

# CREATIVE

## Wealth Maximization Strategies

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**“The whole aim of practical politics is to keep the populace alarmed (and hence clamorous to be led to safety) by menacing it with an endless series of hobgoblins, all of them imaginary.”**

*- H.L. Mencken*

## FEAR FACTOR IN FINANCIAL PLANNING: Is That All There Is?

Suppose for a moment you are faced with a life-and-death situation. You assess your predicament, trying to decide which course of action to take, knowing your life depends on the choice you make. At that moment, a thought races through your mind:

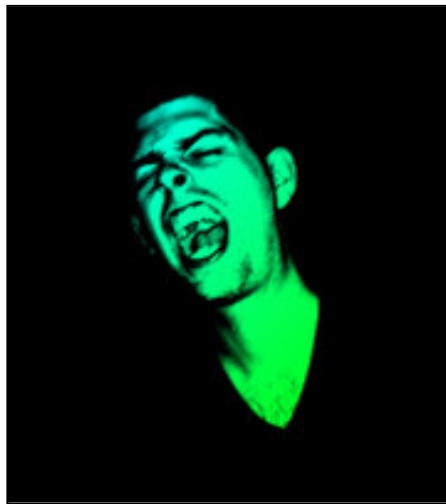
**“But what if I live?”**

Huh? What kind of question is that? *But what if I live?* What situation could possibly make someone think staying alive might not a desirable outcome?

According to Gregory Salisbury, PhD, the dire prospects of retirement for baby boomers prompt this thought! Salisbury has written a book about the challenges American baby boomers will face in retirement. The title: *But What if I Live? The American Retirement Crisis*.

Wow. You gotta admit the title gets your attention. But it sounds a little over the top, so maybe you just chalk it up to over-zealous advertising hype. Except...

In an August 21, 2006 press release from *Business Wire*, Salisbury says he “believes that the label of ‘crisis’ is not an overstatement when discussing the seriousness of America’s retirement outlook,” and “My profound worry is that the Boomers will be the first generation that will be worse off in retirement than the generation before.”



### The Economy of Fear

If the headlines are to be trusted, it seems the financial future for 21<sup>st</sup>-century Americans is bleak. Gas prices are up. Pensions are vanishing. Jobs are leaving the country. The national savings rate is negative. And many Americans may find retirement means slinging burgers at McDonald’s, smiling as greeters at Wal-Mart, or living alone in a nursing home. Are you scared yet? Remember, it’s a “crisis” over which some expert has “profound worry” (“But what if you live?”).

Not to be insensitive to these events, but our response is: **“Piffle.”** (piffle – *n.* nonsense or drivel.)

It’s true that life is filled with challenges. The possibility of loss (financial, physical, emotional) exists in many situations. But responding fearfully to every potentially threatening situation (“ooh, this could be bad!”) is not conducive to long-term financial (or mental) health.

It’s also true that fear is a very effective motivator. Fear gets people to act, often with good reason. Fear can be an effective means of getting your attention, and getting you to take action. But fear can also be cultivated and exaggerated. And it can be manipulated to sell something.

This isn’t meant to be cynical. Many people who deliver fearful messages are sincere – like Mr. Salisbury, they have “profound worries.” And quite often, their concerns are genuine, although perhaps overstated.

(Preparing for retirement is an important issue. Does that mean the baby boomers' future retirement is really a "crisis?")

But it's also worth remembering that many media sources are primarily supported by advertising. In order to deliver results for their advertisers, those books, magazines, radio and television programs must provide a compelling, ongoing reason for people to read, watch or

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listen. This often means sensational headlines, filled with the emotional phrases, like "Crippled Economy," "Jittery Consumers" and "Despondent

Investors." And quite often, there's usually an emphasis on urgency in the solution. It's all about "What To Do Today," or "10 Steps To Take Right Now," or why you must buy the financial "flavor of the month."

There's no doubt you can make a profit by marketing fear. But as a consumer, can you profit by responding to it? Our observation here is no.

Financial decisions made under duress will more often than not be poor decisions. In the frenzy of "something has to be done," there isn't time for thorough examination of issues or alternatives. There isn't time to think.

