

CREATIVE Wealth Maximization Strategies



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"A year from now you may wish you had started today."

- - Karen Lamb

RETIREMENT PLANNING FOR THE "10 PERCENTERS"

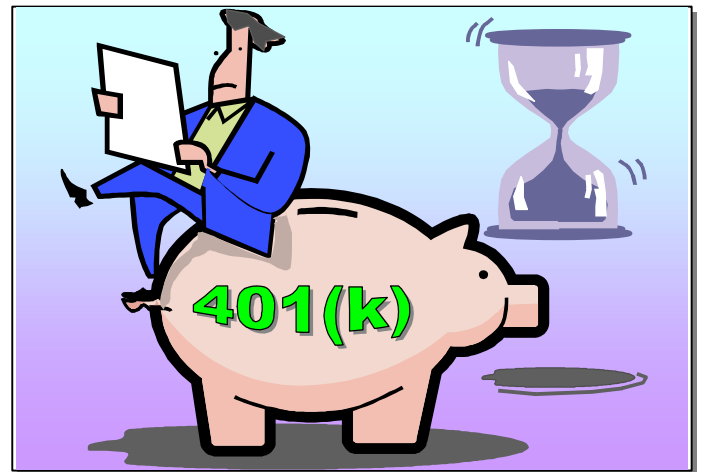
Is there something bigger and better than Retirement alone?

By most standards, Lawrence Kotlikoff would be considered a smart guy. After all, he's the chairman of the economics department at Boston University. In 2001, along with two other "smart guys," he published an academic paper declaring tax-deferred retirement plans "may be tax traps for lower- and middle-income people," and concluded, according to a July 19, 2004, *Wall Street Journal* article, "many investors are better off putting smaller amounts in their plans, and that some people should skip the 401(k) route altogether."

Mr. Kotlikoff's arguments against using a 401(k) primarily centered on the uncertainty of the future tax consequences for participants. Rising overall tax rates, the comparative tax status of retirement account withdrawals to capital gains or dividends, and the impact withdrawals might have on Social Security could create a situation where money deposited to a tax-deferred retirement plan could actually be financially detrimental.

Following up on this academic study, Mr. Kotlikoff, along with Jagadeesh Gokhale, a senior fellow at the Cato Institute, a Washington think tank, have developed a software program (called ESPlanner) that supposedly can help individuals determine just how much (or little) they should place in a 401(k) or other tax-advantaged savings plan, in consideration of the possible tax consequences. Apparently, this program is pretty sophisticated, as Mr. Kotlikoff declares the decision on how much one should invest in a retirement plan is "more complicated than trying to get a spaceship to the moon."

This perspective, that contributing to a 401(k) or similar retirement plan might be damaging to your financial health, flies in the face of "accepted wisdom," according to the *Journal* article. Accepted wisdom says, "stuff as much money as allowed into your 401(k) retirement-savings plan. Or else brace yourself for lean retirement years." Yet the article also acknowledges that a "growing number of heretics" are making a case for putting less money in your 401(k).



It may be a bit of hyperbole used for dramatic effect, but characterizing Kotlikoff as a "heretic" is an interesting choice of words. The dictionary defines a heretic as "one who holds beliefs or opinions contrary to the established doctrines of his religion." And indeed, those who hold to the "established doctrines" of retirement savings plans, see Kotlikoff's analytical conclusions as almost irrelevant.

Ted Benna is credited with creating the first 401(k) plan in 1981, and is currently the president of the 401(k) Association. When asked by the *Journal* about Kotlikoff's assertions and research, he responded:

"My advice when those kinds of arguments are made is to put the money in your 401(k). Ninety percent of people don't have the discipline to save on their own. The biggest benefit of the 401(k) is that it converts people from spenders to savers."

(Continued on next page)

Another interesting choice of words. According to Benna, the “conversion” of people from spenders to savers is more important than whether or not the process used to effect the conversion (participation in a retirement plan) actually delivers a financial benefit! Taking literally Mark Twain’s sarcastic observation that “nothing so needs reforming as other people’s habits,” it seems many financial commentators see the 401(k) as primarily a tool for behavior modification. According to these experts, most people, left to their own devices and undisciplined inclinations, wouldn’t save for retirement, and thus must be “guided” toward doing what is really in their best interest by people that “know better.”

