

CREATIVE Wealth Maximization Strategies

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“The chains of habit are too light to be felt until they are too heavy to be broken.”
-Warren Buffet

“The road to hell is paved with good intentions.”
-Anonymous

EMERGENCY RESPONSE PLANNING

If you are a homeowner, you can probably relate to this story:

“It was five in the morning on a Friday. I was drowsy, but awoke to a humming noise I couldn’t recognize. Then I heard it again and identified the noise as my water pump, which shouldn’t have been running since no one was awake and using water. Right then I knew something was wrong. I dashed down to the basement as I heard the pump start up again.

I wasn’t sure why the pump was running, but I was betting it had something to do with the water heater. See, I had checked it last week, and could see that we needed a new one, because the old water heater was corroding out at the bottom, and there had been some water dripping on the floor.

Thinking only of getting to the pump to shut it off, I pulled open the door to the utility room. We had put a weather strip along the bottom edge, and as I yanked the door open, four inches of standing water blocked behind the door came gushing into the finished part of the basement. In stocking feet, I sloshed over to the pump, and flipped off the power switch, then tried to close the door again to keep more water from wrecking the basement.

It was too late. We had to replace the carpeting and some other items were wrecked too. The really crummy thing about the whole situation was that I had intended to replace the water heater that weekend. I knew it needed attention but put it off because I was busy. If it had just lasted one more day, this never would have happened. As it was, I used up a couple of work days just cleaning up the mess and spent more than I wanted to on the additional repairs.”

A question concerning the homeowner’s story (which is true): How do you evaluate the circumstances? Was it an act of God, or an act of negligence? Probably a little of both.

Accidents happen, and not when we expect them. The homeowner knew the repair needed to be made, but didn’t take care of it right away because other things were more pressing at the moment. However, as soon as the water heater broke, it quickly became the most urgent item on the list. This response is pretty representative of the way people often function, not only with appliances but almost everything, and especially with money.

We are in “emergency response mode” a good part of the time. Whatever issue has reached a crisis, that’s the one we focus on. Money issues are no different; we often make our financial decisions based on need or urgency.

Make no mistake, there are a lot of legitimately urgent things to address every day. In many ways, just meeting day-to-day financial needs is a major achievement! Those daily demands drive us to get better jobs, make more money, buy a home, set up bank accounts, etc. Unfortunately, a lot of those financial actions are usually made under pressure. Something has been ignored too long and now must be addressed.

Still, most people intuitively know there’s a better way to handle financial decisions. But the majority of Americans never go any further than saying “I’m gonna have to plan for the future”, and then get distracted by other things. One morning they wake up to see retirement on the horizon and, realizing that the planning can’t be put off any longer, begin to give it top priority.

Like most other things done on an emergency basis, the outcome of last-minute financial planning is usually less than the best. We settle for something instead of getting what we could have had.

In the long run, *not planning* is costly. It’s not only the extra costs you pay to correct earlier mistakes, but also what those extra dollars could have been worth if you had kept and invested them over your lifetime. This “lost opportunity cost”

can aggregate to hundreds of thousands of dollars over numerous sloppy financial decisions.

Some people see this cycle of “crisis living” as the natural course of things. They just do the best they can to respond to the unexpected challenges that life throws at them. Since they know they can’t anticipate all future possibilities, they rationalize away the value of any planning and deal with the consequences.

While it’s true that planning can’t anticipate every circumstance, *not planning* isn’t the answer. That’s like saying there’s no point in exercising because you might die in an automobile accident. This perspective isn’t useful, but for some people it doesn’t change until after they’ve had a heart attack. Could a heart attack have been prevented by exercise? Maybe, maybe not. But *not exercising* certainly doesn’t help.

