

CREATIVE

Wealth Maximization Strategies



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**"What separates those who achieve from those who do not,
is in direct proportion to one's ability to ask for help."**

- Donald Keough, former president of Coca-Cola

Being Your Own Best Customer

Please read the following short story and answer the two questions at the end. A discussion of your answers (and ours) will follow.

You are the owner of a local grocery store. This business is your livelihood – selling bread off the store's shelves puts bread on your table.

Here is the essence of your grocery store business: You have fixed overhead like the building, the display shelves, refrigerators and freezers. Depending on the size of your store, you may have employees. And you have inventory – the groceries that stock the shelves.

Profit margins for groceries are slim, usually no more than 2-3% for each item sold. For example, a can of peaches that you purchase from a wholesaler for 98 cents will be sold for a dollar. In order to be successful, you must rely on volume. Simply put, you need to sell lots of cans of peaches (and other items) to cover your store overhead and make a profit. Assuming you properly manage the facets of your business, you can earn a comfortable living. Do this for several years, and you and your store become a fixture in your community.

But one day, change comes to this happy scenario. Seeing an opportunity to expand into a prospering community, one of the big chain grocery companies opens a store down the street. With their volume purchasing power, the chain can sell the can of peaches at retail what you are paying wholesale – and still make more money. For example, the can of peaches that cost you 98 cents to put on the shelf only costs the national chain 96 cents. Consequently, the chain sells the peaches for 98 cents – the amount you paid wholesale – and still makes a profit.

Of course, just because your competitor has an economic advantage doesn't mean your business is finished. Many of your customers will continue to shop with you because of your location or your service, even if your prices are a little higher. And you may have to manage your store a little better as well, perhaps by trimming employee hours, or reducing losses from theft. But you do what all good businesses do: you recognize the competition and adjust.

Now for the questions.



A flyer comes in the local paper announcing a "Truckload Sale" by the chain store. Peaches are now selling for 95 cents – retail! You are looking through the store specials of your competitor when your family walks in, grabs a shopping cart and pulls up to your counter. You take one more look at the sale flyer, then at your family, and wonder:

1. **Where should my family buy its groceries? And why?**
 - a. Right here – shopping here helps our bottom line.
 - b. Right here – if we don't shop here, why should anyone else?
 - c. At the big chain store – the better price means money saved.

and...

2. **What price should my family pay – especially for the peaches?**
 - a. We pay our retail price, the same as all of our customers.
 - b. We pay wholesale.
 - c. We don't pay anything, and just take the peaches out the back door. After all, they're our peaches.

How do you answer those questions? Why?

Our answers – and why

Since you own the store in this hypothetical exercise, you can answer the questions any way you want. However, here's how we would answer both questions:

#1: a. Here's why:

Regarding the question of where to shop, if you go to the chain grocery store because of the better retail price, you are helping a direct competitor make a profit – *with your money*. If you are going to spend some of your money, why not spend it in your own store, where it can come back to you as part of future profits?



Most people understand this concept. They've heard that most business owners who are both providers and consumers of their product or service should be their "own best customers."

But not as many people agree to the answer to the second question...

#2: a. They should pay full price for what they buy from themselves. In fact, many people balk at paying anything for using their own inventory. This is a crucial mistake, because not paying full price is a form of theft.

To explain the theft, let's change the example.

Suppose you want to buy a new car. The purchase price is \$30,000. You have \$50,000 in accessible savings (in a bank account, money market, insurance policy, etc.) that you have earmarked as your "emergency/opportunity" fund. You are currently contributing \$700 each month to a savings/retirement plan, and also have a monthly car payment of \$500 to your local bank or credit union. For several reasons, you decide you are going to replace the existing vehicle with a newer one. After calculating the trade-in value, your new car will have the same \$500 a month payment – you can upgrade your transportation for the same monthly price.