For those following the established doctrines of the 401(k), the possible negative tax consequences don’t really matter, because the overarching purpose of saving is to provide for retirement. Since the assumption is that most people won’t save for retirement, any retirement program, even a highly-taxed one, is preferable to no retirement saving at all.

Thus, while some financial experts might acknowledge that individuals might be well-served to save for a down payment on a house, save for an automobile purchase, or save for college education of their children, these items are considered secondary saving objectives. First and foremost, the reason the population is being encouraged to submit to the automatic deduction from their paychecks for regular deposits to a retirement-savings plan is so that eventually they can retire. For these retirement-driven financial experts, anything that takes a greater savings priority than retirement better be an emergency.

Want to save to buy a vacation cottage? Or a hobby farm? Or start a business? Well, go ahead. But don’t expect the dyed-in-the-wool retirement-oriented financial advisor to approve – unless you can produce a mathematical projection that shows you are still saving enough for retirement. Because remember, if you don’t save enough, you’ll have to brace yourself for “lean retirement years” – subsisting on Social Security, Alpo, and the benevolence of others.

What they need is to understand that financial planning can be more than just secure retirement after age 65.

A BETTER REASON TO SAVE – IF YOU HAVE THE DISCIPLINE...

Retirement is a psychologically compelling topic, because it carries both carrot and stick motivations. And there’s no doubt that those who focus on retirement as the primary goal of saving and planning are well-intentioned. But this approach ignores the greater rewards that could be derived from financial strategies. And that’s a shame.

Using Mr. Benna’s numbers, 10% of the population has the internal discipline to save without the assistance of a 401(k). So what’s the point of these “savers,” (as opposed to “spenders” who need to be disciplined into doing what’s best for them) saving in a 401(k), especially if the tax benefits of participation are perhaps less than favorable? Do they need a 401(k)?

No, what they need is the understanding that retirement planning can be more than just secure retirement after age 65. – it can also be about building wealth right now, and achieving your financial dreams today. This is old news for regular readers, but the wealthy individuals of the world aren’t obsessing over building a retirement account for 20 years from

now. They are taking financial action with the intent of making a profit starting today. And if they do that consistently, there’s a good chance retirement will take care of itself.

Here’s a very broad example of “today” thinking about saving. Suppose you have accumulated \$50,000 through regular saving. One day, you are overwhelmed to find a beautiful farm property in a prime location by the lake, for sale at a reduced price. After a few calculations, you use the \$50,000 as a down payment. The money you had been saving each month pays the mortgage. You call your retirement-oriented planner, who wails “but what about your retirement?” and faints.

You and your family enjoy this property immensely. The kids have a place to run, the sunsets are fantastic, and the memories priceless. You lease some of the farmland to pay the taxes, and some of the maintenance. 20 years pass, and when an offer comes along that you can’t refuse, you sell the property to a developer for a significant profit. “Wow,” you say to yourself, “We can retire on this money. How about that?” It’s a simple illustration, but one that’s based in reality, and is probably more fulfilling than eyeballing a retirement account statement every three months.

This is not to say financial strategies shouldn’t consider longer time horizons. People forty-five years old should recognize the very real possibility they will live for another forty-five years. But those plans need to be flexible, open to the possibility of change, and ready to meet challenges and opportunities that may occur in five years as well as forty-five years from now.

But if you already have the saving habit, you should know that real wealth, and the immediate enjoyment of it, can result if savings are used to acquire assets – businesses, property, etc. – instead of investing in retirement. As much as the retirement fanatics might protest, acquiring wealth is a better motivator, a more inspiring reason to save. As Paul Ferrell put it in a May 27, 2004, *CBSMarketWatch* article:

“Instead of offering you freedom today, the high priests of the retirement gods represent a way of life and a mindset that actually traps us into the safe path. They’ll act like scolding parents wagging their bony fingers at us if we ever hint at failing to plan for the future.

So today I’m questioning that assumption and challenging America’s obsession with retirement and planning for the future. That obsession should never substitute for living your dreams today. Never!”

Maximizing the present is the best way to plan for the future.

