

# CREATIVE Wealth Maximization Strategies



**Alliance Financial Group**  
14021 Metropolis Ave  
Fort Myers, FL 33912  
(239)-561-2900  
**John J. Bellino III**  
John\_J\_Bellino@glic.com

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## GRAY MATTERS: GETTING THE REST OF THE STORY

**“The first to plead his case seems just, Until another comes and examines him.”**

**Proverbs 18:17**

The financial world is filled with numbers, and sifting through them can be an overwhelming task. Not only do you have to wrestle with a barrage of statistics, percentages and numerical indicators, but you also have to get a grip on the significance of some very large numbers (i.e. is \$3 trillion really a lot of money, when considering a statistic regarding the U.S. economy?)

One of the ways to bring a sense of understanding to all the mathematical data is to proportionally reduce the big numbers to figures the average person relates to, and apply them to every-day circumstances. It’s not a perfect translation, but sometimes the reduction can result in a much clearer perspective. And then again, sometimes the “simplified” picture generates a false understanding. What follows is a classic example of the clarity – and misunderstanding – that can arise from simplified illustrations.

Here’s the example:

**Let’s put (income) tax cuts in terms everyone can understand. Suppose that every day, 10 men go out for dinner. The bill for all 10 comes to \$100. If they paid their bill the way we pay our taxes, it would go something like this:**

**The first four men – the poorest – would pay nothing; the fifth would pay \$1, the sixth would pay \$3, the seventh \$7, the eighth \$12, the ninth \$18 and the tenth man – the richest – would pay \$59. That’s what they decided to do. The 10 men ate dinner in the restaurant every day and seemed**



*Does this story really illustrate the true taxing situation?*

**quite happy with the arrangement – until one day the owner threw them a curve (in tax language, a tax cut). “Since you are all such good customers,” he said, “I’m going to reduce the cost of your daily meal by \$20.” So now dinner for the 10 only costs \$80.**

**The group still wanted to pay their bill the way we pay our taxes. So the first four men were unaffected. They would still eat for free. But what about the other six – the paying customers? How could they divvy up the \$20 windfall so that everyone would get his “fair share?” The six men realized that \$20 divided by six is \$3.33. But if they subtracted that from everybody’s share, then the fifth and the sixth man would end up being PAID to eat their meal. So the restaurant owner suggested that it would be fair to reduce each man’s bill by roughly the same amount, and he proceeded to work out the amounts each should pay. And so the fifth man now paid nothing, the sixth pitched in \$2, the seventh paid \$5, the eighth paid \$9, the ninth paid \$12, leaving the tenth man with a bill of \$52 instead of his earlier \$59. Each of the six was better off than before. And the first four continued to eat for free.**

**But once outside the restaurant, the men began to compare their savings. “I only got a dollar out of the \$20,” declared the sixth man, point to the tenth man, “but he got \$7!”**

**“Yeah, that’s right,” exclaimed the fifth man, “I only saved a dollar, too. It’s unfair that he got seven times more than me!”**

*(Continued on page 5)*

### INSIDE THIS ISSUE...

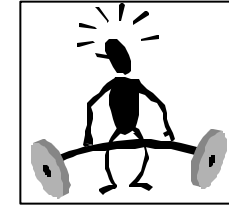
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# News Digest

(Snippets from stuff we've read, including differing points of view, not all of which we agree with. Want to know more? Give us a call and we can provide you with the complete article.)

## NEARLY EIGHT IN TEN RETIREES NOT FINANCIALLY SECURE

"Prudential Financial has released the results of a survey that should be a wake-up call for the millions of Americans getting closer to retirement. The study found that 79 percent of pre-retirees are not as financially 'fit' as they should be at a critical stage in preparing for a secure retirement. 'Too many of those polled are not financially ready to retire comfortably,' said Judy Rice, president of Prudential Investments. 'In fact, when rating their financial health, a mere 21 percent are considered to be in excellent shape. The rest are not as fit as they should be, including 34 percent in outright "frail" financial health.' "



*Newstream, May 2003.*

## THE DOUBLE WHAMMY AT WORK – MORE STRESS...

"Forty percent of employees say their workload is unreasonable, according to surveys conducted by the Discovery Group, a management consulting firm specializing in assessing employee opinions.



