

CREATIVE Wealth Maximization Strategies

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The universe rewards us for understanding it and punishes us for not understanding it.” - Jack Cohen and Ian Stewart

STOP TRYING TO MAKE IT EASIER – YOU NEED THE CHALLENGE!

With so many cable television channels, it was bound to happen: There just isn't enough programming to go around.

Look at how many opportunities you have to watch re-runs of “Who’s the Boss?” or other forgettable programs, let alone classics like “The Lucy Show,” “The Beverly Hillbillies” or “M*A*S*H”. Except for the new commercials, half of the “hundreds of channels of viewing choices” are reruns from the 60’s and 70’s.

Considering the lack of worthwhile content, some marketing geniuses masquerading as television programmers have decided to skip the pretense of providing entertainment in between the advertising. Instead, the entire channel is devoted to selling you something – QVC, Home Shopping Network, etc. It’s advertising as entertainment – what a concept!

In order to keep viewers “entertained” while they are encouraged to buy, there has to be a “hook” that keeps their attention. The hook that works best?

“This (overpriced-gadget-we’re-selling) makes (an-everyday-task) easier.”

Think about it. It’s the car care product that means you only have to wax *once*. Or the exercise device that needs *only 15 minutes a week* to turn you into a lean, mean fitness machine. Or the wealth-building program that makes you a millionaire *in your spare time*. Everyone wants the challenges of life to be easier, using a product that “does all the work”.

Hey, there’s nothing wrong with the idea. In theory, making life easier means making it better. But in practice, how many people really get a slimmer physique, or become wealthy, or

even have a clean car as a result of their purchase? Very few, right? Ever wonder why?

It’s never a successful strategy to buy “the easy way” to accomplishment.

You could pay someone to attend college for you, and maybe you could get a degree (*just look at some college football players*). But at some point, the easy way always breaks down. A golf pro could play a round for you, and maybe qualify for the U.S. Open, but the moment you had to play the game yourself, you would be exposed as a fraud. If someone else exercises, do you get in shape?

Intuitively we know success comes from effort. Products and people may be able to assist us, but personal effort is an essential ingredient to succeeding. This is especially true of financial planning.

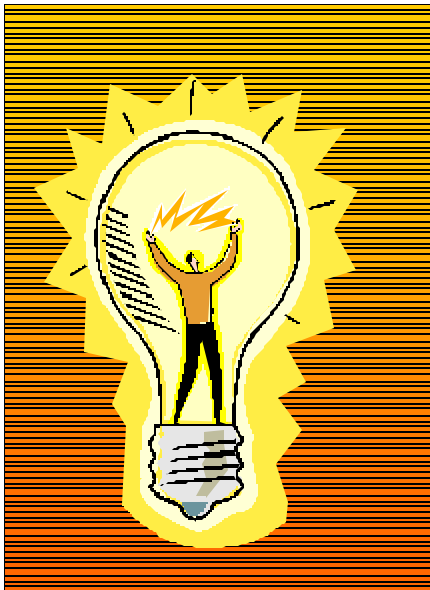
Gimmicks get attention, but not necessarily results.

A fair number of financial planning programs are a lot like the gadgets and quick-fix methods you see on TV. It’s the dirty little secret of the financial planning industry: ***For all the great ideas and products available, most financial plans never get executed.*** (*And many of those that do get started, don’t last.*)

In fact, financial planning is a lot like dieting for most people. There are so many methods, and so little real success, even though both types of programs promise to “get you in shape”, one physically, the other financially.

With dieting, the typical scenario involves numerous attempts to lose weight, always chasing the latest and greatest “breakthrough” that will magically slice off the pounds. After some initial excitement, your enthusiasm or discipline sags. The typical result: no change, some discouragement, and quite often the individual ends up weighing more than before.

