

CREATIVE

Wealth Maximization Strategies

Alliance Financial Group
14021 Metropolis Ave
Fort Myers, FL 33912
239-561-2900
John J. Bellino III
John_J_Bellino@glic.com

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"A coach is someone who tells you what you don't want to hear, who has you see what you don't want to see, so you can be who you have always known you could be."

-- Tom Landry

PLANNING: THE ANTIDOTE FOR FINANCIAL PSYCHO-BABBLE

Although the stock market and the economy seem to be rebounding, the last three years put serious pressure on the financial lives of many Americans. Whether it was losing a job or losing value in the stock market, the downturn resulted in a reshaping of many of the plans people had for their futures. For some, the prospect of an early retirement vanished with the falling market. For others, the stock options that were supposed to be the basis for career independence became worthless. While most have perhaps survived, there's little doubt the last few years have exacted a financial and emotional toll of many Americans.

So, as financial commentators look back on the economic and financial wreckage from 2000 to 2003, the understandable inclination is to attempt to identify what went wrong, and propose strategies to avoid similar pitfalls in the future.

It may signal a larger cultural trend, but many of the analyses of the past three years are focused less on the technical and statistical aspects of the recession and more on "psychological" forces that are believed to have conspired to create financial discomfort. When looking at financial issues, it almost seems as if psychologists have replaced economists as the experts.

And psychologists see a completely different picture. The theories that have been put forward, and some of the proposed solutions that result, are so different, so "opposite," that you may have to read them twice to be sure these experts are really serious in their assessments.

What follows is a sampling of some recent commentary:

You have too many choices.

Barry Schwartz is a professor of psychology at Swarthmore College. In a January 22, 2004 *New York Times* editorial titled "Nation of Second Guessers," Schwartz states that one of the reasons most people fail to obtain fulfilling employment, or secure a comfortable retirement is because there are **too many options available**. According to Schwartz, "increased choice can lead to a decrease in satisfaction."

In support, Schwartz offers the following evidence:

Sheena Iyengar and Mark Lepper, psychologists at Columbia and Stanford respectively, have shown that as the number of flavors of jam or varieties of chocolate available to shoppers is increased, the likelihood that they will leave the store without buying either jam or chocolate goes up. According to their 2000 study, Ms. Iyengar and Mr. Lepper found that shoppers are 10 times more likely to buy jam when six varieties are on display as when 24 are on the



shelf.

Interesting, eh? But that's jam and chocolate. What do these findings have to do with financial planning? Read on:

In another study under way, Ms. Iyengar found that as the number of mutual funds in a 401(k) plan offered to employees goes up, the likelihood that they will choose a fund – any fund – goes down. For every 10 funds added to the array of options, the rate of participation drops 2%. And for those who do invest, added fund options increase the chances that employees will invest in ultraconservative money market funds.

This “psycho-logic” of too much choice, as Schwartz calls it, is actually a **debilitating** force in people’s lives:

For starters, increased choice creates an enormous burden on people to seek the information needed to make a good decision. Who has the time to find the best digital camera, the best cellphone plan, the best 401(k), the best health insurance or the best school for his children?

Similarly, an abundance of options raises people’s expectations about how good the option they have chosen will be. In this regard, the objective quality of the choice gets lost as it is compared with high expectations generated by the host of rejected alternatives.

Finally, increased choice forces people to take personal responsibility for all choices that turn out to be less than perfect. With so many options available, there is no excuse for anything less than perfection, and when less than perfection is what you end up getting, the fault must be yours.

Whoa. If the problem is too many choices, then what’s the solution? No choices? Schwartz doesn’t go quite that far, but...

While a life without any freedom of choice would not be worth living, it appears not to be true that more choice inevitably leads to more freedom and greater happiness. Indeed, there may be a point when choice tyrannizes people more than it liberates them. The implication of this news, both for individuals and for government officials, is that sound social policy simply cannot consist of throwing an ever-greater menu of options at the American people.

“Choice tyrannizes people more than it liberates them?”

That sounds a lot like George Orwell’s 1984, a chilling world of totalitarian government in which the citizens are told that “Freedom is Slavery.”

Here’s another “psycho” observation about individual financial actions:

You have too many other things to do.