'Many employees are mentally and physically exhausted on their jobs,' said Dr. Bruce Katcher, an industrial-organizational psychologist and author of the study. 'This exhaustion results in a lack of enthusiasm, tardiness, day-dreaming, and a drop in the productivity and quality of their work,' he said."

*Tip Sheet, August 4, 2003.*

## ...WITHOUT MORE MONEY

"Employers are dispensing notably smaller pay raises this year – well below the 4 percent-plus increases routine before the economy lost its footing – and workers should not expect much improvement in 2004.



Companies tapped in a pair of surveys have budgeted pay increases averaging 3.3 percent to 3.5 percent this year and plan about the same next year, the smallest raises for workers since at least the mid-70s. The belt-tightening reflects employer efforts to balance pay with rising worker health care bills and pension costs in a business climate that has made it difficult to raise prices for their own products."

*Adam Geller, Associated Press, July 30, 2003.*

## SMALL BUSINESS OWNERS LACK FINANCIAL GUIDANCE

"Despite consulting numerous financial professionals for business and personal planning advice, only one-third of American small business owners feel very certain they've appropriately planned for their business' future. This is a key finding of 'Financial Advice Today: A Small Business Perspective', a recent survey from Nationwide Financial.



'Small business owners are turning to several financial professionals, but often have no one responsible for their overall financial plan,' said Michael Butler, senior vice president of NFS Distributors, Inc., a division of Nationwide Financial. Business is not the only area of uncertainty for small business owners. When it comes to their personal financial plans, less than half (45 percent) currently have a personal financial comprehensive plan, and only two-thirds of them used an investment professional to prepare it."

*PRNewswire, July 15, 2003.*

## CAN FUTURE RETIREES ACTUALLY RETIRE?

"Whether Americans can provide for their own retirement is a crucial issue today. The majority of workers don't qualify for traditional pensions, and there are concerns about the viability of the Social Security system. In addition, many people hurt in the bear market are afraid to get back into stocks, which are among the few investments that can outpace inflation.



So can Americans possibly save enough?

'Yes, they can,' said J. Michael Scarborough, chief executive of the Scarborough Group, Inc. retirement advisory firm in Annapolis, Maryland. 'But will they? I don't think so.' Scarborough blames the problem, in part, on complacency. After all, most people say their parents and grandparents manage OK in retirement, so they assume things will work out for them, too.

'They forget that their grandfather lived on a farm that was paid for and had a garden and killed a couple of chickens a week,' he said. 'And their parents retired before companies started killing pensions and cutting health benefits.'

The new reality for young workers is that 'somehow, some way, 15 percent of your income has to go into retirement savings,' he said. 'Then money won't be an issue.' "

*Eileen Alt Powell, Associated Press, August 10, 2003.*

## **“CONTROL”, REVISITED...**

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This publication often discusses the intangible financial benefits of controlling or owning assets. While these benefits may be hard to mathematically assess, the ability to control an asset (as an owner, major shareholder or creditor) is what marks someone as a “true investor,” and one who has a greater chance of maximizing the personal profit potential from his/her investment. Here are two wealthy individuals whose actions and comments clearly demonstrate their belief that having control is a valuable asset in one’s portfolio.

### **MARK CUBAN**

In the Summer, 2003 issue of *Young Money*, a financial publication marketed to college-aged students, billionaire Mark Cuban, owner of the Dallas Mavericks professional basketball team (and an entrepreneur who earned his fortune from several Internet and information technology ventures), distilled this disdain for the stock market to one sentence:

***“The stock market is probably the worst investment out there.”***

Several readers wrote the publication asking Cuban to explain himself. In the editorial section of the August/September, 2003 issue, Cuban didn’t back down from his original comments:

***“Warren Buffet never buys 100 shares of a stock and just holds it. He, like myself, buys shares to get some level of control of the company. That’s far different than buying a stock and PRAYING that the stock goes up.***

***If you have the resources to take control of a company, and you think it’s a great investment, do it. If you want to try to guess on some companies, buy their stock, and hope it goes up. You might as well go to Vegas, because you have no advantage at all.***

***Remember this little tidbit. Whenever you make a business deal, and that includes buying stock, always look for the fool... If you can’t find the fool... it’s you.***

***Interest rates are low right now, and that’s frustrating, but cash doesn’t lose 40 percent of its value in a year. Stocks can.”***

Strong words, no doubt. From Cuban’s perspective, he’s not-so-subtly implying many shareholders are the fools.