IF YOU ARE ALREADY ONE OF THE “10-PERCENTERS” WHO DOESN’T NEED EXTERNAL DISCIPLINE TO SAVE MONEY, ARE YOU LOOKING FOR WAYS TO MAXIMIZE THE PRESENT VALUE OF WHAT YOUR SAVINGS CAN ACCOMPLISH?

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.)

ONE OF EVERY 125 AMERICANS IS A MILLIONAIRE!

Four years after a stock market downturn flattened many investment portfolios, a new study finds that one of every 125 Americans is a millionaire – a return to wealth levels not seen since the bursting of the stock market bubble four years ago.



The 2004 World Wealth Report, compiled by brokerage firm Merrill Lynch & Co, and consultancy Capgemini Group, paints a picture of financial resurgence among the world's wealthy. Most striking: the study found that in the U.S. and Canada, the number of ultra-rich – those with investment assets of more than \$30 million – has reached 30,000, about the same number of people as live in Juneau, Alaska's capital.

Robert Frank, *Wall Street Journal*, June 15, 2004.

GM SAYS HEALTH CARE ADDS \$1,400 TO VEHICLE COSTS

Providing health care benefits to workers, their dependents and retirees adds \$1,400 to the cost of every vehicle General Motors Corp. builds in the United States, the company said on Thursday. "It costs us \$1,400 per vehicle built in the United States," John Devine, GM's chief financial officer, told an automotive conference in this lakeside resort in northern Michigan.



Devine, who called for a national solution to the U.S. health system, said health care costs are expected to rise 8 percent this year. "Costs are unsustainable," Devine said. "Solutions aren't easy," he added. "We aren't expecting an overnight success. We don't think there's a single answer."

GM, Ford Motor Co. and DaimlerChrysler's Chrysler division all have enormous health care liabilities that put them at a competitive disadvantage with foreign-based automakers with U.S. manufacturing operations. The foreign companies, or so-called transplants, have nonunion work forces and lower health care costs because they employ younger workers and support fewer retirees. © Copyright 2004 Reuters.

Poornima Gupta, *Reuters*, August 5, 2004.

SOME OLDER EXECUTIVES FORCED INTO EARLY RETIREMENT

Amid the layoffs that have become a routine part of corporate downsizing, mergers and outsourcing, there is a growing trend: older executives who can't find new jobs.

Few of these managers ever imagined this could happen to them at what was supposed to be the pinnacle of their careers. But after aggressive job hunts, many former executives discover that even though the economy is picking up, new managerial jobs tend to go to younger workers. Some have responded by starting their own businesses or trying consulting, but others have essentially



been forced into early retirement, sometimes many years short of their financial goals.

Rebecca Blumenstein, *Wall Street Journal*, July 20, 2004.

RETIREMENT PLANS ARE DISAPPEARING

Retirement plans – whether pensions or 401(k)s – are disappearing from the benefits packages of more small businesses, according to the Employee Benefit Research Institute. These days some 32% of employees who work at a company with 100 or fewer workers are offered a retirement plan, down from 34% in 2000. For large companies (with 1,000 or more workers), that number has hovered around 75% during that same period. A recent EBRI survey shows that the crunch is likely to persist at smaller firms.



DaisyChan, *Forbes Small Business*, July/August 2004.

FEWER PEOPLE HAVE WILLS

Fewer people have wills these days, a trend that some experts attribute to an overall slowdown in estate planning and concerns over tax-law changes. A will ensures that, after your death, assets are distributed according to your wishes, not the mandates of the state in which you live. It can also specify guardians to take care of your children. Yet, in 2004, only about 42% of adults had a will, down from 47% in 2000, according to legal resource Martindale-Hubbell.



Procrastination is a common culprit for not drafting a will, but other factors also appear to be coming into play. Some people have delayed creating wills because they have fewer assets to pass along to heirs after the recent prolonged market downturn. Other are postponing all aspects of estate planning, including wills, for fear that they will have to redo this work later due to uncertainty over estate taxes. The estate tax is set to phase out in 2010, only to return in 2011 unless there's a permanent repeal.

Kathy Chu, *Wall Street Journal*, June 10, 2004.

LIVING AN EXTRA-LONG LIFE CAN BE A FINANCIAL BURDEN

For retirees who didn't bargain on taking breakfast out on their Florida veranda into their late 80s or 90s, an extra-long life can be an unkind financial burden. Financial planners and actuaries usually recommend that people save for retirement assuming they'll live until around 80, but there's a 50% chance of living longer than that.