Consider the eerie similarities in most peoples’ financial planning. It begins with a friend or a magazine article, or a cold caller that wants to show you a financial planning



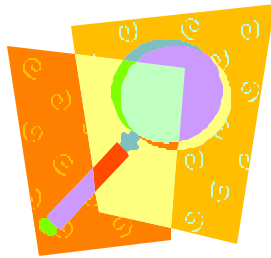
“breakthrough” that will lead to prosperity beyond imagination. Frustrated by the poor progress you perceive yourself to be making, you change advisors, change plans, and start all over with the “new” approach. Sometime later, you find yourself disillusioned (again), and sometimes even further behind than before. Frustrated, you either pursue another “breakthrough” or resign yourself to not getting ahead.

What’s the right approach to successful financial planning?

The solution, both to weight loss and financial success, is to stop looking for the easy way, and start working the right way. A long-time financial planner with some keen insight to human behavior, once said, “Everyone seems to be looking for a way to make it easy. But success is born of hard work. Work can be fun, and we should enjoy it. We should all try to have some complexity in our lives, because it makes everything more interesting. If you shot par every day, life would actually be boring. Challenges are what make games enjoyable.”

People who take the time to learn and practice some of the complexities of life often find success gets easier as it becomes a habit. So the next time someone tries to sell you on the newest “easy way” to make more money (or lose more weight), don’t be suckered. Changing plans usually creates further delays to progress. Keep learning and practicing the right way, and long-term success will follow.

With that idea in mind, what are some of the “complexities” of finances in which you should become more familiar? The following list is by no means comprehensive, but certainly covers the basics.



1. Understand the money multiplier effect, or what some people call the *velocity of money*.

In simple language, both phrases contain the idea of keeping a dollar in “circulation” – that is, using it to buy something (like a business), or create an income (from a loan), or some other business activity. Saving is a good financial habit to acquire, but it’s a simple one. The next (more complex) level is finding ways to put the money that has been saved into motion. This is a crucial concept to grasp, because effective application of the multiplier effect is at the core of most great fortunes.

In finances, understanding this concept may seem as difficult as Einstein’s Theory of Relativity, but it is just as important. There are many areas where this principle is used, but most are not easy to explain, because of the many factors involved. (We told you it was complex.) Banks are prime examples of how the velocity of money works, but because money is their only product, the explanation can be difficult to grasp. An easier illustration might be a rental property. A small down payment can control an asset that has the potential to produce a cash flow, increase in appreciation, and generate tax benefits. Thus, one dollar put in circulation can provide a variety of financial benefits.

You may say, “But I’m not interested in real estate.” That’s not the point. Most people can apply the money multiplier effect in their existing financial program – *if they learn how*. That’s where the challenge comes in.

2. Become a tax planner. Taxes are a fact of life, and according to Oliver Wendell Holmes, the price we pay for a civilized society. If you are making money, the government will want some of it. That’s the simple part. The complex part is understanding how taxation affects your financial plans.



Qualified retirement plans (IRAs, 401ks, TSAs, etc.) provide a good illustration of the possible complexities with taxes. Initially, there may not be much difference between taking the tax-deferral offered in a qualified retirement plan, and the tax deduction or tax-free status of some alternative. However, once you elect tax-deferral, future decisions to “move” the money may incur prohibitive taxes and penalties – you may find you can’t afford to make the change. Future tax rates and regulations are unknown variables that create the possibility of paying more taxes to spend the money than the break you got when it was deposited. In the long run, the “easy” plan (having an employer take contributions directly from earnings) may not be the best. Of course, doing better tax planning is more complex, requires more work...well, you know – it’s a challenge.



3. Learn how to evaluate risk.

If telling you a product makes life easier is the biggest hook to induce you to purchase something, the second biggest is saying the product is guaranteed, or a sure thing. Not to burst anyone’s bubble, but in the financial world, there are no absolute guarantees. Every financial choice carries an element of risk.

Government bonds state they are backed by the “full faith and credit of the United States government.” But this doesn’t mean an investment in T-Bills makes you immune to negative outcomes (like inflation or changing yields). Your bank claims FDIC insurance, but that’s only for the principal, and if the bank goes into receivership, it could be months before you see your money. A mutual fund may have a winning track record for the last five, ten or even twenty years, but could still lose big this year. (Repeat the phrase “past performance does not guarantee future results.”) The risk may sometimes be hard to understand or assess, but that doesn’t mean the damage from a poor decision will be any less real.

