CREATIVE
Wealth Maximization Strategies

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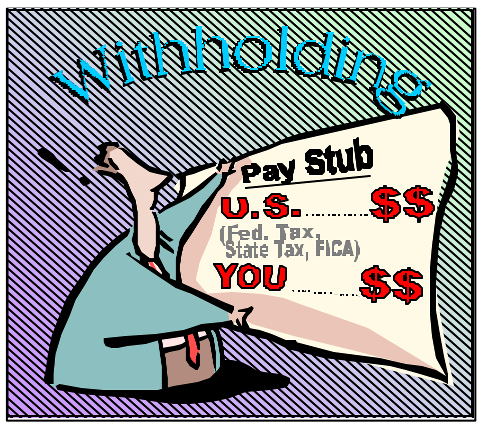
THE BEST FINANCIAL STRATEGY THE GOVERNMENT EVER DEVELOPED

Taking potshots at government ineptitude is almost a birthright in democratic societies. And between the politics, the bureaucracy, the taxes, and the waste, there's usually plenty to grouse about. But every now and then, government comes up with something that works. And when it does, it's only fair to give the government its proper respect and recognition.

So in the interest of being "fair and balanced," let's give a nod of acknowledgement to one of the best financial strategies ever implemented. It's an approach so effective that millions of Americans use it every week and don't even know it. Let's hear it for our good friends at …

The Internal Revenue Service.

What? The IRS?



It may be hard to believe, and even harder to stomach, but it's true. When it comes to financial strategies, the IRS implements this one like none other, and proves its effectiveness over and over. Indeed, if everyone committed to using the same technique, the financial change would be so dramatic that it would rearrange the political landscape as well.

What is this magic strategy?

"Withholding."

WITHHOLDING – WHAT A CONCEPT!

For all W-2 wage earners, the IRS requires employers to withhold amounts from gross earnings for the payment of anticipated federal income taxes, state and local income taxes, and Social Security and Medicare taxes. Before the earnings ever touch the wage-earner's hands, a portion has already been sliced off (by the employer) and sent to the Treasury.

At a later date (usually around April 15th), the wage-earner files a tax return with the IRS, assesses how much he/she really owes in taxes, and matches the amount against what has already been withheld. If the amount is more, the wage-earner sends in the difference, hopefully only a small, relatively insignificant amount.

If the tax due is less than what has been withheld, the taxpayer files for a "refund," and receives the overage. This tax refund, a return of one's money (without interest), is an economic phenomenon without peer. Whenever possible, the IRS releases statistics about the increasing average refund amount. ("We're not only taking more than you owe, and holding it, but we're taking it in larger amounts! Isn't that great? Here's your check!") Taxpayers actually build portions of their financial lives around the refund, using it to fund an annual vacation, or purchase big-ticket items. Car dealers, furniture retailers and other merchants have tax refund sales.

This is brilliant. Sheer genius.

Withholding isn't great because the government gets the use of your money for up to 16 months before your taxes are due and does so without paying interest -- that isn't fair, even if it is legal. It's not great because withholding puts the burden of collection on the employer instead of the government. In fact, the recordkeeping and regulation employers must endure at the hands of the IRS is probably a drag on productivity and profitability.

Withholding is a great concept because it recognizes human nature, and addresses it effectively.

Once a year, the IRS wants taxpayers to settle up and pay taxes. Considering that taxes represent a sizable percentage of earnings, that once-a-year payment could be a fairly large number, with the dollar amount running into the thousands or even tens of thousands.

The logical approach to handling any large, annual, future expense would be to diligently set aside a small amount from each paycheck. The amount, perhaps deposited in a bank, could earn interest while it is saved. When the bill is due, the debtor could make the payment with minimal financial (or psychological) aggravation, because the cost and inconvenience

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would be spread over the entire year, instead of consuming a large amount (or all) of a few paychecks.

But this little-bit-every-payday program, while logical, goes against natural human tendencies. Each pay period, an army of large and small temptations works to sabotage the plan to set something aside for the future. There are sales and specials and emergencies and rationalizations ("I can double up next time"), and opportunities that become "necessities". It's natural to spend, to seek immediate gratification. Given the freedom to choose, most people will struggle to deny the present, especially if the saving-every-paycheck plan is for something (taxes) which people don't want to pay in the first place. Even worse, from a tax-collecting standpoint, the tendency to spend makes it more likely that some citizens will not be able to pay their taxes promptly. This not only means more work for the tax collectors, but also less tax revenue.