Financially, there are too many variables to hope the “emergency response” approach will work every time. There’s no telling what might happen with taxes, interest rates, inflation, technology, currency or political and civil unrest. **You need to make every financial transaction count, because you never know which one could be the critical “heart attack” in your financial life. Sloppiness will cost you, maybe not now, but some time.**

250 years ago, John Wesley, an English minister, articulated a creed of maximization: ***John Wesley’s Rule: Do all the good you can, By all the means you can, In all the ways you can, In all the places you can, At all the times you can, To all the people you can, As long as you ever can.*** This statement was a summation of what some scholars later characterized as the “Puritan Work Ethic.” According to Wesley, it was the responsibility of every individual to apply all of one’s energy to every skill and asset under one’s control, and to produce as much as possible from each endeavor. While some of Wesley’s comments reflected “good deeds” done for the betterment of society as a whole, he specifically connected this attitude of maximization to financial efforts as well. The following is a contemporary expansion of Wesley’s thoughts:

In order to maximize your financial potential, you must have an organized process for managing risk, saving, and investing. This doesn’t mean creating a detailed financial “to-do list”. Rather, it means getting a basic concept of what it means to “maximize”, financially. Here are four guidelines used to define this maximum philosophy:

?? ***The primary goal is to accumulate as much as possible, not as much as is thought to be needed.*** Don’t be fooled into thinking a number chosen arbitrarily today will still be valid in the future. As long as you continue to earn money, you should be concerned about saving a part of it for your future and making the most you can from those savings.

?? ***It is also necessary to plan to spend as much as possible.*** A financial program that concentrates only on accumulating overlooks a basic concept: money is only worth something to us when we can spend it. Include a strategy for spending wisely as part of your financial plan. Too many fortunes are lost because of ill-planned spending.

?? In case all of the accumulation is not spent, it becomes crucial ***to control the transfer of assets***. Too often the major recipients of our wealth are the government, financial institutions, and other wealthy people, instead of heirs or charities. Don’t give it away needlessly - know where it’s going if you don’t spend it.

?? Finally, ***plan to succeed under all circumstances***. Risk management is a vital part of any financial program. “Conservative” investments, insurance, tax strategies and legal documents should be part of your financial plan. In hindsight, you may have done better taking the risk, but you must recognize the peril of suffering a loss. Time is relentless, and you may not always have the luxury of “catching up” for unforeseen events.

Consistent application of these principles will mean better decision-making and fewer emergency responses. Operating from a maximization perspective should also keep you from second-guessing. If you have done the best you can, there’s no reason to wonder if your projections are accurate, or the target number is large enough. Maximizing ***is*** the best you can do.

Even after reading this section, maximization may still be a fuzzy concept. Here’s a practical application, hopefully illustrating the approach:

Some people have the perspective of buying life insurance according to current needs, (i.e., “How much coverage would be needed to cover all obligations if I died

today?”). But a person intent on maximizing the effect of premiums spent on life insurance might instead ask “how much can I get?” This thought process would reflect several “maximization” realizations.

1. You may not be able to buy more later because you don’t know what your health will be, and health status affects insurability.
2. You cannot accurately assess future needs, so you don’t know if you will need more life insurance later... but you might.
3. Thus, if you believe life insurance is a desirable long-term piece of your financial plan, the best option is to obtain as much coverage as possible, given your current budget and the limits established by the insurer.

Maximizing each financial transaction is not “set-it-and-forget-it” financial planning. You can’t maximize by completing a one-time, comprehensive, customized, computer-generated report, and then assume you can just “follow the directions” believing that nothing will change the rest of your life. Maximizing your financial affairs is a never-ending process. For many people, it’s like doing laundry. It’s work. But remember two things:

?? ***As you get better at it, it gets easier (and more profitable).***

Achieving prosperity is not an easy task for most people, but for those that work at it, diligent practice usually produces something nearer to perfect. Saving gets easier the longer you do it. A second business or real estate purchase usually isn’t as stressful as the first. Like everyone else, you learn from your mistakes and apply the knowledge gained from the experience to progress further.

John Wesley’s Rule:

Do all the good you can,
By all the means you can,
In all the ways you can,
In all the places you can,
At all the times you can,
To all the people you can,
As long as you ever can.

?? *Nobody said you had to do all of it yourself!* Good advisors can be invaluable assistants in helping you maximize your financial plans. Good advisors also have a strong financial incentive to help you, because a maximization approach is one that requires using many of their services and products. If they can deliver for you, your position as a preferred client can also be profitable for them. But the key is finding an advisor that understands the maximization perspective.