Also, while fear might get you to do what you need to do, it rarely compels you to do all you can. When every decision is driven by the need of the moment, there's a tendency to stop once the fear has been alleviated.

It's like the factory worker who wakes up in January and realizes he's overspent on Christmas. The credit cards are due, and he doesn't have the money, so he tells the boss he will take any available overtime shift. For three months, he works 10-12 hours a day, and makes good money. In no time, the credit cards have zero balances. He's been so productive he's even got a little bit extra socked away in the bank. Financially, he's on a roll.

So what happens in April? The worker tells the boss "no more overtime for me." Why? It's not because the pay scale has dropped. It's because the only reason he was working was to get rid of the debt, and the economic discomfort that came from having it. Sure, now that his debts are satisfied, continuing to work overtime could have meant a better retirement, a bigger college fund for his kids, a second home on the lake, or the seed money for a rewarding business opportunity. But he wasn't thinking about what else could be done with the extra earnings; he just wanted to get the fear out of his life.

Operating from an economy of fear, our factory worker may get by, but he probably won't ever get ahead.

### Wants and Dreams Make a Better Economy

Every year around Christmas one of the cable networks shows the 1983 movie "A Christmas Story" continuously for 24 hours. With the repeated showings, the movie has achieved cult classic status, and in some ways become a "family tradition." For those who've watched the movie over and over, little bits of dialog ("My old man was a turkey junkie") have become touchstones. You hear the phrase, and you know the scene.

One of the central plots in "A Christmas Story" involves young Ralphie's hope of receiving a Red Ryder BB gun for Christmas. As he tells his parents, teacher, and the department-store Santa Claus of his fondest Christmas wish, they all respond with the same warning:

**"You'll shoot your eye out!"**

Each time an adult dismisses Ralphie's Red Ryder as foolish or dangerous, his spirits droop. But in short order, his desire overwhelms despair and hope returns. Regardless of what others may say, Ralphie is undeterred. It doesn't matter how many times he hears "you'll shoot your eye out;" Ralphie wants a Red Ryder.



A Christmas Story DVD cover

Here's the connection: while a bunch of financial commentators are trying to motivate the American population out of its financial lethargy by scaring them, the ones who are making the most financial progress are those who ignore the fear approach and focus on achieving their goals and dreams. If you want to realize your financial potential, you must have aspirations great enough to motivate you to do more than just what "needs" to be done to alleviate the economic fears in life. Great aspirations are the beginning of great accomplishments.

This is perhaps a broad simplification, but too many personal financial programs start and end with a "needs analysis." How much insurance would your family *need* if you died tomorrow? How much money will you *need* in retirement? What will you *need* to cover the expenses of a possible long-term care incident? These are all good questions, and they should be answered, but is that all there is?

What about asking these questions (and developing plans to answer them)?

- What do you want your financial life to be like?
- How much insurance do you want to have?
- How much money do you want in retirement?
- What do you want to accomplish?

When put in front of some serious-minded, well-intentioned advisor, your financial dreams and aspirations may seem “unreasonable,” given your current circumstances and financial history. But if these are really your dreams and aspirations, be slow to surrender them – even to expert opinion. If an advisor is telling you it can’t be done, maybe you have the wrong advisor.

**When you discover the things that really inspire you, you have the enduring motivation necessary to execute a good financial plan.**

This “follow your dreams” perspective on financial planning may sound like a bunch of positive-mental-attitude psycho-babble. But when you discover the things that really excite and inspire you, then you have the enduring motivation necessary to execute a good financial plan.

A strong financial dream makes it possible to:

**Save and accumulate. And keep doing it.** The commitment to saving and accumulating assets is the “quantum leap” that moves one to financial success. In 2002, The GE Center for Financial Learning released a study that found 1 in 5 Americans don’t save money on a regular basis, while 3 in 5 save less than 10% of their earnings. Saving is an acquired habit that demands discipline and consistency – it’s a long-term thing with a big pay-off. But most people don’t have a motivation strong enough to sustain the habit. They are constantly distracted – they accumulate, then liquidate over and over.