> ***"An aim without a target is worthless."***
>
> *-- Fred Smith*

Withholding bypasses all those psychological hurdles. Because you never even have the money, you can't spend it. Furthermore, not having the money takes away some of the natural temptation to buy, because what's the point of looking if you know you can't buy it? Instead, withholding forces you to learn to live with the lesser amount. You may tell your friends what you earn using the gross number, but you live on the net (i.e., after taxes).

Further, because the government requires your employer to handle the withholding and payment details, you don't experience any feelings of having sent away "your money," withholding is almost painless. If a contractor took more of your money than was due him for services rendered, you would be upset, and probably consider legal action to get your money back. Yet even though you intellectually understand that the government took a slice of your income that may not belong to them (that's why they send you refunds), somehow it doesn't feel like you're being cheated. In fact, many see the return of what's rightfully theirs as a "bonus." When it comes to effectively setting aside money for future obligations, could there be a better plan than withholding? Admit it. When it comes to getting money removed from your checkbook, and putting it aside, nobody does as well as the IRS.

If you follow the logic, it should be easy to discern the parallel thoughts connecting IRS withholding to using the same strategy in your financial plans.

For the IRS:

1. The IRS needs to collect money in the future to continue the operation of the government.
2. The amount needed may be sizable.
3. To reach its objectives, the IRS must learn to overcome the natural human tendency to spend what's at hand.

For you:

1. You need to collect money for your own financial future, whether it's for retirement, business, or other opportunities.
2. The amount needed may be sizable.
3. To reach your objectives, you must learn to overcome the natural human tendency to spend what's at hand.

MAKING WITHHOLDING WORK FOR YOU

Similar goals lead to similar strategies. If withholding works for the IRS, why not have it work for you? The principles that the IRS uses are good ones to follow in implementing a personal withholding plan.

Make withholding an every-pay event. There are always reasons not to save. And every reason is a good one. But you know what? The IRS doesn't allow employees the option of "occasional" withholding. The payroll deductions are applied to every paycheck, and while you can change your tax withholdings, there are limitations, the procedure isn't convenient, and you usually have to wait a pay period or two for the change to take place.

If you really want to save money, you must make withholding an every-pay event. No exceptions. Yes, it means there will be less money to spend than before, but if the withholding is part of every pay, you will adjust. (This assumes that the amount you intend to withhold is reasonable. The individual who declares they will withhold 50% of income and simply "adjust" is probably going to fail – or starve.)

Get someone else to do the dirty work. Unless you get paid for it, no one wants extra paperwork or complexity. The more checks you have to write, the more deposits you must make, the greater the chances withholding will not be done. A personal withholding plan will fail if you have to run it, so find someone else to handle the details.

Your employer may offer direct deposit options. Use them. Likewise, find out what your bank or credit union can do so that one deposit (the paycheck) is automatically distributed to separate accounts. If you are participating in other personal financial programs on a regular basis, consider electronic fund transfers to pay the life insurance premium, or dollar-cost-average into a mutual fund.

Give yourself occasional refunds. This idea isn't a staple of the financial planning industry. Most of the conventional thinking says spending some now only decreases what will be available later. While this is true, think about following the government's lead to give yourself occasional refunds.

One of the reasons withholding is palatable for most taxpayers is the brief psychological "reward" that a refund provides. Yes, it is a return of "your money," but it's also money you have learned to live without, and no longer had expectations for spending. Getting some of it back – with no strings attached – is enough to make one giddy. It's also enough to keep you in the withholding program. So every now and then, designate some of your personal withholdings as "refunds."

