

# 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

September, 2003



## HINDSIGHT ADVICE:

*What's the point?*



After every unfortunate situation, there's always someone willing to offer an expert opinion on how the tragedy could have been avoided. "You know," they begin, "this never would have happened if only you had ..." Hindsight being 20/20, it's easy to see the cause-and-effect conditions that led to the problem, and what actions could have been taken to avoid it.

Some of the time, the after-the-fact assessments are true. Some of the time, the comments provide a perspective that hopefully prevent the negative situation from reoccurring.

But some of the time, hindsight advice is worthless, and just plain irritating.

And a lot of the time, some of the most worthless and irritating hindsight information comes from the financial press.

As investors begin to sift through the financial carnage wrought by three years of negative returns in the stock market, there are plenty of after-the-fact experts stepping forward to offer insight on how the losses could have been avoided. Given the benefit of hindsight, it now seems so obvious – "all of the signs were there, if only we had been paying attention." But it wasn't obvious, and some of the commentary is so far off base, it's not going to help individuals deal with the stock market in the future either.

Here's a headline from a June 2003 article by Stan Hinden of the *Washington Post*:

### **"In hindsight, investors should have known better."**

In the article that follows, Hinden says he "learned some valuable lessons about how to invest in a bear market." But are his "lessons" really valuable or just the hindsight opinions of somebody with access to a word processor? Consider the advice:

*"In its simplest form, the market is like a pendulum. When it swings too far in one direction, it swings back. Investors who understand market behavior have a better chance of keeping gains and cutting losses."*

Based on hindsight, it's a logical and historically accurate assessment. But it is also absolutely worthless as far as

helping individuals anticipate future developments. And indirectly, Hinden provides the evidence that his insights have no future value.

*"Consider these S & P 500 performance figures for the 1995-1999 Bull Market: 1995, up 37.4%; 1996, up 22.9%; 1997, up 33.4%; 1998, up 28.6%; 1999, up 21%.*

*Given that long-term gains from stocks are generally about 10.5% a year, these Bull Market gains were way above average. Something had to give. And it did. During the 2000-2002 Bear Market, the S & P 500 turned in these results: 2000, down 9.1%, 2001, down 11.9%, 2002, down 22.1%.*

*It should have been easy to anticipate that after a huge five-year run-up, topped by Internet fever, stocks were going to fall. But few investors want to leave the party early."*

### ***It should have been easy to anticipate...? Really?***

Based on Mr. Hinden's pendulum analogy, one could have reasonably concluded that the time to get out of the market was in 1996. Or 1997. Or 1998. Or 1999. And for sure, in 2000. Each year was so far above the average, that the only way to go was down, right?

Yet each year, the market kept climbing. Those who expressed concern about an "overheated market" or "irrational exuberance" were jeered as the gains kept piling up. Some conservative mutual fund managers lost their jobs because they didn't keep riding the stock market wave. And others questioned whether Warren Buffet's investment touch had left him. The path the stock market pendulum traveled over the past eight years may be clear to Mr. Hinden now, but it certainly wasn't clear then.

Robert Prechter is the author of the *Elliot Wave Forecast*, a financial newsletter that attempts to predict stock market performance based on a series of complex, but measurable

financial rhythms. Beginning in the mid-1990s, Mr. Prechter's analyses signaled a significant stock market decline, but at each calculated "breaking point," when the market was supposed to turn, it kept climbing, forcing Prechter to constantly reevaluate his data. To his credit, Prechter never deviated from his bearish assessment, and beginning in 2000, looked quite the prophet. But prior to the crash, he lost a large number of subscribers because they thought he cried "wolf" about crashes that never materialized.

Not only does Hinden's pendulum logic not provide a forward look at when to get out of the stock market, it is no help in anticipating when individuals should re-enter the stock market. After all, given the historical data, consecutive down years are rare, and three-year drops are almost unknown. So following the first down year, it "should have been easy to anticipate" that the market would rebound. And if not after the first year, then certainly the second. Yet the third year, the one that almost never happens, was the year that incurred the greatest losses. Does this sound like a situation that "should have been easy to anticipate?"