**Control costs.** Spending is the most natural use for money. People who don’t know what they want to accomplish financially will be wasteful with money – even if they “save.”

On one hand, fearing they may not have enough in retirement, people pile contributions into a qualified retirement plan. They even claim to like that the money is “locked up” (“it’s better if I can’t get at it”). Then those same people use credit cards to support their current lifestyle – because they don’t have the money. This situation (which is quite common) is a form of financial schizophrenia. Because of fear, they may save for the future, but at the same time they sabotage the future by borrowing to support today.

**Deal with the fear factors in advance.** Just because you have a financial program based on your dreams doesn’t mean that all economic challenges will be eliminated. You might still lose a job, make a bad investment, incur a pile of medical bills, get sued. (In “A Christmas Story,” Ralphie gets the BB gun, and you guessed it...shoots his eye out. Well, sort of. A ricochet hits Ralphie’s glasses, and the glasses are shattered, but Ralphie is unhurt.)

But when you have a financial program that matches your real aspirations, you become **future-oriented**. Believing your future will be worthwhile, you are much more willing to take intelligent, pre-emptive steps to keep economic fears from disrupting your plans. Instead of knee-jerk decisions made under pressure (from the situation or some salesperson), your **dreams** compel you to take initiative. You want to handle the fear factors now, not later.

**Do you want to get your financial life focused, and maximize your financial potential?**

One of the first steps is figuring out what you really want. Another is finding someone who can work with you to reach those objectives. After that, the rest (though not always easy), is simple.

Don’t let the hype of today’s headlines distract you. If you constantly develop, emphasize and reinforce your financial dreams it will help you stay focused on basic fundamental strategies that, if consistently practiced, lead to success.

***Pssst...***

Think your dreams may be outlandish or unrealistic? Here are a couple of reasons to keep dreaming:

***“Ah, but a man’s reach should exceed his grasp. Or what’s a heaven for?”***

**- Robert Browning**

***“Reasonable men adapt themselves to their environment; unreasonable men try to adapt their environment to themselves. Thus all progress is the result of the efforts of unreasonable men.”***

**- George Bernard Shaw**

## NEWS DIGEST

*(Snippets from stuff we've read, including differing points of view, not all of which we agree with. Want to know more? Give us a call and we can provide you with the complete article.)*

### **AMERICANS UNPREPARED TO DOCUMENT PROPERTY LOSSES IN A DISASTER**

Catastrophic property loss – whether from fires, floods, earthquakes, tornados or hurricanes – threatens all Americans. Hurricanes Katrina and Rita alone damaged or destroyed an estimated 350,000 homes. Yet a recent survey revealed only 3 in 10 homeowners and renters have taken steps that would help them verify their losses to insurers in the event of such a disaster. And nearly 7 in 10 have no idea how to begin.

The Federal Emergency Management Agency and other government agencies urge people to prepare for property loss and damage by recording their household possessions. Having a complete, accessible record is invaluable in speeding up and receiving accurate insurance claim settlements. Yet only 30% of homeowners and renters are heeding this advice, according to the third Annual Quicken Financial Literacy Survey.

*Business Wire, August 1, 2006.*

### **EMPLOYERS FAVOR BONUSES OVER PAY RAISES**

Employers are making employees work harder for their money. Most workers will receive modest raises this year and next, as employers reward employees with performance-linked bonuses rather than broad salary increases, according to a survey by consulting company Hewitt Associates Inc. to be released today.

“More companies are relying on bonuses as the basis for pay for performance than they are on merit increases,” says Hewitt consultant Ken Abosch. Bonuses can help employers manage costs and are “very effective around creating focus” on business objectives, Mr. Abosch says. Hewitt’s annual survey included about 1,000 large and midsize U.S. organizations this year.

*Erin White, Wall Street Journal, August 28, 2006.*

### **LONG-TERM CARE INSURANCE: MOST NEED IT BUT FEW UNDERSTAND WHY**

When you think about your plans for retirement, a nice place to live, traveling, playing golf and leaving an inheritance for loved ones may all be part of your plan. Sounds lovely. But what will happen to your plan if you become unable to care for yourself due to an illness, accident or maybe just the effects of getting older? You'll need some type of long-term care, and that won't come cheap.

