family Life Center and other practicum opportunities.

The Department of Family, Consumer, and Human Development is committed to excellence in teaching and research enabling students to gain an understanding and appreciation of the complexities of individuals and families as they interact within various contexts. Students learn to address the needs of consumers, and to apply this knowledge in educational, organizational, and outreach programs.

**Major Core Requirements (56 credits):**

- **FCHD 1100** Critical Issues in Family, Consumer, and Human Development
- **FCHD 1500 (BSS)** Human Development Across the Lifespan
- **FCHD 2400 (BSS)** Marriage and Family Relationships
- **FCHD 2450 (BSS)** The Consumer and the Market
- **FCHD 3130 (QI)** Research Methods
- **FCHD 3210** Families and Cultural Diversity
- **FCHD 3280** Economic Issues for Individuals and Families
- **FCHD 3310** Consumer Policy
- **FCHD 3340** Housing: Societal and Environmental Issues
- **FCHD 3350 (QI)** Family Finance
- **FCHD 3450** Consumer Credit Problems
- **FCHD 4220** Family Crises and Interventions
- **FCHD 4230** Families and Social Policy
- **FCHD 4330** Family Finance Career Seminar
- **FCHD 4350** Advanced Family Finance: Investing, Retirement, & Estate Planning
- **FCHD 4460** Financial Counseling
- **FCHD 4950** Practicum: Consumer Science (off campus internship)
- **FCHD 5340** Housing Finance and Regulations
- **FCHD 5950** Financial Counseling Practicum

**Minor Requirements (15 credits)**

- **FCHD 2450 (BSS)** The Consumer and the Market
- **FCHD 3350 (QI)** Family Finance
- **FCHD 3280** Economic Issues for Individuals and Families
- **FCHD 3310** Consumer Policy
- **FCHD 3340** Housing: Societal and Environmental Issues
- **FCHD 3450** Consumer Credit Problems
- **FCHD 4350** Advanced Family Finance: Investing, Retirement, & Estate Planning

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Graduate Programs in the Consumer Sciences

An M.S. and Ph.D. in Family, Consumer and Human Development is available with a specialization in Consumer Sciences. This specialization includes a foundation in theory and decision-making processes related to allocation of individual consumer and household resources. Students study economic interactions of families and consumers with an emphasis on the analysis of household consumption, household financial management, human capital investment, and allocation of time. Theories in economics, finance, sociology, psychology, and quantitative methods are applied to investigate policy questions and decisions made by consumers/households.

The Family Life Center

The Family Life Center is a unique component of the Family Finance program offering opportunities for hands-on financial counseling and workshops. Members of the community are greatly benefited by the services offered by this non-profit institution, which is run mostly by students. Financial Counseling opportunities include areas of specialization in Budget Counseling, Credit Management Counseling, Debt Reduction Counseling, Risk Management Counseling Housing Counseling specialties include, Pre-purchase Counseling, Post-purchase Counseling, Rental Counseling, Mortgage Default Counseling, Home Equity Conversion Mortgage Counseling

Student Activities

The Family Finance Club offers opportunities to expand your experiences. Additionally, the faculty members encourage professional development. Opportunities for joint research with faculty and scholarships are available to help students attend professional conferences such as ACCI – American Council on Consumer interests, AFCPE - Association for Financial Counseling and Planning Education, AAFCS – The American Association of Family and Consumer Sciences, and HERA – Housing Education and Research Association

Professional Development and Networking

As part of the Family Finance Career Seminar, students are strongly encouraged to attend the annual conference of the Association for Financial Counseling and Planning Education (AFCPE).
Job Placement of Graduates

Graduates from the Family Finance program have found themselves in many diverse jobs. Positions of some of our graduates: Estate Planning, Community Financial Educator, Family Finance Instructor, Housing & Financial Counseling Director, Extension Educator, Home Ownership Workshop Coordinator, Neighborhood Non-Profit Housing Corporation, American Express Advisor, Financial Literacy 2001 staff, Fidelity Investments advisor, Federal Bankruptcy Court Chapter 13 Program Director, Chapter 13 bankruptcy trustee staff, university Financial Aid Officer, Consumer Credit Counseling Service Education Director, Franklin Covey Financial Coach, Mortgage Loan Officer, Fair Housing Project Assistant, Financial Planner and Therapist, employee assistance program counselor, personal banker, Family Support Consultant for U.S. Military, USDA-CSREES National Family Economics Leadership Team Program Assistant, Bank Student Loan Manager, Bank Manager

Faculty

Faculty and staff in the Family Finance Emphasis include:
Faculty and their primary research interests:
Jean M. Lown, Ph.D.
Lucy Delgadillo, Ph.D.,
Yoon G. Lee, Ph.D.,
Alena Johnson, M.S., lecturer
Dr. Barbara Rowe, Ph.D., Extension Program leader and Family Resource Management Specialist
Staff:
Kay Hansen, Director of the Housing and Financial Counseling program at the USU Family Life Center
Susan Ericksen, practicum supervisor
Marilyn Kruse, academic advisor

Facts at a glance

Location: Logan, Utah, population 42,670 (70 miles north of Salt Lake City)
Enrollment: Main Campus: 16,130 Continuing Education: 7,778
Address: Family, Consumer, and Human Development
2905 Old Main Hill
Logan, UT 84322-2905
Phone: (435) 797-1501

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Fax: (435) 797-3845  
Website: http://www.usu.edu/fchd/

Estimated cost of enrollment per semester for undergraduates based on 15 credit hours for the 2005-2006 academic year.

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References

JOURNAL OF PERSONAL FINANCE
GUIDELINES FOR AUTHORS

The Journal of Personal Finance publishes empirical research, case studies, practice management tutorials, and literature reviews dealing with financial consultation and planning topics, programs, and issues.

Articles are written by practicing financial planners and counselors, personal finance academicians, behavioral scientists, psychologists, and specialists employed in business, industry, and academia.

Articles deal with all aspects personal financial planning that apply to practice management, business settings, and planning techniques. Topics of interest to readers include:

- Client Relationship Management
- Financial Planning Trends
- Technology Issues
- Planning For Special Needs
- Regulation Overview
- Ethics Of Financial Planning
- Practice Management Techniques
- Novel Planning Tools And Techniques
- Investment Decision Management
- Marketing Methods
- Personnel Selection And Training
- Risk Assessment And Management
- Marketing And Consumer Behavior Research
- Employee Benefits And Assistance Planning
- Employee Counseling
- Personal Finance Research Methodology And Statistics
- Computer Applications In Personal Finance
- Book Reviews

It is important that manuscripts be well organized and concise. The development of ideas and concepts should be clear. In general, readers prefer articles that avoid dull, stereotyped writing and the use of scientific jargon. Authors should aim at achieving clear communication of ideas. Generic masculine pronoun or other sexist terminology should be avoided.

Tables should be used only where appropriate and should include only essential data. Tables should be understandable as a stand-alone
product. All tables should be created using Word Table formats. Columns must have headings, and data should be doubled spaced.

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