Because he believes investors can easily understand the trend of the stock market, another of Hinden's "lessons" is **"It's often better to sell a falling stock and take a small loss than wait and take a big loss."** That's a hindsight special. It's great observation about the past that is just about impossible to implement in the future.

When is a loss a "small loss?" How do you determine if a stock's drop in price is just a dip before a climb to higher levels, or the beginning of a steeper slide? Not only is this advice just hindsight observation, the assumption that one can accurately determine when a small loss is occurring also goes against statistical evidence.

Clint Willis, in an August 11, 2003 article for *Reuters* begins with the headline:

### **"Market timers often guess wrong."**

Drawing from a July 2003 study released by the Boston research firm Dalbar Inc., Willis notes that individuals almost never assess the market properly. As a result, "investors earned a mere 2.6% annually in stock funds during the 19 years through 2002. That's compared to a 12.2% annual return for the Standard & Poor's 500."

What accounts for the poor performance? Interestingly enough, Willis puts some of the blame on hindsight thinking. Individuals "tend to give far too much weight to *the facts they know*, while ignoring the potential relevance of other information." (emphasis added)

Much of the "facts they know" are historical. But history isn't necessarily the future. The Dalbar report indicated that many mutual fund investors "chase" returns, moving their money in an attempt to catch up to sectors of the market that are currently delivering big returns. Usually this approach means paying premium prices to receive either the smaller gains at the end of the boom, or even worse, experiencing the beginning of a decline. In other words, they pursued strategies that, in hindsight, looked good. But relying on past performance did not equal future success.

The data in Willis' article strongly suggests that individuals cannot time the market because they cannot use past experiences to accurately forecast future financial outcomes. Hinden may think investors should know better,

but the evidence says they can not, because they will never be able to make future-oriented decisions using hindsight.

**Is there a better way?** So how do you make financial decisions about the future? Is it just hunches and guesses? What else is there besides hindsight to guide you?

Remembering that every situation is different, the following general thoughts may be helpful in shaping a plan for financial success:

**Good planning is based on specific application of proven general principles.** Even if hindsight advice is worthless, it doesn't mean historical evidence is irrelevant. There are specific actions and strategies which, if faithfully employed, are successful almost all of the time.

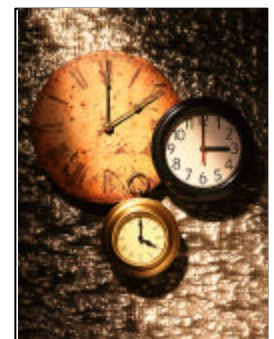


For example, people that save regularly almost always reach a higher level of financial success than those that don't; that's a general principle. Robert Kiyosaki, the author of *Rich Dad, Poor Dad* says, "You must know the difference between assets and liabilities and buy assets. If you want to be rich, this is all you need to know. It is Rule No. 1. It is the only rule." Another axiom: in the stock market, the opportunity for greater gain is usually accompanied by a higher level of risk. These are basic financial principles that have a direct correlation to financial success.

By the way, principles should not be confused with statistics. It is statistically true that returns from the S & P 500 have averaged a 12.2% annual return for the 19 years from 1984-2002. But from that statistical information, it is not possible to declare that as a general principle, the S & P 500 should continue delivering such returns.

Once you decide on the principles on which you base your plan, the work of planning is determining how to apply those principles to your specific situation. Once you commit to saving, the issue is "where"? Once you commit to buying assets, the question is "what"? The selection process is not always easy. For good financial professional and deliberate clients, the specific application is often the hardest part.

**Good planning involves a projection of the future.** Progress is defined as moving *forward*, not assessing what has already happened. Hinden's article listed all the mistakes investors made in the past, but didn't use the information to provide practical solutions for making changes in the future. For the most part, the article was a list of "all the mistakes we/you made." That's not helpful.



