

CREATIVE Wealth Maximization Strategies



Alliance Financial Group
14021 Metropolis Ave.
Fort Myers, FL, 33912
Phone: (239) 561-2900
www.johnbellino.com
John J. Bellino III
john@johnbellino.com

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*“Long-range planning does not deal with future decisions,
but with the future of present decisions.”*

- Peter F. Drucker

COST-BENEFIT ANALYSIS

You saw an ad for the car in a magazine, and decided you had to have it. So you went down to the showroom and chatted with the salesman.

You knew you couldn't afford it right away, but the salesman said that was no problem - most people just made monthly payments, and picked up the car when they retired. And since it was almost guaranteed the car would increase in value over time, the car was not only something to use in retirement, but a good investment. Further, the car was so special the government said you could deduct your car payments from your annual income taxes.

When anyone signed up to buy a car, the dealership engraved their name on the car and moved it to a back lot (for safe keeping). Each year, you would receive a statement from the dealership verifying your payments, and how much the vehicle was now worth.

What was not to like? Everything sounded great, so you signed up.

For the first few years, things *were* great. You got the car (well, the dealer put your name on a car - you didn't get to drive it), you got your tax deduction, and each year the dealer's statement verified how much it was worth. With a sense of self-satisfaction, you occasionally mentioned to your friends how well your "investment" was doing.

But every now and then, you had fleeting doubts about your purchase. After all, you had a car but couldn't drive it. That seemed a bit odd, especially when your van broke down, and you had to shell out more money to buy a new one. But the salesman reminded you that your "special car" was really for retirement.

And then, as some of your friends started to retire, you heard about governmental "driving fees" and other extra costs that kicked in when they started driving their cars. One guy said he

figured it cost so much to drive the car that he would just as soon wait awhile. That didn't make sense. Why set aside all that money, then not enjoy what you bought with it? You wondered if the car was really a good purchase after all.

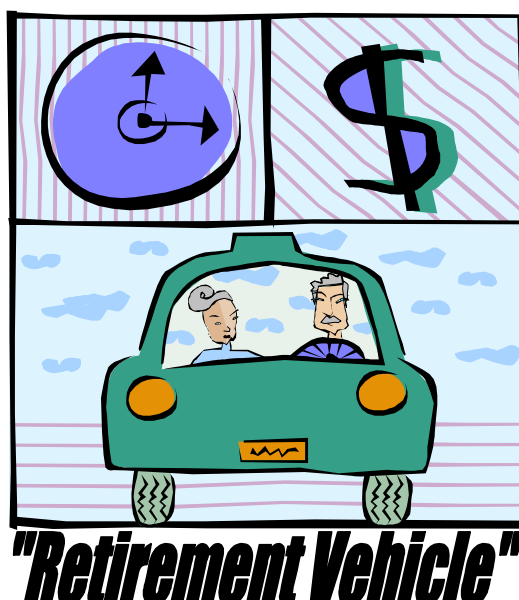
It wasn't as if the dealer had lied. The car had increased in value, and you had received a tax break, just like the dealer said. But while the benefits had been covered in detail, the real problem was nobody had ever fully explained the costs.

Get the Whole Story - Including the Costs

We're talking about an imaginary car, but this discussion could be about any investment "vehicle" - a 401(k), a mutual fund, an annuity, a life insurance policy, or whatever else. When the individual is trying to make a decision - even with the help of an adviser - often there's a lot of discussion about the benefits, without a similar evaluation of the costs. Seeing only one side of the cost-benefit equation increases the likelihood of making a poor decision.

"Costs" in financial product are management fees, sales and surrender charges, taxes and other expenses that occur as a direct result of a financial decision. In order to fully understand the effectiveness of your financial products, you must identify the costs associated with your products as well as the benefits.

Can you imagine the consequences if a business owner focused only on the perceived benefits of building a new warehouse, and never considered the cost of building it? Maybe things would turn out okay, but there's obviously great risk of financial failure by operating from such ignorance. This one-sided approach isn't good in business, and it isn't good in personal financial planning. It's not enough to project that you will have \$2 million dollars in a retirement account at age 65.



You must also determine the cost of accumulating the \$2 million.

Evaluating costs is more than having an awareness of the “hard costs,” – i.e, the ones that can be readily seen and quantified. Financial planning also has some other “soft” or indeterminate costs as well.