### **KIRK KERKORIAN**

Another “true investor” mentioned in a recent issue is Kirk Kerkorian, particularly in regard to his actions as a significant shareholder of Chrysler Corporation stock in the mid-1990s. Back then, Kerkorian made news by threatening to remove the Board of Directors if they didn’t authorize a higher dividend payout. Today, Kerkorian is back in the news, and again, the situation involves Chrysler.

In 1998, Chrysler merged with the German automaker Daimler-Benz AG. At the time of their agreement, both parties characterized the union as a “merger of equals.”

However, recent public information indicates Daimler executives deliberately misrepresented the terms and intent of the agreement to Chrysler shareholders, whose approval was needed to complete the merger. In effect, the purported merger was a takeover transaction in which Chrysler became a subsidiary of the German company.

Shareholders filed a lawsuit charging that the misrepresentations had cost them an acquisition premium (i.e., a higher price per share because the company was being sold), and that subsequent management decisions had also contradicted the supposed terms of the merger agreement.

In August 2003, following several years of legal wrangling, Daimler-Chrysler attorneys proposed a \$300 million settlement to shareholders. While not admitting guilt, the proposed settlement is one of the largest ever in a class-action securities fraud case, and in the words of Jay Eisenhofer, who represented the shareholders, “bad cases don’t settle for \$300 million.”

Here’s where Kerkorian fits in. The billionaire investor has filed a similar fraud suit, scheduled for trial in December 2003, against Daimler-Chrysler. But the damages and remedies sought are much larger. Kerkorian is seeking \$13 billion in damages, and also asking the court to dissolve the merger and restore Chrysler as an independent entity.

While Daimler-Chrysler’s steadfastly maintain that both the class-action suit and Kerkorian’s complaint are “frivolous,” the headline from the August 23, 2003 *Detroit News and Free Press* says “**DCX settlement may bolster Kerkorian’s case.**”

When a single investor has the potential to re-direct the operating activities of the fifth largest automaker in the world, that’s financial control.

It must be noted that neither Cuban nor Kerkorian have exemplary public images. Both have been involved in some non-business situations that reflect poorly on their personalities and character. Cuban made some ill-advised comments that Kobe Bryant’s legal problems were “good business” for the NBA, and Kerkorian has been a party in a high-profile child-support and alimony case. They aren’t necessarily likeable characters.

Still, in the financial arena, where their success is unquestioned, their comments and actions regarding control are instructive. While both the examples and the individuals are high profile, the principles and actions at work here do have application at a lesser level. Financial control in a transaction is not something to be forfeited or casually dismissed.

## INVESTOR NEWSFLASH: BUY AND HOLD ISN'T GOOD ENOUGH ANYMORE

“You can't time the market. People who try to invariably end up buying high and selling low.”

That's the conventional wisdom about the stock market that's been presented over the past decade. The only proven way to receive historically higher long-term returns from the stock market is to stay invested, not panicking over the ups and downs, but allowing the long-term trends to work in your favor. “Buy and hold” has been the mantra of a generation of financial experts who have formed their opinions from three decades of high-octane returns from stock-market investments.

But hit a rough stretch (like the last three years), and all of sudden, there are cracks in the buy-and-hold ranks. One of the more prominent (surprising) dissenters against buy-and-hold is Peter Bernstein, an investment risk expert and author of *“Against the Gods: The Remarkable Story of Risk.”*

At a January, 2003 conference of institutional money managers, Bernstein posed the following questions and followed with a surprising answer:

*“What if we can no longer be so confident that stocks are necessarily the best place to be in the long run? What if moving around more frequently is not a necessity rather than a matter of choice? I'm talking about market timing – dirty words.”*

Another prominent commentator who argues against buy-and-hold is Ben Stein, former White House speechwriter, Wall Street Journal editorial columnist, game-show host (“Win Ben Stein's Money”) and part-time actor (the teacher in “Ferris Bueller's Day Off”). Stein also holds a degree in economics. Says Stein: “You do not do well just buying stocks every month. When stocks get to a certain level of ridiculousness, it's time to get out.”

John Bogle, founder of the Vanguard Group of mutual funds, disagrees. While professing respect for Bernstein's reputation, Bogle felt his conclusion was wrong, “I fear his advice is wide of the mark, even ill-begotten”. Roger Ibbotson, head of a Chicago investment-consulting firm also opposes market timing. While acknowledging some investors might profit from jumping in and out, his prevailing opinion is “most individuals and even most institutional investors shouldn't get involved in the market this way.”