You want to know which strategies, vehicles, and perspectives will be good in the future, not just which items were successes or failures in the past. A good plan attempts to use past history and experience to formulate a perspective on what is to come, based on proven financial principles, not statistics.

**Even the best plan can never be right all the time.** Because it involves speculation about the future, every plan must admit that things may not turn out as projected. The future is fraught with unknowns, so all projections, even ones that are dressed up with graphs and charts, and historical data, are still guesses, even if they are educated guesses.

This reality needs to be acknowledged by all parties in the planning process. But despite all evidence to the contrary, many financial professionals and clients stubbornly cling to the belief that there are systems, hunches, and “secrets kept hidden from the masses,” that guarantee sure-fire results. It’s not true. Even the Law of Averages does not guarantee individual outcomes.

This unrealistic expectation that advice can be relied on as correct 100% of the time is the source of many problems in financial planning. Some financial professionals truly believe the programs they present are fool-proof. Some clients have the same expectations. When something goes wrong, fingers are pointed, money is lost, reputations are destroyed and lawsuits are filed. To make sure it “never happens again,” new rules and regulations are implemented. And both the professional and the client become more cautious – in their dialog, recommendations and actions. It’s hard to define the extent of the damage, but believing that every plan will always deliver perfect results decreases the chance of planning effectively.

**Good planning includes backup plans.** Knowing that something might not go as planned, it’s prudent to consider alternatives, and how easy or difficult it may be to respond to unforeseen challenges.



In the financial realm, this means discussions about insurance, emergency funds, and possible responses to losses. It’s not the fun stuff, but it is part of good planning. Because even if there’s no official supporting study, the empirical evidence strongly suggests that most things in life do not turn out exactly as planned or anticipated. In other words, “s\_\_\_ happens”.

An article touting a particular financial approach may conclude its argument with this logic: “Considering all of the issues, why would you do anything else?” According to proponents, this is clearly the best choice, and all other options are lesser alternatives.

That may be the case for today. But things will change. Does the plan include other possibilities, just in case? Good plans do.

The next time you read a financial article, or hear some talking head on the television, ask yourself, “Is this just statistics and hindsight advice, or does this information develop good principles that can be used to better manage the future?” That’s a long-winded question, one you probably wouldn’t ask yourself, let alone say out loud, so let’s simplify: is this truth or trash?

And what about the discussions and reviews you have with your financial professionals? Are statistics and hindsight guiding your actions, or principles? **ASK YOUR FINANCIAL PROFESSIONAL IF YOUR CURRENT**

**PLAN IS FLEXIBLE ENOUGH TO WITHSTAND “UNFORESEEN” CHANGES LIKE DISABILITY, EARLY DEATH, OR LOSS OF YOUR JOB (AND IT’S INCOME).  
THINGS THAT MAKE YOU GO “HMMM...”**

**HOW MUCH DO WE MAKE? ASK MY HUSBAND AND SUBTRACT 10%**



Anecdotal evidence says that one of biggest sources of contention in marriages is over how money is spent. But updated statistics from the U.S. Bureau of Labor Statistics indicated the problem goes deeper. As H.J. Cummins said in a June 27, 2003 *Minneapolis Star-Tribune* article:

**“Maybe you’d stop fighting about how much you can spend if you just agreed on how much you make.”**

According to the report, which has regularly tracked about 1,200 couples (some since the 1960s), husbands tend to estimate family income 10% higher than their wives, and the family’s net worth (home equity, stocks, etc.) 30% higher. On the flip side, wives report more estimated debt.

In the opinion of research author Jay Zagorsky, this difference in perception cannot be attributed to lack of financial information available to one spouse or the other. In 60% of the households, the women pay the bills. And based on those couples who have been tracked the longest, the respective views of the family’s money situation have stayed fairly consistent through the years.

Zagorsky is an economist, not a psychologist. But, according to Cummins, he makes the following observation: people make their spending decisions based partly on how much money they think they have.

*Hmmm...* So if couples agreed on what they make, they would agree on what they spend. If that’s true, a logical (though slightly twisted) extension is that accountants would make the best marriage counselors. Or else Dr. Phil should earn his CPA designation.

