

CREATIVE

Wealth Maximization Strategies



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"We can't solve problems by using the same kind of thinking we used when we created them." – *Albert Einstein*

Is Your "FP" Just a Collector? (And is that all bad?)

What is the official title of your "financial professional?" Is it...

- Broker?
- Account Executive?
- Registered Representative?
- Financial Planner?
- Attorney?
- Insurance Agent?
- Accountant?
- Dad?

In reality, the official title of your financial professional (referred to as "FP" for the rest of this article) is just a name, and is often dependent on the guidelines and licensing requirements of whatever regulatory or professional association oversees their work. And regardless the term, the relevant question isn't the title of the person(s) you listen to on financial matters.

It is: what does your FP do for you?

Often, the first response that comes to mind is "financial advice." The dictionary definition of advice is a "recommendation regarding a decision or course of conduct." And in the strictest dictionary context, that definition is accurate. While keeping this definition in mind, here are some observations about the types of "advice" offered by financial professionals – whatever their titles.

Some FPs are really asset collectors. Think of all the different financial vehicles available to individuals. There are stocks, bonds, mutual funds. And all sorts of life, health, disability and auto insurance. Not to mention mortgages, promissory notes, certificates of deposit and other bank instruments. The financial marketplace offers a lot of options, and to borrow from Jack Nicholson in *A Few Good Men*, "people want these products, they need these products."

The simplest formula for business success is "find a need



and fill it," and that's all some FPs do. You provide the assets – i.e., the money for a deposit, premium, down payment, etc. – and the FP provides the financial product. Their principal "service" as financial professionals is to consistently collect assets and provide product.

Some FPs are really asset organizers. Since there are so many financial options, it's easy to get overwhelmed and confused. How many insurance policies do you have? What about that IRA you started 10 years ago before your employer offered the 401(k)? Is that a line of credit or a second mortgage? Is this will current, or was it changed last year? For many people, their finances are organized like the junk drawer in the desk in the spare bedroom; everything's there, but it's gonna take awhile to identify and sort out the pieces.

To gain a competitive advantage over run-of-the-mill collector FPs, some may add value to their collecting services by providing organizational assistance. Their "advice" may consist of offering "one-stop shopping for auto, home and life." Or they may tout themselves as a "full-service financial firm," allowing you to consolidate accounts. Having all the information and financial products in one place usually means fewer junk-drawer safaris, better organization, fewer surprises, and hopefully, better results.

Getting financially organized is a big issue for many consumers. The recent (fall 2005) ING Financial Planning and Investing Study found that almost half of consumers said

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“retirement planning was harder than raising a child,” and “nearly three out of four respondents would switch to a financial services company that would make managing their money less challenging” (PRNewswire, January 12, 2006).

Some FPs are really paint-by-number financial artists.

Even if every financial product is organized and accounted for, there’s still the question of whether or not these financial products make a complete financial program. It’s like a paint-by-number picture: If and when all of the areas are colored in, is there a finished painting? (And is it supposed to look like Elvis, or just some abstract arrangement of colorful shapes?)

A paint-by-number FP has a series of “plans,” usually in the form of sophisticated computer programs. (“Which do you like, the one where you retire at 55, or the one that sends your daughter to Stanford? What about this one, where you leave an inheritance?”) You select the program variables, and the computer spits out a report, telling you which products to buy and how much to allocate each month. With the help of this FP, you faithfully “paint-by-number,” with the expectation that the final picture will look just like the program promised.

Some FPs are really financial philosophers. There are a few possible drawbacks to paint-by-number financial programs. What if you decide you want a different picture? What if circumstances force you to consider other issues than those that are part of your current plan (like health problems, having to care for aging parents, etc.)?

So instead of a paint-by-number program, some financial professionals help people by providing a philosophical foundation for all financial decisions. These underlying philosophies help shape specific strategies, and serve as a guide for making financial decisions, even as things change.

Just as there are a lot of products in the financial marketplace, there are a lot of philosophies, and even “sub-philosophies,” that are offshoots of the major one. As an example, look at all the theories/philosophies related to stock market investing. Some promote a buy-and-hold approach in mutual funds, while another emphasizes market timing. And either approach might be modified by the use of a qualified retirement plan. Switching gears, you could find a “Dogs of the Dow” philosopher, or maybe a value investor proponent who tracks the strategies of Warren Buffet.

Financial philosophy isn’t just about the stock market. It can shape borrowing decisions (15- or 30-year mortgage?), and influence the structure of one’s retirement plans (should you start taking Social Security at 62?). Your financial philosophy can determine your insurance strategies, affecting decisions about coverage limits and deductibles.