Of course, there's always the risk that the occasional refund could turn into a regular monthly withdrawal and undermine the saving plan you are trying to execute. Hopefully, the same people and institutions that did the dirty work to establish your withholding plan can help you exercise some restraint. The money market account you're using may require any checks drawn on the account to exceed $250 or $500, so you probably won't use that account for a midnight pizza. Life insurance, cash and mutual fund accounts may have similar minimum withdrawal restrictions, and paperwork requirements. You can get the money, you just can't get it today, and there's a little bit of work/inconvenience involved. And quite often, accessing the

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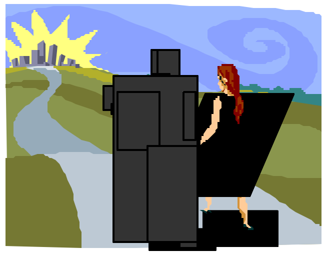
THE "DETOUR" OF A LIFETIME



Some of the questions that compel consumers to consider purchasing life insurance are not only uncomfortable, but seemingly unanswerable. Even though it might be a legitimate question, just how does one respond to "What would happen if your husband/wife died prematurely?" or "How much money would you need/want if your spouse died tomorrow?" *Yuck.* Those questions would make anyone squirm.

Besides being morbid, the projection of the financial impact of a spouse's death is impossible to anticipate. It's only after the process is over that each situation reveals the impact, financial and emotional, from a spouse's passing. However, the financial experiences of those who have suffered the premature loss of a spouse provide strong incentive for making sure one's life insurance program is more than an after-thought.

A new study of widows and widowers by MetLife, titled "Financial Impact of Premature Death," surveyed 1,000 widows and widowers between August 4-19, 2003. Participants had all lost a spouse within a period of 6 months to 5 years prior to the survey and the deceased was between 30 and 55 years old at the time of death.

The results from the survey reveal the long-term financial toll of the premature death of a spouse is considerable. In fact, survey respondents said it was four to five years before their financial circumstances returned to what they were at the time of their spouses' deaths. Some of the specifics were sobering:

?? Two-thirds of spouses (65%) reported that the death had a "devastating" or "major" financial impact on the families' financial security.
?? More than one third (39%) of surviving spouses received no life insurance proceeds at all.
?? Two-thirds of spouses who did receive life insurance benefits received proceeds that were less than three times the annual income of the deceased. One in four beneficiaries received benefits that replaced less than one year of the deceased's income.
?? Less than half (46%) of the spouses who received life insurance proceeds described the amount of coverage as "adequate."
?? Nearly half (46%) of deceased spouses did not have a will.

The survey found that many families were required to make significant financial adjustments, including working additional jobs, longer hours; withdrawing money from savings accounts, retirement accounts and investments; moving to smaller, less expensive housing, reducing spending on their children's education; and borrowing money.

The financial equation of life insurance is not exactly win-win because someone has to die for the benefit to be paid. But neglecting the situation and avoiding life insurance leaves one exposed to the potential of a significant lose-lose scenario.

THINGS THAT MAKE YOU GO "HMMM…"

IT'S "GENERALLY LOUSY" BUT YOU SHOULD BUY IT

"Long-term care insurance is expensive, unreliable and generally lousy -- but a new study by Consumers Union says you might want to buy some anyway." So writes free-lance reporter Linda Stern, in an October 19, 2003 news article.

What?

The Consumers Union report referenced in the article identified several issues that have converged to cause what may be a change in the long-term arena. On one hand, these issues expose the potential shortcomings of long-term care insurance. On the other, the same issues point to long-term care as the only effective solution.

The crux of the issue is **money** and **longevity**. Insurers are hiking their rates rapidly as they discover that nursing home care costs more than they thought it would. And as medical science improves, people live longer and nursing care gets more expensive.

For insurance companies, this combination of increasing lifespans and increasing costs creates some actuarial challenges, because when insurance companies pay more benefits than they collect in premiums, they cease operation. The response, at least right now, is increased premiums. However, according to Marilee Driscoll, a consultant and author of "*The Complete Idiot's Guide to Long-term Care Planning*," the price increases are reaching the point where only the wealthiest Americans can pay for the insurance – and many of them have enough assets to pass on buying the coverage. If that's the case, who will buy long-term insurance?

The flip side of the story is that there remains a strong consumer need for a long-term care solution.

Unless you're very well off, you aren't going to be able to cover your long-term care costs should worst-case scenarios strike. According to an October 2003 Reuters article, "nursing home care costs an average of $52,195 a year and can go a lot higher than that. The average stay is just under three years, but as many as 8% of people 65 or older will face five years or more in a nursing home." These expenses expect to increase in the future, and can have a devastating financial impact on individuals, spouses and their families.

In addition, states are tightening their Medicaid rules. Middle-class people who planned on impoverishing themselves to qualify for Medicaid long-term care benefits may find the requirements more stringent in the future.