**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.*)

### **MOST AMERICANS PREFER HEALTH COVERAGE OVER HIGHER SALARIES**

“By a striking margin, more Americans say they would choose a lower paying job with health coverage over one with a higher salary but no health benefits, according to a national survey by Stony Brook University.

When asked if they had to choose between a job with health coverage and a lower salary, and a higher paying job that lacked health benefits, 71% would take the lower salaried job with benefits, while only 24% would take the higher paying job with no coverage. Even when asked to rate the two issues separately, the result was equally surprising: 73% rated good health care benefits as very important, while only 37% rated a higher salary as very important. Good retirement

benefits and job security also ranked higher than salary, with 66% and 71%, respectively, rating these as very important.”

*Business Wire*, August 19, 2003.

### MAJOR CUTS LOOM IN SOCIAL SECURITY

“Younger Americans face tax increases, cuts in government programs and services and reduced retirement benefits – or a combination – to restore long-term financial health to Social Security, congressional investigators said Tuesday.

The General Accounting Office, the investigative arm of Congress, said that to avoid benefit cuts, payroll taxes would have to rise 46%. If Social Security is not overhauled, workers eligible in 2042 would see a 27% cut in promised benefits. In 2077, a 35% reduction in promised benefits would be required.”

Leigh Strope, *Associated Press*, July 30, 2003.



### USING CREDIT CARDS ON VACATION – THE PAYMENTS NEVER END

“According to the annual *Summer Vacation Survey* by Myvesta, a nonprofit consumer education organization, the average vacation this season will cost \$2,378, up from \$2,172 in 2002. Of those taking a trip, about 78% say they plan to pay for all or part of their getaway with credit cards, and 28.5% plan on taking three or more months to pay off their vacation charges.

American Express’ 2002 *Leisure Travel Survey* came up with similar results. Respondents to its survey said they planned on spending an average of \$2,031, putting most of it on a credit card.

If every bit of that \$2,031 was charged on a credit card with an annual percentage rate of 18%, the cost of the vacation would rise to \$2,234.42, if paid back at \$186 a month for one year, points out the Association of Credit Counseling Agencies (AICCA).

But if the vacationer decided to just make the minimum payment of 2% of the unpaid balance (which is about what many credit card issuers require), that vacation would end up costing about \$5,200 in interest alone and take 31 years to pay off.”

Michelle Singletary, *The Color of Money*, June 29, 2003.



### THE RICH DO PAY MORE IN TAXES – BUT “RICH” IS LESS THAN YOU THINK

“In 2000 the top 1% of earners paid 37.4% of all federal personal income taxes, yet they earned only 20.8% of all adjusted gross income reported to the IRS. In other words, the richest Americans pay in taxes nearly double their proportion of national income. And their share has risen in the past 20 years, from only 19% in the early 1980s.

According to IRS data, the top 50% of income tax filers continue to pay 96.1% of all U.S. income taxes. To qualify for this richer half of all American earners, all you had to do is pull down a whopping income of \$27,682.”

*Wall Street Journal*, November 2, 2002.

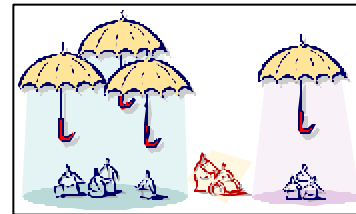


### THE MARKET IS UP, BUT MANY DON’T WANT THE RISK

“After three years of a difficult economy, rising unemployment and declining stock prices, consumer investment preferences have changed in a fundamental way that will continue even after the economy recovers, according to a national survey of consumers conducted by Plan-it Marketing Intelligence, Inc. for John Hancock Financial Services.