Opportunity Cost – the “Stealth Cost”

When you incur a tax, fee, or sales charge as a result of your financial transactions, your cost is not only the dollar amount, but what those dollars could have been worth to you in the future if you hadn’t paid them. These are opportunity costs.

Opportunity costs are “stealth” costs — unless you go looking for them, you won’t find them -- because even though opportunity costs are real, they are also

arbitrary. One person may value his/her opportunity costs at 5%, another at 10%. What is a reasonable compounding rate to apply to money you don’t have because you chose to place it somewhere else? That’s up to you.

But even if opportunity costs are hard to determine, and even if most people don’t recognize that they exist, it doesn’t lessen their financial impact. *The dollars you surrender today are the dollars that can’t work for your benefit in the future.* Opportunity costs you a huge “rest of the story” that doesn’t often get told. Here’s why:

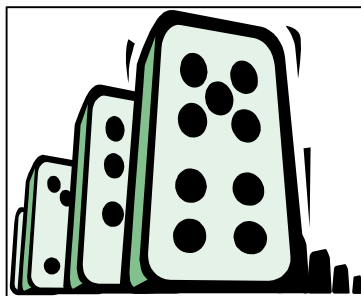
If you have had any exposure to traditional financial planning, you have probably seen a concept dubbed “The Magic of Compound Interest,” which is an illustration of how small initial deposits can grow to enormous numbers over time through simple compounding.

With opportunity costs, compound interest is working *against* you, not for you. Thus, Opportunity Cost is the “dark side” of the Magic of Compound Interest, because it makes small financial costs grow to enormous losses over time.

The better you understand opportunity costs, and apply them to your financial strategies, the more efficient you will be. Sometimes not losing money is the best way to save it.

The Ripple Effect

You must further recognize that a financial decision in one area may have ramifications in another. Taken separately, some financial options may seem positive and practical. But when you consider the consequences that follow from committing to that option, your assessment may change.



You may plan to contribute regularly to a qualified retirement plan, with the intention of building a large nest egg for the future. Your actual returns may even exceed your expectations. But even with greater-than-anticipated performance, even if you have thoroughly studied the real costs

and opportunity costs of the 401(k), this decision must be evaluated within a larger context.

For example, if you maximize your deposits to a 401(k), and earn 10% annually, but you continue to carry credit-card balances charging you 18% interest, is this approach really “making money”? When you need to put a new roof on the house, and don’t have the emergency funds available to cover the cost, what is the cost of taking an unsecured loan from the bank? It should be clear that the decision to make the 401(k) a financial priority impacts other areas as well.

Another often-overlooked ripple effect is investment risk. What would happen if the financial option you are considering doesn’t pay off? If the opportunity for higher returns turns into greater losses, what will happen to other financial plans?

In order to make good financial decisions, you must in some way account for the impact your decision may have on the rest of your financial life.

Making Good Cost-Benefit Decisions

It may take a little effort, but you don’t have to be a rocket scientist to figure it out. All you really need is a few simple questions that you can ask yourself and can also be answered by someone else who understands costs, and will work with you to make better decisions. So... even if you change nothing else in your financial plans, implement this strategy:

STEP #1:

The next time you are about to make a financial decision, ask yourself, ***“What are the costs associated with the benefits of the financial vehicle I’m considering?”***

See what costs and ripple effects you can find relevant to your situation. ***As much as we all might like to think otherwise, there is no free lunch! Every financial transaction has a cost.***

STEP #2:

See if the person presenting the financial “vehicle” will mention the cost issue as part of his/her presentation. If they don’t, ask ***“What will this cost?”*** If the sales rep, broker, adviser or next-door neighbor can’t answer the cost questions, ***find someone else to work with!***

Are you evaluating the **costs** of your financial decisions? What about the financial “advisors” and salespeople with whom you do business – are they talking about costs, or just the benefits?

WE SPECIALIZE IN EXPLAINING THE COSTS, AND WE HELP YOU FIND WAYS TO GET YOUR MONEY’S WORTH! CALL US TO ANALYZE YOUR CURRENT OR PROSPECTIVE FINANCIAL VEHICLES AND MAKE SURE YOU GET THE BEST “MILEAGE” FOR YOUR MONEY.