There’s another area where most individuals don’t accurately assess risk. When things are going well, it is human nature to assume things will continue on the same track. But for most of us, it wouldn’t take much to derail our financial train. An unexpected termination, downsizing, illness, or accident could quickly wipe out years of financial progress. Yet surveys consistently show that a majority of households are 30 days from bankruptcy if the major household provider becomes unemployed.

Considering the potential trauma that could result from an unexpected loss of income, the logical response is to establish a “safety net” of liquid savings and insurance. But in our experience, very few arrange their financial plans to respond to such a situation. Instead, they are surprised, saying, “I never thought it could happen to me” or “it’s not fair.” Those are

probably true statements, but they don't change the consequences.

One of the reasons most people dislike insurance of any kind is because they don't understand risk. Since they don't understand the complex financial forces that drive insurance companies (ever try to talk with an actuary about risk?), they usually make wrong decisions about coverage, and end up feeling "ripped off". But the insurance companies aren't the problem – it's often ignorant consumers who don't take the time to understand the complexities of insurance, and are thus



prone to buying the wrong coverages.

4. Finally, develop methods to stick with it. If you knew everything about exercise, but never worked out, you'd still be out of shape. Like most other endeavors, consistent practice results in long-term success. If you implement a financial program that takes too much time to implement or oversee, pretty soon something is going to be missed.

You may need someone else to assist you, like an advisor, bookkeeper, CPA or attorney. While they can't take responsibility for your actions, they often can assist you in deciding if you are taking good actions. And good advisors can be good teachers, helping you further understand the financial complexities that define great success or average results.

HOW IS YOUR FINANCIAL IQ? DOES YOUR PROGRAM NEED SOME "COMPLEXITY"? ARE YOUR ADVISORS EDUCATING YOU IN THE FINER POINTS 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 the complete article.)

**WOMEN: ARE WE OK?
MEN: HUH? IS THERE A
PROBLEM?**



"Women are more concerned than men about retirement security, partly because of less confidence in investment portfolios and savings levels, according to a survey.

The study – released last week by Prudential Financial Inc. – found that only about half of the women polled are confident they could achieve their retirement goals, compared with about seven of ten of their male counterparts. Only 57% of women believe that their investments are on the right track, compared with 75% of the men.

'It's a confidence issue; it's a learning issue, but also, women are faced with the demographic issue of living longer

and having to prepare for that,' said Gail Farkas, vice president of agency-distribution marketing for Prudential Financial.

And while women are making more decisions and have more responsibility in their households, the majority of them still need professional advice to plan for retirement. Only 44% of women said they could make their own decisions concerning their golden years, compared with 68% of the men."

Dow Jones Newswires, June 17, 2003

A SKEPTIC'S VIEWPOINT

"Congress is currently going through its annual bipartisan denial of reality, and that reality is this: The enormous baby-boom generation is approaching 65, which means that the number of seniors on Social Security and Medicare is about to explode. The Congressional Budget Office estimates that by 2030, Social Security and Medicare together will consume more than one of every ten dollars of the nation's income.

Leaders would point out to citizens that such unrestrained spending growth is a threat to America's future economic health. *Leaders* would make the case for trimming entitlement benefits before the baby boomers start turning 65 (around 2011). *Leaders* would propose either raising the eligibility age for the programs or cutting benefits to wealthier retirees.

Instead, Congress last week began debating different ways to add even more spending to Medicare – in the form of a prescription-drug entitlement."

Timothy Lamer, World, June 21, 2003



ANOTHER SKEPTICAL VIEWPOINT

"The bulls are back on Wall Street, and that means investors are finally feeling good again. So why isn't everyone cheering?

Some market-watchers say the recent positive shift in investor sentiment could mean trouble. They point to history, which shows that when investors get too giddy about stocks, a pullback is often right around the bend.