On a positive note, most current long-term policies now cover home health care and some assisted living services. This often affords more humane and dignified care than might be provided in institutional settings.

According to Driscoll, the financial protection and dignity that long-term care provides makes the coverage worthwhile. "Long-term care insurance has a lot of problems, but it is the best solution we have right now."

Stern concurs, adding the following thoughts: "Lousy as it is, if you're worth more than $100,000 and not so rich that you don't have to worry about money, you might want to buy this coverage. This is an evolving and uneven industry, so you should be very careful before you put your money down and make your choice."

Hmmm… Based on demographics, the long-term care dilemma isn't going away. If the "lousy" option is still the best one today, doesn't it present a great opportunity for someone to come up with a better solution?

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.)

INSURANCE DISCOUNTS FOR LOSING WEIGHT

"'Insurance companies should give discounts to customers who lose weight and exercise every day and the U.S. government plans to help them do it', Health and Human Services Secretary Tommy Thompson said on Monday. He praised Milwaukee, Wisconsin-based Fortis Health for its plan that gives a 15% discount to customers who stay at a healthy weight and said more insurers should make similar changes to encourage disease prevention. 'Right now most people are insulated from the cost of their behavior,' Thompson told a news conference. 'When Mr. Smith has an unhealthy habit, his co-workers, his company and the taxpayers pay for the consequences of his choices.' "

Reuters, July 23, 2003.

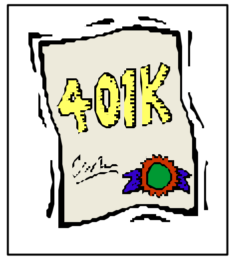
DO MARRIED MEN EARN MORE THAN BACHELORS, OR DO MEN THAT MAKE MORE GET MARRIED?

"Marriage isn't just good for a man's heart. It also may be good for his wallet.

Married men take fewer health risks, eat better and are involved in more health-enhancing behaviors, according to the Men's Health Network and the Association for Worksite Health Promotion. Now, a new crop of studies has shown married men also earn an average of 10% to 40% more than those who have never married, even with similar education and work experience.

Two main reasons are thought to drive the phenomenon, say Hyunbae Chun and Injae Lee of the department of economics at New York University. First is the 'productivity hypothesis': having a partner to support, encourage and motivate makes the other partner more productive. Second is the 'selection hypothesis': women tend to marry men with characteristics that make them more successful in the workplace, and avoid men who don't."

Jennifer Wirth, *Florida Today*, October 27, 2003.



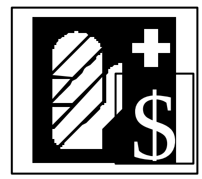
"THIS ISN'T WHAT WE MEANT BY '*BUY & HOLD*'"

"Though the stock market has regained some ground this year, the value of Americans' holdings in their 401(k)s plunged about $456 billion from 2000 to 2002 according to the Federal Reserve. So how are people dealing with the problem?

'By not doing anything,' says David Wray, president of the Profit Sharing/401(k) Council of America, a trade group based in Chicago. He says people have heard the message from experts that they should stay the course and invest in their 401(k)s for the long term. But, he says, they've misunderstood that to mean they should leave their asset mix unchanged.

A study published in June by Hewitt Associates, Inc., a Lincolnshire, Ill., consulting firm, found that only 17%, or 1 in 6 of active 401(k) participants made trades in 2002 in any of the investments in their accounts, which might include mutual funds, stocks and bonds. Put another way, about 83% of account holders failed to rebalance their 401(k)s last year."

Sonya Ryst, *Encore*, August 11, 2003.

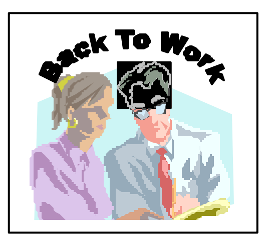


HEALTH PREMIUMS, NOT TERROR ATTACKS, WORRY PUBLIC

"Politicians take note: Americans fret more about losing their health insurance than being a victim of a terrorist attack, according to the results of a poll released on Tuesday. That's among the findings of the survey showing health care premiums climbing at their highest rate in more than a decade, driven by steeper doctor and hospital fees and health insurers' profit gains.