Today, a majority of consumers are more focused on protecting their assets rather than growing their assets. About three-quarters of consumers describe themselves as more conservative investors (76%) and say they are less likely to invest in financial products that run the risk of losing money (73%). Approximately two-thirds are more focused on asset protection versus growth (63%) and are more likely to invest in financial products with guaranteed rates of return than products with variable returns based on the stock market (66%). As further evidence of their more conservative financial decision-making, consumers agree they are more likely today to consider purchasing conservative and protection focused products such as fixed-rate annuities (71% more likely to purchase) whole and term life insurance (60% and 59% more likely to purchase, respectively) and long-term care insurance (53%). Additionally, consumers do not consider their more conservative financial decision-making as temporary; nearly three-quarters (72%) will continue to invest in products with guaranteed rates of return even once the economy recovers.”

*PRNewswire*, August 19, 2003.



### A BACKWARDS CAREER

Here’s the scenario: After attending college for several years, and perhaps not even graduating, you enter the workforce, taking an entry-level position with an average annual salary of \$900,000. While the work is strenuous, the contract only calls for 20 weeks of employment, although most entry-level employees continue to work year-round to improve their skills.

For most employees, this “career opportunity” will last less than four years. And because of the limited application of your unique skills, it’s quite likely that you will never achieve the same level of earnings in another field. In fact, for the rest of your working life, you will probably be paid much less.

What is this “backward career,” where the big money is earned at the beginning, then drops significantly for the rest of one’s life? This is the career of a professional football player. And for many players, the adjustment to a “normal life” is often a financial shock.

Leo Lewis, a former NFL player and now director of player development for the Minnesota Vikings, gives current players advice on how to handle the transition. Among his suggestions, he encourages NFL players to make friends



outside of football. They'll eventually need them. He also advises players to prepare their families for the day they leave football.

Many players are almost corporate entities. Their paychecks support agents, personal trainers, accountants, advisors, as well as friends and extended families living the good life. But the average NFL career is just 3.8 years, and most players earn less than the average NFL salary of \$900,000. That's a lot of overhead. "Families need a reality check," says Mr. Lewis. "They think money will keep coming in, but 90% of players will have to work after their careers are over."

Not that professional athletes have it rough, but in light of their limited window of opportunity, one might actually conclude that pro football players are not overpaid. Just for fun, here's an illustration to prove the point:

Assume that two individuals begin their careers at age 22. One is employed as a professional football player, the other an entry-level executive.

The football player plays four seasons, earning \$900,000 each year, then is cut. Following his release from pro football, he takes a position with a local auto dealership, earning \$40,000 the first year. On average, his annual salary climbs 4% each year. At the end of 34 years, at age 55, his annual income is now \$124,746. Including the \$3.6 million earned in his four years in professional football, his total earnings are \$5,843,398.

On the other hand, the business executive, perhaps due to his area of expertise, starts at \$50,000 a year, but sees his income increase at a 7% clip. By the time he reaches 55, his annual earnings are \$466,267. That's just a little more than half of what the football player made in his first year, but nearly four times what the ex-player is earning now. The total earnings for the same period? \$6,412,938.

This is only an illustration, and much of the math is based on assumptions that can't be verified. It doesn't take into account the amount of money the player pays his agent, if the retired athlete finds work right away outside of football, or whether the business executive's career continues on a steady upward trajectory. Still, the numbers do tell a story. Just like the tortoise and the hare, a steady long-term career path can be just as lucrative as one that delivers a lot more money but for a much shorter time.

## STATISTICS ON AGING AND THE COST OF HEALTH CARE

According to futurist Peter Drucker, many financial issues are influenced by population demographics. If you understand the demographics, you can begin to make some reasonable assumptions about the future. For Americans, many of these reasonable assumptions involve the impact of the Baby Boom generation (often defined as those born between 1946 and 1964).