WHAT IS YOUR PLANNING "MODUS OPERANDI?" ARE YOU OPERATING IN "EMERGENCY RESPONSE MODE," OR DILIGENTLY PLANNING TO MAXIMIZE YOUR CURRENT FINANCIAL OPTIONS? FURTHERMORE, DO YOUR OTHER ADVISORS HELP YOU UNDERSTAND AND APPLY MAXIMIZING STRATEGIES? NOW IS THE TIME TO BREAK THE "EMERGENCY RESPONSE" HABIT AND START MAXIMIZING YOUR FINANCIAL EFFORTS.

THE IMPACT OF AGING IN AMERICA

Do your financial plans include caring for aging parents?

Most financial planning discussions are about *your* retirement, *your* estate plans, and sending *your* kids to college, but it's beginning to look like taking care of *your parents* may also need to be added to the list.



"The future looks very unlike the past," according to Lynn Friss-Feinberg, deputy-director of the National Center on Caregiving and the Family Caregiver Alliance. At a recent conference in Sacramento, California, Ms. Friss-Feinberg detailed how the aging of the population and changing patterns of family life will affect nearly every American family in the 21st Century.

In a nutshell, it is Friss-Feinberg's contention that the demand for caregiving to an aging population will increase at the same time the number of caregivers decrease. By 2020, 16% of the U.S. population – 3 million people – will be 65 or older, but smaller family size today means that older family members have fewer younger persons to rely on for care. In addition, delayed marriage and childbearing increases the "sandwich" pressures on those family members, because they are taking care of both their parents and their own children simultaneously.

Orange County Register reporter Jane Glenn Haas wrote in a May 21, 2003 article that one in three Americans is currently providing some form of care to an ill or disabled family member or friend. Further, some 23 million households aid someone 50 or older, and that number will almost double in just four years.

Caring for a parent or older relative can be both a drain on one's energy and finances. Typically, the caregiving issue hits people in midlife. According to Ms. Friss-Feinberg's statistics, the average age of family caregivers is 43, an age when many individuals are concerned about impending college expenses for their children, and the need to accelerate saving for their own retirement.

401(k)s AREN'T PROPERLY UTILIZED

Regular readers of this newsletter know we have reservations about the value of participation in 401(k)s, primarily because of the control one forfeits over the money. This opinion flies in the face of mainstream financial opinion, which has consistently touted the 401(k) as the cornerstone of retirement planning. But after two decades of existence, even the proponents of 401(k)s are beginning to admit that many individuals are not effectively using their plans. And in some measure, this misuse may negate the value of the plan for retirement.



A May 1, 2003 *Wall Street Journal* article detailed the concerns expressed by various financial planners and financial institutions. Among the problems:

Employees are found to be poor managers of their own accounts. A study from Fidelity found that, in spite of a falling market, just 13% of participants made changes to their portfolio allocations, thus continuing to pour money into losing positions. Almost as bad, when they do make changes, employees "tend to sell at the lowest level and buy at the highest level," says Shlomo Benzarti, a professor of accounting at UCLA. Also, when given the choice, employees tend to heavily invest in their company's stocks, often resulting in an unbalanced and volatile account.

Participation is declining. When not encouraged by an employer match, many employees don't participate at all. At least a dozen major employers have cut or suspended contribution matches to their 401(k)s since the start of 2002. Just 73% of workers participated in their company's 401(k) retirement-savings plan last year, the lowest level since at least the early 1990s, according to Buck Consultants, a human-resources consulting firm.

Borrowing from 401(k) accounts is prevalent. As many as 25% of people with 401(k) plans that allow loans have raided them for extra cash. Fidelity Investments says the number of 401(k) loans grew by 10-12% last year, largely because many people who have already borrowed from their 401(k)s are tapping their accounts yet again. By one measure, a survey by the Profit Sharing/401(k) Council of America, about one of every four workers with a 401(k) plan that allows loans had borrowed against their balance in 2001.