"The reality is that 60 percent of Americans who reach age 65 will someday need long-term care services and in many parts of this country, these services can cost more than living in a five-star hotel," said David F. Woods, CLU, ChFC, president of the LIFE Foundation. "People need to learn more about long-term care insurance and understand the chance they're taking by not insuring themselves against the risk of one day needing assistance with the tasks of daily living. Delaying or avoiding the decision to buy a long-term care insurance policy can mean the difference between living your retirement years on your own terms or facing some very difficult financial realities."

*PRNewswire, August 1, 2006.*

### **25 PERCENT OF U.S. CONSUMERS HAVE NO SPARE CASH – BUT IT'S GETTING BETTER**

The United States and Portugal top 42 markets for the most cash-strapped consumers according to a recent global online survey from ACNielsen, the world's leading provider of consumer and marketplace information. Nearly one-quarter (22%) of U.S. respondents said that once they have covered their essential living expenses, they have no money left over.

While the U.S. may have the highest percentage of consumers with no spare cash, this number dropped 6 percentage points since the last ACNielsen survey in May 2005. The improvement dovetails with other signs that U.S. consumers are trying to improve their financial situation. For example, of U.S. consumers who do have spare cash, their first priority for that money is debt repayment. This number had increased nine percentage points since October 2004. Additionally, more than one-third (35%) of U.S. consumers report putting spare cash into savings – up 12 percentage points since October 2004.

*ACNielsen US News Release, January 24, 2006.*

### **BUYING NEW OR USED: WHICH IS BEST?**

When it comes to buying a car, the decision whether to buy new or used is easy, financially speaking: Your best deal is likely to be a used car that's two or three years old.

“Buying a used car is actually one of the unheralded secrets of keeping your money in your wallet and reducing your automotive costs,” said Philip Reed, consumer advice editor at Edmunds.com, the auto research and information site. “People will do things like clip coupons. That's nothing compared to the savings you will find in your cars,” he said. Cars depreciate about 30% in their first year on average, Reed said. “The most significant depreciation moment [is] when you drive it off the lot and it goes from being a new car to a used car. You want someone else to incur that penalty.”

*Andrea Coombes, MarketWatch, September 21, 2006.*

## SMALL SAVINGS COULD ADD UP

On its *Personal Finance Features Archive* page, the General Electric web site (ge.com) features an article about Financial Independence which highlights the cumulative financial effect of making small decisions to save money. For example, bringing coffee to work instead of buying it is estimated to save a dollar a day. But if that dollar a day was invested in an account earning 8% interest over 30 years, the total balance would be \$32,291.12. Buying 5 less lottery tickets each week for 30 years (an extra \$5/wk.) would also generate \$32,291.12. Among the other suggestions:

- ♦ Using only your own bank's ATM - \$19,374.67
- ♦ Renting a movie instead of going to the theater - \$22,355.39
- ♦ Saving all your change - \$64,582.24

These are simple math exercises; you choose a dollar amount, calculate interest and let the account compound over time. For a 35-year-old, changing these five everyday, low-dollar transactions could mean an extra \$170,000 at age 65. Imagine that.

Besides illustrating how little things add up, the example also points out how important it is to start doing the right things as soon as possible. The longer time period you are able to save and compound, the greater the long-term benefit.

## THINGS THAT MAKE YOU GO "HMM..."

### IRS Attends the Oscars, Passes Out 1099-MISCs

You may not have known this, but celebrity presenters receive a "gift bag" for their services as compensation for walking to the podium to read category nominations and present an award. These gift bags usually contain sample products from retailers eager to garner some public relations value for having a star connected to their product.



Over the years, these gift bags have become more extravagant. This year's event featured gifts totaling \$35,000 and included (according to columnist Eva Rosenberg) "four nights at Honolulu's Halekulani Resort, with a 24-hour butler, valued at \$25,000." In consideration of the size of the gifts, the Academy of Motion Picture Arts and Sciences voluntarily met with the IRS to determine the extent of tax liability and reporting that would be required.