What do you want your FP to be good at?

Reading this commentary, you might be tempted to conclude that the FP who offers “more” is a better person to have on your financial team. Not necessarily. Every service offered by an FP, from collecting and organization to paint-by-number painting and philosophizing, has value.

If you’re already financially organized, and have your own financial philosophy, do you need anything more than a competent and reliable asset collector to help execute your wishes? Some very successful FPs owe their success to doing the simple things well. They are pleasant to work with and do a very good job of making it easy for their customers to obtain the desired financial products.

And while paint-by-number programs may seem inferior to philosophically-based planning and strategies, some people have paint-by-number lives. For them, a standard plan is a good fit, and easy to execute and oversee. There isn’t a need for learning a new philosophy if the paint-by-number one works. Even worse, if you don’t agree with the FP’s financial philosophy, it may make it difficult to even execute the asset collecting activities, because every transaction ends up being a cause for discussion. (“Yeah, you can buy the mutual fund, but based on this approach, why would you want to?”)

That said, an FP with a good financial philosophy can bring an incredible amount of value to your financial world. First, when all financial decisions are made in agreement with an over-arching philosophical paradigm, the result tends toward better performance and higher satisfaction. It’s often a situation where the whole equals more than the sum of the parts, because all the pieces fit together.

Second, as you become more familiar and comfortable with the financial philosophy, you may find you can use these principles to uncover and evaluate opportunities beyond the immediate realm of your FP. If one of your FPs is called a Registered Representative, their realm involves securities. But you may find that a good financial philosophy (say, about the use of securities in the distribution phase of retirement) may also have application to evaluating another financial opportunity with which that FP has no connection.

Finally, as an extra benefit, a comprehensive financial philosophy usually makes it easier to address the collecting and organizing details as well.

Are all your FPs on the same page?

Given the definition and list above, most people with any interest in their personal finances have more than one FP. It might be differing philosophies, competing services, or personality conflicts, but with multiple FPs, there’s always the possibility that too many cooks are going to spoil the meal. But ultimately, you’re the one that has to eat it. So it’s important that your FPs work together, or at least don’t step on each other.

There are two ways to address this challenge: One, you act as the chief and make sure everyone on your team subscribes to the same philosophy (either yours or the one you’ve chosen from a particular FP). Two, appoint one as the liaison to all the others. Either approach will work, because each creates a framework wherein ideas and actions are intended to be sifted through the same financial screen.

Take a moment to mentally review the FPs in your financial program. What are their roles in your financial affairs? Are they collectors, organizers, paint-by-number artists, or philosophers? Does your financial program operate from a consistent financial philosophy? Do all of your FPs work from the same philosophy? How strong is your team?

“The difference between failure and success is doing a thing nearly right and doing it exactly right.”

-- Edward C. Simmons

A PROVEN FORMULA TO DOUBLE YOUR MONEY: A GOOD MARRIAGE

Even if you can't do a precise mathematical calculation, it's easy to understand that non-financial events in one's personal life have a financial impact. For example, chronic poor health can mean less working days, and greater medical expenses. And according to a recent study by Jay Zagorsky, an Ohio State University researcher, no other personal event has as big an impact on personal wealth as a good marriage.



As reported in a January 19, 2006, Associated Press story, Zagorsky found that "a person who marries – and stays married – accumulates nearly twice as much personal wealth as a person who is single or divorced."

Marriage seems to boost personal wealth for two reasons. The first is simple economics, as one household is cheaper to maintain than two, according to Zagorsky's study, which was published in the January 2006 issue of the Journal of Sociology.

The second reason is that married people usually become more economically productive. David Popenoe, a co-director of the National Marriage Project at Rutgers University, says "They work harder, they advance further in their job, they save more money, and maybe invest more wisely. That's because, one can speculate, they are now working for something larger than themselves. They are working for a family."

In contrast, divorce reverses those benefits. For those that divorce, the event doesn't mean a simple halving of financial wealth. The process of unwinding a marriage ends up destroying personal wealth, and Zagorsky found that, on average, divorcing couples lose three-fourths of their personal net worth.

"Divorce looks like one of the fastest ways to destroy your wealth," Zagorsky said. "Getting married for a few years and then getting divorced is clearly not the path to financial independence."

The study tracked the wealth and marital status of 9,055 people from 1985 to 2000. The participants are now between the ages of 41 and 49, and Zagorsky cautioned that these results, while representative of younger baby boomers, might not apply to older and younger generations of Americans who may have different attitudes about marriage and divorce.

THINGS THAT MAKE YOU GO "HMMM..."

