

# THE BOOK ON RETIREMENT



*A Better Way to  
Stretch Your Retirement Dollars  
While Living the Lifestyle of Your Dreams*

**FRANK GUIDA**     **NICK GUIDA**

**MICHAEL CANET, JD, LL.M.**



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By **FRANK GUIDA, LUTCF®**  
**NICK GUIDA**  
&  
**MICHAEL CANET, JD, LLM**

Impact Publishing®  
Lake Mary, Florida



## DEDICATIONS

I dedicate this book to my loving father and mother, (Nick's grandfather and grandmother), Nicola and Maria Guida. I have learned so much from both of you and you are the inspiration for the writing of this book. All those years ago in our family meat market/grocery store, you taught me how to treat people the right way. Our customers were like family to us, and you always made sure whoever walked into our store's door was given the best products and services – something we have continued in my own financial planning practice. I will always be grateful to you. Our clients at **A Better Way Financial** are always treated like family because of the wonderful things you taught me.

*Frank Guida*

This dedication is for my lovely wife, Melat. You inspire me to continually grow and develop. Thank you for your love and support.

*Nick Guida*



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## INTRODUCTION

Retirement planning can be very overwhelming and there are so many moving parts when it comes to creating a sound financial plan. Our goal in writing this book was to make something that can be complicated and convoluted, a little simpler. We wanted to give the reader the tools and information to make smart decisions, but at the same time, follow the suggestion of wise men before us: *keep it simple*.

In this book, we share many ideas that we feel are important to investors and retirees. Between us and our collective teams, we bring over a century of knowledge and experience to this book. As you can probably imagine, trying to cram it all into one book is not an easy process. So, we try to deliver the most important tidbits for you – the inquisitive investor standing on the doorstep of retirement.

We are sharing some of what we think are the most pressing issues for retirees and those soon to be retired. A recurring theme throughout the book is CHOICE. You as an investor have so many choices. One of those is whom you CHOOSE to partner with, as far as finding the right advisor – one that works for YOU, not some investment firm. CHOOSING to work with a Fiduciary, from our perspective, is paramount to any retiree's success.

Other important themes you will find as you read through this book:

- (i). *It is wise to take the least amount of risk necessary to accomplish your goals.*
- (ii). *Creating a secure income during retirement makes sense.*
- (iii). *Always pay the least amount of taxes legally possible.*

Remember – you will have to make several CHOICES.

CHOOSE A Better Way.

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## **TWO FINANCIAL RULES TO LIVE BY**

**1. “Rule No. 1: Never lose money.”**

~ Warren Buffet – Berkshire Shareholder Mtng., 9/3/2020

**2. America’s retirees #1 Fear? Running out of money!**

~ AARP<sup>1</sup>

Question:

If one of the greatest investors of our time has a simple rule: never lose money; how can it be that so many retirees fear running out of money?

Answer:

Read on... *there has to be A **Better Way**...*

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1. <https://www.aarp.org/retirement/planning-for-retirement/info-2019/retirees-fear-losing-money.html>



## CHAPTER 1

# WHAT DOES RETIREMENT LOOK LIKE?

*Retirement is like a long vacation you should never have to cut short.*

### WHAT EXACTLY DOES RETIREMENT LOOK LIKE?

If you are like most Americans, you probably haven't given it much thought. Craig and Rose certainly had not thought too much about retirement until they walked into our office. Like most of us, they had worked hard over the years. They made smart choices – diversified their investments, saved regularly in their retirement and brokerage accounts, and always lived within their budget. They were good stewards with their money. Now it was time to enjoy all the fruits of those years of labor.

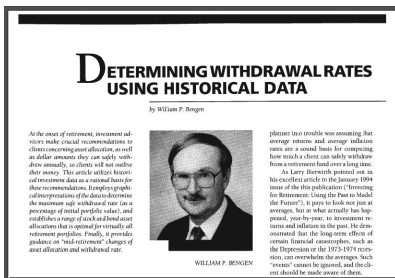
Craig and Rose had been working with a broker for many years. During that time, they had met with him once a year to review their retirement accounts. Craig and Rose were pretty happy with what they had managed to accumulate over the years, and they were looking forward to enjoying the rest of their lives together using those funds.

When they sat down with their advisor and told him that they wanted to retire, he did the normal advisor thing – he reviewed their accounts. Craig had a 401(k) with just under \$1M in it. Rose had slightly less at \$800,000. In their checking and savings, they

had another \$100,000, and in their brokerage account they had another \$500,000 in mutual funds. All in all, they had accumulated just under \$2.5M. In addition to their investments, Craig had a significant pension, and they both would be receiving social security. Their savings and investments amounted to a very solid number, and they were proud that they had managed to accumulate such a nice nest egg over the years. The question they had for their broker was: could they afford to retire responsibly, without having to worry about running out of money?

Seems like an easy enough question, right?

After looking at their accounts, their advisor said they could withdraw about \$82,250 a year from their portfolio, and “statistically” – yes, he told them “statistically” – Craig and Rose would never run out of money. When Craig asked how the broker came up with the \$82,250 number, the broker explained the “4%” rule. When Craig pointed out that \$82,250 wasn’t 4% of their assets, the broker explained that because Craig and Rose were both just 58 years old, they would need to take out a smaller percentage.



*In 1994 William Bengen published an article in the Journal of Financial Planning detailing his empirical simulations of market returns and determined that a person could “drawn down” 4% annually from their portfolio without fear of running out of money. This “4%” rule has become widely accepted and is a staple of many advisors and financial firms.*

*Source: <https://www.forbes.com/sites/wadepfau/2018/01/16/the-trinity-study-and-portfolio-success-rates-updated-to-2018/?sh=577dd2c76860>*

Craig was a little perplexed but continued to ask questions. He wanted to know what changes should be made to the portfolio as they entered into retirement. The broker explained the “Rule of 100” to Craig and Rose.

Simply put, he advised Craig and Rose that they should take the number 100 and subtract out their age. The resulting number would be the percentage they should hold in equities and the balance should be in fixed income. For Craig and Rose, the broker was recommending that they hold about 40% of their portfolio in equities and 60% in bonds.

Again, the answer perplexed Craig. He started to feel like this was a cookie-cutter way of doing things. When Craig asked about the tax implications of taking these withdrawals and how they would balance the retirement accounts and the brokerage accounts, the broker explained to them that the firm's policy was that they were not allowed to provide tax advice or guidance, but that he could refer them to a CPA to discuss the tax implications.

This conversation did not give Craig and Rose the confident feeling they were looking for heading into their retirement years.

*So, they went in search of **A Better Way!***



## CHAPTER 2

# A HISTORICAL PERSPECTIVE

*Everybody knows what happened in 1929.*

### THE STOCK MARKET CRASH OF 1929 AND THE RESULTING SECURITIES EXCHANGE ACT OF 1934

The Stock Market Crash of 1929 is still considered the worst economic event in American history, maybe even in world history. Over the course of four days the DOW lost 42%. When the crash started on October 24th, some of the biggest banks, investment firms, and investors of that time stepped in to try to halt the slide. Morgan Bank (precursor to Morgan Stanley), Chase Bank, William Durant, Carnegie, the Rockefellers, and a host of other very powerful and wealthy families and businesses all attempted to halt the market from crashing. It helped, but only for one day. By the time November arrived, the market resumed its slide and continued to slide until March of 1933. Over a period of almost four years, the Dow lost a total of 89.2%.



The ensuing result was the election of FDR and the start of the New Deal. While there were many components of the New Deal, the one that still impacts investors today was the passage of the Securities Exchange Act of 1934. What specifically did it do

Among other things, the New Deal created the Securities and Exchange Commission. The SEC is charged with overseeing securities: the buying and selling of stocks, bonds, mutual funds, variable annuities, and over-the-counter securities. It also has the responsibility to oversee the conduct of financial professionals, including brokers, dealers, and investment advisors.

After the debacle of the 1929 Market Crash, the SEC, in its regulatory oversight, created a standard that all brokers must follow. These same rules established in 1934 are the same rules that still govern the brokers today. The rule established that the broker is a “middleman” between you and the market. He’s there to help facilitate your purchase of investment products. The broker must now disclose certain things:

- That he works for the firm (called a Broker-Dealer), **not for you.**
- His duty of loyalty is to the firm for which he works – after all, they do provide him a paycheck.
- He is not allowed to provide investment advice, but rather, he can ascertain whether a particular transaction is “suitable.”

What does this mean...suitable?

According to the regulatory body which oversees Brokerage Firms and their employees (the brokers/investment advisors/financial advisors/registered representatives are among the many names they may call themselves), Rule 2111 requires:

- **Reasonable-basis suitability** requires a broker to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least some investors. Reasonable diligence must provide the firm or associated person with an understanding of the potential risks and rewards of the recommended security or strategy.
- **Customer-specific suitability** requires that a broker, based on a particular customer's investment profile, has a reasonable basis to believe that the recommendation is suitable for that customer. The broker must attempt to obtain and analyze a broad array of customer-specific factors to support this determination.
- **Quantitative suitability** requires a broker with actual or *de facto* control over a customer's account to have a reasonable basis for believing that a series of recommended transactions, even if suitable when viewed in isolation, is not excessive and unsuitable for the customer when taken together in light of the customer's investment profile.<sup>2</sup>

Notice that nowhere in that definition, in the Financial Industry Regulatory Authority (FINRA) regulation, does it mention anything about being *in the best interest of the client*. It actually says, "suitable for at least some clients," not "you" specifically, but "some clients." Nowhere does it mention avoiding conflicts of interest: like selling proprietary mutual funds that carry higher than average management fees or that the broker earns higher commissions for selling specific products.

In addition, for the first time, the broker was required to actually take a test, a basic knowledge test. The name of the test? It is called the "*GENERAL SECURITIES REPRESENTATIVE EXAM*." The name itself is important because it indicates that ultimately, the licensee is acting as a *representative* of the broker-dealer (BD), not the client. Who do those registered representative's work for? You have probably seen their commercials on TV

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2. <https://www.finra.org/rules-guidance/key-topics/suitability>

or perhaps you have seen their name on the side of a very tall building: Merrill Lynch, Wells Fargo, UBS, or Morgan Stanley – at least, those are some of the big wirehouses.<sup>3</sup> Along with these massive BD’s, there are numerous small BD’s out there that also follow the same suitability standards created in 1934.

**TWO PATHS TO BECOMING A FINANCIAL ADVISOR**

	<b>REGISTERED REPRESENTATIVE</b>	<b>INSURANCE AGENT</b>
<b>COMPANY</b>	Broker-Dealer	Insurance Company
<b>PRODUCTS/ SERVICES</b>	Selling Investment Products	Selling Insurance Products
<b>REQUIREMENTS</b>	Series 6 or 7, and Series 63	State Life/Health Insurance License

It is important to understand this aspect of the New Deal. The New Deal does not require the broker to explain to you that the broker actually works for the Brokerage Firm: that is correct, those types of brokers work for “The Firm.” *They do not work for you. They work for somebody else.* They have a manager who tells the broker what they can and cannot do for the client. They have a manager that sets the sales quotas for the month, quarter, and for the year. The Firm provides incentives for selling the most of something or for selling a certain dollar amount of some product. The Firm actually tells them which investment choices they are allowed to offer the clients. As a matter of fact, you are not a client of the broker you are working with; rather, you are a client of the firm. As soon as that broker leaves the firm, you will be assigned to the next 24-year-old vice president in line to start taking on clients.

You notice what else seems to be missing? Conflicts. There is no rule requiring the BD (Broker-Dealer) or the Broker to disclose conflicts of interest. This is important to understand because most of these larger wirehouse firms also have an investment banking side to their practice. What is an investment bank?

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3. Wirehouse is an old term for a full-service Broker-Dealer whose employees work for the firm.

When a company wants to raise money by selling bonds (debt) or by issuing stock, they go through a middleman to facilitate the process. These wirehouses are those “middlemen.”

For example, when Google wants to raise money in the capital markets, the stock market, they go to investment banks like Merrill Lynch, UBS, and Morgan Stanley. These wirehouses agree to handle and distribute the stocks to all the other firms (think Fidelity, Schwab, Edward Jones, Ameriprise, etc.). These middlemen all agree to sell “X” amount of the stock within a targeted, specified price range. When the offering becomes available, would it be reasonable to assume that the brokers of all these firms recommend the stocks to their clients? Or at least, their favorite clients? With an offering that turns out like Google, we usually look at those results as being a good thing.

But what about when they are recommending Enron? And how about when they are recommending mortgage-based credit default swaps? Remember those two debacles? Any worries about the firm getting paid large fees, called solicitor agreements, to push the sale of those stocks? If the firm received large fees to be able to bring the offering to the table, do they have an incentive to push the sale of those positions over others?

It feels like there is an inherent conflict of interest. They get paid large sums to sell stocks to their clients who pay them a fee to buy those very stocks. Hmm... seems like a potential conflict...

Another potential conflict of interest we often see is that many of these larger wirehouse BD's have their own proprietary funds. Anybody who has held accounts at Wells Fargo frequently sees Wells Fargo funds in their portfolios. This isn't to suggest that WF funds are all bad funds, not at all. But it does beg the question: did the employee of WF (your Broker) recommend the WF fund because it was the best fund for you or because it pays him a better commission? Or perhaps because his manager

requires a certain portion of assets to be allocated into WF proprietary funds? Does WF earn fees on managing the funds they offer to their clients?

Again, this is not to suggest that WF funds are inferior or that the broker is doing something “bad” to the client, but it does beg the question: Is the recommendation in the best interest of the client or just “suitable”?

As an investor trusting the advisor with your life savings, which do you want? A “suitable” investment recommendation, or a recommendation that is in *your* best interest?

Think about it from this perspective, imagine sitting down for dinner at a restaurant. The server gives you a menu of your options and it looks like this:



For those of you who remember the movie, *My Cousin Vinny*, this is the menu at the local restaurant. They were sitting down for breakfast and after reviewing the menu, they opted for “BREAKFAST.”

Frequently, this is how a brokerage firm or wirehouse sells their products. They provide the broker an option of products that the FIRM CHOOSES and then the broker sells those approved products.

What happens when you order the lunch, which advertises the price at \$2.49? The server lets you know that it is a burger and fries. He asks how you want it cooked and whether you want lettuce, tomatoes, and pickles? Sounds good, and when the plate comes out, it looks great. The only thing missing is ketchup for the fries but that shows up immediately. When you are done, you ask for the check and instead of seeing a bill for \$2.49, it shows as \$21.00. Wait...how can that be?

Well, like working with a broker or wirehouse, frequently the devil is in the details. Remember, they have a “suitability” standard, not necessarily a fiduciary standard. If they were a fiduciary, they would have told you that the lettuce, tomato, and pickle were all \$2.49 each, that delivery to the table was another \$2.49, and that the water you drank was also \$2.49. Don’t forget the ketchup, another \$2.49, and don’t forget the automatic tip included... the broker’s version of a commission. All in, it’s a \$21.00 lunch.



## CHAPTER 3

# THE FIDUCIARY AND INVESTOR CHOICES

*There has to be A Better Way.*

### THE INVESTMENT ADVISERS ACT OF 1940

For investors, the Investment Advisers Act of 1940 is significant. This is the Act that made an Investment Adviser take a test to be allowed to give investment advice. The Act goes further and actually requires that the Investment Advisor “conform to regulations designed to protect investors.”<sup>4</sup> This was a new standard for a new type of advisor. An advisor was finally able to give actual advice in the best interest of the client, instead of just acting like a middleman providing a product that was “suitable.”

The SEC, in creating rules for the Act, determined that the Adviser’s advice must be in the best interest of the client. That means that the Advisor must find the best investment vehicle for the client. The Advisor must also disclose all conflicts of interest, potential or actual, and that the Advisor could actually provide financial planning. Finally, the rule allows the Financial Planner to become licensed and work for the client instead of working for the Brokerage Firm.