The same day that Mr. Schwartz’s comments appeared in the *Times*, Alicia Munnell, a Boston College economist, and co-author of “Coming Up Short,” a book on 401(k)s, was quoted in the *Wall Street Journal* on her opposition to allowing individuals the option (choice) to personally direct their Social Security “contributions.”

People make mistakes at every step along the way. It’s not that people are dumb. People live complicated, busy, rich lives, and they don’t have the time or interest to turn themselves into financial planners. Nor does that sound like a very good option. Do we want people to coach Little League less and learn more about finance?

Who knew that the decline in Little League coaches was because so many people had to “turn themselves into financial planners?” Given our already “complicated, busy, rich lives” it’s

understandable that financial planning would be an unreasonable challenge. So what is the solution? David Wessel, the author of the piece says...

Ms. Munnell offers a common-sense solution: let people do what they want, but don’t make it easy for them to do the wrong thing. Make use of human inertia: automatically enroll eligible workers; set worker contributions at a level to take full advantage of employers’ matching contributions; put 60% of the money in stocks and 40% in bonds; and give workers a low-cost annuity at retirement.

Some of Ms. Munnell’s ideas are already moving toward practical application. In a January 12, 2004 *Associated Press* article by Justin Pope, he notes

...plan administrators and fund managers have begun wondering if there’s a better way than prodding and pleading with workers to set aside a higher percentage of their income.

In the coming year, look for more companies to experiment with innovative ways to help investors help themselves – by “precommitting” to investment strategies that tie their own hands.

The strategy for better financial outcomes is to “tie their own hands?” Obviously, these psychological assessments of human behavior aren’t very optimistic. From this perspective, the best options are those that remove choice and responsibility from the individual. While individuals may occasionally display rational and controlled behavior, the vast majority must be protected from their own financially self-destructive behavior.

Is less freedom, less choice the only answer?

Upon further review, this “restrictive” approach to financial planning is probably bleaker than it needs to be. Even if the psychological assumptions are correct, there’s evidence that other responses generate equal, if not better, outcomes than increased control.

Know what you want.

The challenge of too many choices is only a problem when you don’t know what you want. If you want Hershey’s chocolate, it doesn’t matter how many other brands are on the shelf. If you want a mid-cap stock fund, it doesn’t matter if your 401(k) offers a high-yield bond fund.

This is a generalization, but the real financial planning problem for most Americans is that *they don’t know what they want to accomplish*, and they *don’t know how to do it*. But once you have a plan, the choices become much clearer, and the decisions much easier.

Get expert help.

Ms. Munnell bemoans that people “don’t have the time or interest to turn themselves into financial planners.” But that’s like saying the only way for individuals to be healthy is to turn themselves into doctors. Most people don’t become doctors, yet they use a doctor’s services to improve their health (and some of them find time to coach Little League as well). Similarly, you don’t have to become a financial planner to plan successfully,

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.)

DISABILITY ON THE INCREASE AMONG YOUNG ADULTS

"The latest casualties of Americans' rapidly expanding waistlines are young to middle-age adults, whose disability rates have jumped in the last 20 years due in large part to obesity, according to a study.

While people over 65 still had the largest share of disabilities, those under 50 had the fastest growing disability rates among any group, according to a survey from the Rand Corporation. The largest increase was for 30 to 39-year-olds, whose overall disability rate jumped by more than 50% between 1984 and 1996. Obesity, defined as having a body-mass index above 30, topped the list of likely causes, followed by the technological advances that save the lives of people who would otherwise die of their medical problems, the study postulated.

Dr. Robert Anfield, vice president and medical director of Chattanooga, Tenn.-based UNUM Provident, the No. 1 U.S. disability insurer, says the study's findings match the company's small but growing number of claims that list obesity as the primary diagnosis."

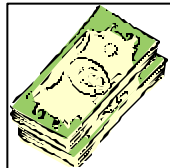
Kristen Gerencher, *CBSMarketWatch.com*, January 14, 2004.



IT'S NOT EXACTLY DR. PHIL, BUT...

"Money is the No. 1 reason that couples argue and is also a leading cause of divorce. Take care of your debt, and you and your significant other can switch from fighting about not having any money to what to do with the money you now have available. I would recommend creating a spending plan and getting on the same financial page. Then you can pick a totally new topic for arguments."

Steve Bucci, *www.bankrate.com*, January 13, 2004.