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.)

RICH AND POOR BOTH WEALTHIER

The world is growing richer. Merrill Lynch and consulting firm Capgemini released their annual "World Wealth Report" last week, and it says the number of millionaires in the world grew 7.5% to 7.7 million people. The report predicts worldwide wealth among millionaires to grow 7% per year to exceed \$40 trillion by 2008.

Overall, the world is a much more prosperous place than it was 20 years ago. According to World Bank, the number of people living in extreme poverty (living on less than \$1 per day) has been halved in that time, from 40% to 21%.

Both the poor and the wealthy seem to be benefiting from long-term financial plans. According to the "World Wealth Report," more millionaires are devising "100-year plans by which they manage their assets. This type of planning not only takes "the emotion out of investing," as Alvi Abuaf, Vice President at Capgemini and leader of its North American Securities Industry Consulting Practice says, but also focuses people's goals on accumulation and distribution of wealth rather than preservation of capital.

Thomas Kostigen, *CBS.MarketWatch.com*, June 21, 2004.



UNINSURED PROBLEM REACHES MIDDLE CLASS

A study unveiled on Wednesday shows that during the past two years, a third of all Americans under age 65 lacked health insurance at some point. The study by the consumer group Families USA found that nearly 82 million Americans went without health insurance at some point in 2002 or 2003. More than two-thirds lacked coverage for more than 6 months; more than half were uninsured for more than 9 months. "But what is really astounding is how deeply this reaches into the middle class," said Families USA Executive Director Ron Pollack. The study found that a quarter of people in families with incomes between \$56,000 and \$75,000 went without coverage at some point during the study period. "This constitutes an enormous epidemic that warrants serious and immediate action," said Pollack.

Reuters Health, June 17, 2004.



ECONOMY IMPROVING, BUT NOT REFLECTED IN RAISES

If you thought an improving economy was going to get you a bigger raise this year, guess again.

U.S. businesses are, on average, increasing their salary budgets 3.5% for 2004, the same level as last year's forecast, according to a new survey from the Conference Board, a private research group.

If the 2004 gains come to pass, it would mark the second time in 11 years that salaries have advanced at less than the 4% mark. Worse, the expected salary gains for 2005 are also expected to come in below 4%, the report said.

Michael S. Derby, *Wall Street Journal*, June 24, 2004.



AMERICANS MIGHT BE WARY ABOUT STOCK MARKET, BUT STILL LIKE TO GAMBLE

Americans may have turned more risk-averse in their investing, but the nation's appetite for gambling grew at a steady pace last year, according to a study released Thursday.

In its annual survey of casino revenue, visitation and demographics, the American Gambling Association trade group found that 53.4 million people visited gambling halls in 2003, a jump of about 2 million from the year before.

The study, compiled by Harrah's Entertainment and market research firm, NFO World Group, found that casino gamblers are slightly older and richer than the average American. Their median age is 48, as opposed to 46 for the general population, and median household income tops \$53,000, versus just under \$46,000.

Lotteries remain the most common form of wagering, with 46% of the adult population playing the numbers last year. Casinos were visited by 27% of the population, while 19% were in sports betting pools. 12% played poker, 7% went to the track, and just 2% did their betting online.

William Spain, *CBS.MarketWatch.com*, May 27, 2004.

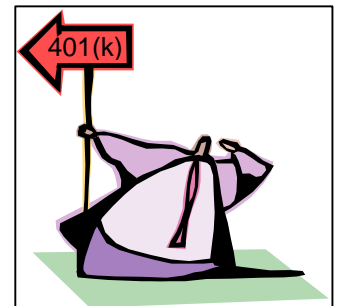


YOUNG WORKERS IGNORE 401(k)s

A large group of young workers (are) ignoring the chorus of financial planners who tout employee-sponsored retirement plans as their best chance of enjoying a comfortable retirement.

Only 41% of workers age 21 to 24 and 54% age 25 to 34 work for employers who sponsor retirement plans, according to the Employee Benefit Research Institute. And of those eligible for 401(k) plans, some recent studies show that less than half of workers in their 20's participate.

Michael P. Regan, *Associated Press*, June 20, 2004.



THINGS THAT MAKE YOU GO “HMMM...”