For instance, *Investors Intelligence's* bulls-to-bears ratio now stands at about 2.4, which is above the 2.0 threshold that has consistently – 11 out of 11 times since July 1999 – been followed by declines in the market averaging 6% over the subsequent four weeks, according to Prudential chief investment advisor Edward Yardeni."

Rachel Beck, Associated Press, June 18, 2003



EMPLOYEES MAY PAY MORE FOR RETIREMENT PLANS

"Employees may soon have to pay more out-of-pocket costs related to their retirement plans. Recent guidance from the Department of Labor is expected to lead to more companies socking employees with expenses related to processing requests and calculating benefits under defined-contribution plans. These costs can run anywhere from a few dollars to hundreds of dollars, depending on the paperwork and resources involved.



In general, plan sponsors aren't required to cover many of the costs of administering and maintaining defined-contribution plans, such as 401(k)s, although they must bear the expense of creating the plan. As a result, some companies may have divvied up these costs among plan participants. But others have chosen to pay for expenses themselves, out of corporate profits."

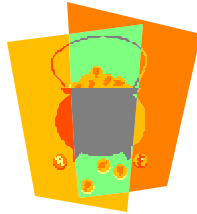
Kathy Chu, *Wall Street Journal*, June 24, 2003

**CUT OFF FOR THE TOP 400:
\$86.8 MILLION - A YEAR**

"America's richest got richer between 1992 and 2000, according to an Internal Revenue Service report released Wednesday.

The adjusted gross income of the country's top 400 taxpayers totaled almost \$70 billion in 2000, according to the IRS, for an average of \$173.9 million. The richest 400 in 1992 accumulated just under \$19 billion, for an average of only \$46.8 million. Over the nine-year period, the minimum adjusted gross income to get on the top 400 list more than tripled, from \$24.4 million to \$86.8 million."

Associated Press, June 25, 2003



Over the next few years, analysts expect that the new tables could mean significant changes in the pricing of all life insurance, with the change being most noticeable in term life coverage. Some observers think premiums could drop by as much as 30%, depending on the length of the term coverage.

Although the decrease in premiums may not be as steep, other life insurance policies, such as whole life or universal life, should also be priced lower. While this may make permanent coverage more affordable, James Van Elsen, a consulting actuary with the American Academy of Actuaries, says the cash value accumulations in newer policies may also be lower as well.

THINGS THAT MAKE YOU GO "HMMM..."

SELF-HELP INVESTMENT BOOKS ARE NO HELP

Roger Lowenstein is a financial author (his most recent book is "Origins of the Crash") and reviewer of other financial literature. Recently, in the June 13, 2003 *Wall Street Journal*, Mr. Lowenstein reviewed three newly-released books that promised readers information on how to "beat" the market, either through timing strategies, stock-selection criteria, or the changes in recommendations of other analysts. While it isn't necessarily surprising that Mr. Lowenstein's assessments of all three books were negative, his reasons for criticism are quite thought provoking.



First, Mr. Lowenstein notes that all three books offer a "contrary promise – to assist their readers in the pursuit of time-sensitive and crowd-beating techniques." But this promise is one that no author can keep. Says Lowenstein, "for practical purposes, such an approach shares a deficiency of primers on golf. We can all become more devout or more thin, but we will not all become winners at golf, simply because we compete against one another. Likewise, not all of us – not even most of us – will be able to spot investment trends ahead of the rest of us."

Second, Lowenstein notes that, similar to the fashion industry, "opinion in the field tends to be cyclical, not cumulative. One would not expect to see a home-improvement volume with the title 'The New Reality of Plumbing.' But the science of investing, at least as it is propagated by financial writers, undergoes a seeming revolution every couple of thousand points on the Dow."

Hmmm...if Lowenstein's assessments are correct, the only way to outperform the stock market is to find a time-tested investment program that no one else is using. Of course, if it were time-tested, wouldn't others be using it?

NEW LONGEVITY STATISTICS

For the first time in over two decades, regulators are revising one of the most important tools in the life-insurance business – the mortality tables that estimate how long people will live. The statistics contained in these tables are a critical component used by actuaries to establish premiums, and were last revised in 1980.