You have the funds to make a cash purchase from your personal account, or you can get the car financed through your local bank. To parallel the grocery store example, the first question is:

1. Where do you "shop for money," at your own "bank" of accumulated assets, or the bank down the road?

Then, assuming you decide to use your own bank, comes the next question:

2. What price do you pay for the use of the money? Do you simply liquidate enough shares, write a check, and say "hey, it's my money" – or do you plan to pay the account back, just like you would with a car loan from the bank?

If you borrowed money from the bank down the street, you would expect to repay the bank with interest for the use of its money. And, if someone borrowed from you, you certainly expect to receive interest from them for the use of your money. If you didn't pay the bank, or a lender didn't repay you, criminal charges would most likely follow, because to borrow and not repay is a form of stealing.

In both situations, the interest paid is recognition of the "opportunity cost" that results from placing the money in someone else's hands. Logically, it follows that if you would pay for the use of another's money, and would expect others to pay for the use of your money, you should be willing to pay yourself for the use of your money. It's an acknowledgement of

the opportunity cost you experience for liquidating the investment account to buy the vehicle.

(Some might argue that this "internal transaction" is really an asset transfer – the value moves from your account to a new car. If you were transferring from one fund account to another, this might be true because there is the expectation that the new account will continue to appreciate. But in this case, the new car will steadily decline in value as it is used, until the vehicle's worth has decreased to scrap metal. Buying the car definitely incurs a financial opportunity cost.)

"Okay, this is a (somewhat) interesting bit of mental gymnastics, but what does it have to do with my financial planning?"

In the book *Becoming Your Own Banker*, author R. Nelson Nash uses a variation on the grocery store illustration presented above to illustrate several key, but often misunderstood, concepts about the impact of banking transactions on our financial lives. Nash asserts that every bank transaction (even "free checking"), entails opportunity costs. His question is "who's collecting the fees and interest from your transactions?"

Individually, we can't function as a true institutional bank. But think of how many financial transactions you make today (and will make in the future) that send either interest to lenders (if you borrow from them), or incur opportunity costs for you (because you paid cash). Think of what that interest or opportunity cost could be worth to you if you were paying it to *yourself* instead of to them. (From our example above, what if your car payments were earning interest for you? Not only would there be the \$700 each month adding to your accumulation, but so would the \$500 car payment.)

Going back to the \$50,000 in an "emergency/opportunity" fund, many people might think of a financial opportunity as a chance to buy a business, speculate on a private placement stock offering, or purchase an office building. Did you ever think that lending to yourself could be a "profit opportunity?" If you are willing to pay someone else interest for the use of their money, why not pay yourself for the use of your own?

Have you structured your financial program so that when the opportunity arises, you can be your own bank?

Hmmm.... A car loan from the Bank, or from yourself?

Since you can be both a provider and consumer of money, make sure you are being your own best customer. Make sure the dollars in your "bank" aren't robbed of their opportunity costs when they are used!

THINGS THAT MAKE YOU GO “HMMM...”
THE RELATIONSHIP BETWEEN ACCUMULATION AND DEBT

“There is a fundamental relationship between what you earn, how much debt you have, and what you can afford to save.”

*Charles Farrell,
Dorman Farrell, LLC*



Since so much of financial planning is quantified by numbers, you can’t pick up a financial publication or flip on the television without coming across some sort of formula, whether it’s to calculate how much you need for retirement, predict what the stock market will do in the next week, or determine how much life insurance you should own, etc. Some of the formulas are so complicated, situation-specific, or just plain bizarre that their application is limited in value. And others are so general that they may not be of much use in your particular situation.

But Charles Farrell, a financial planner in Medina, Ohio has developed a formula that makes an interesting connection between debt and savings. This formula, while it might not apply perfectly to every individual situation, should provoke some thoughtful consideration about how and when it is appropriate to take on more debt (such as a larger home) and when it might be better to keep saving.