THE “MINORITY REPORT” FOR LIFE INSURANCE

(YOU MIGHT NOT BE FAT NOW, BUT ARE YOU AN “OBESITY RISK?”)



“Minority Report,” a recent movie starring Tom Cruise, featured the idea of law enforcement using quasi-scientific methods to identify and apprehend criminals *before* they committed their crimes. In a similar way, a recent study recommends that life insurance

companies may eventually take the same approach to evaluating prospective life insurance candidates, particularly in regard to obesity.

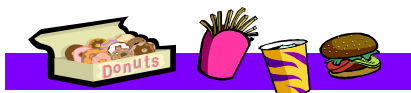
Life insurance actuaries know that overweight people represent higher health risks. Obesity is associated with heart diseases, diabetes and some types of cancers and is linked to premature death. Research shows that an obese 40-year-old, even if he did not smoke, could die six to eight years earlier than otherwise expected. Actuaries attempt to offset these risks by establishing insurability guidelines, such as weight charts and other similar criteria. Applicants whose bodies are outside these parameters may either pay more for life insurance or be declined.

However, unlike many other health factors that remain constant in one’s life, the problem with obesity from an insurer’s perspective is that many people who aren’t overweight when they apply for life insurance end up being that way over time. This “moving risk” poses a serious financial problem for insurance companies.

According to an April 14, 2004 *Reuters* report, “Bulging waistlines are set to weigh on life insurers’ profits, as obesity gains on smoking as the leading cause of preventable death, particularly in the United States.” The article goes on to state that research shows the number of overweight people in developed countries has risen three-fold over the last 30 years. “If left unchecked, it will have negative consequences for adult health and mortality in the future,” said researchers at SwissRe, the world’s largest life and health reinsurer. “Obesity presents the greatest threat to (existing) business where margins are tightly squeezed due to competitive factors and insurers are unable to raise rates.”

Since most life insurance policies (apart from group contracts), have fixed premiums, companies cannot adjust costs for existing policyholders. Instead, the costs of obesity will have to be factored into pricing new policies. The SwissRe study suggested that somebody looking to buy life insurance might have to be screened for the risk of becoming obese.

Hmmm... How to evaluate if someone who isn’t overweight now might be at risk for obesity in the future? Will insurance exams include an inspection of your car to see how many Big Mac wrappers and Krispy Kreme boxes there are?



IF YOU’RE GONNA COMPARE APPLES TO APPLES, YOU MUST ALSO CHECK FOR ORANGES, AND GRAPES (AND MANGOS, TOO)

The following sentence appeared on a recent savings account for the statement period from March 30, 2004 to May 26, 2004:

“0.24% is the annual percentage yield earned for the statement period.”

0.24%? As in *less than 1%*? After recovering from the shock of receiving such a low rate of return, a natural response of an account holder might be to look for a higher-yielding alternative. In the course of a cursory examination, one might come across this single statistical line from the Friday, June 25, 2004 “Markets Diary” in the *Wall Street Journal*:

	THU	WED	TTL RTN
DJ Corporate	YIELD	YIELD	YTD % CHG
Bond Index	174.04	173.35	- 0.52
	5.30	5.36	

Since the phrase from the savings account has been burned into the account holder’s brain for the last month, what might be the first thing that catches his/her attention?

How about: THU
YIELD
5.30

5.30% yield versus 0.24% yield? No degree in rocket science needed to figure out which number is better, right?

Not exactly. For the bond index statistical line mentioned above, other numbers matter as well.

An index is formed by selecting a group of similar financial instruments (stocks, bonds, funds, etc.) and calculating a cumulative value for the aggregate. In theory, index calculations provide analysts and investors with a broad sense of what is happening in financial markets.

The first number (under “THU”) is the calculated value of the index of selected bonds at the end of the business day on Thursday, June 24.

How does one
earn 5.3% interest
and still lose
money?

Compared to the third column, WED (June 23), Thursday shows a slight increase in value.

The second and fourth columns (THU YIELD and WED YIELD) are measurements of the interest rate for the index relative to its calculated value. The average annual percentage yield rate for the bonds listed in the index is 5.30%. In other words, an individual who made a \$10,000 purchase of the bonds comprising the index on June 24 could expect to receive \$530 (5.30%) in interest payments over one year.