Job hoppers don't rollover their accounts. When employees change jobs, 23% of them withdraw the money instead of rolling it over into a new retirement account, according to Fidelity. Cash-outs are most common when accounts are under \$10,000, but each time the employee cashes out of the existing plan, he/she usually incurs taxes and penalties. And essentially, the process of saving for retirement starts again at square one.

In a way, these behaviors suggest that human nature and financial realities aren't always agreeable with the provisions of a 401(k). "My ability to be a long-term investor depends on my ability to keep my job," says Jack Smith, a network administrator for a small manufacturing company, when asked why he stopped making contributions to his company's 401(k). In spite of good intentions, other needs and desires get in the way, and undermine the usefulness of the program.

That's why the 401(k) works well for the "15% to the 20% of the population that has the know-how and desire" to take control of their retirement savings, according to Brigitte Madrian, an associate professor of economics at the University of Chicago. "But," she adds, "they don't work well for the majority of the population."

HOW MUCH DO YOU REALLY KNOW ABOUT YOUR 401(K) PLAN? SOME COMPANIES ARE ACTUALLY SUGGESTING PARTICIPANTS SEEK A FINANCIAL PROFESSIONAL TO HELP THEM USE THEIR RETIREMENT PLAN(S) WISELY. CALL US TO DISCUSS COORDINATING ALL YOUR RETIREMENT PLANS.

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.)

MANY AFFLUENT HOUSEHOLDS LACK SUFFICIENT LIFE INSURANCE

"Most Americans with household incomes of \$100,000 or more lack sufficient life insurance to permanently replace their salaries yet say they have sufficient coverage, according to a new survey commissioned by The Hartford Financial Services Group, Inc. The internet-based survey, conducted by an independent research firm on behalf of the Hartford, found that 64.6% of all respondents had less than \$500,000 in life insurance and 10.6% had less than \$100,000 in coverage. Many financial planners recommend buying a minimum of between seven and ten times your annual salary to replace your income and adequately protect your family."

PRNewswire, April 29, 2003.



THE SITUATION IS GETTING WORSE FOR GOVERNMENT PROGRAMS

"Barry Anderson, an MBA with a beard and a raucous laugh, is one of those smart, influential, but largely anonymous bureaucrats who appears on TV only when sitting behind a big-shot witness at a congressional hearing. Since Jimmy Carter was president, he has watched and sometimes helped politicians create budget deficits, conquer deficits, and recreate deficits.

So how does the U.S. fiscal picture compare to 1980, the year Mr. Anderson went to work as a junior bean counter at the White House?

'We're worse off,' he says. 'Not because of the level of current deficits, but because we're 20-plus years closer to the (demographic) time bomb. Not only haven't we improved things, but we've made things worse, and we are about to make things even worse.'

So as the baby boom turns grayer, the U.S. is going to spend more on retirees and their health care. Perhaps the government will cut benefits a bit to save some money, but it's going to spend a lot more, and government will grow. The money is going to come from the rest of society – in higher taxes and bigger borrowing. Already, Social Security and Medicare taxes eat 15.3% of wages, and 80% of taxpayers pay more in those payroll taxes (including taxes paid by employer and employee) than in income taxes."

David Weissel, Wall Street Journal, May 8, 2003.



MANY COLLEGE GRADS ACQUIRE CREDIT-CARD DEBT

"College students graduating this spring will be confronted with more than the challenge of finding a job in a tough economy. Many will also face a mountain of credit-card debt. Credit-card companies aggressively target college students in marketing campaigns, so it's not surprising that some college students carry an average balance of \$2,327, according to Nellie Mae, which provides education loans to students and parents. One in five college students has a balance between \$3,000 and \$7,000.

This doesn't necessarily mean that college students are being financially irresponsible. In four-year colleges and universities, about three-fourths of undergraduates work part-time, according to the American Council on Education."

Marshall Loeb, CBS MarketWatch, May 12, 2003.

LOW INTEREST RATES HAVE A DOWNSIDE

"In a world where somebody complains about everything, low interest rates enjoy a rare exemption. Rates have been low for a couple of years, since a barrage of 11 cuts by the Federal Reserve in 2001. Ask anybody who knows, and they'll tell you low rates promote economic health.