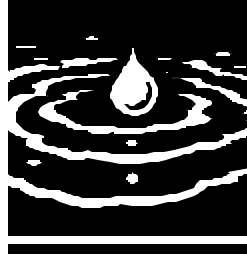
In general, the new tables reflect good news on two levels. First, due to healthier lifestyles and medical advances, people are living longer. Second, life insurance premiums should drop, because the longer policyholders live, the longer the insurance companies get to hold onto the premiums they collect.

A June 24, 2003 *Wall Street Journal* article published the following statistics provided by USAA regarding increased life expectancies for both for men and women. Here's a summary:

In 1980...			In 2003...		
At age...	Male	Female	At age...	Male	Female
0	70	75	0	76	80
30	72	77	30	77	81
50	74	79	50	78	82
60	77	80	50	80	83
65	78	81	65	81	85

THE RIPPLE EFFECTS OF TAX POLICY

How the stock market affects tax revenues



In physics, it is assumed that every action generates a reaction. It's the ripples in the pond after a stone is tossed in, or the change in the course of a river as the current scours its banks. Sometimes the impact is obvious and direct, and other times the reactive response may be hard to discern, or hidden for many years.

The same perspectives of action and reaction relate to governmental attempts at influencing financial activity. While the primary goal of a particular piece of legislation may be straightforward (i.e., encouraging home ownership by making mortgage interest tax-deductible), more economists and researchers are beginning to explore the less-obvious side effects that may result.

In 2000, one such study addressed the savings impact of Individual Retirement Accounts (IRAs) and similar government-authorized plan (SEPs, 401(k)s, etc.) The report, by Brianna Dusseault and Jonathan Skinner of Dartmouth, is titled *“Did Individual Retirement Accounts Actually Raise Revenue?”*

At question in the report are two central issues: 1.) Did the enactment of legislation allowing tax-deductible contributions actually increase saving among Americans? And 2.) Did this saving help or hurt government revenues?

Not that the following equations will shed any light on the subject for most of us, but it's worth knowing that Dusseault and Skinner developed specific mathematical formulas to determine their answers to the above questions. For example:

In the conventional IRA, the initial investment is given by $A_t = V / (1 + \tau)$ where τ is the marginal tax rate, t is the initial year, and V is the amount shuffled out of private saving (think of $V = \$1,460$). The asset is then accumulated according to the following equation,

$$A_t = A_{t-1} (1 + r_t + g_t) - w_t$$

where t subscripts the year, r_t is the rate of return on interest and dividends, g capital gains, and w_t withdrawals from the IRA in this blended asset A_t . Note that values for A_t are for December 31 of each year net of withdrawal. Finally, the net of tax value of the asset is given by $A_T^* = A_T (1 - \tau_a)$ where τ_a is the tax rate assessed on IRAs. The revenue accumulated to period T (or 1998) is

$$R^a = \sum_{t=1}^T \tau_a A_t + \sum_{t=1982}^T (1 + r_s^*) \sum_{t=1}^T [w_t \tau_t] (1 + r_s^*)$$

where R^a is comprised of three parts: the taxes collected at time T , $\tau_a A_T$, minus the revenue loss from the initial debt issued when the IRA contribution was made, $\tau_a A_t$ plus the revenue resulting from the withdrawals taxed at the rate of ordinary income. The revenue is accumulated forward at the after-tax rate on government bonds, r_s^* .

Got that? We didn't either.

However, besides the mathematical explanations, the report makes some interesting and illuminating comments about the financial consequences for both individuals and governments of encouraging saving through IRA accounts.

As to whether or not Americans saved more because of the tax incentive, or simply transferred their existing saving from taxable accounts into the IRA accounts, the subject is still open to debate. Dusseault and Skinner concluded that because data existed supporting both positions, it was impossible to determine whether saving actually increased as a result of the establishment of IRAs. In other words, while the action (establishing the IRA) definitely created a reaction (people setting up accounts), it was not possible to fully assess the impact of the act.