But what about TTL RTN YTD % CHG? That stands for “Total Return Year-to-Date Percentage Change.” This calculation assesses the overall financial performance of the index from January 1, 2004 to June 24, 2004. In this time period, the index shows a loss of .52%. Thus, an individual holding \$10,000 in bonds in the index on January 1, 2004 would have an account currently worth \$9,948 on June 24 – including

the interest received as part of the calculation. In contrast, \$10,000 in the aforementioned savings account would have a June 24 value of approximately \$10,012.

Hmmm. This brief examination of two seemingly related statistical statements from two different financial instruments should demonstrate that simply comparing yields – an “apples to apples” evaluation – isn’t enough. What’s happening in other areas, i.e., the “orange and grapes,” might make the other alternative’s “apple” look less attractive.

And there’s more. If the “orange” of this comparison was Total Return Year-to-Date Percentage Change, the “grape” might be taxation. The “kiwi fruit” might be investment risk, and the “mango” could represent the desire for income versus accumulation. To continue the analogy, this means you must examine the “whole basket” of issues, not just one individual item. In this very simple example, any one of those issues could be pivotal in deciding which alternative best meets the needs and objectives of your situation.

A true evaluation is not just the condition of the fruit today, but an assessment of its “shelf life” in the future.

This necessity for examining all facets of a particular financial alternative applies not only to individual instruments, but also financial strategies. And because strategies are usually applied with a future-orientation, a thorough evaluation isn’t just about current features (today’s yield, taxation, risk, etc.) but also about *assumptions* regarding what will happen going forward. Because of other factors, things that look good today may “spoil” or be “rotten” in the future.

A good example of the need to fully examine the assumptions as well as the current status of different options is the debate between obtaining permanent life insurance (PLI) as opposed to buying term life insurance and investing the difference (BTID). On the surface, both strategies consist of two apples-and-oranges features: life insurance and accumulation. This common ground leads naturally to mathematical comparisons: which approach provides more insurance and/or accumulation?

But it’s the assumptions behind the mathematical calculation that determines the results. With the PLI and BTID approaches, there will be assumptions regarding rate of return, whether it’s the crediting rate or dividend scale of a permanent life insurance policy, or the projected rate of return for the investment vehicle used by the BTID for the “difference.” Along with rate of return will be the question of whether the investment risks are comparable. Taxation can certainly enter the evaluation, and if certain gains or withdrawals are to be considered taxable, the further question will be “at what rate?”

BTID assumes there will come a point where life insurance will no longer be needed, and coverage can/should be discarded. But when will that point occur? If coverage is still required or desired beyond the assumed date, is the individual assuming a risk of being uninsurable?

The length of time over which the evaluation is made is another critical issue. Because establishing a PLI plan may include larger up-front costs, most BTID scenarios show stronger performance in the early years of a comparison. However, depending on the length of time used in the evaluation, PLI projections may out-distance the BTID strategy.

From experience, assumptions are often the determining factor in any evaluation between PLI and BTID. Changing

assumptions about rate of return, taxation, and period of evaluation can change the “apples-to-apples” outcome.

You can’t make good evaluations without education and expert input.

Making good evaluations of competing financial alternatives is not easy. You must commit to becoming more knowledgeable – and to finding knowledgeable advisers to work with you.

Even though it’s not discussed in this article, there is a logical explanation for bonds yielding 5.30%, but still having a negative overall return. You could research this topic on your own, or you could ask someone licensed or qualified in the arena of bonds and bond markets to educate you. You could also ask your barber, or brother-in-law, but unless they are retired bond traders, how reliable is their information and perspective?

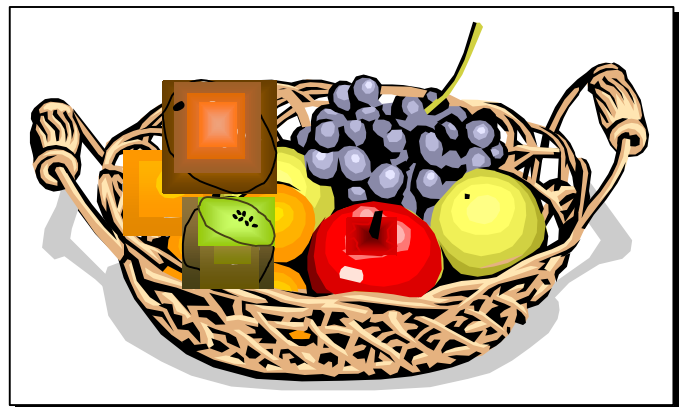
Same story for PLI vs. BTID. The debate between the two approaches has been almost constant for the last three decades, but very few advisors are truly qualified, by regulation and ability, to make comparisons and explanations between policies and accumulations. And while they may be very intelligent, your doctor or auto mechanic isn’t likely to be an expert on the other fruits in the basket that make up PLI or BTID.