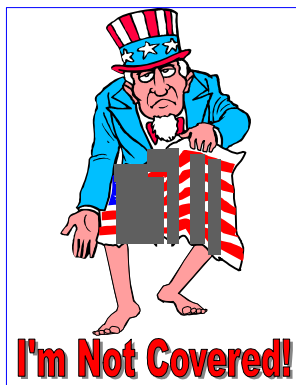


Many people don't plan for just ordinary expenses of an extra-long life. And should they need long-term care, that changes the whole equation. Many people ignore the possibility of long-term care or make faulty assumptions about who pays for it, thinking Medicare or regular health insurance will (it won't).

Elizabeth Weinstein and Megan Ballinger, *WSJ.com/Reports*, July 19, 2004.

Things that make you go “Hmmm...”

STATISTICIANS SAY: THE UNITED STATES IS UNDER-INSURED!



Give statisticians enough data, and they can assess anything. On July 7, 2004, Swiss Re, an international life and health insurance company, released a report evaluating the “life assurance protection gaps” for entire *nations*. That’s right – nations.

The company’s researchers attempted to measure the cumulative life assurance protection gaps – defined as the

difference between the resources needed and the resources that would be available to maintain the family’s current living standard after the death of its primary earner – in Australia, Germany, Italy, Taiwan and the United States. Then the researchers made a calculation of the cost of term life insurance that would be needed to be purchased to cover this gap.

Having the largest economy and population of the nations surveyed, the United States showed the greatest protection gap, with a difference of \$10.6 trillion dollars. However, “solving” this protection gap issue would require US households to spend less than one quarter of one percent (.23% actually) of their annual income on additional life insurance protection. On average, the cost of additional term life insurance equated to \$444 a year per household.

Hmmm... While the statistics are interesting, and no doubt the result of voluminous evaluation, the relevance of these findings for individuals is minimal. It’s not really a question of whether a nation has enough life insurance; it’s whether you do.



THE FAQs OF RETAINING A FINANCIAL PLANNER

Q: Do You Really Need A Financial Planner?

No.

To be financially successful, you need to plan. You need knowledge, a course of action, and a commitment to act. You need to work and save consistently, and look for opportunities to acquire assets. But none of those things require a financial planner. Contrary to television advertisements, retaining the services of a planner is not a necessary ingredient for a healthy financial life.

Q: Do I Want A Financial Planner?

Probably.

Personal finance is a multifaceted subject. It’s not so complex that a person of average intelligence can’t understand it, but there are a lot of pieces. Truly grasping the dynamics and philosophies of successful financial planning requires on-going study, regular involvement, and practical experience.

Most of us have other things to concern ourselves with besides studying finance in our spare time — things like career, family, recreation. A good planner gives you a double dose of benefits: expertise and experience to make things easier, and the time to focus your energies on other things you find equally important.

Q: How Are Financial Planners Compensated?

In general, there are three formats of compensation for those individuals who perform financial planning activities.

1. Commissions from products used by the client
2. Fees for service
3. A combination of 1 and 2

Each format has its proponents and detractors, strengths and weaknesses.

The Argument For Commissions

In order for financial planning to be effective, the strategies discussed must be implemented. Since most financial strategies involve the use of some financial instruments — stocks, bonds, insurance policies, mutual funds, legal documents, etc. — it makes sense to compensate the representative when an item is purchased. The commission provides incentive for the planner to make the idea become a completed action. And since most people won’t commit to spending money on something they don’t believe they need or want, the commission-based planner must satisfy the client in order to be compensated.

In addition, most financial instruments available from a planner/registered representative/agent are items that are intended to be in place for several years. For example, in order to maximize the possibility of receiving a historically average rate of return, the conventional wisdom is that a mutual fund should be held for at least five years, preferably ten. Insurance contracts usually require ongoing premiums to keep the coverage in force. To encourage “persistency” — that is, having clients continue with the financial instruments that were purchased - financial institutions often provide “trail commissions” to representatives for business that stays on the books.

To keep receiving the trails, and keep open the opportunity for future transactions, a commission-based planner has a fairly strong incentive to provide follow-up service. This follow-up includes regular reviews, written contact, and assisting with service issues that arise in regard to your accounts.