Taken from a March 23, 2005 *Wall Street Journal* article, the chart below show ratios of debt and saving accumulations in relation to annual income. For example, according to Farrell’s calculations, a 40-year-old earning \$100,000 annually should have \$180,000 in savings (\$100,000 x 1.8) and \$125,000 in debt (\$100,000 x 1.25). As one gets older, the accumulation numbers go up, while the debt numbers go down. According to Farrell’s model, maintaining these accumulation-debt/income relationships will result in the likelihood of a comfortable retirement.

Age	Savings-to-Income	Debt-to-Income
30	0.1	1.70
35	0.9	1.50
40	1.8	1.25
45	3.0	1.00
50	4.5	0.75
55	6.5	0.50
60	8.9	0.20
65	12.0	0.00

Hmmm... Historically low mortgage interest rates over the past decade have encouraged people to buy more house for the money, since most people evaluate their housing budget in terms of what they can afford as a monthly payment, as opposed to the amount borrowed. Using Farrell’s numbers, how many 45-year-olds with an annual income of \$100,000 have a mortgage for less than \$100,000?

How To Stop Paying Dues In The “Starbucks Retire-Now Club”

Paul Farrell is a distinguished personal finance writer whose work has appeared in books, the *Wall Street Journal*, *CBS MarketWatch*, and several other formats. Occasionally, Mr. Farrell admits that he wonders if most of his writing is an exercise in futility, since it’s his observation that “nobody’s listening.” Farrell notes that “Back in the early 1980s America’s savings rate was 12 percent. Today, it’s about zero. Americans are saving exactly nothing.”

Instead of saving for a future retirement, Farrell concludes that many have decided to retire in a whole new way, by “retiring” just a little bit every day. He calls it the Starbucks Retire-Now Club, where a triple Caffe Americano and a muffin costs you five bucks, and buys a daily moment of relaxation and escape – a little bit of “retirement” today. This daily \$5.00 exchange of future savings (which Farrell estimates could easily be worth \$1 million over one’s lifetime) for immediate pleasure makes any financial planning a waste of time.

What’s the answer to this problem? Nothing fancy. It’s found in an excerpt from Farrell’s February 13, 2005 column. We’ll call it:

The 10-Percent Guarantee

Want to retire with a million in cash? Here’s the perfect solution, for you in particular, and for America’s retirement system overall. In fact, if everyone were using this simple strategy today all of America’s 294 million citizens could retire in comfort and with dignity. Guaranteed! What’s this marvelous secret?

Save 10 percent!

Too simple? You expected some wisdom about the magic of diversification? The beauty of no-load index funds? Maybe some insider tips on the best stocks for the long haul?

Nope, just “Save 10 percent!”

OK, you’ve heard it before. But after writing a thousand columns and several books, reading hundreds of great books on investing, all the newspapers and magazines, and spending every day tracking news online, everything always comes back to this one fundamental equation:

Zero saved equals zero invested.

Wow. If brevity is the soul of wit, then “Save 10 percent!” is the soul of financial planning.



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 ARE REALISTIC ABOUT SOCIAL SECURITY AND RETIREMENT

Contrary to existing research and conventional wisdom showing that American workers continue to unrealistically plan on Social Security to fund the significant portion of their retirement income, the newest *Principal Financial Well-Being Index* reveals that Americans are indeed listening to the public debate over Social Security and they appear to “get it” when it comes to Social Security’s true place in their retirement picture.



According to industry expert Larry Zimbleman, president of Retirement & Investor Services at the Principal Financial Group, much of the former research on the subject reports that most Americans believe Social Security will replace all or most of the income they need to live in retirement, while new data paints a picture of a more knowledgeable set of American workers today. The vast majority of respondents (77%) said they expect Social Security to provide about 50% or less of their income replacement in retirement, which Zimbleman validates as being on target.

Business Wire, March 15, 2004.

THEY MIGHT BE REALISTIC, BUT IT DOESN'T MEAN THEY ARE COMFORTABLE

Millions of Americans are uneasy about their financial prospects in old age – a nervousness that complicates President Bush’s uphill efforts to persuade them to accept dramatic changes he’s proposing for Social Security. Almost half of Americans who haven’t retired say they don’t think they’re doing a good job getting ready for that time in their lives, an Associated Press poll found. One-third say they’re not confident they’ll have enough money in retirement.