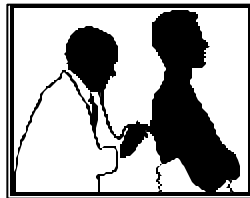
WILL INVESTORS LEARN FROM THEIR MISTAKES?

"Eighty million Americans lost half to 80% of their stock wealth during the market downturn, estimates William O'Neil, founder of Investor's Business Daily.

O'Neil said investors should use the painful lesson of the past three years to break bad habits. 'Most people operate on opinion and feeling. They need to operate on facts.'

Many investors let their portfolios get slaughtered because they lacked discipline about when to sell and didn't believe the markets could fall as they did."

Aldo Svaldi, *Denver Post*, October 13, 2003.



HEALTH CARE COSTS ARE HIGH BECAUSE WE PAY FOR THEM WITH INSURANCE

"Today's high cost of health care reflects the way that the tax law has subsidized the use of insurance to pay for health care. Private insurance now pays 70% of all non-government health-care costs and more than 90% of non-government hospital costs. Because out-of-pocket payments at the time of care are only a small fraction of the total cost of producing that care, individuals naturally want "the best care" that medical science can provide. And the demand for that high-tech care drives medical innovation toward new and more expensive modes of treatment.

The demand for the typical health-insurance policy reflects the tax provision that allows employees to exclude payments for health insurance from their taxable income. Since the annual premium for a family may be as much as \$10,000, the resulting tax savings is a very large subsidy for the purchase of the kind of comprehensive, low-deductible insurance policy that drives up health care costs and that has led to the imposition of controls on patient choice."

Martin Feldstein, *Wall Street Journal*, January 19, 2004.



BABY BOOMERS ON A COLLISION COURSE WITH RETIREMENT MATH

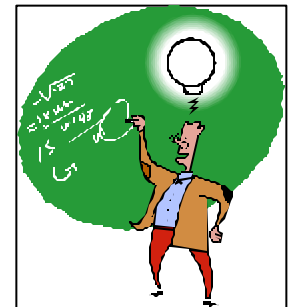
"If your total savings don't add up to more than \$50,000 to \$100,000, my best advice about retiring can be summed up in one word:

Don't.

Sorry if that sounds harsh, but it is high time that Americans, particularly aging baby boomers, realize they are on a collision course with the mathematics of retirement

savings. Numerous surveys show that Americans consistently underestimate how long they are likely to live in retirement and how much money they'll need while overestimating how much they can withdraw from their retirement kitty each year without undue risk of running out of money."

Humberto Cruz, *Personal Finance*, January 12, 2004.



**Be a strategist -
not
an opportunist.**

What is your Human Life Value?

For those that choose to buy life insurance, one of the most basic, and elusive, decisions is “how much?” Specifically, what is the amount of life insurance coverage that will effectively address the issues (income for survivors, estate planning, etc.) that prompted you to consider life insurance in the first place?

A simple method of calculation is the “multiple of earnings” formula. In this approach, one’s annual income is multiplied by a number, usually between 5 and 10. As an example, a 45-year-old earning \$75,000 with a multiple of 8 is calculated to “require” \$600,000 of life insurance.

The multiple in this calculation is somewhat arbitrary. For younger applicants, it may be larger, primarily to account for the effects of inflation over a greater period of time. But under any circumstance, “multiple of earnings” is just a rule-of-thumb calculation.

A more accurate method for determining coverage amounts is the Human Life Value approach. This is the same method that the court system usually uses to award judgments in wrongful death lawsuits. More complex than multiple of earnings, Human Life Value is defined as the present value of all future income that you could expect to contribute, less taxes and personal consumption through a planned retirement date.

This method attempts to include calculations for inflation, anticipated raises and promotions, as well as the “non-wage value” to one’s family (i.e., the value of one’s domestic and child-raising services). Once these projections are in place, a “discount rate” is calculated, providing a present-day lump sum that would generate enough money to meet the projected future earnings. In a situation similar to the one mentioned above, the 45-year-old’s Human Life Value could easily calculate to \$1,500,000. From experience, insurance company actuaries have developed a shorthand method for “ball-parking” Human Life Value by using multiples of earnings. Here are their guidelines:

<u>Age</u>	<u>Multiple of Salary</u>
25	25
35	20
45	15
55	10

How does your life insurance coverage match up with the chart above?