Monthly premiums for employer-sponsored health care in the United States jumped by 13.9% between spring 2002 and 2003, the sharpest spike since 1990, according to a report by the Kaiser Family Foundation, a nonprofit research group. Costs paid by workers out of their own pockets for prescription drugs and doctor visits jumped by at least 50% in just the last three years, the report found. Spending on health care is set to hit 17.7% of U.S. gross domestic product by 2012, up from 14.1% in 2001, according to government estimates."

Reuters, September 10, 2003.



COMING BACK FROM RETIREMENT

"Already, there are signs of an exodus out of retirement. Spherion Corp., a recruiting firm with 800 offices nationwide, says it has seen a 40% growth in job-hunting retirees since 2001, and a 20% increase in companies seeking such experienced workers, often for 'interim executive projects.' Certainly, not all of this is by choice. Some seniors have been forced back to work by financial need. But many are healthy go-getters who eschew the notion of an idle retirement. By 2015, estimates the National Council on the Aging, 20% of the U.S. work force will be over age 55, up from 13% in 2000."

Jeffrey Zaslow, *Wall Street Journal*, October 21, 2003.

(continued from page 2)

account means talking with an agent or advisor, someone who in theory has an interest in your long-term financial well-being, and may challenge you to remember the big-picture reasons for establishing a withholding plan in the first place.

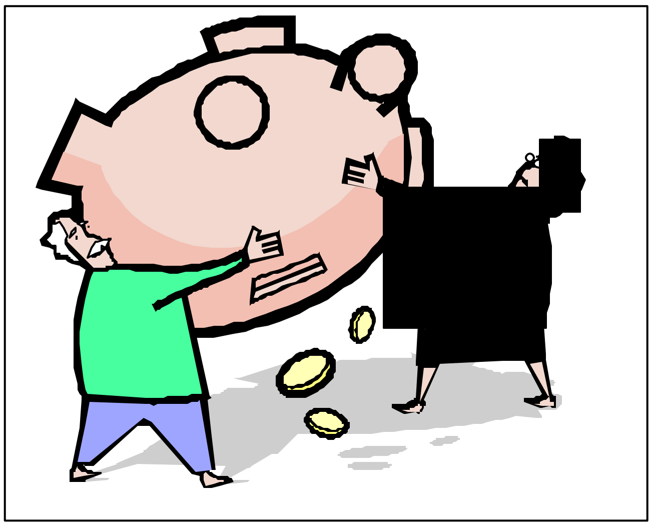
Whatever the particulars of your situation remember this: withholding works. If you want to maximize your ability to save, some sort of personal withholding plan should be in place. Consider your own situation:

?? Do you make saving an every-pay event?

?? Do you have someone else taking care of the withholding details?

?? Are you getting any refunds?

The government is using withholding, with great success. Are you?



<u>NEWS FLASH:</u> LONGEVITY CAN CAUSE POVERTY!

It's a classic "good news/bad news story".

Here's the good news: Due to medical and nutritional advantages, people are living longer. Considering the alternative, this must be considered a positive development. In theory, living longer means more time to enjoy more of life – more retirement, more travel, more time with grandchildren, etc. To elaborate, here are some amazing facts about people living longer:

?? Two-thirds of the senior citizens (those over age 65) in the world who have <u>ever</u> lived are alive today!

?? Two out of every three seniors are women.

?? If you retire today at age 62, average life expectancy is 85. (That's 23 years of "unemployment" to pay for!)

?? For retired couples, the odds are better than 50% that one member will live beyond 90.

?? In 1920, only 1 in 25 Americans was a senior citizen. In 2000, the number was 1 in 5.

So what's the bad news about living longer? It's expensive – even if you aren't living high on the hog. A million dollars might seem like a lot of money, but even a modest retirement can vaporize the entire amount. Look at the mathematical example in *Figure #1*.