THE ROTH 401(k)...THE BACK STORY

Beginning this year (January 1, 2006), many employers are offering employees the option of establishing a new retirement account, the Roth 401(k), as a companion to an existing 401(k) plan. Here's a brief overview of the particulars:

- **Roth 401(k) contributions are made with post-tax dollars** and are **separate from your pre-tax contributions to the 401(k) or individual Roth IRA.**
- **Maximum contribution limits follow 401(k) rules** - so in 2006, you may contribute up to \$15,000 post-tax dollars to this account (\$20,000 if you're over age 50). *Note: The \$15,000 limit is calculated using all 401(k)/Roth 401(k) contributions. In other words, \$10,000 in the 401(k) means an additional \$5,000 can be put in the Roth 401(k). Any matching contributions from employers have pre-tax status.*
- **Roth 401(k) eligibility rules follow 401(k) rules**, so folks not eligible for Roth IRAs because of income can contribute to the new Roth 401(k).
- **Contributions to a Roth 401(k) are irrevocable**, a huge difference between the Roth IRA and the Roth 401(k). Once money goes into the Roth 401(k), it falls under 401(k) rules. With a Roth IRA, you can change your mind and withdraw contributions without penalty - for the Roth 401(k), you will be penalized for withdrawing your contributions, except under certain conditions.
- **Money can be withdrawn from Roth 401(k)s without penalty if you are over age 59½ and have had the money in the account for at least five years** (these requirements are generally in line with Roth IRA distribution rules).
- **Forced minimum disbursements at age 70½.** This guideline matches 401(k) rules. In contrast, the Roth IRA has no forced minimum disbursement requirements.
- **Rollover Roth 401(k) to Roth IRA on retirement or termination.**

The Roth 401(k) is a curious piece of governmental financial planning. The plan was enacted as part of 2001 tax legislation, but not scheduled to take effect for five years. And unless extended by Congress, Roth 401(k) plans will exist only through 2010. Even with five years to prepare, the IRS is still in the process of ironing out the details (if you rollover to a Roth IRA from a Roth 401(k) do you still have to make a minimum distribution at age 70½?). And for reasons only a bureaucrat could understand, some lawmakers want to rename the Roth 401(k) to a Roth ESRA.

"..the Roth 401(k) proves a long-time planning axiom has turned out to be false."

So far, the Roth 401(k) concept has met mixed reaction. Rep. Benjamin L. Cardin, a Maryland Democrat, wants to repeal it on the grounds that the retirement products market is "swamped" and the plan will cost the government money. After a cursory attempt to decipher the comparative tax advantages and consequences, Jeanne Sahadi, a senior writer for CNN/Money, concluded, "Chances are you're going to have to consult a tax professional before signing up." On the other hand, Ed Slott, in a January 16, 2006 AP article said, "The Roth 401(k) is a fantastic opportunity to sock away a lot of money...If it's offered, I'd definitely contribute."

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But behind all the blather, there's one critical point that's not getting much attention. The emergence of the Roth 401(k) proves a long-time planning axiom has turned out to be *false*.

For the past two decades, a core justification for the use of pre-tax qualified retirement plans (IRAs, SEPs, 401(k)s and the like) has been that the tax deferral on contributions and earnings, with tax due on distributions, will be worthwhile because "you will be in a lower tax bracket in retirement."

The introduction of the Roth 401(k) is a clear signal that the "you will be in a lower tax bracket in retirement" mantra is by no means an accurate assessment. And if the lower-tax-bracket-in-retirement scenario is not true, then a 401(k) doesn't make much financial sense.

As Stephen Utkus, a principal with the Vanguard Center for Retirement Research, told Eileen Alt Powell in a January 16, 2006 article "If you're sure you're going to be in a lower tax bracket in retirement, you want to keep contributing to the traditional 401(k); if you think you'll be in a higher tax bracket, you'll want a Roth."

Hmmm... Part of the reason 401(k)s aren't as attractive is a result of tax law changes (dividends and capital gains are currently taxed at a lower rate than distributions from 401(k) plans). Given the inevitability of tax law changes, what's the chance that five or ten years from now another tax law change might negate the advantages of Roth accounts?

shrugged off by consumers. Since an outstanding account handled by a private collection company can wind up in a credit file, more consumers are discovering that niggling government fees – like unpaid speeding tickets or dog-catcher fines – are marring their credit.

Jane Spencer, *Wall Street Journal*, January 3, 2006.

GEN X, GEN Y,... GEN P?

Young consumers so consistently reach for debit and credit cards that Visa USA has anointed the age group "Generation Plastic," or Gen P."