While it is customary for many businesses to hand out complimentary merchandise as a way to say "thank you" to special customers, the IRS determined that items distributed by the AMPAS to the celebrities were a form of advertising, and the gift items were deemed to be compensation to the celebrity for the use of his or her notoriety. This compensation must be reported as income by both celebrity and AMPAS, and AMPAS is required to provide each celebrity with a 1099-MISC at the end of each year.

*Wait, there's more.* Most of the glamorous women attend the ceremony in designer gowns. Since the designer is presumed to have benefited from the star's endorsement of their product, the star must report the fair market value of the gown as income. According to Rosenberg, many of these one-of-a-kind garments have "high-five figure values."

*Hmmm...* F. Scott Fitzgerald is reported to have told Ernest Hemingway, "the rich are different than you and me." Hemingway supposedly responded. "Yes, they have more money." Based on these examples, the IRS finds different ways to tax the rich for having more money.

## IF THE RULES KEEP CHANGING, HOW DO YOU KNOW IF YOU'RE WINNING THE GAME?

For Ben Franklin, the only certainties in life were death and taxes. As an amendment to that statement, Franklin might add a clarification: taxes are a certainty, but it is also certain that tax laws will change.

Susan Tompor, a syndicated financial columnist for the *Detroit Free Press*, began a September 17, 2006 column about government-sponsored college savings plans with these words:

"The miserable part about trying to save money for your child's education – besides actually having to save money – is that the tax rules keep flip-flopping...How can a parent be expected to make Halloween cookies, take kids to basketball practice, read books with a child, save money for college and, yes, keep up with tax rules?"

Tompor's lament involves the recent changes to Coverdell Education Savings Accounts. Beginning in 2011, funds from these accounts will not be able to be used for elementary or high school tuition or related expenses. Unless the funds are withdrawn to pay for college expenses, parents face taxes on the earnings, plus a 10% penalty on the withdrawal.

This change presents a problem for those who established Coverdell accounts when their children were born, then hoped to use the funds for something like tuition at a private high school. The money was deposited based on the assumption that the tax rules governing the plan would be the same 10 or 15 years later. But the rules have changed, and Coverdell account holders are left to deal with the fallout.

At the same time, an August 8, 2006 *Wall Street Journal* article details a “new lease on life for 529 plans.” Congress gave permanent status to 529 college-savings plans, the provisions for which were set to expire in 2011. This preserves the tax-free withdrawal status of 529s, and also allows account holders to roll over their plan to a different state plan once a year without requiring a change in beneficiary.

Neither article provides much insight into the reasons for the changes to both plans. And neither offers any assurance that things won't change again. Tompor quotes Harris M. Abrams, an RIA tax analyst from Thomson Tax & Accounting: **“There's no question that it makes tax planning difficult when you have no predictability.”**

In recognition of the unpredictability of future taxes, some account holders are looking for ways to perhaps minimize future tax consequences on their savings by paying some of the tax today. For some, that means exploring the possibility of converting a regular IRA into a Roth IRA. For a variety of reasons, it may be better to pay taxes now than have an unknown tax cost looming over every withdrawal in retirement.

Another variation on this “pay the taxes now” strategy is called Net Unrealized Appreciation (NUA). The details are complex, but here's an attempt at a simple overview:



The tax rules keep flip-flopping...How can a parent be expected to keep up with tax rules?"

If you own company stock inside a retirement plan, and think you might hold the shares even after you terminate your employment, you have the option of transferring the stock to an after-tax account. Similar to the IRA-to-Roth IRA conversion, some tax must be paid with the change. (This tax cost can be calculated from an average share price which, depending on when the shares were purchased and their current price, could be less than your actual cost.)

The potential advantage is that when you finally decide to liquidate the stock, the sale is from a personal account and thus is subjected to capital gains tax, not income tax. If you kept the stock in a 401(k) or rollover IRA and cashed out directly from those accounts, you could pay as much as 35% income tax. Current capital gains taxes rates can be significantly lower. (Note: This is a complex transaction, both to calculate and execute. Do not attempt without professional assistance!)

In light of the likelihood of change, but the uncertainty of what might change, you might ask “is the tax advantage I think I'm getting really worth surrendering control of the funds?"

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