The Argument Against Commissions

Some would argue that from a practical standpoint, it is impossible for planners to give objective advice if the only way they get paid is by commission. This is because there are two incentives working against the planner making the client’s interests the top priority.

First, people working on commission are salespeople, and their perspective on reality - in financial matters or anything else - is colored by their need to sell their products. Therefore, as salespeople, planners will do and say what is necessary to make the sale. Thus in certain circumstances, a commission-based

financial planner may be inclined to recommend a lesser strategy or financial instrument simply because it's the approach that will conclude in a sale. This "tilt" toward making the sale has the potential to work against the client's best interests.

Second, because the commission payment comes from the financial company rather than the client, the planner's allegiance to the company is greater than his allegiance to the client. In some instances, this divided loyalty may shortchange the client's interests.

Following these lines of reasoning, it is impossible to accept as accurate the advice offered by a commission-based planner. Depending on your perspective, this argument against commission-based compensation is either pragmatic or cynical.

On the other hand...

Despite this perception by some of divided loyalties and conflicting incentives, there's no question that honest, straight-shooting, commission-based financial planners exist. And although it may not be as obvious, commission-based planners do have strong incentives to provide objective, helpful advice.

First, providing good service means secure renewals and lucrative future business for the planner in the way of additional sales and referrals. Second, the sale of most financial products requires state licensing and selling agreements with the institutions that provide the stocks, bonds, mutual funds, insurance policies, etc. Improper behavior by a planner can mean suspension of his/her license and loss of representation.

If you are in philosophical agreement about the planning strategies presented to achieve your financial objectives, it's quite likely that a commission-based planner has a working knowledge of the details these strategies entail — and the financial instruments to make them work.

The Argument For Fee-Based Planning

With a fee-based approach, the client pays the planner a fee for planning services. Depending on the arrangement, these fees can be charged on a pay-as-you-go basis (each time you meet with the planner, you are charged an hourly rate), or on a regular billing cycle (monthly, quarterly, semiannually, etc.). For the regular billing, the fee amount may be a set number, or represent a percentage of assets under management. Most states require those providing fee-based services to be licensed, and to clearly delineate their fee schedules to prospective customers.

In theory, because the planner is being paid directly by the client for his/her knowledge and financial diagnostic skills, the client receives more objective assessments and advice. The client is not being asked to purchase a product as a way to pay for the advice.

And even though the client will pay a fee for the advice or service, whether good or bad, the planner has strong motivation to provide the best advice possible in order to receive continuing fees. The "renewal income" for a fee-based planner comes from the client's ongoing favorable assessment of the planner's guidance, not the persistency of the product that was sold.

The Argument Against Fee-Based Planning

If fee-based planners are paid only for their knowledge and opinions, there isn't any financial incentive to make sure that discussed plans are ever completed. In fact, in order to maintain an "objective" perspective, a fee-based planner may not even possess the needed licenses and registrations to buy the financial instruments (stocks, bonds, insurance, mutual funds, etc.) that

would make the plan work. Once the discussion is completed, the client is left on his own as far as implementation.

With the variety of financial tools available, the complexity of their features, and the government bureaucracy that tries to oversee all of it, the purchase of financial products can be a time-consuming task for someone not familiar with the task. If the planner doesn't have specific knowledge of the products available (perhaps the case if the planner doesn't have licenses to sell the products), he/she may miss something that would be a perfect fit for your situation. Even if the guidance provided by a fee-based planner in regard to product selection is current, the client may still end up requiring the services of a commission-based agent in order to implement the plan.

On the other hand...

Depending on the services offered and the structure of the compensation, a fee-based planner may have some strong incentive to facilitate the implementation of your plan. For example, if the fee is based on a percentage of assets under management, the assets will have to be organized and placed where they can be counted in order to assess the fee. If the account grows, the fee increases, rewarding both the planner and the client.

Combining Commissions And Fees

Combining the two compensation formats either allows you to have either the best of both worlds, or the worst.

Planners who are compensated by a combination of commissions and fees may have an initial consultation fee paid up front. This amount may be reduced or eliminated if the client also chooses to purchase financial products from the planner. In either event, the fee charged by "combination planners" will typically be lower than fee-only planners because the combination planners can make up the difference in commissions.