Their habits are driving even more merchants to accept debit and credit cards, fueling legal battles over the fees underlying the cards and raising more concerns about the nation's shriveling savings rate.

Plastic payments – including online commerce – now account for 50.4% of the spending among consumers ranging from 18- to 24-years-old, with cash and checks making up 41.1% of their spending. Consumers 25 to 34 spend about 45% either way, while everyone older still uses cash and checks at least half the time, according to Visa, the nation's largest payment network.

Michael Liedtke, *Associated Press*, January 12, 2006.

LOOKING BEYOND COMPANY RETIREMENT PLANS FOR SAVING CHOICES

Workers are getting the message: Planning for your own future is increasingly up to you.



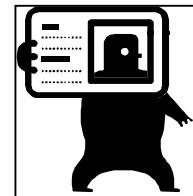
Against a backdrop of spiraling medical costs, failing pension plans and the uncertain future of Social Security, American workers are squirreling away money in retirement accounts beyond just their company's 401(k) plan. Warning signs abound that more individuals could reach retirement age without as much money as they need. During the past five years, companies have killed off more than 640 underfunded retirement plans, affecting the retirement of some three-quarters of a million people.

Little wonder that two-thirds of workers who already have a company retirement plan are now also stashing money in other accounts as well, according to a survey released late last year by Transamerica Retirement Services... That is up from 52% a couple years ago."

Jeff D. Opdyke, *Wall Street Journal*, January 7-8, 2006.

SSN IS "DE FACTO" NATIONAL ID

Social Security numbers were first issued in 1936 by the Social Service Board as part of the new Social Security laws. The nine-digit number was supposed to be used exclusively by the federal government to track working individuals for taxation purposes and to track Social Security benefits.



However, the Social Security number has become the most frequently used record-keeping number in the United States. Now, Social Security numbers are used as student IDs, patient identifiers and authenticators to set up bank accounts and obtain loans.

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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.)

IF THE LOTTERY IS YOUR BEST PLAN, YOU NEED TO LISTEN UP!

I know you're probably tired of hearing about these surveys and what folks don't know about their finances. But I see them as a constant reminder that we all have to do better. And clearly some folks really need a reminder because they think their best chance at wealth-building is luck. In a recent survey (conducted by the Opinion Research Corporation), an unbelievably high percentage (21%) of respondents said the most practical way to accumulate several hundred thousand was to win the lottery.

Michelle Singletary, *Washington Post*, January 15, 2006.



UNPAID FINES AND TICKETS CAN AFFECT YOUR CREDIT SCORES

A growing number of routine municipal fines and fees – including unpaid parking tickets, library fines, and trash-collection charges – are starting to damage consumer credit scores.



In the face of budget crunches, major cities, including New York, Chicago and Miami, are hiring private collection agencies to chase down small debts that are frequently

Ironically, during the first few decades that Social Security cards were issued, they contained the phrase, "Not to be used for identification." However, since no law was passed to prohibit the use of Social Security numbers as identification, institutions, including hospitals and banks, began using the nine-digit number to identify their customers.

The Social Security Administration estimates that approximately 227 million individuals have Social Security numbers. According to the Government Accountability Office, or GAO, Social Security numbers have become the de facto national identifier.

Kristin Arnold, *bankrate.com*, December 27, 2006.

THE CASE FOR TERM INSURANCE

Considering the source, here's a surprising statement:

**Sometimes, term life insurance
is good life insurance.**

In previous issues of this publication there have been some critical appraisals of those financial commentators who would argue that buy-term-and-invest-the-difference (B-T-I-D) is a sound financial strategy. So if you have been a regular reader, you may be rubbing your eyes, wondering if what you just read is what you think you just read. You did, but for reasons different than you might think.

But before we get to the reasons to buy term life insurance, let's briefly summarize the criticism of B-T-I-D, and its use of term:

One of the strongest arguments against the B-T-I-D concept is that the success or failure of this approach relies on a bunch of best-case scenarios. If everything goes right (personal health, consistent saving, moderate inflation, excellent investment returns, low tax costs) the B-T-I-D approach *may* be successful. But if something goes awry, the "Plan B" options for B-T-I-D aren't always that hot.