Will Lester, *Associated Press*, March 2, 2005.

ONLY 1 IN 120 INDIVIDUAL RETURNS ARE AUDITED

The year the kinder, gentler IRS came into being, about 1 of every 79 tax returns was audited. Today’s tax scofflaws have a better chance of escaping notice.



Although the total number of individual audits in fiscal 2004 exceeded one million for the first time since 1999, most people still escape IRS examination. In 2004, nearly 128 million returns were filed, making the chances of any single filer getting audited still quite slim. Even when cheaters were caught, a study by the Treasury Inspector General for Tax Administration found that the creative filers faced little risk when they disregarded tax penalties.

Kay Bell, *bankrate.com*, March 8, 2005.

AS AN INVESTOR, DO YOU REMEMBER MARCH 2000?

If you own shares of a mutual fund, March 10, 2000 is a day that lives in infamy. That is the day – five years ago, Thursday – when the tech-laden Nasdaq Composite Index peaked after climbing nearly 80% in 1999. But then there was the trip down the other side of the mountain, when the index fell 59% from its peak, wiping out 1999’s gains.



The bear market was so tough that four of the 10 top-performing funds in 1999 have vanished because of fund mergers... Those who hung in through the bear market took a beating. They got a reward of sorts, with the past two up years for stocks, though most funds are still underwater from the peak.

Ian McDonald, *The Journal Report*, March 7, 2005.

IS YOUR 401(k) PROTECTED FROM THEFT?

Retirement plans are facing a growing threat: theft. Labor Department investigators found 1,269 instances of missing 401(k) money in the fiscal year ended Sept. 30, 2004. That is a 37-fold increase from 34 violations found in 1995.



Defined-contribution plans such as 401(k)s – in which employers and employees make contributions but which offer no guaranteed payouts – have skyrocketed in popularity. But worker protections are relatively weak. While the federal government requires a yearly, independent audit for retirement plans with at least 100 workers, that doesn’t cover the vast majority of plans. According to the Labor Department’s most recent statistics, 627,905 defined-contribution plans covered fewer than 100 workers and had no required audit in 1999. Only 55,195 such plans fell under the rule.

Employees often have little recourse. Traditional pension plans with fixed payments to retirees, known as defined-benefit plans, can be bailed out by the Pension Benefit Guaranty Corp. if they fail. There is no such safety net for defined-contribution plans.

Kelly Green, *Wall Street Journal*, March 2, 2005.

USE AN UMBRELLA TO PROTECT AGAINST A LEGAL SOAKING

Do you...

- Own a swimming pool?
- Have frequent guests or visitors in your home?
- Operate a personal watercraft or other high-risk recreational vehicle (like an ATV)?
- Have a large number of assets?
- Have a high public profile?
- Operate a business?
- Own rental property?
- Drive a high number of miles, or have teenage children that drive?
- Own a dog?



If you answered “yes” to any of these questions, you should give serious consideration to obtaining PUL insurance. If you answered “no” to all of these questions, it still might be a good idea to obtain PUL insurance.

PUL stands for **Personal Umbrella Liability** insurance. As the name suggests, this is coverage that provides insurance protection to help offset the costs you might incur from a lawsuit judgment against you. PUL insurance is usually a supplementary policy that coordinates with the existing liability protections that are part of our homeowner’s or automobile insurance. The PUL adds an extra layer (or “umbrella”) over the base coverage amounts.

According to Jennifer Openshaw, CEO of Family Financial Network, PULs are growing in popularity in response to the increasing number of personal-injury awards in excess of \$1 million. Since the amount of liability protection on either home or car insurance is commonly between \$300,000 and \$500,000, those without PUL run the risk of exposing personal assets to judgment.