Problem is, that simple view leaves untold another side of the story, the stresses and strains occasioned by low interest rates.

Start with savers and investors accustomed to relying on income from money-market funds. The average money-fund yield was more than 6 percent 2 1/2 years ago. Now it's less than 1 percent. No need to stop there. Consider the role low rates have played in the underfunding of pension plans – a concern that now clouds prospects for earnings recovery at many businesses, especially large ones."

Chet Currier, Bloomberg News, May 9, 2003.



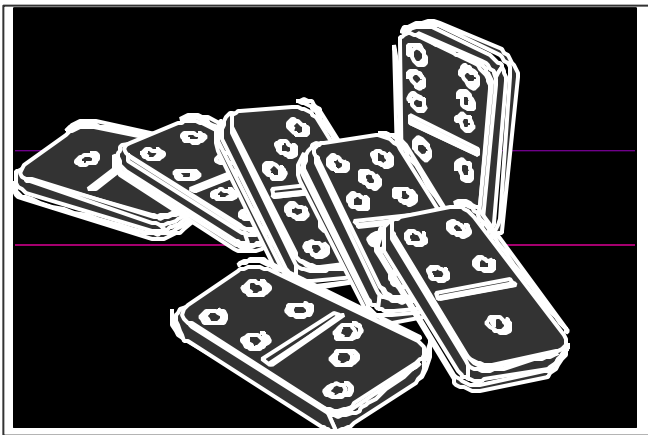
LOWER PRICES MAY MEAN DEFLATION IS A PROBLEM

"The Labor Department reported that wholesale prices fell 1.9% in April, the largest drop since the government first compiled such figures in 1947.

The concern is that falling prices, unless fueled by increases in productivity, will lead to a situation similar to that for Japan. Falling prices there have cut deeply into profits, sapping economic growth and hurting the manufacturing economy. Fed Chairman Alan Greenspan and his colleagues earlier this month signaled that they were prepared to cut interest rates to ward off deflation at the Fed's June 24-25 meeting. Interest rates are already at a 41-year low."

World, May 24, 2003.





PENSIONS & RETIREMENT BENEFITS: THE NEXT DOMINO

The stock market decline that began in the second half of 2000 has had a ripple effect, disrupting different segments of the economy much like a row of dominos tumbling one after another. Early on, it was the speculative stocks of the “New Economy,” the dot-coms and the venture capital investors that took a beating. Then, the downward trend spread through the broader stock market, and large, established institutions began to feel the pain. Eventually, upon opening their next quarterly statement, small investors and 401(k) account owners gulped when they saw their losses, and many were forced to recalculate their retirement dreams.

The stock market decline has tumbled other dominos as well. The decline signaled an end to booming business growth, and forced many companies to downsize their plans for expansion. Without new orders, or the capital to increase market share, companies began cutting jobs. Because lower employment means less spendable income and less consumer activity, it often leads to even fewer orders, which in turn means additional job cuts.

To end this downward cycle, one solution for some companies is filing for bankruptcy, allowing them time to reorganize in order to respond to the demands of a stripped-down business climate. Often the reorganization involves the sale of the company assets to a new owner, and the company may begin operating under a new name.

In a bankruptcy, some of the likely changes involve reduction or elimination of pensions and insurance benefits for retirees. These promises made to workers by the old company, are not binding once the company files for bankruptcy protection, because under Chapter 7 of the bankruptcy code, employees are considered unsecured creditors and are far down the list of those to be repaid out of a company’s remaining assets.

If a company declares itself unable to continue paying for retirees’ pensions or other benefits, the alternatives available to stranded retirees are often poor substitutes. The Pension Benefit Guarantee Corporation (PBGC) is a quasi-public insurer that assumes responsibility for pension plans of failing employers, but the coverage may not fully replace one’s previous retirement income. For medical insurance, coverage is available under the provisions of COBRA, a federal law that temporarily extends existing coverage, but usually at a much higher cost.