With the passage of the Investment Advisers Act, a new world

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4. <https://www.sec.gov/investment/laws-and-rules>

of investment advice opportunities became available for both the investor and the advisor. Amazingly enough, nothing really changed in the ‘big box’ wirehouse world though. Why? Why didn’t the large firms embrace the opportunity to step away from commissions and their duty to their employer and embrace the opportunity to get licensed and provide actual investment advice to their clients?

Remember, under the *Securities Exchange Act of 1934*, these firms had a fairly simple approach: find clients to sell investments, provide *suitable* investments, and collect big commissions. *Once they found a client, they kept selling them investments, to keep those commissions coming! These large institutions became large institutions by making money, lots of money, on that business model.* If they stopped selling products that paid those large commissions and encouraged investors to pay a much smaller fee instead, they could face a significant reduction of revenue.

Clearly this model, at least in our opinion, is flawed. It is based upon an outdated 20th Century mindset of “selling” to investors. The very notion of not being required to look out for the client is a huge flaw in the financial services industry today. Not being responsible enough to do your very best to make sure the client’s best interests are taken care of, and the mere fact that Advisors are still allowed to have direct and inherent conflicts of interest, just doesn’t make sense! Not today! Not in the 21st Century! Not with the ability to CHOOSE to provide services as a Financial Planner instead. That’s right: Advisors today can CHOOSE to continue to use an outdated 20th Century sales approach OR those Advisors can CHOOSE to earn a *fiduciary standard of care* for their clients.

It is our suggestion that you CHOOSE to work with a fiduciary. We all expect the Doctor we CHOOSE to look out for our personal care and health. We all expect the Attorney we CHOOSE to represent us in our estate planning affairs and to look out for

our best interests. Why would you not **CHOOSE** to work with an Advisor who has the same duty of care for you and your life savings as you expect from your Doctor, Attorney, or even your CPA?

You get to **CHOOSE**. There is *A Better Way*.

Now, let's go back to Craig and Rose. Remember their dilemma? They were looking for financial planning advice from their broker. True, he did not call himself a "broker," his official title was "Financial Advisor" although he was listed in the company directory as a "Registered Representative." He was a representative of the company he worked for, not for Craig and Rose. The problem for Craig and Rose, was that their broker of almost 30 years had never quite explained to them that he was not licensed, or allowed, per his firm, to provide comprehensive financial planning.

What Craig and Rose were about to learn was that the first 30 years was the easy part, that is called the *Accumulation Phase* of life. This is the time when people are working and saving so they can get to retirement with the investments they need in order to have the retirement they've always dreamed about. The *Retirement Phase* of life, however, is a completely different story.

As we are nearing and/or entering into retirement, that is when the real challenge to retirement begins. The more difficult part of retirement is to protect and preserve your life savings to ensure your hard-earned retirement nest egg lasts throughout your retirement. And not just make it last, but that it can be distributed to you as tax-efficiently as possible, and then passed to your heirs as tax-efficiently as possible, if that's your future goal.

Craig and Rose showed up in our office looking for a second opinion. They wanted to see if there was a better strategy available to them than their broker proposed. They were looking for a more comprehensive approach and had done some research

about how to find a retirement-focused advisor. During their research, they found our firm; they liked our holistic approach to financial planning, and the fact that we're fiduciaries. Remember, as Advisors, "we" get to make the choice whether to work for somebody else or work for the client.

Like any good financial planning firm, we wanted to review their financial documents leading up to the meeting so we could be prepared for our conversation. We asked for copies of their investment statements, social security statements, pension statements, their estate planning documents, their life and long-term-care insurance, as well as the last two years of their tax returns. From our perspective, the tax return is always the starting point of any conversation about retirement income. It reveals all sorts of information: expenses, charitable donations, income, and assets—it has it all.

With those documents in hand, we sat down with Craig and Rose and asked them about their goals, their passions, and their income needs. We discussed their desire to leave a legacy to their daughter and their grandkids. We discussed the tax implications of their investments and income.

Turns out, their current broker didn't ask any of the questions we asked. We learned that Craig likes camping, fishing, boating, and in general, being outdoors, and he assumed they would spend their retirement years in a Winnebago. Rose, on the other hand, explained during our meeting that they would probably move closer to their daughter and the three grandkids. She was interested in a cruise or two, but wasn't quite sold on the idea of "glamping" around the country in an RV!

When we brought up the topic of income, Craig said that their broker told them they could withdraw about \$80K a year based on "something called *The Four Percent Rule*." After our collective chuckle, we asked them how much income they actually wanted during retirement? That question was never actually asked of

them before. Their broker only had conversations with them about how much they would have, not how much they actually needed, or wanted, for that matter.

As we continued our conversation, we were reviewing Craig and Rose’s portfolio. A concern that all investors should have is about the fees associated with their underlying investments. One of the many positions recommended by their WF Advisor was the Wells Fargo Index Fund. This fund was intended to “mirror” or “track” the S&P 500. When we pulled up the costs associated with this fund, Craig and Rose were unpleasantly surprised.

**I. Last Year's Itemized Costs of Owning This Fund in a non-qualified brokerage account (WF Index Fund WFILX)<sup>5</sup>**

<b><u>Itemized Fund Management Fees</u></b>	<b><u>Total %</u></b>
Amount you paid for fund Administration	0.233%
Amount you paid in uncategorized fund Management Fees	0.312%
Total fund Management Fees you paid	0.55%
Amount you paid for Fund Distribution	n.a.
Your share of the fund's Transaction Costs	n.a.
Taxes you paid for holding the fund	3.24%
<b><u>One-Year Total Cost of Ownership</u></b>	<b><u>3.79%*</u></b>

That is correct, for this S&P 500 Wells Fargo Mutual Fund, their estimated fees were over 3.7%!

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5. <https://personalfund.com/app/>

When we looked at their mid-cap growth fund their Advisor had chosen for them, we discovered the following fees:

**II. Last Year's Itemized Costs of Owning This Fund (WF Discovery Fund WFDAX)<sup>6</sup>**

<b>Itemized Fund Management Fees</b>	<b>Total %</b>
Amount you paid for fund Administration	0.229%
Amount you paid in fund Advisory Fees	1.168%
Amount you paid in uncategorized fund Management Fees	n.a.
Total fund Management Fees you paid	1.40%
Amount you paid for Fund Distribution	n.a.
Your share of the fund's Transaction Costs	0.28%
Taxes you paid for holding the fund	1.33%
<b>One-Year Total Cost of Ownership</b>	<b>3.01%*</b>

With their small cap growth fund, the fees looked like this:

**III. Last Year's Itemized Costs of Owning This Fund - Ivy Small Cap Growth (WSGAX)<sup>7</sup>**

<b>Itemized Fund Management Fees</b>	<b>Total %</b>
Amount you paid for fund Administration (Not reported)	n.a.
Amount you paid in fund Advisory Fees	0.984%
Amount you paid in uncategorized Fund Management Fees	0.225%
Total fund Management Fees you paid	1.21%
Amount you paid for Fund Distribution	0.296%
Your share of the fund's Transaction Costs	0.30%
Taxes you paid for holding the fund	2.30%
<b>One-Year Total Cost of Ownership</b>	<b>4.11%*</b>

Needless to say, Craig and Rose were shocked at the amount of fees. Their Advisor had told them the fees were just 1% and that the funds internal management fees were less than 1%. The Advisor wasn't being completely forthright with them, HIS fees were just 1% and

6. <https://personalfund.com/app/>

7. <https://personalfund.com/app/>

the fund management fees were about 1% (but those were just two of the line items of the fees they were paying). The Advisor never explained all the other costs associated with owning mutual funds. Perhaps he didn't think it was necessary, because he only had to make sure that the investment was "suitable," not necessarily that it was in *their* best interest.

We'll delve more into fees later, but we showed Craig and Rose a quick comparison to another index fund mirroring the S&P 500 that is available on the open market as well with significantly lower fees:

#### IV. Last Year's Itemized Costs of Owning This Fund (VG Index VOO)<sup>8</sup>

<b>Itemized Fund Management Fees</b>	<b>Total %</b>
Amount you paid for fund Administration	0.027%
Amount you paid in fund Advisory Fees	0.002%
Amount you paid in uncategorized Fund Management Fees	0.03%
Total fund Management Fees you paid	0.03%
Amount you paid for Fund Distribution	0.006%
Your share of the fund's Transaction Costs	n.a.
Taxes you paid for holding the fund	0.39%
<b>One-Year Total Cost of Ownership</b>	<b>0.43%*</b>

Even though we showed Craig that the costs were substantially lower, Craig was curious about the returns. After all, there is that old saying "sometimes you get what you pay for." In this case, the extra fees didn't quite equate to extra returns.

We used a software program to illustrate the difference in historical performance between the two funds NET of fees over the past five years. In the chart at the top of the next page, the *light* line displays the returns over the previous five years, through 11/20/2020, for the VG Index Fund. The **dark** line represents the Index fund used in Craig and Rose's brokerage account. Rose

8. <https://personalfund.com/app/>



was deeply troubled by the large drops and wanted to better understand how those drops could impact their retirement. Like most advisors, their planner had done a risk tolerance test for Craig and Rose. True, he hadn't actually done one in over a decade but two things occurred each and every year:

- #1: Craig and Rose always said, "we are happy with our returns."
- #2: WF always sent out a document showing their risk level of their allocation.

By doing so, WF met their obligation to make sure that the investments were "suitable."

After further review, we noticed that there was a ROTH IRA account on one of their statements, but it had not been funded yet. In our conversations, they explained that they went to the CPA that their Advisor had suggested, and she had hold them not to convert any IRA accounts to a ROTH. However, their financial advisor suggested that they convert \$150K to the ROTH.

We asked them why? Why convert? Why not convert? Why \$150K instead of \$120K or \$170K? The simple answer was that Craig and Rose had no idea. They were just relying on their

Advisory firm to guide them. They had no idea because they actually had no formal retirement plan.

We ran the numbers for them and helped them calculate how much in conversions they should do for the next five years. It turns out that they *should* convert from IRA's to ROTH's. However, \$150K wasn't the right number, but the Advisor was correct, they should convert something. That was the good news. The bad news was the CPA said no. The CPA wasn't discussing tax planning with the Advisor, and the Advisor wasn't discussing investment planning with the CPA. The two individuals, who should have been their most trusted Advisors, each missed an important opportunity to communicate to their clients. Furthermore, their Advisor was all about growing the assets and wasn't focused on protecting and distributing the income tax efficiently. In fact, the Advisor didn't even have a distribution plan in place – the Advisor was relying on the old standard “4%” rule to guide him.

The CPA was so used to looking at last year's tax situation, her focus was not on tax-planning for the future. She was good at her job but didn't take the time to actually do tax-planning to help reduce or eliminate their tax bill going forward.



You can teach a monkey to put numbers on a page. That doesn't make him any more of a tax planner than having a CPA designation!

The approach of their CPA and their Advisor was, sadly, quite typical and all too common. All do his or her own job while wearing blinders for all kinds of reasons. For some, the job is routine and does not encourage critical thought; for others... it's just a paycheck. Basically, they do their jobs, but anything

outside of their narrow focus, they take the attitude of “well, it’s not my job.” We find that it is better to have the CPA and the Advisor on the same page so that one hand knows what the other is doing and is working in collaboration for the best outcome for the client.

Imagine buying a car from a manufacturer who doesn’t do any safety testing on their cars before selling them to the public... or a restaurateur who doesn’t verify that their food handlers have food safety certifications...or having a house built and the builder and general contractor on the job never show up to give direction to the carpenters.

Like any service you rely on, you want someone to make sure the entire job is being done correctly. In the case of your money, and your ability to retire, you don’t want someone who can’t or won’t look at the big picture. You deserve the best quality service. Craig and Rose certainly saw the light.

This is what led Craig and Rose to become our clients.

They found *A Better Way*.

## CHAPTER 4

# NOT YOUR PARENT'S RETIREMENT

*Retirement isn't the end of the road, it is a change in direction.*

### **WHAT DOES A BETTER WAY TO FINANCIAL AND RETIREMENT PLANNING ACTUALLY LOOK LIKE?**

First, investors need to understand that retirement today is not like our parent's retirement. For our parents, they worked the same job for 40 years. They lived in the same house you grew up in. They always spent less than they earned. (Credit cards? Never!) They didn't buy McMansions, BMWs, or Gucci shoes. They didn't shop at Prada and didn't own \$1,500 purses from Louis Vuitton. They saved wisely and invested in the stock market seeking reasonable returns for reasonable risk.

They knew their retirement income would be secure. They retired with the promise of a pension from their employer. They knew that they would also receive Social Security. They could rely on reasonable interest rates from the bank to supplement their income needs. Plus, many had health care from their employer or union they could count on to supplement the Medicare they received from the Federal Government.

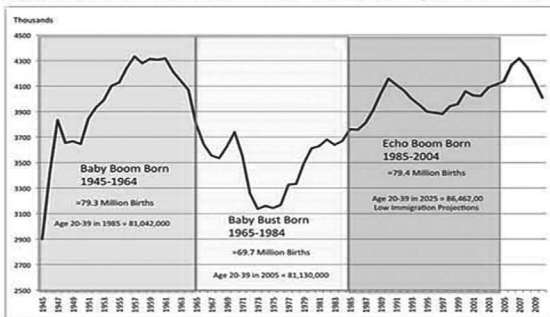
Life was different. Slower. Less complicated. Work 40 years. Live

within your means. Save a little each year. Retire. Get a pension. Collect Social Security. Maybe dip into savings now and again for the extras in life or to help the kids. Retirement was different.

In fact, when we look at retirement today, what we are really talking about are the Baby Boomers (born 1946 through 1964), and the generations who come after. Retirement is different for them and for the generations to follow. Why? Well, to start, Boomers are the largest group of Americans to ever enter into retirement. There are almost 10,000 boomers retiring each and every day. They started retiring in 2008 at the age of 62, when many started collecting Social Security (SS), followed by Medicare a few years later.

What are Baby Boomers, and why are they such a populous generation? In 1946, men came home from World War II. They settled down and started making babies – a lot of babies. Between '46 and the Korean War, a population chart would show an almost straight-up line of baby-making, aptly named *The Baby Boom*. There was a little dip at the start of the Korean War, because when men go off to war, they stop making babies, but a couple of years later, they were home and back to making babies again. So, between '46 and '62, a lot of babies were made, and we mean a *lot* of them.

**Annual Births in the United States (1945 – 2010)**

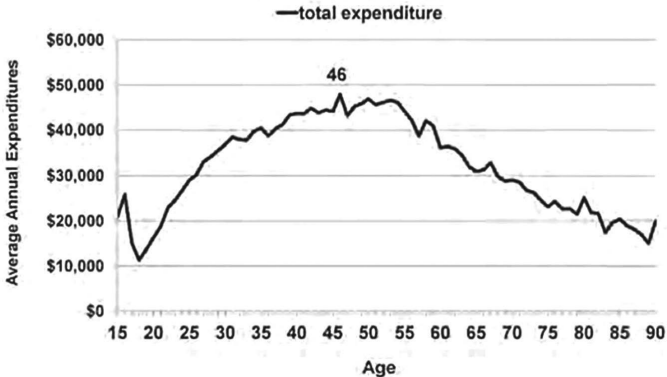


Sources: United States Census Bureau and the National Vital Statistics Report

Notice the steep incline starting at the end of 1945 that continues until 1964. These are the Boomers.

All those babies ultimately grew up and became consumers, and here's what we know about that: consumers have what are called *predictable spending habits*. The government does a consumer expenditure survey every year, in which it studies 60,000 American families. These 60,000 American families report what they spend their money on – kind of similar to how the Nielsen ratings work for TV and radio. Some interesting patterns come out when you look at these consumer expenditure survey results. Statistically speaking, a majority of us go off to college or some sort of trade school at 18 or 19. We spend three to five years getting trained in some particular field of work. When we're finished training, we get a job in that particular industry.