And taxes? Even supposed experts like CPAs will often offer conflicting advice or assessments regarding taxes. Trusting an Internet web site that promises “tax secrets” (publicly posted?) is asking for an audit.

Input from advisers is most effective when the individual receiving the information/education/advice has enough personal understanding about the topic to discern critical issues as they relate to their situation. Even the experts can’t help someone who can’t understand the advice.

Ultimately, the choice is yours.

Because everyone’s circumstances are different, every assessment is in some way conditional upon the unique aspects of one’s own financial world. Solomon observed that “there is wisdom in a multitude of counselors,” but that doesn’t mean the majority opinion is always the right one for you. However, a wide spectrum of awareness can help you discern how all the fruits in the basket impact your apples-to-apples evaluations.





SO MANY INDEXES, SO LITTLE INFORMATION?

It seems like each day brings a new set of numbers about the stock market. But when some talking head on the television says “the Dow broke 11,000”, or “the Nasdaq was off 30 points today”, what are they talking about?

The Dow, the S&P 500, and the Nasdaq are stock market indexes. Indexes are selected lists of individual stocks that are averaged each day to provide some sense of what’s happening in the overall market.

As an example, The Dow Jones Industrial Average (DJIA) is the granddaddy of all indexes and was reportedly invented in 1884 by Charles H. Dow, the first editor of the *Wall Street Journal*. The DJIA is a measure of 30 “blue-chip” stocks – large, well-established companies that are leaders in their field, such as Proctor & Gamble, AT&T Corp., IBM Corp., and General Motors Corp.

Originally, the sum of all the prices was divided by 30 for a true average. Over the years, the formula had to be adjusted as the firms on the list increased the number of their shares, so the calculation is now a bit more complex.

Today, stock market indexes seem much like personal web pages; everyone has one, some change constantly, and some say different things about the same stuff. Such as:

The Frank Russell Co. is known for formulating the Russell 3,000 Index (catchy name, eh?), a list of 3,000 of the largest U.S. stocks. But Russell 3,000 isn’t the only index compiled by the company. There are 20 others, (like the “Russell 2,000” – another slick name).

Besides the venerable DJIA, Dow Jones posts a DJ World Index (up 3.3% from January 1 to June 24, 2004). The Wall Street Journal carries the calculations of three indexes for China and Japan, with surprisingly divergent results. The Dow Jones China 88 reports a 16.41% loss since the first of the year, while the Dow Jones Shenzen is only down 8.88%. In Japan the Tokyo Nikkei 300 is up 21.3% year-to-date, which is good news. But the Nikkei 225 is up a startling 1,067.51% since January 1, 2004!

When following the Dow and other indexes, keep in mind that it’s the percentage of change that matters, not the numbers or the points. Thirty years ago a dip of 80 points in one day on the Dow would have been a noteworthy 10% loss back when the index hovered around 800, but today it’s less than 1% of the index’s value.

FOR INVESTMENT PROFESSIONALS, INDEXES CAN BE VALUABLE TOOLS. BUT MOST LIKELY, THE RESULTS OF YOUR INDIVIDUAL INVESTMENTS WILL NOT PERFECTLY CORRESPOND WITH ANY INDEX. SO EVEN THOUGH AN INDEX CAN PROVIDE GENERAL INFORMATION ABOUT MARKET CONDITIONS, YOU STILL HAVE TO PAY ATTENTION TO YOUR OWN STUFF, BECAUSE ULTIMATELY THE ONLY INDEX THAT REALLY MATTERS IS YOUR OWN.



John J. Bellino III

Alliance Financial Group
14021 Metropolis Ave.
Fort Myers, FL 33912
Phone (239) 561-2900
(800)-964-6639 (where available)
Web: www.johnbellino.com
Email: john@johnbellino.com

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