Since PUL insurance is only responsible for the “excess” risk, the pricing can be very reasonable, especially if the coverage is purchased from the same company that insures your car or home. Openshaw states that it is “not uncommon for many people to start out with a \$1 million PUL for...only \$200 to \$300 per year.” Higher liability limits are also available (even up to \$10 million). Also, the actual pricing for PUL protection may be affected by your occupation, lifestyle and driving record.

Openshaw notes that PUL coverage protects not only people who currently have substantial assets, but is also important for those who need to protect their financial futures. “A 22-year-old delivery driver need not only worry about protecting his relatively minor assets, he must also worry about a judgment against the next 25 years of his salary being garnished by a jury award.”

By the way, the Insurance Information Institute reports that one-third of all homeowner’s liability claims, totaling more than \$1 billion, are the result of dog bites.

To steal a phrase from Warren Buffet, one of the objectives of financial planning is to construct an “economic castle with an unbreachable moat.” It would be a shame to let your financial castle be breached by a freak or frivolous lawsuit because you left a small portion of your moat exposed by not having a PUL policy in place.



THE 2005 LIST OF BILLIONAIRES – ARE YOU NEXT?

Once again, *Forbes* magazine has compiled a list of the World’s Richest People, providing a ranking of all the individual billionaires across the globe. *Forbes* determined that the total number of billionaires grew to a record 691 in 2004, up from 587 last year. A big factor in the 20 percent increase in billionaires was attributed to strong performances in many overseas stock markets and the declining value of the dollar.

Below is a list of the top 15 billionaires, according to *Forbes*, along with some background information.

Some items of note:

- Even though his calculated net worth dropped slightly, Bill Gates retains his position as the richest individual in the world for the 11th year in a row. However, the combined fortune of the Wal-Mart heirs (Sam Walton’s wife and his four children) is almost double Gates’.
- Of the top 25 fortunes listed by *Forbes*, only one could be considered as derived from stock market investing. That would be Warren Buffet, the founder of the Berkshire-Hathaway investment company. (Prince Alsaud’s investments are primarily in real estate and hotel properties.) The vast majority of the billionaires have achieved their wealth either through ownership of a business or inheritance of a business.
- The 25th-richest individual, Silvio Berlusconi of Italy, is not only the richest person in his country but also the prime minister.
- Almost none of the wealthiest individuals are retired, even though many of them are over 65. With the exception of Helen Walton and two of her children, those whose wealth is primarily a result of an inheritance are still actively involved in the family business.
- Martha Stewart, just out of prison, made the list for the first time this year, ranking 620th.
- The *Forbes* website even has a “billionaire quiz” of 10 questions that can predict whether or not you have the right stuff to become a billionaire yourself.

(continued...)

Forbes' 2005 List of The World's Richest People

Rank	Name	Age	Worth in Billions	Citizenship	Source	Industry
1	William Gates III	49	\$46.5	United States	Microsoft	Software
2	Warren Buffett	74	\$44.0	United States	Berkshire Hathaway	Investments
3	Lakshmi Mittal	54	\$25.0	India	Steel	Manufacturing
4	Carlos Slim Helu	65	\$23.8	Mexico	Telecom	Communication
5	Prince Alwaleed Bin Talal Al Saud	48	\$23.7	Saudi Arabia	Investments	Investments
6	Ingvar Kamprad	78	\$23.0	Sweden	Ikea	Retailing
7	Paul Allen	52	\$21.0	United States	Microsoft	Software
8	Karl Albrecht	85	\$18.5	Germany	Supermarkets	Retailing
9	Lawrence Ellison	60	\$18.4	United States	Oracle	Software
10	S Robson Walton	61	\$18.3	United States	Wal-Mart	Retailing
11	Jim Walton	57	\$18.2	United States	Wal-Mart	Retailing
11	John Walton	59	\$18.2	United States	Wal-Mart	Retailing
13	Alice Walton	56	\$18.0	United States	Wal-Mart	Retailing
13	Helen Walton	85	\$18.0	United States	Wal-Mart	Retailing
15	Kenneth Thompson & family	81	\$17.9	Canada	Publishing	Media



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