Figure 1-2: Total Consumer Expenditure by Age



Data Source: U.S. Census Bureau

As we all know, any time you hire somebody new, they're initially more of a burden than a benefit, because it takes them several years to become truly productive in what they're doing. That means by the time an employee is 25 or 26 years old, they're finally a productive member of the company, producing more benefit, revenue, or more widgets, for the company than it costs the company to have him or her in place.

You get to be 25 or 26 and you start thinking about settling down. Typically, we get married between 26 and 28 years old. When we first get married, we live in apartments and condos. Most of us don't go out and buy a house. We have our first child between 28

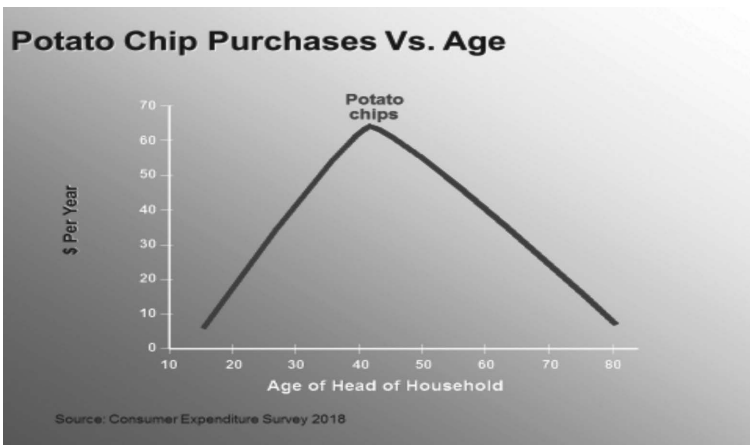
and 30. At that point, we look for our first house, and it's typically a smaller house because our income is less. Now we're spending a little more of our income because we spend more money on our children. We want them to have all those things that we didn't have, and we want them to have a better life than we did. This is especially true for the Baby Boomers. Their parents grew up in the Depression, so they had a very frugal approach to expenses. Boomers were raised to see their parents' mentalities as stressful and overcautious: "I can't spend it because I'm so afraid I'm going to lose it." Now, the Baby Boomers (and some of Gen Xers) pushed back against that, saying, "We're going to spend. We're not going to be like our parents, who were so ridiculously tight."

So, we get to age 30, we have a kid, and we've bought our first house. Sometime between 30 and 35 we have our second kid. The average American family has 2.3 children (we know that 0.3 children is kind of scary, but we do have 2.3 children), and we buy a bigger house. By age 50, we've bought the biggest house we're ever going to buy. Here's what happens between the ages of 40 and 50 for many of us: we have teenagers in the house. Now, anyone who has ever raised teenagers knows what teenagers do. They get up in the morning – actually, more like 2:00 in the afternoon – and they open their mouths, and they start eating.

Most teenage kids will get up at 2:00 in the afternoon and they will have a bowl of cereal. Then, they'll ask their mom to make some pancakes. Then, they'll go play on the computer, and they'll come back around 4:30 or 5:00 PM and have a sandwich and a bag of potato chips. Then it's time for dinner, and top that off with a bowl of ice cream, another bowl of cereal, some popcorn, a couple slices of pizza, another bag of chips, and six sodas – and it's only 10:30 at night. Caloric intake for teenagers is huge. They're consuming more calories between 12 and 18 years old than they do at any other point in their lives, because their bodies are going nuts!

But the corresponding extrapolation from that is that we spend

more and more money on food so that they can have that intake. The result is that between age 40 and 50, we spend more money than we do at any other point in our lives. But it isn't just for grocery shopping; it is on clothes, activities, driving, technology – who doesn't have a child or grandchild with the latest smartphone growing out of her/his ear? Think about this for a minute: we spend more money on potato chips at age 44 than we do at any other point – and that's not because we're the ones eating them. At age 44, we're thinking about salads and oatmeal and our bulging waistlines, but we are buying potato chips for our kids.



Consumer consumption is 70% of the gross domestic product (GDP). That means that 70% of all production and all the spending that goes on in the United States is driven by us buying stuff. That's everything from computers to cars for our teenagers, to bicycles and clothes and whatever the latest gadget is – the iPad, the iPhone, the iWhatever. We spend a boatload of money on raising kids.

Now let's go back and think about what happened on 9/11. Right after 9/11, President Bush went on national television, and one of the things that he stressed was that we couldn't let those terrorists win. Go shopping. If you remember back to then, he sent you \$300. In 2008, when the stock market was crashing, Bush sent

you more money. From the crash of 2008 and the election of President Obama, the government sent money left and right to Middle America through rebates, energy credits, education credits, payroll tax cuts, Making America Work credits, anything and everything the Administration could think of to get more money into our pockets, *hoping* that we would go out and spend it. When Donald Trump was elected President, the first thing he did was pass major tax cuts in anticipation that we would see more money in the pockets of working Americans, and they in return would go out and spend it.

When the Covid pandemic of 2020 first began, almost 14M people were laid off or lost their jobs. Small businesses were shuttered. Malls closed. The economy almost ground to a halt. Like previous economic downturns, congress and President Trump stepped in and sent consumers a \$1,200 check to try to keep people spending money. They also extended out unemployment benefits as the virus spread and some businesses were forced to shut down while other businesses slowed way down. Many people saw more in their unemployment checks than they actually made while they were working. There was a hold on mortgage foreclosures, credit cards suspended payments, evictions were put on hold, and even car payments were extended. Everything was geared towards keeping money in the consumer's pocket and keeping them spending. One of the first pieces of legislation that President Biden passed when he was elected, was the American Rescue Plan - it distributed checks to Americans. Why? To keep the economy moving forward.

This is important to understand because the only way the economy grows is for people to continue buying stuff, again and again and again. Employers are not going to hire more people just because they pay lower taxes, or because they have lower pension obligations. They can have trillions and trillions of dollars on their books, but they're not going to hire new workers until people start consuming (think about the Trump tax cut – corporate America purchased trillions in Stock Buy-Back Programs). It does not

matter how many widgets you can build or even how cheaply, if people don't purchase them, corporate America is not going to make them. The economy, the stock market, and the government want people to spend money on consumption. They want us to spend a lot of money on consumption

As much as things change, they also stay the same. We can look back on the financial realities of the past ten, twenty, even thirty years. Looking back to the early 80's, Americans went on a spending binge – including the Federal Government, but we'll get to that shortly.

Back to our Boomers with their 2.3 kids, big house, and lots of potato chips. It's clear that Baby Boomers have spent a lot of money raising their children. But what happens when that child turns 18 and heads out the door? Our spending starts to slow down. By the time most Americans are 55, the kids are moving out of the house, and now Boomers are paying off debt and saving (in earnest) for retirement. Both of those are good for the individual, but not for the economy. They are no longer buying "widgets." Now those people who spent and spent are looking to save and save. They want to prepare for retirement.

***Just like they purchased the newest and best electronic gadgets for their kids, retirees today recognize that the advice provided to their parents is probably not the advice they should follow in today's economy.***

To some extent it goes back to the beginning of this book and the old-fashioned approach the Advisor was taking to provide retirement advice. Too often, retirees resign themselves to outdated notions of what retirement means, all because that is all their Advisor knows.

Think about that for a moment:

- Outdated notions?
- The 4% rule?

- The age 100 rule?
- What about rules on diversification?

*After the 2008 debacle, can a retiree really look at diversification in the same way as our parents did?*

It certainly explains why Craig and Rose were so perplexed that in 2020 their Advisor was making suggestions based on technology, taxes, and planning ideas from back in the 1940's and 1950's.

As you read through this book, keep in mind that what our parents taught us, and know that today's investment environment has changed substantially. There is so much financial noise. Every time you turn on the TV, we see advertisements to:

- follow the little green arrow
- what is your number
- talk to an origami orange bunny
- watch beautiful whales

...and even to talk to Chuck.

There are dozens and dozens of subscriptions out there touting the latest “hot” stock and “picks for the year.”

Consider the following from the Motley Fool in December of 2007: The Best Stocks for 2008<sup>9</sup>

Their Top Picks...?

The results if you invested in their Top Picks:

1. Apple: Down 57%
2. GE: Down 56.3%
3. IMAX: Down 34.6%
4. J&J: Down 10.34%
5. Garmin: Down 80.24%
6. Starbucks: Down 53.79%

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9. <https://www.fool.com/investing/general/2008/01/04/and-the-best-stock-for-2008-is.aspx>

How about those recommendations? Think that the people who followed the advice of the stockbrokers who made those recommendations were happy? We all know what happened – when the market started dropping, the Adviser said, “It’s a long-term investment, don’t worry about it.” When it dropped further, the Adviser said, “It’s only paper losses.” Then what happened? You stopped opening your statements and the Advisers stopped answering their phones. That is no way to go into retirement and certainly not the way to go through retirement.

Clinging to these old, antiquated ways, CHOOSING to follow those old approaches, is a little like taking a road trip with an original Garmin GPS. They had those little suction cups on them so you could attach them to your windshield. Remember them? That was before every smart phone had Google Maps...and before WAZE. How about McNally’s Road Map? It was stuffed in the glove compartment of the car with coffee and soda stains on it. It never folded back up the same way, remember? Imagine using that to navigate today’s roads.

CHOOSING to navigate using those old standards and tools is a little like using that clunky old paper map, or punching in numbers into your old, suction-cupped Garmin GPS units to drive to a new area of town: you are likely to get lost and worse yet, end up going the wrong way altogether.

Boomers chose to pick up a briefcase, work hard, and along the way, they helped the United States become the largest and most powerful economy in the world. Are they ready to put down that briefcase and pick up the golf bag?

. . . Only if they find *A Better Way*.



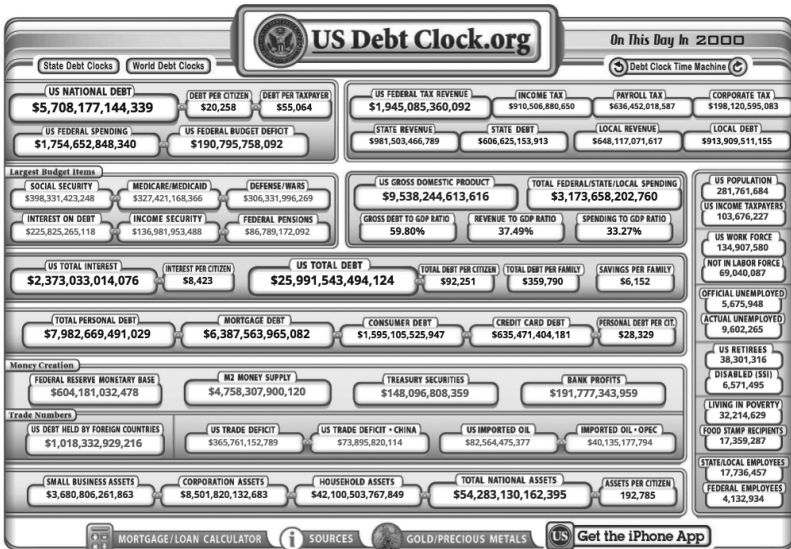
## CHAPTER 5

# HEADWINDS: DEBT

*...the tailwind is now a headwind.*

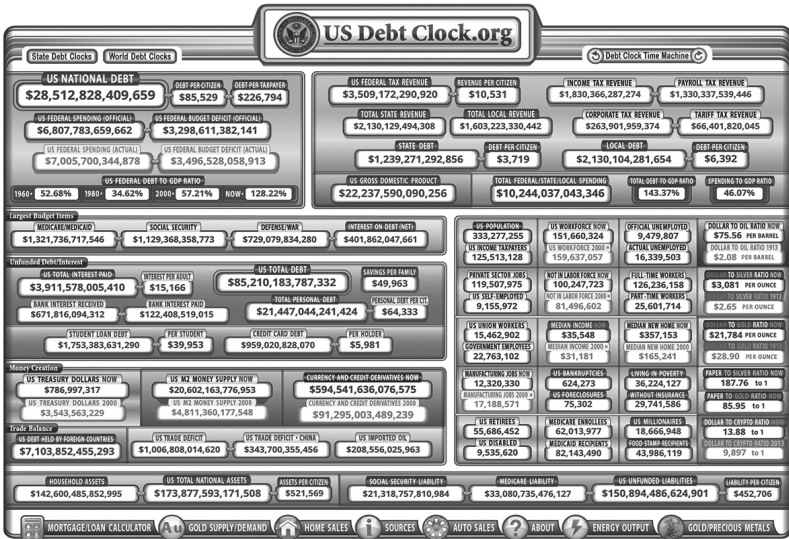
### TODAY'S RETIREMENT

Navigating today's retirement has unique challenges. You are faced with different obstacles than previous generations. These obstacles, or headwinds, make planning for retirement a little more difficult.



One major headwind we're all dealing with economically is our soaring national debt and the impact it plays on us taxpayers

Since 2000, the national debt has gone from under \$5,000,000,000,000 to over \$28,000,000,000,000. That is a 560% increase in debt.



By the way, the real number? It is over TWENTY-EIGHT TRILLION DOLLARS when you count unfunded liabilities like Social Security and Medicare. Do you think our parents ever thought our country would be more than TWENTY-EIGHT TRILLION DOLLARS in debt?

In 2021, we will need to borrow more than \$1T just to pay our bills.<sup>10</sup> This means that almost 20% of our spending is just the interest we are paying on our bills. We know that Social Security (SS), Medicare/Medicaid, the Military, and the interest on the debt represents about 94% of the overall budget. With us borrowing 20% of our spending needs, what happens when interest rates increase from these historically low rates in 2022?

We know that President George Bush (“W”) added almost \$7.5T to the deficit, President Barack Obama added another \$8.5T, and President Donald Trump increased it by \$6.5T. President Joe Biden is also on his way to making major additions to our

10. <https://www.wsj.com/articles/treasury-to-borrow-over-1-trillion-in-2019-for-second-year-in-a-row>

national debt. Clearly, the Federal Government isn't a good steward with our money. Is there anyone who believes that future Administrations will not continue to add to the national debt? The threat of increasing tax rates to pay for this debt is just one of the headwinds facing today's retirees.

Another Headwind is the prospect of rising taxes in order to continue to fund the debt and our growing consumption. We know that the government does not spend our money wisely. As they continue to expand the deficit, there will come a time that either they must raise taxes or cut spending. The government seems to be really good at raising taxes and not so good at cutting expenses.

A reoccurring theme is: raise taxes on the wealthy, change who can collect Social Security, and at what age they can collect. Let us look back into history for some guidance. In 2006, a CPA named David Walker went on a speaking tour and he called it the "Fiscal Wake-Up Tour." During the tour across the country, Walker spoke to local and state governments, politicians, and every group who would take the time to listen to his dire warnings.

In 2006, Walker was warning people about a "dirty little secret" everybody in Washington knew – we as a country were on a fiscal cliff and if we didn't do something to correct it, we would drive right over the edge. He was warning everybody when the nation's debt was \$8.5T. (Think about that for a minute: in 2006, the national debt was \$8.5T. In 2022, at the time of this printing, it is now over **\$29T**).



*“Regardless of what politicians tell you, any additional accumulations of debt are... basically deferred tax increases.”*

Source:

<http://www.cnn.com/2009/POLITICS/04/15/walker.tax.debt/index.html?iref=24hour>

Walker spent almost two years telling anybody and everybody who would listen to him that the nation was headed off a financial cliff, and that was the time to address the issues. Just with simple math, Walker explained that there was not enough revenue coming into the Treasury to pay the bills. There was not enough money being collected by the Treasury to pay the bills of that time, let alone the bills that were going to come due in the future.