EVERYONE’S SITUATION IS DIFFERENT, BUT IT MAY BE PRUDENT TO SEE IF YOUR CURRENT INSURANCE COVERAGE SHOULD REFLECT YOUR HUMAN LIFE VALUE.

POLITICS OF MONEY

IS A STATE BUREAUCRAT MAKING INVESTMENT DECISIONS FOR YOU?

For many participants in state-sponsored **IRS Section 529** college savings plans, part of the attraction is the professional management services and investment options provided by well-respected mutual-fund companies. But as the details of the snowballing fund-trading scandal spread to implicate more fund companies, PR-conscious state officials that oversee the 529 plans have wasted no time in looking to remove management firms that may or may not be connected to the scandal.

According to a November 6, 2003 CBS MarketWatch.com article, education officials in Ohio are deciding whether Putnam Investments should continue to manage the \$2.6 billion in the state’s 529 college savings program. Meanwhile, their counterparts in Wisconsin, Oregon and Nevada are reviewing 529 plan management contracts with Strong Capital Management totaling about \$1.2 billion.

Other states with 529 plan managers that have run afoul of securities regulators over trading abuses include Rhode Island, which uses Alliance Capital Management; Indiana, which uses Bank One’s One Group; and South Carolina, which uses Bank of America.

On one hand, state officials could be applauded for acting as a responsible fiduciary for the 529 plan participants. On the other hand, a more cynical observer might see firing the mutual fund management as a calculated political move to enhance one’s own reputation by kicking a scapegoat that’s already down and reeling. After all, what level of expertise does some bureaucrat possess that allows him/her to assess the trustworthiness and competence of a mutual fund management team? And how can plan participants be sure that the change is really about protecting investors?

In July, New York State dropped TIAA-CREF as the management firm for its college-savings plan. Why? Not necessarily because of poor performance or illegal activity. Rather, the assessment was that programs offered by other fund companies, such as the Vanguard Group and Fidelity Investments, were *more popular*. Whoa. A politician endorsing the more popular plan of the moment – now that’s something unique, isn’t it?

This information serves as another opportunity to reiterate a foundational statement about achieving true wealth: control of your investment money is key.

Saving for your children’s college education expenses is a worthwhile and noble financial objective. But sacrificing control over the use and allocation of the funds in exchange for a modest tax break, coupled with a stack of regulations and restrictions is usually not an approach that allows the individual to maximize the financial possibilities from their hard-earned savings.

Maybe it’s okay for some people to sacrifice control. Maybe they don’t want the hassle of managing the money, or even the temptation to spend it. But when basic investment decisions are controlled by a politician who may have conflicting incentives for selecting or rejecting some of the choices, does that sound like a situation in which the individual investor is assured of being given the highest consideration?

(Continued from page 2)

you just have to know a good one that can help you. It's that simple.

You must participate.

Can you imagine someone recommending that doctors force (“precommit”) all their patients to follow a single exercise and eating regimen? Can you imagine doctors accepting that responsibility? Can you imagine this approach being successful? Of course not. In order for patients to get positive results, they must participate in their care. Without patient participation – following the program, getting better educated, etc. – there is almost no chance for success. On the other hand, plenty of motivated Americans do achieve better health, and do so using a variety of methods and medical assistance.

**Those who exercise
financial control are the
ones who achieve real
financial prosperity.**

Mr. Schwartz and Ms. Munnell conclude that financial planning is “too hard” for the average American. But why should financial health be different? If people who participate in their physical health can change their lives for the better, wouldn't the same principles apply to finances?

Taking control is key to long-term prosperity.

This point has been hammered home on a regular basis in this publication, but it bears repeating. Those who exercise financial control are the ones who achieve real financial prosperity. Any decision to relinquish control is a decision to reduce your financial opportunities and potential.

The psychologist may argue that allowing someone to “tie your hands” is for your own good. But giving control to someone else is only “good” if you believe your current financial behaviors are self-destructive – and unchangeable. Invariably, any financial plan that sacrifices control can also sacrifice profitability, because the people “looking out for you” have to be paid for their “services.”

The Better Choice

Given all the options, the two best things anyone can do to improve their financial picture is to

- 1. determine what they want, and**
- 2. find an advisor/planner to help them get it.**

(In fact, if you just found a good financial advisor that might be enough, because he/she could probably help you determine #1 above -- what you want -- also.) With a good plan and good help, the problems of too many choices and not enough time vanish. And you can still coach Little League if you want.