On the other hand, whether total saving increased or not, the researchers could make some comments about the effect of IRAs on government revenues. Based on historical data, there is strong evidence to suggest that government revenues have benefited from the establishment of IRAs. The reason: the growth of the stock market in the past two decades. Here's the researchers' explanation, much simplified:



According to the report, “the government is presumed to have funded the IRA tax breaks through deficit spending.” Thus, for an individual in the 27% marginal tax bracket, a \$2,000 contribution to an IRA resulted in the government issuing another \$540 in debt (for tax revenue it did not receive).

Assuming this debt is represented by US Treasury instruments issued to lenders, the question then becomes whether or not the future tax paid at distribution of the IRA will equal or exceed the government's cost of borrowing (including the accruing interest) from the time of the IRA deposit.

Since investors in the stock market over the past two decades have tended to earn a much higher rate of return than what the Treasury paid for its bonds, the debt incurred by the government was more than paid back by the taxes due on distribution.

Using a hypothetical \$2,000 deposit made in 1982 to a generic stock market investment, Dusseault and Skinner calculated the account's end value to be \$13,554 by 1998. Without any penalty, and at the same tax rate of 27%, cashing out of the account would generate \$3,660 in taxes. This amount would easily pay the initial \$540 tax debt (which would have grown to \$1,313, given the interest rates for Treasury instruments over the same period). Further, this cash-out tax payment would have also covered the \$1,460 in taxes that would have occurred if the deposit had been left in an annually taxable account for the past 16 years. Overall, the total “profit” to the government for subsidizing the tax deduction at the beginning was \$504.

By these calculations, even if the establishment of IRAs did nothing for overall private saving, the government is estimated to have generated a net gain in revenue of \$14 billion over the 16-year period mentioned in the survey. In concluding this section, Dusseault and Skinner opine: *(See next page)*

The historical record suggests that conventional IRAs have been remarkably efficient at raising revenue for the Treasury. Under the IRA program, the Treasury issued bonds paying a low rate of interest, and in return took a 27% equity share in the investments made by IRA contributors. Even in the worst-case scenario, where IRAs did nothing to encourage private saving, these investments have paid off handsomely over the past few decades...



In further evaluating this situation, the researchers make several points worth pondering. First, when individuals invest their IRAs in the stock market, it is possible for the government to “effortlessly raise revenue under the guise of a tax giveaway” – provided the stock market outperforms Treasury instruments. Second, the historical data suggests that Social Security could be transformed from a “pay-as-you-go structure to one that is entirely self-financing with only minimal increases in contributions” – if the funds were invested in the stock market.

The key to both assumptions: the performance of the stock market. As Dusseault and Skinner conclude, “(T)he stock market now affects more than just the general economic climate – it increasingly affects future tax revenue.”

However, as some less obvious ripples from participation in a tax-deductible retirement plan become apparent, individuals may begin moving away from such plans.

This year, Philip R. Fink, an attorney, CPA and professor of taxation at the University of Toledo published a professional article titled “401(k) Plans Are Not All They Are ‘Cracked Up’ To Be.” According to Mr. Fink’s assessment, 401(k) plans contain several negatives that, when viewed in total often make taxable investments a better choice.

Fink notes that distributions from a retirement plan are deemed as ordinary income regardless of the character of the income generated by the investments inside the plan, which is higher than the tax on long-term capital gains. Further, he sees the pre-(age)-59½ penalties and required minimum distribution rules as impediments to those who either want use of the funds early, or don’t need them later. The fact that such retirement accounts receive no “step-up” in basis in the hands of heirs is a negative from an estate planning perspective. As for non-tax issues, Fink says 401(k) investments may have higher sales charges than comparable accounts outside the plan format.

It is Fink’s contention that “many financial planners concentrate solely on the tax deductibility of contributions and the tax-deferred growth of 401(k) plans when advising clients on whether to invest in 401(k) plans.” After providing a case study, Fink concludes: **“In many instances, investing in taxable accounts will result in more wealth accumulation, net of tax, than investing in a 401(k) plan.”**

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