In 2006, he was talking about obligations in the amount of \$40 – \$50 Trillion dollars. He was off by a factor of more than 2. We have over \$155 Trillion in future obligations and the number continues to grow. Where will that money come from?

Again, Walker talked about simple math. According to Walker, we would be required to raise taxes AND cut benefits. Here is the simple math:

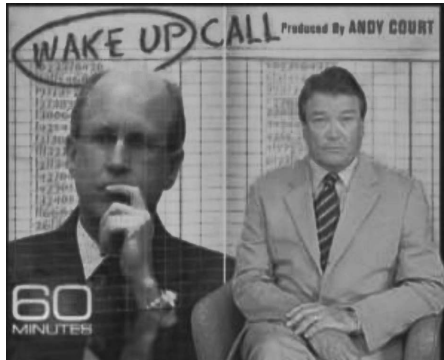
*“If Social Security, Medicare, and Medicaid go unchanged, the rate for the lowest tax bracket would increase from 10% to 25%; the tax rate on incomes in the current 25% bracket would have to be increased to 63%; and the tax rate of the highest bracket would have to be raised from 35% to 88%.”*<sup>11</sup>

So, who is David Walker and why does his opinion matter? He was the Comptroller General of the United States during the Clinton and Bush Administrations. He was the nation’s top Accountant and ran the Government Accountability Office, an investigative arm of Congress. He was responsible for making sure the nation’s books actually balanced...which for a few short years in the 90’s, they did. But that stopped dramatically by 2006 and is why Walker spent so much time talking about the dirty little secret.

Demographics: It is all about the Baby Boomers. Remember them? In his now-famous interview with CBS *60 Minutes*,

11. Source: [https://www.cbo.gov/sites/default/files/110th-congress-2007-2008/reports/05-19-longtermbudget\\_letter-to-ryan.pdf](https://www.cbo.gov/sites/default/files/110th-congress-2007-2008/reports/05-19-longtermbudget_letter-to-ryan.pdf)

Walker described the problem with Baby Boomers and their drain on society.



[https://www.youtube.com/watch?v=U19\\_OkPRggE](https://www.youtube.com/watch?v=U19_OkPRggE)

### **Another headwind is the threat of decreases to Social Security and Medicare programs.**

Walker explains that the Baby Boomers, those born between 1946 and 1964, number about 76 million people (immigration offsets deaths, so 76 million is still the US Census number).<sup>12</sup>

Starting in 2008, those same Boomers would become eligible for Social Security, and by 2011 would be eligible for Medicare. That part was no secret

The secret was that Social Security was never designed for this stress-test of accommodating so many recipients: for 76 million people to collect benefits for 20–30 years. Think about that for a minute. In August of 1935, under the New Deal, when Social Security started, the life expectancy was about 58 years old for men, and 62 for women.<sup>13</sup> Even accounting for childhood deaths, roughly 55% of those who made it to 21, actually lived to collect Social Security. What does that mean? A significant portion of those who paid into Social Security either never collected it, due to early death, or died shortly after electing to receive Social Security benefits.

12. <https://www.prb.org/justhowmanybabyboomersarethere/>

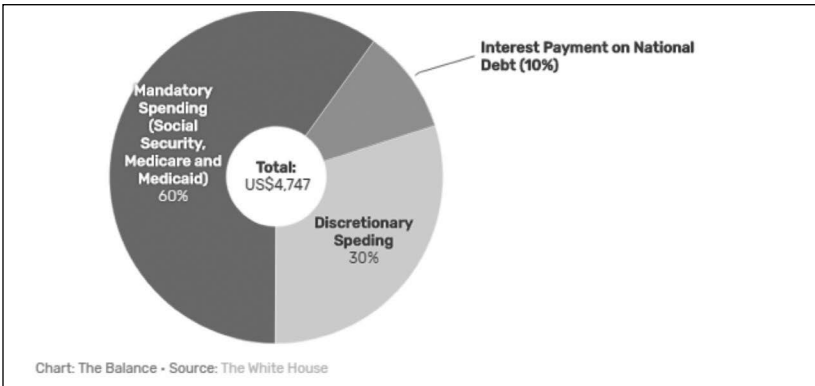
13. <https://www.ssa.gov/history/lifeexpect.html>



On January 31, 1940, the first monthly retirement check was issued to Ida May Fuller of Ludlow, Vermont, in the amount of \$22.54. Miss Fuller, a Legal Secretary, retired in November 1939.

Ida May Fuller worked for three years under the Social Security program. The accumulated taxes on her salary during those three years was a total of \$24.75. Her initial monthly check was \$22.54. During her lifetime she collected a total of \$22,888.92 in Social Security benefits.

This means that on average, during this time, most Americans collected Social Security for 13–15 years. Today, people are living much longer. 90 years is not an uncommon lifespan these days—in fact, 20% of men and 33% of women who reach age 65 will live to see their 90th birthday. That means a bigger drain on Social Security and on Medicare resources.<sup>14</sup>



*Piechart: The U.S. Federal Budget for FY 2020 is \$4.7 trillion. That's \$2.8 trillion in mandatory spending which includes Social Security, Medicare and Medicaid. That's \$1.4 trillion in discretionary spending that includes Defense, Education and Energy. Interest payment on the national debt is \$479 billion.*

We are currently spending almost 60% of our national revenue on mandatory items, with almost \$1.8T just on Social Security and Medicare. And that is with us only about halfway through the Boomers wanting their benefits – we hit “full” capacity of demand around 2026.

With that as the backdrop and keeping in mind that David Walker warned us in 2006 about the pending issues, let us look

14. [https://www.ssa.gov/OACT/NOTES/as120/LifeTables\\_Body.htm](https://www.ssa.gov/OACT/NOTES/as120/LifeTables_Body.htm)

at the health of the Social Security Trust Fund, and how much we have set aside to fund Medicare. According to the 2018 Social Security and Medicare Trust Fund Report, Social Security (SS) will be able to pay unreduced benefits until 2034 and Medicare is purported to have funding through 2026.<sup>15</sup>

This is an improvement, being fully funded until 2034. As recently as 2010, SS was actually posting grim statistics on their annual statements they sent out warning people that by 2037, recipients would only be receiving about 76 cents on the dollar. That is almost a 25% decrease in income!

For years, the Social Security Administration would send out an annual earnings statement to let you know about your reported earnings, and the estimated amount you would receive in SS benefits in the future. They also let you know that SS was in deep financial trouble, going as far as to include the following paragraphs:

*Now, however, the Social Security system is facing serious financial problems, and action is needed soon to make sure the system will be sound when today's younger workers are ready for retirement.*<sup>16</sup>

*In 2016 we will begin paying more in benefits than we collect in taxes. Without changes, by 2037 the Social Security Trust Fund will be exhausted and there will be enough money to pay only about 76 cents for each dollar of scheduled benefits.*<sup>17</sup>

*We need to resolve these issues soon to make sure Social Security continues to provide a foundation of protection for future generations.*<sup>18</sup>

Now, it's important to understand that the shortages faced by Social Security and Medicare go beyond people living longer and the Baby Boomers wanting their share. When SS first began in 1940, there were 159 workers supporting each recipient.

Obviously, in 1940 there were not that many people actually receiving Social Security benefits. By 1960, there were 5.1

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15. <https://www.ssa.gov/oact/TRSUM/>

16. Form SSA-7005-OL (01/15)

17. <https://www.ssa.gov/policy/docs/ssb/v70n3/v70n3p111.html>

18. <https://www.ssa.gov/history/ratios.html>

workers for each claimant, and by 2010, there were only 2.9 workers supporting a claimant. That number will continue to drop, and by 2035, it is estimated that the number will be closer to just 2 to 1.<sup>19</sup>

Our unfunded liabilities, the money we owe for things like Social Security, Medicare, and Federal Debt, exceed \$156,000,000,000,000. Think about that, ONE HUNDRED FIFTY-SIX TRILLION DOLLARS. And that number grows dramatically each and every year.

Where is that money going to come from?

Taxes? Will they raise taxes? Certainly, David Walker thought so, but that discussion is for another chapter. So, is it reasonable to think that the government is going to raise taxes in the future? Heck, even create new ones? We think that's a strong possibility and one that we need to plan for by being proactive right now.

What we do know is that the US National Debt isn't going away anytime soon. We also know that one side effect from the National Debt is that it keeps interest rates low. How so? According to an October 2020 report from the Brookings Institute, an economic think tank:

*To limit the economic damage done by the pandemic, the Federal Reserve—the Central Bank of the United States—lowered its key short-term interest rate nearly to zero (as it did back in 2008). Then it began purchasing hundreds of billions of dollars of Treasury debt securities from investors banks in what is known as quantitative easing, or QE. Even though the Fed isn't lending money directly to the Treasury, the more the Fed buys, the lower the interest rate on Treasury debt in the market, and the lower the interest rate that the Treasury has to pay to borrow—and the more it can borrow without worrying about pushing up interest rates. More importantly, the lower long-term interest rates, the more people are willing to borrow to buy homes, expand businesses, etc., helping to stimulate the economy.*<sup>20</sup>

That leads us to another headwind. . .

19. <https://www.crfb.org/blogs/number-workers-social-security-retiree-declining>

20. <https://www.brookings.edu/wp-content/uploads/2020/10/Debt-level.pdf>

## CHAPTER 6

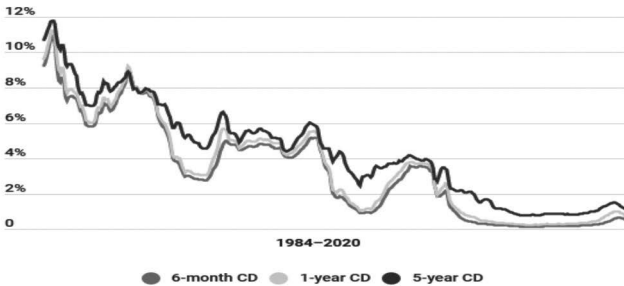
# HEADWINDS: INTEREST RATES

*...at the end of the day, it isn't normal to have interest rates at zero.*

### INTEREST RATE MOVEMENTS

#### Average CD rates: 1984-2020

CD rates in 2020 -- and inflation -- are significantly lower than they were in the past.



Note: Monthly average interest rates  
Source: Bankrate national survey

You may remember when everybody put money in the banks and when banks actually paid what was considered reasonable interest rates. There was a time when short-term interest rates on savings accounts was actually double digits. Remember those days?

Double-digit returns and NO RISK? Why would anybody put money in the stock market, taking the risk of loss, when they

could get 10% or more in a safe and secure bank account? That was the logic our parents and grandparents took in their savings approach.



Source: Board of Governors of the Federal Reserve System, retrieved from FRED.



US Treasury rates have continued to drop over the last four decades putting even more pressure on a retiree’s ability to find safe and secure income streams. This has forced many retirees to shift their investments and savings into the stock market looking for better returns. With that stock market exposure comes additional risk.

How did we get here?

It all changed in the early 1980’s with the election of Ronald Reagan and the implementation of David Stockman’s “supply side economics.” Yes, it is true, as George Bush said at the time, it was “voodoo economics.” Stockman has acknowledged that the whole idea of “supply side economics” was a ploy to get Congress to go along with massive tax cuts. Reagan and Stockman had concluded that the only way out of the quagmire of the economic stagflation the US was in at the time was a major jolt to the interest rate markets. If you remember, interest rates were running 10–15%. Imagine getting 15% interest on your CD’s. The problem

was that inflation was running close to 15%. To make matters worse, prices were dropping – consumers couldn't make enough in order to save enough to buy their widgets. When the consumer stops buying, prices drop. Think about how cheap it is to buy a VCR today.

As you can see from the chart below, shortly after the passage of the Reagan tax cuts, not only did interest rates drop, so did inflation. Lower inflation meant more buyer power for the US consumer. This was the exact result Reagan and Stockman envisioned.



In 1981 when Reagan took office, inflation was running about 13.5%. By the time he left office in 1988, it was just over 4%. Today inflation hovers in the 2% range. Quite a drop.

One of the side effects of lower inflation is that banks offer lower interest rates to consumers. While the media certainly plays up these low rates, it is typically from the perspective of the consumer is still working and spending most of his income on good and services.

It is wonderful that in 2021, a person can go to a bank and get a loan for a new house, and only pay roughly 3.25% in mortgage interest. That is great for the consumer. Credit card companies are offering 2.9% interest rates if you run up credit card debt. Car companies frequently are offering zero percent financing if you will just purchase a new car. All those things are terrific if you are in the *Accumulation Phase* of life. For consumers buying stuff on credit, you want the credit costs (interest rates) as low as possible, so you can buy more “stuff.”

Conversely, as a retiree, or someone soon-to-be retired, you want reasonable rates of return so you can retire with the security of knowing you won't outlive your money.

Let's review those retirement rules from the beginning of the book:

Remember Rule #1? ***“Rule No. 1: Never lose money.”***

Remember Rule #2? ***America's retirees #1 Fear? Running out of money!***

And therein lies the problem.

Certainly, when Michael came in to see us, those two rules were on his mind. Michael was ready to retire and had two main questions: one, how could he retire and ensure that he would never run short of retirement income; and two, could he retire and still afford to purchase his retirement dream home to live out the rest of his years?

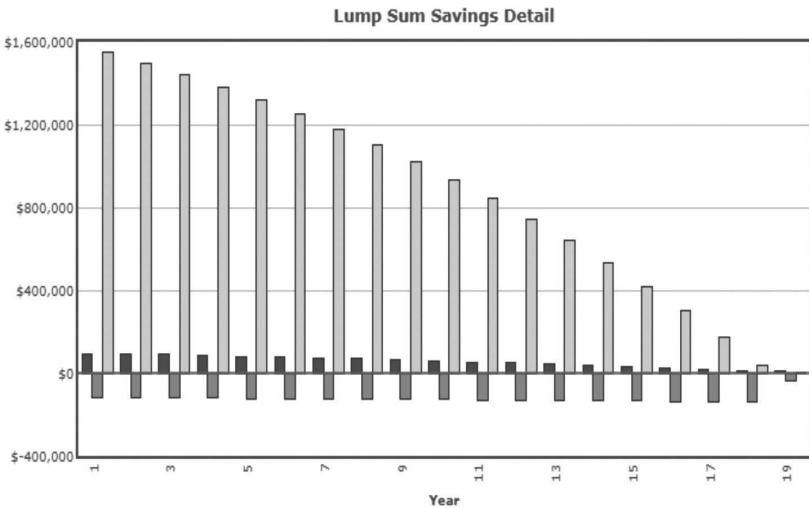
The way Michael described it; you could visualize exactly what the house would look like. Michael loved the house – it was a beautiful ranch that backed up to a state park. Nobody would be building behind him, so plenty of quiet on his three-acre lot. It had three bedrooms and three and one-half baths. It had a huge barn and garage which was perfect for him. He loved restoring cars: he had owned a Studebaker in college and loved finding old ones and bringing them back to life. At night, when it was quiet, he would be able to hear the stream that was about forty yards past his property line. It was perfect.

Michael told us that he sat down with his Merrill Lynch Advisor and discussed his pending retirement, including the purchase of his dream home. His Advisor said he could help and even sent him down the hall to a mortgage lender at Bank of America (BOA). It seemed very convenient. (Certainly, BOA loves it when ML Advisors send potential borrowers their way!)

But what about the potential conflict of interest? How about a Merrill Lynch (owned by BOA) Advisor, sending its client to BOA to get a loan?

BOA came back to him with a very reasonable 3.35% offer on his \$500,000 loan. At the time it was a very competitive rate. His total payment would be just over \$2,800 a month. He had a number from the lender, the next question was for the Advisor: could he afford that amount with his savings and retirement income on top of his other lifestyle expenses?