A May 12, 2003 *Wall Street Journal* article, detailed the financial dilemma of retiree Chuck Kirilko, as a result of the bankruptcy of his former employer, LTV Steel. LTV was originally Republic Steel, and went through three bankruptcies before being sold to International Steel Group in February, 2002.

After almost 40 years with the company, Mr. Kirilko retired in 2001. At the time, Mr. Kirilko and his wife owned their home free and clear, and had an additional \$35,000 in savings. He received a full pension of \$2,450 a month, and his health insurance, subsidized by the company, cost only \$115 a month. The insurance covered 100% of Mr. Kirilko and his family’s medical costs, and typically required them to pay only \$10 to \$20 for prescriptions.

Following the reorganization, both Mr. Kirilko’s pension and medical insurance were eliminated. The PBGC stepped in to continue providing a pension, but the monthly check was reduced to \$1,529 a month. Adding to the misery of a reduced income, the insurance premiums under COBRA jumped to \$1,305 a month.

In January 2003, the cost of insurance went even higher: over \$2,800 a month! Despite his high cholesterol, diabetes, infected lungs and weak heart, Mr. Kirilko couldn’t afford to keep paying health insurance premiums. Three months later he finally qualified for a private insurance plan for \$614 a month, but the plan provides only 70% coverage with just a 10% discount on prescriptions. At age 58, Mr. Kirilko knows he is just one major medical incident away from being broke. Mr. Kirilko’s assessment of his situation: “I hope nothing happens to my health... I’m scared to death.”

Perhaps the scariest part of Mr. Kirilko’s circumstance is that so many other retirees are vulnerable to similar occurrences. For many large companies with a long history, the cost of providing for retirees is an ever-growing burden that can no longer be carried. Bethlehem Steel, which was also sold to International Steel Group in 2003, had 95,000 retirees and less than 7,500 current employees, a ratio of 13 retirees for each current worker. Ford Motor Co. has acknowledged that it spends three times as much on benefits for retirees compared to current employees. US Airways says it’s ratio is even higher, with \$55 million allotted to health benefits for retirees, dependents and surviving spouses, compared with \$12 million for current employees.

Given the current economic climate, the future profitability and survival of many of these companies is conditional on the ability to decrease costs that don’t contribute to productivity. It’s a situation that almost begs for management to consider the bankruptcy option. (As an example, following bankruptcy, and the jettisoning of retiree obligations, LTV is expected to operate profitably as part of International Steel.) Not all companies will pursue this course, but the fact that they can means no pension or retirement package is ever a sure thing. In other words, you can’t count on it.

Considering the aging of the baby boomers, and the fact that fewer workers are available to replace them as they age, it’s a quick leap of logic to declare that all sorts of financial programs, from pensions to Social Security and Medicare, can’t remain viable. Something *has* to change - and it will.

It’s much more difficult to ascertain what those changes will be, and whether they will be to one’s advantage. As voters, baby boomers represent a big chunk of constituents, and it’s

reasonable to expect that politicians will be receptive to changing things, especially if doing so means getting re-elected. But it's also reasonable to expect that legislative changes (such as health-care reform, or some form of national insurance) will not only take a while to enact, but will be minimal solutions. Only those who are desperate or foolishly optimistic should rely on the government to fix this dilemma of vanishing benefits.

These situations only reinforce a comment made often in earlier issues: **a key component of any financial plan is who controls the plan.** A company pension and a health insurance program are definitely benefits to the recipients, but the benefits are *not controlled by* the recipients. That's a crucial distinction.

If you haven't understood this already, it should be clear that no matter how comprehensive your employer benefits are, you can't afford to rely on them exclusively. ***You must build a financial program apart from your employer – and this includes not only accumulation for retirement income, but also other benefits and insurance.***

If recent events are any indicator, one specific aspect of a private "retirement package" – however you define it – is that you must prepare for the possibility of paying for your own health insurance. Without insurance, under our current healthcare structure, the cost of one major medical incident could quickly overwhelm a lot of accumulation plans. The thought of having to provide one's own insurance is a sobering contemplation, in that it may significantly increase the accumulation amount one will require for retirement, or significantly increase monthly expenses that will need to be paid for.



“A key component of any financial plan is who controls the plan.”

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