There's a legitimate rationale behind this combination approach. The planner's knowledge and expertise are valuable commodities. Having the client pay a fee for the planner's expertise reinforces, for both parties, the importance of the strategies, as well as the products used. It compensates the planner for time spent with the client, and hopefully, moves the planner away from selling commission-based products out of financial necessity.

On the other hand...

Implementation of a financial plan involves legwork. Once the tools for the plan are chosen, there are logistical issues that must be attended to. Accounts must be established, funds transferred, applications filled out, and in the case of insurance, underwriting assessments must be made. The commissions can be justified as reasonable compensation for the planner's efforts to bring the plan off the drawing board and into reality.

Q: How Does One Decide Which Approach Is Best?

It's not a matter of which compensation format is best. The real question is whether the planner can help you reach your objectives, no matter what form the compensation takes. It's more important that you first determine what you want a financial planner to do for you.

Most of the financial planner's duties and expertise fall under the category of **saving**. The planner isn't a career counselor or a business consultant. His/her focus is on the effective use of financial instruments to help you increase your savings, and protect the assets you have already acquired.

That said, a good planner also must understand the relationship between your work and your saving, and what interest you have in using your savings for things other than retirement. In other words, your planner should be able to assist you in what you are trying to accomplish beyond just saving money. Depending on your objectives, some saving strategies may actually be counterproductive.

Determining how well a prospective planner sees your big picture and can implement strategies to help you progress toward completing your personal financial objectives usually requires an interview. This interview could be accomplished in a casual conversation or in a formal meeting with you asking a list of prepared questions. Besides discussing financial philosophies and compensation, here are some other topics to consider:

- **Ask about the size of the planner's current client base.** It also helps to ask about the type of clients the planner is currently assisting. If he/she mentions that a large percentage of the planning work involves business owners or highly compensated professionals, that's probably a good sign that they have familiarity with the opportunities and challenges that face prosperous people.
- **Find out about the planner's professional contacts.** It may also be helpful to ask the planner about the other professionals with whom they have a working relationship. This means attorneys, CPAs, real-estate brokers, and other "prosperity specialists." No one knows everything. But a good network can be an invaluable resource, both for the planner, and for you.
- **Decide whether you want the planner to be your liaison with other members of your financial team.** You must consider whether you want the planner to help you coordinate the services of other financial professionals that may work for you, such as accountants, attorneys, and other financial professionals.

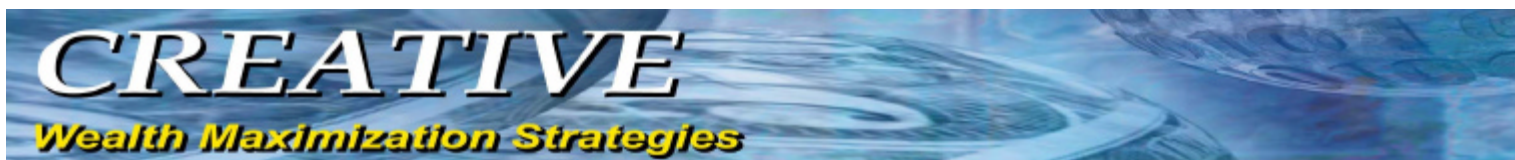


- **Clarify communication expectations.** Some clients expect "hand-holding" — weekly calls, monthly face-to-face meetings, and quarterly written reports. Some planners, for various reasons, can't make that commitment. Instead of discovering this after the fact, get the communication guidelines squared away up front.

There are pros and cons to giving the financial planner this responsibility. A planner with good management and people skills can make for a more efficient plan - things get done faster, and they get done right. On the other hand, you still have ultimate responsibility for every decision in your financial plan. Delegating may result in making you less informed, and there may be consequences

A final thought: Some assessments can only be made over time. In general, what you will discover is whether or not the planner delivers on what he/she says they will do. Does he/she return phone calls? Does necessary paperwork get completed? Is their information accurate? Is the advice consistent? Do they have integrity?

As mentioned at the beginning, you don't need a financial planner to be financially successful. A lot of wealthy people don't even have a planner until after they achieve prosperity. But, in our humble opinion, a good financial planner can make a tremendous difference, either to help you move up the financial ladder, or to keep you from sliding down.



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