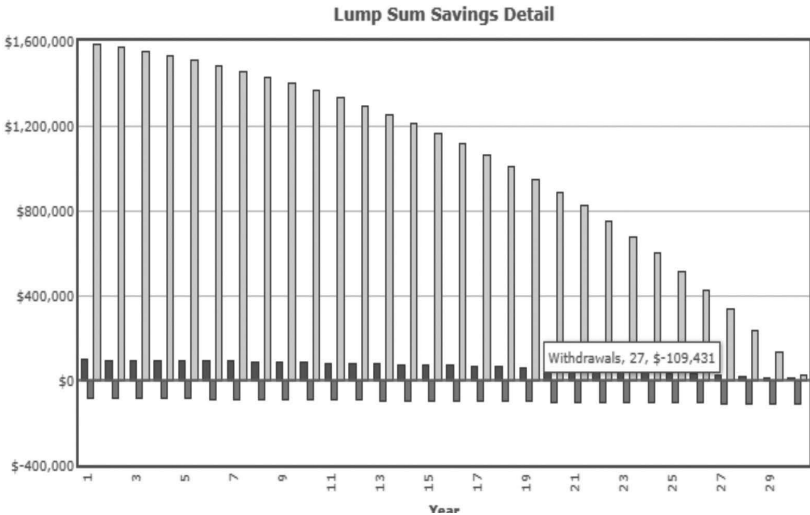
With the mortgage payment, Michael wanted an additional \$7K per month to cover his travel, medical, long-term-care premiums, food, utilities, and all the other expenses that go along with life. All in, after taxes, Michael needed about \$10K a month. Counting taxes, that meant he would need about \$165K a year of gross income. Fortunately for Michael, he did have a pension and Social Security which amounted to about \$48,000 per year. That left him short \$117K/year. Michael wanted to know if his \$1.6M in 401(k) money would be sufficient to create that \$117K/year



**Chart A:** \$1.6M earning 6% average return, \$9,750 monthly withdrawals adjusted 1% per year to cover inflation.

Clearly and rightfully the Advisor told him the answer was NO. He couldn't afford to buy the house and still have the income he

wanted. According to the Advisor, if Michael took the amount he wanted, the money would only last about 19 years. The Advisor even provided a depressing little chart showing how long the money would last. He explained to him that he would have to figure out how to cut his budget because according to the Advisor’s calculations, he wasn’t going to make it. Michael could create about \$7K a month – leaving him about \$2,750 a month short of his goals: almost a 30% pay cut.



**Chart B:** \$1.6M earning 6% average return, \$7,000 monthly withdrawals adjusted 1% per year to cover inflation.

### Chart B

Michael wasn’t happy with what he was hearing, so he went in search of *A Better Way*...

The first thing we suggested to Michael was that we should shop the BOA mortgage to see if there was a better way to finance the house.

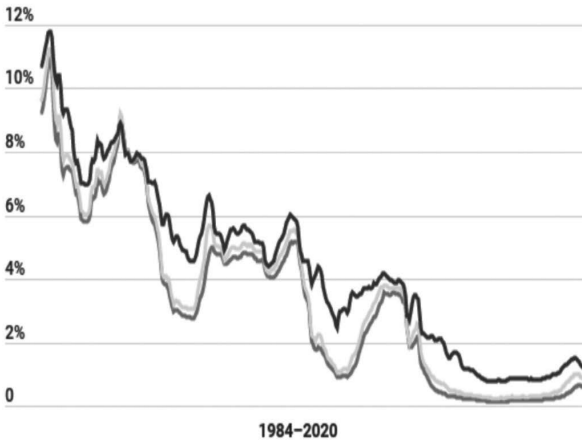
There was in fact a better way. Michael spoke with his credit union and was ecstatic about the interest rate he was being offered 2.65% over thirty years. Certainly, better than the 3.35% offer from his broker’s affiliated BOA mortgage referral. For

Michael, with the taxes, insurance, and the principal and interest payment (P&I), his total payment would be just over \$2K a month. Coupled with the additional \$7K a month he wanted, his total need for the year would be about \$150K (to account for taxes). Taking our comprehensive approach, we calculated that his money would last almost 22 years. Given that Michael would be 65 years old at retirement, the income would get him to age 87. Michael felt comfortable with that, given that he would still have a pension and Social Security should he live beyond that. In Michael's case, he didn't want to sacrifice his dreams in early retirement to have a lot of wealth in his very old age.

While Michael was ok, it didn't make sense to only plan for his needs to age 85, after all, his parents both passed away when they were in their early 90's. Michael had longevity in his family. Only having income to cover those 22 years didn't seem reasonable. We even discussed the options of refinancing in the future, if necessary, in later years, if he did indeed run out of money. Or even doing a reverse mortgage at that time—which by the way would work just fine for him (provided that they were still available in 22 years).

The real culprit here? It was interest rates. While they worked wonders for Michael when it came to buying the house after all, that was one of his two goals. Michael's second goal is Rule #1: never run out of money. Therein lies the problem. Interest rates have been at historic lows since the housing market crash of 2008.

While low interest rates favor us when we are borrowing, they absolutely destroy our ability to create a safe and secure income based upon interest rates. Remember our parents saving money? Remember the interest rates of the 70' and 80's?



The chart to the left shows CD rates from 1984 to 2020. We can see how they have dropped consistently.

Going back to the mid 1970’s, CD rates were hovering in the 10-15% range. For retirees then, putting money in the bank made sense. Certainly, in Michael’s situation, having his retirement savings in a 10% yielding CD would certainly accomplish his goals of never running out of money.<sup>21</sup>

For retirees like Michael, they can’t rely on those higher rates to secure their income. Fortunately for Michael, we were able to come up with a solution that allowed him to have the safe and secure income he was looking for (remember Rule #1), and also provide him some additional flexibility during his retirement.

Under the old plan from his ML Advisor, he was going to have to commit 100% of his \$1.6M towards his retirement goals, and would still have come up short:

\$1.6M using the 4% rule	\$64k
Plus his pension	<u>\$48k</u>
Total Income from ML	\$112k

Less taxes of 28% = \$80k or about \$6,700 a month

Michael wanted clarity on why we said that he would have to

21. <https://www.bankrate.com/banking/cds/historical-cd-interest-rates/>

commit 100% of his retirement nest egg under the ML proposal. The money would be liquid and in the stock market so from his perspective, it meant it was available. When we explained to Michael that if he took out, say \$300K to buy a new widget, then his \$1.6M would no longer be available to create the \$64K in income his ML Advisor said was possible. \$1.1M would only create about \$44K per year in income. Even when the market was up, and his account value went above the \$1.6M, he couldn't use it because by the very nature of the 4% rule, it assumes that the markets will go up and down. This means that Michael needs to leave the money in the account when it is up to make up for the losses when the market is down.

Sounds confusing, doesn't it? Remember Craig and Rose being perplexed? Michael was just as confused. This approach was not going to work for Michael. He wanted a better way to create his income.

Because Michael was not able to rely on finding those incredible interest rates his parents had during their retirement, we had to look to other reliable sources of income. Michael wanted safety and security. He wanted his retirement income to be as reliable as he felt his pension and his Social Security would be.

A better way for Michael? To meet Michael's goal of never running out of money, and having his dream retirement home, we suggested he utilize an annuity. As your head explodes and you remember the Ken Fisher quote, "we hate annuities, and you should too," Michael had the same thought. We'll dive into the pros and cons of annuities a little later, but for now, it was the solution that worked for Michael.

We were able to commit \$1.382M into an annuity that would guarantee Michael the income he desired – income for life. This particular annuity grew guaranteed by the insurance company, by 7% per year, (much better than any interest rates). When he needed to start his income, it would guarantee a 6% withdrawal

rate from the account for the duration of Michael's life. Better than any offer from a bank (or from any stock market investment for that matter). It wasn't just a statistical number that a Monte Carlo formula calculated and that many advisors rely on.<sup>22</sup>

The ups and downs of the stock market would have no negative influence on his income. He would never outlive it. It was safe and secure. In addition, it allowed him to have an additional \$300K of "wobble room" in his retirement. Remember that in the plan suggested by the ML broker, all \$1.6M was earmarked to the stock market roller coaster.

For Michael, he didn't want to take a 30% pay cut as the ML broker recommended, and he wanted his retirement dream home.

He wanted *A Better Way*. . .

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22. <https://www.investopedia.com/terms/m/montecarlosimulation.asp>

## CHAPTER 7

**HEADWINDS: PENSIONS**

*A corporation's responsibility is to the shareholders,  
not its retirees and employees.*

**THE THREE-LEGGED STOOL**

Pensions, or the lack of them, are another headwind for today's retirees. Remember the "three-legged" retirement stool? You might have seen a picture of it. The metaphor went something like this: you worked hard for an employer, and that employer



provided you a pension when you retired. You lived within your means and saved a little each paycheck to help fund your retirement. When you retired, you received Social Security. These were the three legs of retirement upon which our parents came to rely on for their retirement income.

According to Willis Towers Watson, a retirement plan consulting firm, as of 2019, only 14% of the firms making up the S&P 500 were offering new employees a defined benefit pension plan. In addition, 2019 saw the closing or shutting down of almost 70% of all existing pension plans.

Even with those who still have the opportunity to receive a pension through their state or local government, those state-sponsored plans are roughly 71% percent funded with underfunded obligations nearing \$1.24T.<sup>23</sup> For private companies offering defined benefit pension plans, they are only slightly better funded with about 89% of their future obligations set aside and a whopping deficit of over \$200B.<sup>24</sup> And that was at the end of 2019. Imagine what the 2020 pandemic and market volatility did to those pension plans.

So, what happens when instead of your “three-legged stool” looking like the previous picture, it looks more like this?



It isn't that just 14% of companies are still offering some sort of pension, it is the prospect that your pension could go away. That's right, you could lose your pension. You could lose your health care. Or they can reduce your pension whenever they want.

Think about some of those large companies that have bankrupted their plans: remember GM in the 2008 financial crisis? The unions and government kept it from going bankrupt. Some retirees worked for companies that were not as lucky; among some others: Sears, United Airlines, and most of the Steel Industry. True, the Pension Benefit Guarantee Corporation steps in to assist with failed pension plans. In 2018, they paid out over \$5.7B to help cover the costs of almost 5,000 failed plans, but they typically paid a reduced benefit.<sup>25</sup>

23. <https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2020/06/the-state-pension-funding-gap-2018>

24. <https://www.willistowerswatson.com/en-US/Insights/2020/06/retirement-offerings-in-the-fortune-500-1998-2019>

25. <https://www.milliman.com/en/insight/2020-corporate-pension-funding-%20study#:~:text=The%20January%202020%20PFI%20funded,2019%20Milliman%20%20Pension%20Funding%20Study.>

With the economic damages caused by 2020's Covid pandemic, Senate Majority Leader Mitch McConnell actually said he favors allowing states to file for bankruptcy; thereby allowing states to rid themselves of that \$1.24T of shortage, and he would encourage corporate America to do the same thing.<sup>26</sup> Seems so hard to fathom, working all those years and losing your pension along with other benefits.

Remember Michael? He found his retirement dream home with that huge barn. Remember that he liked restoring Studebakers?

### **A recent restoration!**



If you are a car enthusiast like Michael, you may remember the old-time auto maker Studebaker. Founded in 1852, Studebaker was on the leading edge of automobile design and manufacturing. The Studebakers of the 1950's are often considered the first "muscle cars." At their height of production, Studebaker employed over 23,000 people and each of them were promised an incredible pension.

Flash forward to 1954: Studebaker found themselves in financial difficulties and were eventually bought out by Packard.

By 1963, Studebaker filed for bankruptcy and shut their doors. When they filed, their pension plan was under-funded by over \$15M. While that seems small by today's standard, it equals almost \$125 million, when adjusted for inflation.

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26. <https://www.bloomberg.com/news/articles/2020-04-22/mcconnell-says-he-favors-allowing-states-to-declare-bankruptcy>

This was really the first American corporation to fail to honor its pension obligations. Every employee between the ages of 40 and 60 were given just 15% of their promised pension. For those under 40, they received nothing.

Studebaker is just one example of the many companies throughout history that have faced pension shortages, and it provided an important lesson. You see, a company offering a pension plan is under no legal obligation to actually pay out those retirement dollars. While it is true that Congress created the Pension Benefit Guarantee Corporation (PBGC) as part of the 1974 ERISA Act which was an attempt to protect pension plans, the PBGC has been woefully under-funded for decades. To replace pensions, a few years later, Congress passed the Revenue Act of 1978 and created the 401(k).

What this tells us is that Congress changed the obligation for your retirement from your employer to you, the employee. As a matter of fact, Congress provided an “out” for companies so they no longer had to offer, and could actually discharge, their pension obligations. An interesting note, while Congress gave companies a way out through the PBGC, according to the Committee for a Responsible Federal Budget, the PBGC is expected to be bankrupt itself by 2022.<sup>27</sup>

There has to be *A Better Way*. . .

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27. <http://www.crfb.org/blogs/pension-insurer-expects-be-out-funds-2022>

## CHAPTER 8

# HEADWINDS: INCOME

*It is better to have a permanent income than to have income now and hope it continues forever.*

A final thought on the headwinds facing retirees today from the perspective of interest rates, bonds, and creating income during retirement.

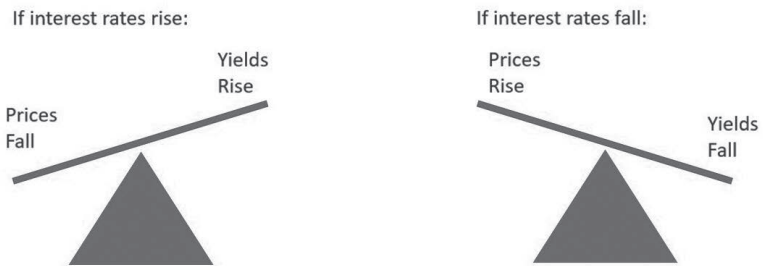
With the onslaught of the 2020 Covid pandemic, as previous Federal Reserve Boards before them, the Federal Reserve, under Chairman Jerome Powell, said they expected the Federal Reserve to keep interest rates at or near zero percent for the foreseeable future. What is foreseeable? In their September 2020 meetings, all 17 Federal Reserve Board Members pledged to keep interest rates low, “at or near zero” through at least 2021 and 13 of the 17 said they expect those rates to remain at zero through 2023.

This is important for retirees because as they enter into retirement, the GARMIN GPS approach to allocation (you know, the antiquated approach) says to move more and more of your investments into fixed income, i.e., bonds. Remember the “Rule of 100” that Craig was so perplexed about? What the Rule says is that the older you get, the more you move out of equities and into bonds. Bonds, because in theory, they are safer than equities. Think about that for a minute. IF you are retired or are entering into retirement, and you are being advised to move a portion of your portfolio into bonds, how will that play out over the next

few years in the current interest rate environment? What is the implication of lower interest rates on the income that bonds will produce?

First, as of April 2021, investment-grade bond interest rates are less than 2.5%.<sup>28</sup> Safer Treasury rates? Two-year bonds are paying 0.13%. Want to go out 30 years? The best rate is paying 1.63%. It is true you can get better rates using “high yield” bonds, but remember, “high yield” actually means JUNK BONDS.

What do these low interest rates mean in relation to bond values? Here is how it works:



Notice that when interest rates go up, current bond prices fall, that is, current bond prices go down. This means that if your current Advisor is suggesting that you put money in bonds for safety and/or income, you have to be prepared to lose money when interest rates go up in the future. We are at historically low interest rates, which means you are locking your money into bonds paying historically low rates; which when traded on the secondary market, can lose value.

For example, say you bought a bond today paying out 1% in interest, and you paid \$1K for that bond. If interest rates go up, who will pay you \$1K for your bond paying 1% interest, when they can spend the same \$1K and buy a bond that’s now paying 2%? That means that you lost value on your bond AND you are stuck earning historically low rates of returns.