WE CAN HELP YOU FIGURE OUT WHAT YOU WANT AND THEN TOGETHER MAKE A PLAN FOR HOW TO ACCOMPLISH IT, WHILE MAINTAINING YOUR CONTROL OVER YOUR ASSETS. CALL US BEFORE ANOTHER YEAR GOES BY....



TAX REFUND = BAD PLANNING

You probably know someone who files their income tax return on February 1st, then gleefully waves a fat refund check in your face a few weeks later as you're just getting around to facing the fact that you need to start working on your taxes. They act so smug, as if they are one step ahead of everyone else. Well, the next time you see them wave their refund check, you can smirk instead. Why?

Because most of the time, a tax refund is a sign of financial ignorance.

In a recent article about National Payroll Week (now *there's* a Hallmark holiday if there ever was one), James Jenkins, a Michigan certified public accountant, explained that refunds “are really a waste of money.” In his opinion, if you normally receive a federal tax refund of over \$100, you aren't planning well enough, because the extra money you leave with the government for the year is basically an interest-free loan.

“It could be earning interest or dividends for you - or at the very least paring down debt. You're paying 18% on a credit card bill and meanwhile the IRS is paying you zero. I just can't stand the thought of that,” says Jenkins. Here, here!, Mr. Jenkins.

Getting a refund usually means you are sending too much money too soon to the government.

Unless you are doing this because you think of your interest-free loan as a charitable contribution to the public welfare, it doesn't make sense. So why do so many people still over-withhold? Here are a couple of possibilities:

1. Complexity. Different taxes that appear on a payroll stub are taxed on different rates. Social Security and Medicare are based on gross income with yearly maximums, while withholding for federal income tax is based on income after health care and retirement plan contributions have been subtracted. Additionally, the standard withholding tables only calculate the expected tax for *one* income, which may be completely different if both spouses are working.

2. Psychology. Taxes aren't just a financial drain; they are psychologically taxing as well. After wrestling with hard-to-understand regulations, minute calculations, confusing forms, and the fear of audit, it's even worse to have to owe money at the end of the process. Having money come back almost seems

like a reward for going through the process, while having to pay is just piling on the misery. Emotionally, many taxpayers would rather receive a refund, even though it represents an overpayment of taxes.

Are there ways to deal with complexity and psychological avoidance that surrounds withholding? Of course. The key is finding an approach that not only helps you keep the most, but doesn't push your stress envelope. Here are a few hints:

Know the rules.

Get a copy of Circular E, an IRS publication that includes withholding allowance tables based on income and marital status. With a minimal amount of research you should be able to determine where you fit based on your adjusted gross income.

Use last year's taxes as a guide.

If income this year is nearly the same as last, try to see if your present withholding will result in overpayment. Two important reminders: if you have a working spouse, combine incomes and withholdings. If you make an adjustment, be sure the new exemption level still adds up to the tax you actually paid last year. Owing more than 10% of your total tax bill next April 15th will make you liable for penalties and interest.

Get help.

Work with your payroll manager or tax advisor. These people are "professionals" – most have charts or computer programs to help bring the numbers into focus. If your payroll contact needs help, direct them to The American Payroll Association website (www.americanpayroll.org).

Save the difference.

If you save the increase in your take-home pay, it should eliminate some of the psychological trauma of paying a bit more when you file your return. If you miscalculate your tax bill and end up owing some money, the only real difference will be that the money earned some interest for you over the year, instead of sitting in the Treasury. Otherwise, whatever is left after filing is yours to spend, to clear debt, or invest – just like your refund check.

Everyone's situation is different, but it's worth a few minutes of everyone's time to see if there's more to keep. Giving an interest-free loan to anyone other than your children isn't a good financial strategy, and it's even worse when the recipient is a sometimes inefficient and irresponsible government that consistently spends more than it receives in revenues.

Getting a (tax) refund usually means you are sending too much money too soon to the government.

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John J. Bellino III

Alliance Financial Group, Inc.
14021 Metropolis Avenue
Fort Myers, FL 33912
(239)-561-2900
(800)-964-6639 (where available)
John_J_Bellino@glic.com

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