Bernstein, known for his work as editor of several academic publications on economics, admits he was once a buy-and-hold advocate. He also acknowledges that jumping in and out of the market during extended rallies usually hurts investors. However, he believes that recent returns indicate a turning of a long-term trend. If so, continuing to hold is to run the risk of continuing to incur losses.

Some money managers admit that Bernstein's comments echo those floating “just below the surface among a growing number of pension and endowment managers,” according to an August 27, 2003 *Wall Street Journal* article. If buy-and-hold is no longer valid, then many of the other traditional stock market methods of evaluation and assessment are gone as well. The ramifications are significant. “Does this mean that style boxes are gone?” asks Allan Bufferd, treasurer for MIT. “What about the role of benchmarking to an index, the role of consultants? There's a lot of stuff to think about.”

*Hmmm...* Bernstein himself provides a closing thought: ***“If we don't know what the future holds, why lock ourselves into a position for the indefinite future?”***



(Continued from page 1)

**"That's true!" shouted the seventh man, "Why should he get \$7 back when I got only \$2? The wealthy get all the breaks!"**

**"Wait a minute," yelled the first four men in unison. "We didn't get anything at all. The system exploits the poor!"**

**The nine men surrounded the tenth man and beat him up. The next night he didn't show up for dinner (or, in the real world, he took his business out of the country), so the nine sat down and ate without him. But when it came time to pay the bill, they discovered, a little late, what was very important. They were \$52 short of paying the bill!**

**Imagine that!**

**And that, boys and girls, journalists and college instructors, is how the tax system works. The people who pay the highest taxes get the most benefit from a tax reduction. Tax them too much, attack them for being wealthy, and they just may not show up at the table anymore. Where would that leave the rest? Unfortunately, most taxing authorities cannot seem to grasp this rather straightforward logic!**

### **It seems pretty Black & White doesn't it? But this is the rest of the story...**

This above text was reprinted as a "Timeless Classic" in a September 2003 automotive trade publication, along with additional commentary. The columnist said he had received the article as an e-mail and attributed it to "T. Davies, professor of accounting at the University of South Dakota School of Business."

Taken at face value, the illustration presents a simple yet persuasive argument against a graduated personal income tax. The illustration is easy to understand, and plays strongly on the emotions.

But it's not the whole story.

**First, the article was not authored by "T. Davies",** although Thomas L. Davies is a Professor of Accounting & Chair of the Division of Accounting and Business Law at the University of South Dakota, School of Business.

The operators of the Financial Sense Online (FSO) web site ([www.financialsense.com](http://www.financialsense.com)) currently post this article under the title "How Taxes Really Work," in their Guest Editorial section. FSO lists the author as "The Unknown Taxpayer," and provide an explanation for the anonymous authorship:

**The above story was sent to us from a Financial Sense long-time visitor. He had received it from someone else. I imagine this story has made the Internet rounds many times! I did track down the source of his e-mail to Professor Thomas L. Davies, Professor of Accounting & Chair of the Division of Accounting and Business Law at the University of South Dakota, School of Business. I searched their site, found his e-mail and wrote for permission to publish the piece on our site. Below is his response:**

*"Thank you for your message. I previously distributed the "How Taxes Really Work" article (as well as other opinion pieces reflecting different perspectives) to my graduate tax class to encourage them to think beyond the rules and regulations. Unfortunately, it is rather easy to focus on the myriad of complex rules and forget that tax policy frequently*

*influences taxpayer behavior beyond what may have been intended. Thus my students are frequently asked to think "outside the box" and consider such topics as tax complexity, alternative forms of taxation, and the impact of taxes on behavior.*

*The article was not written by me, and I have intentionally avoided commenting on its validity in order to encourage my students to think critically, and to assist in the development of their analytical and communication skills. I am unaware of the true author's identity, which is unfortunate, since the piece has generated considerable interest. Unfortunately, one of my students sent it along and erroneously attributed the authorship to me. Obviously I am unable to give permission to reproduce it, and I request that you don't attribute it to me if you happen to send it on."*

While it doesn't necessarily diminish the premise of the article, knowing that Prof. Davies didn't write it might make one a little less ready to believe. We might reasonably assume that an academic like Prof. Davies arrived at the reduced numbers for the 10 diners through careful hypothecation of legitimate data. But what do we know about the "Unknown Taxpayer?" Even though the numbers sound accurate, is there any way to check his/her work? We can't know.