28. [https://ycharts.com/indicators/moodys\\_seasoned\\_aaa\\_corporate\\_bond\\_yield](https://ycharts.com/indicators/moodys_seasoned_aaa_corporate_bond_yield)

The Federal Reserve has said they will keep interest rates low for the near future. As interest rates eventually go back up, the value of your bonds will go down. This was true during the 2020/2021 COVID pandemic and it was true in the 2008 housing bubble. It was true in the Technology bubble of 2000, and it will be true as we move forward. It will be true for retirees regardless of when they retire. Now you understand why Craig was perplexed. Now you understand why Michael was not satisfied.

Now you understand why Michael **CHOSE A *Better Way***.



## CHAPTER 9

# **THREE PHASES OF LIFE: ACCUMULATION, PRESERVATION & DISTRIBUTION**

*The art is not in making money, but in keeping it.*

### **FINDING A BETTER WAY**

The whole idea of retirement is scary for so many Americans. Sometimes we ignore the idea because it seems so far away. Sometimes we ignore the idea because it seems like such an obscure concept. And sometimes we ignore our financial future because it is just so overwhelming.

Tony and Joyce fell victim to this ideology. When we first met with them, the 2000–2002 Tech Bubble was in full swing. Their Advisor had told them that their portfolio was conservative and not to worry about it. In fact, many investors heard the typical “don’t worry, the market always comes back” story from their Advisors.

Tony and Joyce had spent years growing their business. It started out with Tony doing repairs on cars in his back yard to having a full commercial building with room for 6 car bays. Business was good and they focused on growing their customer base. They

had five other mechanics and a receptionist. Tony still turned wrenches, and Joyce did the books. Their son, Tony Jr., was helping by selling their repair shop services to local businesses.

The plan was that Jr. would take over the business one day and provide Tony and Joyce a “pension” of sorts – buying them out over their lifetime.

They had also managed to put away a nice nest egg, which they felt was a pretty solid dollar amount for their retirement. They told their Advisor what their long-term plans were. They knew that they had their SS coming. Jr. would provide a second reliable source of income. They just needed their brokerage account to supplement their monthly budget. They had their three-legged stool for income in place.

Or so they thought...

What Tony and Joyce didn't understand, and what their Advisor had failed to explain to them, is that there are really three phases of our financial lives: Accumulation, Preservation, and Distribution.

## **I. The Accumulation Phase**

The *accumulation phase* is for young folks, where young means anywhere between the ages of 20–50. When we begin earning an income as an adult, we begin the accumulation phase. As the name suggests, we concentrate on making, or accumulating, money in this phase of our lives. Our investment goal is to save, save, and save some more. The beauty of the accumulation phase is our tolerance for risk. To make as much money as possible, we usually employ more aggressive investment strategies. Naturally, that means that we accept a higher level of risk of loss. But that's okay. In the accumulation phase, time is on our side. If we lose money in a market downturn, it's not the end of the world. We're still working, and living off our income, not our investments. We

have time for the market to recover, to regain our assets, and acquire more.

Often, however, time creates a false sense of security for the young investor. It's easy to think, "we've got 30 years left until we retire, we'll have plenty of time to save before then." So, some people put it off altogether or save a very little percentage of their income.

...Bad idea.

It's never too early to start saving with retirement in mind. Yes, there may be decades ahead of you in which to save, but you'll need to be saving and investing consistently in all that time if you expect to have enough for retirement. When asked what the right amount to save for retirement is, we typically recommend at least 10% of your income throughout your accumulation phase. If you haven't done that through all of those accumulation years, then you may have some catching up to do – which means saving an even higher percentage, until retirement.

Start saving in your youth, invest wisely, let it grow, and above all else, *don't touch that money*. You never want to dip into long-term savings before retirement. Instead, establish a short-term six to eight-month emergency fund for times when money gets tight.

Compare starting to save \$6k a year at age 25 vs waiting until you are 30 or even 35. At age 25, you would have slightly more than \$1M. Wait until you are 30 and that number drops to about \$755k and if you wait until age 35, you have just over \$500k. Waiting 10 years can cost you almost 50% less money. It is never too early to start saving.

## Future Value: \$1,046,000.41

PV (Present Value)	\$101,694.45
N (Number of Periods)	40.000
I/Y (Interest Rate)	6.000
PMT (Periodic Deposit)	\$6,000.00
Starting Amount	\$6,000.00
Total Periodic Deposits	\$240,000.00
Total Interest	\$800,000.41

**Future Value: \$754,841.72**

PV (Present Value)	\$98,208.85
N (Number of Periods)	35.000
I/Y (Interest Rate)	6.000
PMT (Periodic Deposit)	\$6,000.00
Starting Amount	\$6,000.00
Total Periodic Deposits	\$210,000.00
Total Interest	\$538,841.72

**Future Value: \$537,271.01**

PV (Present Value)	\$93,544.33
N (Number of Periods)	30.000
I/Y (Interest Rate)	6.000
PMT (Periodic Deposit)	\$6,000.00
Starting Amount	\$6,000.00
Total Periodic Deposits	\$180,000.00
Total Interest	\$351,271.01

Time is your friend during the accumulation phase. Start early and invest often. These numbers prove our point. Why don't more people start saving early and often? There is a significant lack of financial literacy among Americans. No wonder we are so worried about running out of money.

For many of us, we go through elementary school and learn the basics: the three "R's" of reading, writing, and arithmetic. Unfortunately, other than perhaps getting allowance from Mom and Dad, we really didn't learn anything about money. Sure, we learned about pennies and that five of them equal a nickel; but we were really never taught about the time value of money, saving, investing, or budgeting.

In middle school, many Baby Boomers had the opportunity to take some sort of "Home Economics" or "Shop" classes where we learned some basic skills that would be useful around the house. Maybe you even took some basics about auto repairs – but

given today's technology, and all the electronics in our vehicles, "why bother" even opening the hood! We are taught some life lessons, but education about money is still missing in grammar and high school.

*And now you are expected to make all these really important financial decisions for yourselves about retirement and create your own crash course of information to digest.*

There are so many books and journals out there telling us what we should do. It is almost overwhelming. We call it financial noise – here are some of those images we are constantly bombarded with:



How can you possibly work, spend time with family and friends, and still take the time to learn about everything you need to know to make sound decisions about your money and your retirement?

Certainly, you can glean enough to make good choices – when they are provided in a narrow offering. Take your 401(k) for example. You probably have a dozen or so options in which to invest your money, not too difficult. You know you need to be

diversified (not put all your eggs in one basket). You might have heard about correlation, but nothing in your 401(k) documents really explains how to be appropriately allocated for today's market conditions.

Imagine if your 401(k) had thousands of investment choices. Instead of a dozen mutual funds to choose from, what if you had over 9,000? What if in addition to 9,000+ mutual funds, you also had another 1,000+ annuities to choose amongst? Add to that number, hundreds of Exchange Traded Funds (ETFs), Real Estate Investment Trusts (REITs), commodities, alternatives, stocks, currencies, and a host of other possible investment choices? It could get overwhelming very quickly. It is much easier doing your own research and being your own advisor when you only have a dozen or so choices. It changes the dynamics dramatically when the options open up and they number in the thousands.

Just focusing on the 401(k) for the moment, when you first start working, and start putting money into the company's plan or start putting money into your self-directed IRA/ROTH, taking a do-it-yourself approach might be ok. Keep in mind that you can still make serious mistakes if you don't do your research on the investment options.

For example, let's say you're looking to invest in a mutual fund. Maybe a friend recommended something. Maybe you saw a commercial. Maybe you heard something just hanging around the water cooler. However it occurred, you selected a mutual fund without looking at all the things you should be evaluating when making the decision. Let's look at what an ill-informed decision could do in this regard:

If you were able to actually purchase \$6K in the S&P 500 Index (spoiler: you can't, but you can get close), and had ZERO DOLLARS in fees, your balance from the first deposit of \$6K at age 25, until you retired at age 65, you'd have almost \$1M saved.

## Future Value: **\$990,286.10**

PV (Present Value)	\$96,277.78
N (Number of Periods)	40.000
I/Y (Interest Rate)	6.000
PMT (Periodic Deposit)	\$6,000.00
Starting Amount	\$6,000.00
Total Periodic Deposits	\$240,000.00
Total Interest	\$744,286.10

If you started with that same amount, but instead of ZERO fees, you paid a 1% fee to own your Mutual Fund (remember Craig and Rose's internal expenses in their Mutual Funds), your retirement nest egg would shrink to just \$767K, almost a 23% reduction.

## Future Value: **\$767,038.58**

PV (Present Value)	\$108,954.52
N (Number of Periods)	40.000
I/Y (Interest Rate)	5.000
PMT (Periodic Deposit)	\$6,000.00
Starting Amount	\$6,000.00
Total Periodic Deposits	\$240,000.00
Total Interest	\$521,038.58

*Notice here that we have changed the interest rate to 5.0%. That reflects the 1.0% fee charged by the MF.*

What if you purchase what is frequently the number one fund family sold by brokers: American Fund Growth Fund of America?

## Future Value: **\$750,802.89**

PV (Present Value)	\$100,729.08
N (Number of Periods)	40.000
I/Y (Interest Rate)	5.150
PMT (Periodic Deposit)	\$5,655.00
Starting Amount	\$5,655.00
Total Periodic Deposits	\$226,200.00
Total Interest	\$518,947.89

*Notice here that we have changed the interest rate to 5.15%. That reflects the .85% fee charged by the MF. Notice also that we changed the amount going in as a periodic investment from \$6k to \$5,655. That is because this Broker favored fund charges a sales commission to get into the fund: 5.75%*

The returns are vastly different, and we haven't even discussed the tax implications of using a ROTH 401(k) vs. a Traditional 401(k). More on that in the tax section of this book.

There has to be a better way . . .

Perhaps it would make sense to sit down with a fiduciary financial planner and go over the basics of what you are trying to accomplish. It doesn't have to be a detailed analysis. It can be a simple goal-setting conversation and what you need to do to get there.

## **II. The Preservation Phase**

Certainly, by the time you enter the *preservation phase* (which lasts about 15 years and concludes with your retirement), you will want to be working with a fiduciary financial planner.

Can you guess the object of the preservation phase? As you might expect, it's to preserve the money you've accumulated during the accumulation phase. Complicated stuff, right? Although it's easy to define the function and purpose of these financial phases, the difficulty lies in the execution.

This was the part of Tony and Joyce's financial life that was missed. Their Advisor had told them they were "diversified" and that they were invested conservatively. For Tony and Joyce, the money was supposed to be there to supplement their retirement income. At ages 65 and 63, they needed it to be there when they retired in one year. Their Advisor knew about their plans. They had discussed them with him. The Advisor told them the money would be there for them so they could retire with the comfort and security they wanted.

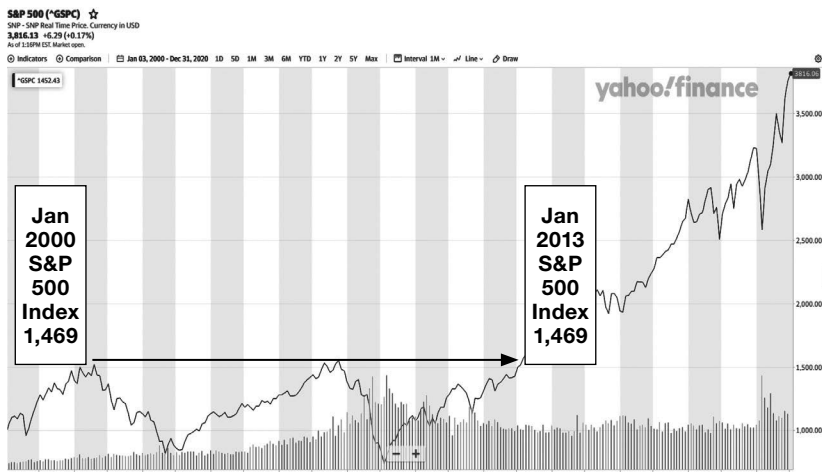
Then the 2000–2002 Tech Bubble happened and their comfort and security, their diversified portfolio, their ability to retire, dropped like a rock, just like the stock market.

Their \$500K nest egg, dropped to just over \$300K, in less than a year. Think about that, they were planning on retiring the following year and they just lost 40% of their nest egg.

Their Advisor told them, “Don’t worry, it will come back!” But at this stage of their investment lives, they didn’t have TIME for the markets to come back, prior to going into those funds to start withdrawing their supplemental retirement income. Apparently, their broker wasn’t “conservative” enough and left too much of their money at market risk!

Obviously, hindsight is 20/20, but the following chart shows the danger of taking the “don’t worry” approach to investments, especially when you are nearing, or already in, retirement.

S&P 500 Index data is hypothetical and for educational purposes only. You cannot invest directly into the S&P 500 Index. S&P 500 Index performance data from Yahoo Finance.



For almost 13 years, the market basically had a *zero return*. Notice that on Jan 1st, 2000, the S&P 500 Index opened at 1,469. Fast-forward 13 years, and in 2013 the S&P 500 is opening at 1,469. Two major things happened during this 13-year period: first, we broke the Buffet Rule of never lose money, and second, the losses resulted in the risk of running out of money. If you intended to retire on Jan 1st, 2000, you can see how taking a 4% withdrawal from your retirement accounts each year, could have resulted in breaking Rule #2: never run out of money!

### III. The Distribution Phase

The *distribution phase* is simple. The distribution phase is your time to rest and enjoy the fruits of your labor. This is the time to create those income streams that you can't outlive – it is the time when the paycheck stops, and retirement begins..

The problem for many retirees is that they didn't execute well on the first two phases. Or worse yet, they relied on an Advisor whose sole approach was to buy and hold for the long term, assuming that we all have 40-50 years before we need to access our investments, and took the approach of: "Don't worry, it's only paper losses until you sell." Well, you need income at this phase of life, isn't selling part of the distribution program? Was the plan just to take dividends and interest? What exactly is the distribution plan?

...And planning is the important part of this conversation.

Think about this – once you start working, one of the benefits of working is that you can finally afford to take a vacation you want. Not the one your parents may have taken you on. You get to CHOOSE your destination. You probably do some research on going to the beach, maybe a resort on some island, or perhaps you prefer hiking in the mountains, or skiing. Regardless of where you go to wind down and relax, you will take some time to do your research. You will look up transportation and lodging options. You will look at what activities are available at your destination. You will estimate the cost of food and entertainment and souvenirs.

***Take at least that amount of time to plan for your financial future.***

How to start? What should the conversation cover at this point? A good starting point is to set your goals. When do you want to retire? How much income do you think you will need? Most people want to retire between the ages of 55 and 65. From there, it is a math calculation – time value of money. If you want to retire

on “X” amount of income, then you will need to save “Y” each year. We know it sounds impossible to know how much you will actually need, or when you will actually retire, especially if you meet with a planner around age 25. Fortunately, when the plan is designed, IT IS NOT WRITTEN IN STONE! That’s right, it’s just setting some goals and taking steps in the right direction.

When are the best times to sit down with your financial planner?

One of the best times is when you decide to get married. A good financial planner can help bridge the conversation about how finances will be handled between spouses. You can discuss housing, savings, life insurance, and retirement as well as begin the estate planning conversations.

Just the thought of getting married takes time and planning: venue, date, time, guest list, food, open bar, entertainment, honeymoon, and the list goes on and on. You spend weeks, maybe months, planning for your wedding. Something that is a one-day event takes an inordinate amount of time to plan (yes, hopefully the results last a lifetime – but it is a one-day event). Spend as much time on your retirement planning.

You will want to sit down again once you start having children. At this point, life insurance will be an important conversation. You will also want to discuss education planning. When you decide to have kids, you spend time reading how to raise healthy, happy kids – too bad they don’t come with instructions, right? You spend time on baby names, choosing cribs and car seats, you take time to fix up the baby’s room, attend Lamaze classes and birthing classes. All in anticipation of having a newborn come into your home. Spend at least that amount of time planning for your financial future.