A 62-year-old with a $1 million nest egg begins

(continued on next page)

Figure #1

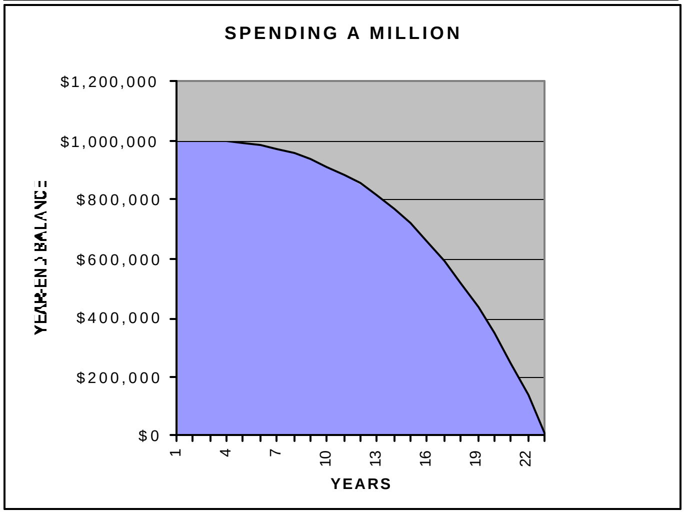
Example: a 62-year-old with $1 million – Drawing funds out for Retirement…

*ANNUAL INTEREST RATE……………… 6.00%
**ANNUAL COST OF LIVING INCREASE…. 4.00%

AGE	YR	BEGINNING BALANCE	AMOUNT WITH-DRAWN**	INTEREST EARNINGS*	ENDING BALANCE
62	1	$1,000,000	$55,000	$56,700	$1,001,700
63	2	$1,001,700	$57,200	$56,670	$1,001,170
64	3	$1,001,170	$59,488	$56,501	$998,183
65	4	$998,183	$61,868	$56,179	$992,494
66	5	$992,494	$64,342	$55,689	$983,841
67	6	$983,841	$66,916	$55,016	$971,941
68	7	$971,941	$69,593	$54,141	$956,489
69	8	$956,489	$72,376	$53,047	$937,160
70	9	$937,160	$75,271	$51,713	$913,602
71	10	$913,602	$78,282	$50,119	$885,439
72	11	$885,439	$81,413	$48,242	$852,267
73	12	$852,267	$84,670	$46,056	$813,653
74	13	$813,653	$88,057	$43,536	$769,132
75	14	$769,132	$91,579	$40,653	$718,206
76	15	$718,206	$95,242	$37,378	$660,341
77	16	$660,341	$99,052	$33,677	$594,967
78	17	$594,967	$103,014	$29,517	$521,470
79	18	$521,470	$107,135	$24,860	$439,196
80	19	$439,196	$111,420	$19,667	$347,442
81	20	$347,442	$115,877	$13,894	$245,460
82	21	$245,460	$120,512	$7,497	$132,445
83	22	$132,445	$125,332	$427	$7,539
84	23	$7,539	$130,346	-$7,368	-$130,175

The cost of living is increasing annually (4%). But the principal (which generates the 6% interest) starts shrinking after the 3rd year, so the account balance begins to decrease and continues to erode the principal until it has been virtually consumed in the 22nd year.

Figure #2



drawing funds in retirement. His accumulated assets yield a 6% annual return. The first year, his retirement income is $55,000. Each year, in order to maintain his standard of living ("cost of living"), he increases his income by 4%. (For illustration purposes, the withdrawals were made as a lump sum at the beginning of each year.)

Admittedly, this projection doesn't accurately reflect reality. The rate of return will not remain stable, and the withdrawals are likely to fluctuate as well. There's no certainty that standard of lving costs will increase at a steady rate of 4%, or even increase at all. But the calculations do provide some interesting observations.

The example shows the retiree's assets earning more than the cost of living increase (6% v. 4%), and his initial withdrawals not invading his principal. Yet in spite of this conservative approach, within three years, his account balance is sliding below $1 million. Why?

Because the cost of living increase attached to the withdrawal is growing, but the principal is not. The consumed withdrawals effectively reduce the "real" rate of return accruing to the principal. Consequently, the $1 million nest egg begins to erode, first in small amounts, and later in precipitous drops. Somewhere in the 22nd year – *poof* – it's all gone.

Of course, you could manipulate the numbers – the amount of withdrawal, the rate of return and the cost of living – and come up with distinctly different outcomes, both better and worse.

But even if the numbers are arbitrary, they provoke two reasonable conclusions:

- ?? $1 million isn't a lot of money, when it's needed to provide financial security for a quarter-century.
- ?? The longer you live, the more challenging it is to preserve assets in the face of increased expenses.

So what's the bad news about living longer? It's expensive – even if you aren't living high on the hog. A million dollars might seem like a lot of money, but even a modest retirement can vaporize the entire amount.

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