### **Wait, there's more!**

Not only is the source of the story unknown, but **also it is possible that there is more to the taxation issue than just income taxes.**

The FSO web site also posts responses to the editorials. While many postings reflect whole-hearted agreement with the "Unknown Taxpayer's" point of view, some of the respondents bring up issues that might lead serious thinkers to conclude the illustration doesn't fully represent the taxation issue. For example, B. M., of East Palo Alto, CA, USA writes:

*"I just read the story about the tenth taxpayer. Given that some people instantly scream "unfair" when tax cuts save more money for the higher income people, this article does a service in clarifying that it's not necessarily unfair. But it's not a lone voice in the wilderness, in that I've heard this point made many times in other media sources, so the value of making this point (yet again) is not earth-shattering.*

*However, I would claim that this article in fact does more to MISLEAD than to inform in that it adds to the parade of people using personal income tax burdens (alone) while conveniently leaving out payroll taxes, sales taxes, and other items that are proportional or even regressive to try to insinuate that the wealthiest people deserve the greatest tax break.*

*Once you add in payroll taxes (and we both know that proper analysis would include the half that the employer pays on behalf of the employee), this picture of the lowest income people getting a free ride gets a bit more blurred. And sales taxes would presumably be regressive too.*

*If you are truly sincere in countering the misinformation of the establishment (both mainstream media and Washington propaganda), you'd point out **that the total tax burden is not as skewed to the rich as it's normally presented.***

*Rather than preaching to the choir (I presume the readership generally already favors making the tax structure less progressive) and adding to the big lie (misinformation repeated so often by so many sources*

that most people don't question it anymore) that individual wealthy tax payers pay almost everything, it would be a truly courageous and informative voice to present the case honestly, with total tax burdens and how they've changed over time.

Given a more honest presentation, I believe the messages that would pop out are:

- 1) The rich do pay a lot of taxes. But, I believe the percentage might be less than the preconceived notions of many people that call themselves conservative or libertarian. And we know the percentage would be more than the notion of many liberals.
- 2) The middle class tax burden as a percentage has grown over the years more than any other group.
- 3) The working poor don't get a free ride.

Thanks for your time (and I hope for the clarification that you will post)."

Hmm...

What are proportional taxes? And regressive taxes? How do you figure payroll taxes? Maybe there's more to the story than is explained by a \$100 dinner divided 10 ways. We don't know anything about the credentials of B.M. from East Palo Alto, but his/her response to the "Unknown Taxpayer" seems to have several reasonable points of rebuttal. The conclusions not only seem quite logical, but more in-depth. They not only explain the black and white of the subject, but some of the grays as well. And as a result, the issue of taxation is placed in a larger context than just personal income taxes.

**The question: given the choice, from whom would you rather receive advice – the one who can tell the story of the 10 diners, or the one who can explain it?**




**When it comes to financial advice, the answer is probably "both."**

Some financial concepts are complex. This is not to say that these concepts are impossible for the average person to understand, but rather that they involve a number of interconnected issues, and the chances for success increase when one understands the "big picture" as well as the issues at hand.

From a consumer's perspective, getting information about the grays in financial issues is important because many of the black and white illustrations are "sales talks" – i.e., they are formats designed to present and sell a particular product or service. These presentations aren't lies. In fact, most are "compliance approved" by legal experts operating under fairly strict guidelines. But while they are accurate representations of a particular product and its applications, these simple, concise illustrations are not designed to address the broader issues that might ultimately govern your decision to use them.

Fully understanding financial issues may not always be possible through the use of a simplified illustration. Sometimes the only way to figure something out is to dig into it, and understand the shades of gray as well as the black and white.

**Think about the conversations you have with your advisors.**

-  **Do the discussions include some of the details from the gray areas of the issues?**
-  **Do your advisors have a good grasp on the gray areas?**
-  **Do you take enough time to discuss the gray areas?**

**Sometimes the only way to figure something out is to understand the shades of gray as well as the black and white.**

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E-Mail \_\_\_\_\_

**John J. Bellino III**

Alliance Financial Group, Inc.  
14021 Metropolis Avenue  
Fort Myers, FL 33912  
(239)-561-2900  
(800)-964-6639 (where available)  
John\_J\_Bellino@glic.com