Remember, these are discussions. The planner will guide and provide ideas and concepts – you will get to make informed decisions.

From age 30 until age 50, it would probably make sense to sit down every two to three years to fine-tune your retirement goals and to make sure you are on the right path. You may pay a fee for this, but we would suggest that the cost is well worth the peace of mind that you are making good decisions for your future.

You go to your family doctor every year for an annual checkup. You probably have to take some time off from work. You have to drive to the doctor's office. You are asked to be there at least 15 minutes early. They usually make you wait 15 minutes past your appointment time to call you back. First, the nurse or medical technician comes in and takes your blood pressure, oxygen, weight, height, and temperature. Then the Doctor comes into the room. Most of the time you spend less than 15 minutes with the Doctor. He or she will do a cursory examination: listen to your lungs and heart, check for lumps, maybe a probing finger, but all-in-all, 15 minutes with the Doctor just to make sure you are on a healthy path. Total time commitment once a year: 90 minutes or so. Spend that same amount of time on your financial health.

See a theme here? You should spend as much time on your retirement as you do on the other important aspects of your life. Retirement will last twenty to thirty years, maybe longer. Spend at least as much time planning for that 30-year period as you do for a one-week vacation, getting married, or raising a child.

Around age 50, you will want to sit down and seriously review your goals and determine how close you are to achieving them. Are you on the right track? It is during these meetings that you will start to change your perspective: no longer is growth the overarching factor. Now protecting and preserving your assets should take precedence. It really doesn't matter how much your money grows if you lose 40% the year before you retire – that can be lifestyle changing.

You will want to fine-tune your retirement date and the amount

of income you will require (more on that later). You will want to start to transition your investments from growth into income and safety. This isn't to say that *all* your money should shift into income-producing vehicles, but you should start securing the money that you need for income into safer investment options.

You will also want to review your estate planning documents to make sure they are accomplishing your goals.

Life insurance planning also becomes important to revisit. While you were younger, you may have used life insurance to protect your family from an untimely death. Now you will want to explore life insurance for tax benefits and legacy planning.

Make sure you also address any long-term-care concerns you may have. You want a plan in place, whatever it may be, by the time you retire. If you wait too much longer, the cost amplifies, and it makes the decision more intimidating.

And don't forget the taxes. It doesn't matter how much you make, it's how much you KEEP that counts, right? From the day you start working, until the day you die, you should always be paying attention to your taxes. We will be devoting a considerable amount of time to tax-planning later in this book. IF you start out early in life with an eye on the tax bill, you may actually retire with 100% tax-free income. Sounds too good to be true? You read that right: ZERO TAXES. The best part of being in the ZERO tax bracket is when (not IF) they raise taxes in the future, you will still be in the ZERO PERCENT tax bracket. We have clients generating in excess of \$100K a year in TAX FREE INCOME. ZERO taxes on their income!

Did we mention that it is important to pay attention to taxes?

That is why it is important to CHOOSE to work with a financial planner, not only one who has a fiduciary duty to look out for your best interests, but also one who can address all the aspects of

your retirement plan. How does one **CHOOSE** the right financial planner? Listen to the financial noise?

Read on. . .

## CHAPTER 10

# FINDING THE RIGHT ADVICE-GIVER

*A goal without a plan is just a wish.*

All was not lost for Tony and Joyce.

When we sat down with them and looked at their actual numbers, we discovered that they wanted an additional \$15K a year from their investments. Their SS and the “pension” from their shop would cover their daily needs. They just wanted that extra income to cover their travel plans. After that 2000-2002 **dot-com** Market Crash, their Advisor had suggested that they curtail their spending, work a little longer, and wait for their investments to grow back. The Advisor clearly missed the important part of protecting and preserving their nest egg. As we have already seen, waiting for that money to come back would not have worked. The S&P 500 was basically flat for 13 years. If Tony and Joyce waited until it “came back” they would have waited almost 20 years.

So, they came in search of *A Better Way*...

Here was the distribution plan we put together for them:

Of the slightly more than \$300K they had left from the 2000-2002 market crash, we split \$150K into a laddered CD and Fixed Annuity portfolio. We left \$15K in cash.

We purchased 1-year, 2-year, 3-year, and 4-year CDs, each earning between 2.4 and 4% at the time. We also purchased a 5-year Fixed Interest Annuity paying slightly more than 5% with \$30K and the balance in a 7-year Fixed Index Annuity with a 100% participation rate, and a cap of 10.25% (more on this later).

This allowed us to ensure that Tony and Joyce always had the \$15K they wanted. We had a CD maturing each year to cover years 2–5. Then we had a fixed interest annuity maturing in the 5th year to cover years 6 and 7 and the Fixed Index Annuity would cover years 8 through 10. With the interest we earned, we were able to adjust the \$15K for inflation. And by using the FDIC insured CD's, that money was 100% guaranteed by the Federal Reserve. The money in the annuities carried the guarantees by the underlying insurance companies – perhaps not as secure as CD's, but Tony and Joyce were willing to absorb a little of the risk in order to achieve greater opportunities for returns. This approach allowed us to “protect and preserve” so that it could be distributed over a 10-year period.

That got us from age 65 until age 75. It was a start, and they were quite happy to know that their remaining nest egg wouldn't be lost to market down-turns. When the markets crashed in 2008, they were ecstatic that they lost ZERO money and the market crash had ZERO impact on their ability to continue to travel – which was the purpose of the money to begin with.

With the balance of the \$150K, we purchased a 10-year Fixed Index Annuity (again, more details on these to come). This particular annuity, purchased in 2003, allowed Tony and Joyce to benefit from the upside of the S&P without any exposure to the downside. They were not actually invested in the stock market, rather, they made money when the stock market went up and didn't lose anything when the market

went down. It is true that they did not get 100% of the upside of the S&P 500. When we purchased the annuity, they were limited to the first 10.25% of the gains of the S&P. That lasted until 2009. Thereafter, until 2012, they only received up to 6% of the upside.

What this meant for Tony and Joyce was that in 2003, the first year they purchased the annuity, when the S&P was up 28.39%, their account was only credited with a 10.25% growth. In 2008, when the market was down 36.79%, they lost nothing. Their account was credited with a big fat ZERO. By the time their 10-year period was up, the \$150K we put into the account was now worth just under \$270K.

Had they continued with their old approach and left the \$150K in the market from 2003 until 2012, the \$150K would have been worth about \$235K. Not a bad run, but that gain over basically a decade did come with the huge drop between late 2007 and early 2009. Avoiding that experience and that stress, the risk of running out of money, should be a goal for all retirees. Certainly, taking that risk off the table after having experienced the damage of the 2000–2002 market drop was attractive to Tony and Joyce. We were able to show Tony and Joyce a better way to distribute their income during retirement – and without the stress!

It does beg the question though: What if they left the full \$300K in the S&P for that time-period, and took their \$15K per year, what would have happened? They would have had \$247K. Not quite as much as our approach, but close. The real problem was that they would have experienced all the ups and downs of the stock market, and all the stress that comes with watching your retirement nest egg go up and down with the ever-tempting thought to liquidate their account at precisely the wrong time.

*We were instead, able to show them a better way for the*

*distribution phase of life and provide them a safe and secure income stream. That volatility and the risk associated with the market makes perfect sense during the accumulation phase of our financial life. It makes no sense during the preservation and distribution phase for money we plan on using for income in the near future.*

Our planning results: at age 75, Tony and Joyce had \$270K in their accounts. They had spent over \$170K traveling and while the initial thought was that they would continue to travel, by the time they got to 75, they were ready to settle down and just enjoy the grandkids. The icing on the cake? They had that \$270K they could use to help with their grandchildren's education!

With a little planning, we were able to help them successfully transition from the preservation part of life to the distribution phase.

A better way! Tony and Joyce found the right financial planners for them. So, how do you find the right planner for you?

Let's talk for a moment about the right tool for the job and the right professional for the job. As we're discussing different phases of retirement planning, we eventually find ourselves in that phase of protect and preserve and distribute tax-efficiently. What Tony and Joyce discovered was the person who got them to retirement clearly was not the person to take them through retirement. What? This might sound surprising but there's a few ways to look at this.



When you were young your parents took you to a pediatrician. Made perfect sense because they were trained to take care of issues related to young children.

As you grew older, you

probably stopped seeing your pediatrician and began seeing a Family Practice physician. (Again, a general Doctor who's good at handling the routine issues that arise as we mature and grow older.)

At some point, we start seeing a specialist in an area of medicine we are having trouble with, those doctors who work exclusively within a certain demographic of patients. Those doctors focus on the issues that we face as we age, it makes perfect sense. We wouldn't want a pediatrician taking care of a 65-year-old patient any more than we want a geriatric physician treating a newborn. Different skill sets for different times of our lives.

The same is true for financial planners. Some Advisors and registered representatives may be good at making recommendations to help you grow your nest egg. That is one set of skills – for the accumulation phase of your life. They probably are not the same people who will have the skill set to help you with the distribution phase of your life. This is the point where you can no longer just “not look at the statements” and you may not have time for “don't worry, it will come back,” or even “don't worry, they are only paper losses.” Now is the time that you need those assets to be in place and be secure enough to last your lifetime; perhaps the lifetime of your spouse or significant other, and even possibly provide for a legacy for your family. Your financial needs have changed.

Let us tell you about one of our favorite clients, a husband and wife, we'll call them Sid and Nancy. Sid and Nancy had a very successful Tech Company in the Lehigh Valley area of PA. They had been working with a CPA for over 40 years. Sid considered himself a “Do-It-Yourselfer” when it came to investments and had done pretty darn well for the family – he accumulated almost \$1.7M in qualified retirement accounts and another \$1.2M in after-tax brokerage accounts.

While Sid considered himself a “Do-It-Yourselfer”, the fact was

that he was working with a brokerage firm and his investments consisted almost entirely of commissioned mutual funds sold by a Registered Representative. He was comfortable with the Registered Representative; he had been working with him for almost 30 years. Sid and Nancy trusted both their CPA and their Registered Representative Advisor. So why did they come to our office? They were referred to us to review their estate plan...at least, that is how the conversation started.

Like any good financial planning firm, we wanted to see their “financial life.” We asked for copies of their investment statements, estate planning documents, life and long-term-care insurance, as well as the last two years of their tax returns. As we have said before, the tax return is always the starting point of any conversation. The tax return tells us almost everything we need to know.

We sat down with Sid and Nancy and asked them about their goals and their income needs. We discussed their desire to leave a legacy to their three daughters. We determined that their SS would not be enough to meet their income needs and Sid didn’t have a pension (in other words, no three-legged stool for them). From there we revisited their tax return. On the return we could see that they were paying significantly more taxes than their income required. That led us to look at their investments and his business.

Their investments were allocated among some variable annuities, a few stocks, a substantial amount in equity-based mutual funds, and some bond mutual funds. We then analyzed their fees – we wanted to know exactly how much they were paying. When we went through the numbers, they were shocked. They had no idea about the fees involved in owning mutual funds coupled with the taxable distributions they received each and every year, despite the fact that they were basically taking a “buy and hold” approach.

We also discussed the risks they were taking. Just like Craig and Rose from our first chapter, Sid and Nancy hadn’t really had a risk

-related conversation with their Advisor since they filled out their initial paperwork almost 30 years ago. Remember, the Registered Representative isn't a fiduciary and has no real obligation to check on a client's changing life circumstances. As a result of this, according to the Brokerage Firm records, they were open to taking an aggressive risk approach to their investments. And like most investors, Sid and Nancy never really read the small print on those annual disclosure forms and prospectuses.

The problem is that Sid and Nancy are getting ready to retire and their risk factors have changed. Remember how not taking action to preserve their wealth negatively impacted Tony and Joyce.

Because we usually start with the tax return, we could see that their CPA and their Advisor were not communicating with each other, and that left Sid and Nancy in a very difficult position. They were paying more taxes because their Advisor didn't understand the tax implications of his advice, and the CPA was only putting numbers on a page to prepare the tax return in the shortest amount of time possible, so he could move on to the next one.

When we reviewed their estate plan, we could see that the beneficiaries on their investment documents didn't match the beneficiaries in their Trust, updating was needed. Their Attorney wasn't communicating with their Advisor and their Advisor wasn't communicating with their Estate Attorney.

This lack of communication amongst professionals is a common theme in our book and a common problem we see people experiencing in our practice. The approach that Sid and Nancy experienced with their CPA, Estate Attorney, and their Advisor, is typical. Each does their own job while wearing blinders. Basically, they do their jobs, but anything outside of their specific expertise means "it's not my job", and when anything goes awry, they're usually quick to point the finger at the *other* guy. Not sure you want to go through retirement with someone who can't or

won't look at the big picture. We see that as a problem. By now you should see this as a problem. Sid and Nancy certainly did.

This problem is what lead them to becoming our clients. We were able to look at the total picture. Isn't that what you should expect from your advisory practice?

## CHAPTER 11

# PULLING THE 'WIZARD OF OZ' CURTAIN BACK ON FINANCIAL ADVISORS: PART I

*...may all your wishes come true.*

With that in mind, when you are contemplating hiring a professional to help with your retirement planning, there are some straight-forward questions you should ask. If the Advisor seems uneasy or is unwilling to address these questions, that should raise a red flag and influence your decision.

***Fiduciary vs Suitability – which role will they provide in the relationship?***

Did they CHOOSE to work for an employer and sell only the products and services their employer approved, or did they CHOOSE to get the extra licensing and training required to work for their clients and have the opportunity to use almost any investment vehicle available?

You also have that CHOICE. You can CHOOSE to work with an Advisor with a suitability standard or you can CHOOSE to work with an Advisor who has your best interests in mind. It is your CHOICE.

For decades there have been two sets of standards for Advisors to apply to their client relationships: the fiduciary standard and the suitability standard. Why two? Advisors typically come in two flavors. One, an Advisor can be a Financial Planner working as a Registered Investment Advisor (RIA) and/or Financial Planner, or two, they can be a Financial Advisor or registered representative working for a Broker Dealer (BD).

Sounds straight forward enough: if we hire an Advisor working for a broker dealer, they must be a registered representative or a Financial Advisor. The key to this is that these people work for a **BROKER DEALER**, not you the client. This means that their obligation is finding investment vehicles to sell you that are merely “suitable.”

This suitability standard is defined by FINRA – the regulatory agency that oversees the work of broker dealers. This standard means that the Broker Dealer/Advisor needs to believe that the recommendations are suitable for the client. Notice it says suitable, not in the best interest of the client, just suitable for the client.

Part of the standard also requires that fees not be excessive, but that term is not actually defined. We do know that an Advisor is not allowed to churn your account just to create fees for the broker dealer. But that doesn’t mean an Advisor can’t use a mutual fund paying the BD a commission of 5.75% with 3% in annual fees to the client, instead of using a mutual fund that pays 2% to the BD and only has 1% in annual fees. Both investments are, technically speaking, “suitable.” But which do you think is probably better for you as the investor vs. which is better for the BD?

Conversely, an Advisor with a fiduciary standard has an obligation to look out for the client’s best interests.

That means that if the choice is between a mutual fund that pays 5.75% commission with 3% annual fees versus recommending a

mutual fund that pays 2% in commissions with only 1% in annual fees, all other things being equal, the Advisor with a fiduciary standard would probably recommend the lower fee mutual fund. Typically, lower fees are in the best interest of the client.

It is reasonable to ask the Advisor you are interviewing whether he or she holds him/herself to a fiduciary standard. If he/she does not, it is reasonable to ask, why not? While working with Advisors who don't hold themselves to a fiduciary standard doesn't mean you won't get good advice, but it does beg the question, why are they not a fiduciary?