Thus, as many of the boomers pass age 50 and approach retirement, it's not surprising that health care issues are beginning to become more prominent, especially those issues involving long-term care and nursing home stays. Some relevant data:

- ?? According to the MetLife Mature Market Institute, there are currently 35 million Americans over the age of 65. By 2030, that number is expected to double.
- ?? Statistics from the U.S. Administration on Aging indicate that men and women currently age 65 can expect to live to 81 and 84 respectively.
- ?? The longer people live, the more likely they will require assistance with Activities of Daily Living (such as toileting, bathing, dressing and eating). Statistics show that new nursing home residents require assistance with at least four ADLs.
- ?? In 2000, 4.5% of people aged 65 and over lived in a nursing home. The percentage living in nursing homes increases with age. In 2000, 18.2% of those over age 85 were in nursing homes.
- ?? The average nursing home cost per day is \$181, although the actual numbers vary widely from state to state. Louisiana had the lowest average rate, at \$96 per day, with Alaska at the other end of the spectrum (\$420/day).
- ?? The average nursing home stay is 2.4 years. Using the average of \$181, the projected annual cost for nursing home care is \$66,153 and the cost of the average stay (2.4 years) is \$158,766.

The combination of longer life expectancies and greater numbers of senior citizens makes long-term care a new priority issue in financial planning. Ready or not, boomers face a major decision: whether to purchase long term care insurance (LTC).



"These results show how quickly the cost of nursing home care could exhaust even a substantial nest egg, and how valuable long term care insurance can be in helping protect the assets accumulated over a lifetime," said Buck Stinson, President of GE Financial's Long Term Care Insurance division. "More importantly, it underscores how critical it is for baby boomers to look into this vital form of protection while they're still healthy enough to qualify."

Stinson's last comment is noteworthy. The MetLife survey also noted that approximately 40% of 65-year olds applying for LTC were declined. That doesn't necessarily mean that 40% of all 60-year-olds would be denied, but it does reinforce the old adage, "the best time to get insurance is when you don't need it."

Obtaining LTC insurance is not the only response to a possible nursing home stay. While you may feel confident in assessing your likelihood of a nursing home stay, it is not a foregone conclusion. In most cases, LTC premiums are not refundable – if you don't use the coverage, you still lose the premiums. Given that prospect, some may determine to save the premiums and take their chances, just paying the costs out of pocket.

Another possible option is using life insurance as a financial hedge against nursing home costs. Many policies include an accelerated benefits rider. The terms of the rider vary by company, but in general the insurance company agrees to pay a portion of the death benefit while the insured is alive, but diagnosed with specific terminal illnesses or requires nursing home care. For those policies that do not have an accelerated benefits rider, the same strategy may be affected through a collateral assignment with a financial institution.

The terms under which the accelerated benefits would be released are usually not as liberal as those of LTC, but the life insurance also guarantees a payment at death, even if no nursing home stay is required. However, this also requires the insurance coverage to be kept in-force well into old age. This usually means term insurance policies are not good fits for this strategy, because the coverage will expire or the premiums will become prohibitively expensive. Those interested in using their life insurance in this fashion must

engage their planner or agent in serious discussion to be sure their current program is capable of providing these benefits.

The looming demographic urgency of long term care protection reflects not only an increase in longevity but a changing social contract. A hundred years ago, larger families, shorter lifespans, and fewer government programs meant many elderly spent their final days or years at home, in the care of family. Today, the demographics have changed the economics and the social dynamics.

Living longer, but in a deteriorating condition, means higher medical and daily care costs, whether in a nursing home or elsewhere. Fewer children, usually living further from home, mean less family resources to meet these costs, which are emotional as well as physical. And most parents, having worked hard to reach a level of independence, "don't want to be a burden." The result is a financial challenge that was relatively unknown a century ago.



Please add a FREE subscription to your monthly newsletter for the following people. I understand you will send them a note explaining I suggested they get this FREE subscription. All they have to do is contact us if they wish to cancel.

1. Name \_\_\_\_\_  
 Address \_\_\_\_\_  
 City \_\_\_\_\_ St \_\_\_\_\_ Zip \_\_\_\_\_  
 E-Mail \_\_\_\_\_
  
2. Name \_\_\_\_\_  
 Address \_\_\_\_\_  
 City \_\_\_\_\_ St \_\_\_\_\_ Zip \_\_\_\_\_  
 E-Mail \_\_\_\_\_

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