Further, buying term insurance in this context almost guarantees that it will be an expensive purchase. If Tom, a 35-year-old male non-smoker in good health obtains \$1,000,000 of 20-year level term life insurance, a competitive annual premium would be about \$1,000. In the B-T-I-D scenario, this insurance will be dropped after 20 years because it will "no longer be needed," and 20 years of premiums will deliver no financial return. That's \$20,000 down the drain (which is typical of term insurance; less than 1% of any term policies remain in force longer than 20 years, and less than 1% result in a death claim). What's worse, the opportunity costs of purchasing a term policy accrue against you for the rest of your life even though the coverage was surrendered after 20 years. Taken out to life expectancy, this financial loss can be significant. Using our 35-yr-old, here's a quick mathematical calculation:

Instead of putting \$1,000 each year into premium, suppose it was placed in another financial instrument with an average annual rate of return of 8%. In the 20 years that premiums were paid (\$1,000 each year), this alternative investment would grow to \$49,400. But even after Tom stops paying premiums and terminates the life insurance coverage, the alternative account

would continue compounding. Ten years later, at age 65, the account would be worth \$106,700. At age 75, the accumulation is up to \$230,000. If Tom lives to 85, his account value, funded only by the equivalent of 20 years of premiums, has reached \$497,000. If Tom lives to a healthy old age (and the insurance company thought he would; that's why they agreed to insure him), the choice to buy term insurance comes with some pretty steep costs – and no long-term benefits.

So if term is so "bad," in the B-T-I-D application, why would anyone use it?



It's simple. Term is used to respond to short-term financial issues. This could be things such as:

Securing human life value immediately. Every person has an "economic value" based on the application of their effort and skill to generate income. In many personal financial planning scenarios, especially at the beginning, the most valuable plan component is the individual who is earning money to accumulate assets – by paying mortgages, funding retirement plans, etc.

Going back to Tom's situation: If, as the main breadwinner, he has a wife, three kids, a mortgage, and minimal savings, there's a huge financial implosion if Tom dies. And while a "permanent" life insurance contract may be the best long-term solution, the annual premium for \$1,000,000 of whole life insurance is about \$12,000 a year. No matter how beneficial the long-term program might be, a guy with minimal savings isn't going to be able to plunk down \$12,000. And even though statistical data says it is unlikely Tom will die in the next year, it is also foolish to wait until he can afford whole life premiums, since there is no way he can guarantee his future insurability.

Buying the coverage now, even as term insurance, is pragmatic and prudent. Yes, there will be lost opportunity costs with the term, but these costs don't have to be as great, because structured properly, the term can gradually be converted to permanent contracts over time.

Meeting specific, short-term, contractual situations. Two individuals start a business, working as partners. What happens if one of the partners dies? How will the business operate going forward? Who will own the deceased partner's share? The answer to these questions is often a buy-sell agreement, funded by life insurance, with each partner purchasing a policy on the other's life.

A businessman wants to expand, and seeks financing for a new building. The bank is impressed with the owner's ability and vision, but also realizes that the business would probably fail should this dynamic individual die. To protect their risk, the

lender may ask the borrower to make a collateral assignment of a life insurance policy, covering the loan in the event of the owner's death.

In both of these examples, the life insurance is a short-term requirement of a business agreement. There may be some situations where the business issue is long-term in nature (such as successor arrangements) and in these, some form of permanent insurance may be a valid choice. But for many business scenarios, paying higher whole life premiums – for a partnership that may not last forever or for a loan obligation that will be paid off in five years – isn't practical. When the partnership is dissolved or the loan is repaid, the insurable interest that exists between the parties is gone.

In the financial services industry, the arguments regarding term or whole life insurance tend to be polarized. You're either in the term camp or a whole life adherent, and often each side treats the other with scorn. The general public might not know it, but the term-versus-permanent insurance debate is an intense professional rivalry.

That's too bad, because the "invisible hand" of the marketplace seems to indicate both versions of life insurance have a place. Really, the discussion regarding term or permanent life insurance isn't either-or, but a discussion of the proper uses for both types of coverage.

Going back to the B-T-I-D strategy, you might say using term insurance is a misapplication, in that a product designed for short-term use plays a major role in long-term financial objectives such as retirement and inheritance planning. Conversely, the up-front costs and relatively slow cash value build-up in the early years of a whole life contract might make it a less than ideal choice to collateralize a five-year loan.

Also, in many financial decisions, cost is a factor that cannot be ignored. Even if a permanent life insurance policy is your preferred solution to a particular financial objective, your ability to implement the plan may be limited by your current financial resources. Term insurance may be a lesser alternative, but often better than doing nothing. Buying term now may be the bridge to securing permanent coverage later.

In the United States, life insurance has a history of over 150 years. As a financial product, life insurance has staying power. From the Industrial Revolution to the Information Age, through World Wars, economic depressions and stock market booms, people have bought life insurance. During that time, companies have issued both term and permanent policies, and consumers have bought both types. The issue isn't whether one is good or the other is bad, it's whether the two are being used appropriately to address the unique circumstances of the moment.

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