We would suspect that they are not a fiduciary because they work for a firm that does not want to be held to that higher standard. And, somewhat cynically, we would expect that that Advisor is generating commissions for the firm for which he works.

It seems that if you are going to entrust your future to somebody, you would want that person to have your best interests in mind. After all, if you went to a doctor for health care – do you want him to do the best job for you and your health, or do you want him to follow some standards set forth by the physician's group, trying to bolster the bottom line of the practice?

It is your CHOICE.

## **HOW ARE FINANCIAL ADVISORS PAID?**

This is a very reasonable question. Some might charge an annual financial planning fee. Some might charge by the hour. Some charge based upon the assets they have under their management (AUM). Some may get paid commissions for the products they sell. Some may do a combination of all four.

Your gut reaction may be that there is a conflict when Advisors get paid a commission. You may question whether they sold the investment because it paid a commission, or because it fits your

goals/needs. Both are reasonable reactions, but as long as you know they are generating commissions for giving you advice, and the product(s) they are recommending fit into your planning needs, if you are comfortable with the Advisor, then there is nothing wrong with paying for that advice via commissions.

It's worth remembering that everyone in the financial industry who provides guidance is getting paid. They are paid either by you, the firm they work for, or by the products they sell. Just like you, they don't work for free.

**It is your CHOICE on how they get paid.**

## CHAPTER 12

# MORE ABOUT FINANCIAL ADVISORS : PART II

*An investment in knowledge pays the best interest.*

That leads us to the following questions you should ask:

### **(1). Who do financial advisors work for? Their Employer or Client?**

This goes hand in hand with the duty of care. As we have already addressed, there is a difference of care required by Advisors working for a broker-dealer (BD). Their responsibility is to their employer. They work for the BD, not you. The BD pays their salary. The BD pays for their benefits. And the BD sets the parameters of what investment choices the Advisors can make.

There are literally thousands of mutual funds, stocks, bonds, and annuities from which to choose. The BD will typically restrict the choices of the Advisor and require him/her to work with “X” mutual fund companies and “Y” annuity companies. It is like going grocery shopping, do you want to do that at a Wawa that has a very limited choice on their shelves, or do you want to go to a Giant or Wegmans with almost unlimited choices?

An independent Advisor, one not restricted by a BD relationship, who works under the umbrella of a Registered

Investment Advisory Firm, those Advisors work for you. Their income is directly related to how they perform for you. Because they charge a fee based upon the dollar amount of the investments, when your investments go up in value, they make more money (just like you), and when your investments go down in value, they lose money (just like you). As much as you can align your interests, working with somebody who has your best interests in mind such as an independent Advisor, probably makes the most sense.

Now, after having said all that, this doesn't mean you can't get excellent advice from an Advisor working for a BD and it doesn't mean you'll get excellent advice from somebody working as a fiduciary for you. You still have to consider all the factors that come from interviewing that person, including how resourceful and knowledgeable he or she is.

They made the CHOICE to work for you or for a broker dealer/wirehouse. You have the same CHOICE. Do you want them to work for you or work for the BD?

## **(2). What is the Succession policy?**

Another key question to ask is about the Advisor's succession plans. Tomorrow isn't promised to any of us, and if we are going to hire someone, we plan on being with them long-term, so we should know what is going to happen to our plan if they get hit by the proverbial pickle truck...or if they get promoted...or if they switch companies. What happens to our accounts and the advice we are receiving?

This is an important question regardless of if you are working with an independent Advisor or somebody at a large broker dealer or wirehouse.

For example, if you are working with somebody from

Merrill Lynch, they have a whole slew of people who will step in. They have a customer service team that takes accounts that don't meet their minimum threshold for providing personalized service. (That is just the next person to pick up the phone).

They have so many Advisors, if your Advisor leaves/dies/gets promoted, they will assign your accounts to the next 24-year-old Vice President in line. They have a system in place to follow to make sure your account does not get abandoned.

The real question is...you CHOSE that specific person to work with for a specific reason. His or her replacement might not follow the same investment philosophy and probably knows nothing about you except what he or she might glean from what's in the company's CRM database.

You want to know who is going to step in should something happen. Will he/she follow the same investment philosophy, or will he/she want to "replant the entire garden" and adjust to a new approach? Is their successor younger or older? Are they more or less experienced? How does he or she communicate?

In theory, hiring an Advisor is much like a marriage. It is a long-term commitment, and you want to make sure your partner is going to be there for the duration.

### **(3). What services do they actually provide?**

Most Advisors provide the same services: they will talk to you about your goals; they will address your risk factors; and then they will make investment recommendations. That is the minimum you should expect from your Advisor. It certainly fits the suitability standard required of registered representatives, broker dealers, and the wirehouse firms.

What else is reasonable to expect? Well, from the perspective of true financial planning, you would want them to know the tax implications of the investment recommendations they are making. Not only the tax implications today, but also the tax implications in the future. *Remember, it doesn't matter how much you make, it is how much you keep at the end of the day.*

**(4). What about withdrawal strategies?**

IF you need income in the future, how is your portfolio going to provide that income? Is it guaranteed income? Is it market-driven income? What if the market drops, how does that impact your income strategy?

**(5). Who manages the money and the strategies used in the asset allocation?**

You may want to inquire about whether they manage the money themselves or pass it off to a third party to manage? IF they pass it off to a third party, how was that third party chosen? Is the third party just part of the company offering or did the Advisor do his/her own research into the third party?

IF they manage the money themselves, what is the criteria for the choices being made? Why this mutual fund or that exchange traded fund? When they go on vacation, does the management of your portfolio also go on vacation while the markets are still open for business?

You may want to know their strategy against extreme market volatility. Are they 100% buy and hold? Do they actively trade in the market? Ask about how their recommendations performed in 2008? What did they do to mitigate the downside risk during the 2020 pandemic?

For many people, a significant cost factor is long-term

care. Do they have a strategy that addresses any potential long-term care costs you may face in the future?

**(6). Do their services involve a review of your estate planning and legacy requirements?**

What about estate planning? Do they understand how your accounts are structured and how they will impact your estate plan? Can they read and interpret your Wills and/or Powers of Attorney?

Depending on what you are looking for with your Advisor will depend on what type of relationship you are seeking. These are but a few of the services you will want to inquire about as you are seeking the right relationship for your needs.

From our perspective, a financial planner's job is to address every major financial decision that involves a dollar sign. Remember the goal of not running out of money? That means that your Advisor needs to understand and address all those monetary issues in life that could violate that rule.

Remember, just like they **CHOSE** to take a fiduciary standard of care or **CHOSE** to follow a suitability standard of care, you are the one who **CHOOSES** what type of relationship you want with your advisory team and how extensive it is.

**YOU CHOOSE A BETTER WAY**

Remember Sid and Nancy? They made a **CHOICE**: they **CHOSE** to work with a financial planning team that took a more holistic approach with a fiduciary standard. What was the final factor? The most troubling factor? Sid's business. Sid was in the process of selling the business and recently had a business evaluation done. His business was worth the better part of \$10M, that's right, \$10M. The gain on the sale was substantial: \$7,200,000.

Sid and Nancy had done a great job preparing for retirement, and their nest egg itself was almost enough to meet their retirement income needs. Coupled with the sale of his business along with the sale of the land where his office building was located, it would put them over the top of his income needs and their retirement goals.

While legacy planning wasn't their highest priority, they did want to help his three girls along the way; he wanted to help out with the education of the grandkids, and if there happened to be anything left over, they wanted the assets to go to their daughter and grandkids as tax-efficiently as possible.

Here is the interesting part. When they sat down with their CPA, the same CPA who had handled the books, payroll, and had advised them against converting anything to a ROTH, the CPA told Sid to be prepared to cut a check in the amount of \$221K to the State of Pennsylvania, and a check for a whopping \$1,692,000 to the IRS. The CPA didn't even blink an eye. He just spit it right out and actually had already prepared the tax coupons. BOOM. Done. Write the checks and call it a day. On to the next client meeting.

When they called their Advisor at the time, he let them know that once the sale took place, he could arrange to have enough liquid cash to cover the tax bill. That was the extent of his advice. As you can imagine, Sid and Nancy balked at the idea of sending almost \$2M in taxes to the IRS and the State.

Sid and Nancy wanted to see if there was *A Better Way...*

When we were presented with the opportunity to run our own scenarios, we stepped up to the challenge.

We evaluated the case, smiled, and asked them: Would you like to save nearly TWO MILLION DOLLARS in TAXES?

Sid and Nancy sure did, and we wanted to help them. With a little work and creativity, we were able to eliminate almost \$1.4M of the tax bill. They came to us because somebody said we could review their financial plan and make some recommendations. They left saving over \$1.4M in taxes!

Here is what we did for Sid and Nancy:

For Sid, almost \$6.5M of the selling price and the bulk of the gains on the sale of his business were in the actual real estate he owned. He owned the very building where the technology and manufacturing was being developed and implemented. Sid needed income during retirement. We decided to avoid paying the tax on the gain associated with the \$6.5M, and we used a tax code, 1031 Exchange, to completely eliminate what would otherwise have been taxes on almost \$5M of gains.

By leveraging the tax codes, we were able to convert what would have been over \$1M in taxes into a stream of tax-efficient income. The \$6.5M created an income stream of over \$357K of annual income. And because of the way the 1031 can work, almost 40% of that income was 100% tax free.

That income was sufficient to take care of their income needs, and with the balance of the sale, we agreed that they could pay about \$250K in combined State and Federal Income taxes. To accomplish that goal, we split the remaining \$3.5M into two buckets:

- (1) The first bucket we put into a conservative (and tax efficient) equity allocation to give them growth potential and liquidity during the first decade of their retirement. That allocation meant they had almost \$2M available any day of the week for all those extras in life: the honey-do list, the round-to-it list, and the bucket list.

- (2) The second bucket took advantage of the Tax Cut and Jobs Act and opportunity zones which allowed Sid and Nancy to delay paying taxes on the balance of the \$1.5M for at least 10 years, possibly longer.

Obviously, there are many intricate details that are involved with these tax strategies, too many to be included here. The important takeaway is that Sid and Nancy chose to work with a financial planning team that truly understood not only investments, but the tax implications of making those recommendations, as well.

**Remember, it is not how much you make, it is how much you keep that counts!**

Sid and Nancy were happy they **CHOSE A *Better Way***.

## CHAPTER 13

# CREATING AN INCOME STREAM FOR RETIREMENT

*Too much income usually isn't a bad thing.*

Have you heard of truisms? They're a bit different from truths.

It's true that oranges weren't originally orange. It is also true that a zombie-creating fungus exists. It is also true that the longest English word is 189,819 letters long (try pronouncing that)! But those truths aren't directly obvious, and while you're probably curious to learn more about each one of them, you'll have to do the research yourself.

A truism, on the other hand, is a truth so glaringly apparent, so laughably self-evident, that it's hardly worth saying. Truisms are tantamount to clichés and include phrases like, “you get what you pay for,” and, “you can't win them all.” Authors who write in truisms are typically ousted from their editors' offices, but we're going to take that risk and use one, anyway:

*“What goes up must come down.”*

Did you roll your eyes? That wouldn't be surprising. That's the reaction truisms normally elicit. “What goes up must come down” is so obvious we wonder how it took us until 1687 to give the notion of gravity any real thought. Sometimes truisms are so

obvious we pay them no mind until an apple falls and smacks us in the head.

That seems to be the case in economics. We've seen economies rise and fall – what goes up always comes down. And yet, governments, economists, and investors still fail to learn from this basic up-down principle of economics.

Since the Great Depression, the United States has experienced about 14 economic recessions. None have been as severe as the Great Depression of the 1930s with the most recent being the great pandemic of 2020 and the ensuing 37.08% drop in the DOW.

Date	Percent Decline
February 12, 2020 – March 23, 2020	-37.1%
October 9, 2007 – February 23, 2009	-52.5%
March 24, 2000 – October 9, 2002	-49.1%
July 16, 1990 – October 11, 1990	-19.9%
August 25, 1987 – December 4, 1987	-33.5%
November 28, 1980 – August 12, 1982	-27.1%
January 11, 1973 – October 3, 1974	-48.2%
November 29, 1968 – May 26, 1970	-36.1%
February 9, 1966 – October 7, 1966	-22.2%
December 12, 1961 – June 26, 1962	-28.0%
August 2, 1956 – October 22, 1957	-21.5%
May 29, 1946 – June 13, 1949	-29.6%
March 6, 1937 – April 28, 1942	-60.0%
September 7, 1929 – June 1, 1932	-86.2%
<b>Average</b>	<b>-38.3%</b>

There is, on average, 1 bear market every 7 years. If you retire at age 62, you will experience at least 4 bear markets during your retirement. Imagine losing 38.3%, on average, every 7 years.

If it is a truism that “what goes up must come down,” it would make sense to create a retirement income plan that can withstand those truisms of the stock market.

Remember our rules? Rule #1: Never lose money. Let's add a rule now about “Never forget rule #1!”

And remember Rule #2: The #1 Fear of Retirees? Running out of money!

With those two rules in place, and having CHOSEN the right financial planner for you, the next step is to create that income stream that you'll need throughout retirement. If you subscribe to the concept of never running out of money, then you will want to pay close attention here.

There is nothing more important than understanding income during retirement. All your working years you received a paycheck every two weeks. It was consistent. You could plan your life around the fact that you knew that those checks were going to be consistent and reliable. They provided you the peace of mind knowing that you would always be able to maintain a certain standard of living: your bills and needs were being met.

The question is, what has changed now that you are entering into, or are already in, retirement? Do the monthly bills change dramatically? Perhaps you have paid off the house or a car, but in general, the day-to-day expenses of living do not change just because you have retired. In fact, we would argue that the day-to-day costs of living have or will increase. We call it the “round-to-it lists,” “the bucket list” and “the honey-do list.”

It is amazing that while you were working, you managed to get those 40+ hours in each week and still find time to entertain, shop, do house and yard work, and even raise a family. Now that you are entering into retirement, you are going to be shocked that you have so little time – you won't be able to understand how you got anything done while you were working! For those of you already retired, you know exactly what we're talking about.

Because of those lists, you may end up spending MORE money during the early years of retirement. We'll call those the *Go-Go Years*. What we typically see is that the average person retires around age 62. From age 62 until about age 70, the retiree's income needs increase year after year. We are pursuing those activities we never had time for: travel, grandkids, hobbies, etc.

They all take time and they certainly all take money. Once we reach age 70, we are typically plateauing on the spending curve. Somewhere between 70 and 80, we actually start to slow down, and so does our spending. We call these the *Slow-Go Years*. By the time we get to age 80, nap time looks pretty good and the best part about nap time is that it is pretty cheap! We frequently see a tremendous drop in spending during that five-to-ten-year period. We call these the *No-Go Years*. And it isn't until a few years later, when the health care costs start kicking in, that we see an uptick in spending.

With that in mind, the question is, how are you going to make sure that you don't outlive your money? We know that is the greatest fear a retiree has: running out of money.

SO how do you avoid running out? You worked hard for all those years. You made sacrifices. You saved. You made smart choices with your money. The real question is, did you save that money for you and your retirement? To help your kids and grandkids out? To leave a legacy for your heirs or charity? Most clients will say that the sacrifices made were first to ensure that they had enough money for retirement. They would like to help their kids and grandkids, if possible. If there is anything left over, that's great.

For those of you who saved, sacrificed, and made smart choices with your money and amassed way more than you'll ever need, you can stop reading this chapter right now. This isn't for you.

Everybody else, read on. . .

This chapter is to show you how to make sure your income needs are met first. Only by meeting your income needs first can you be in a place to help your kids, family, and be charitable. The most important question about creating income is: do you want it safe and steady, like a paycheck, or do you want it to vary with the fluctuations of the stock market?

It seems like a loaded question, but it is fundamentally the first step in deciding how to create and secure your retirement income.

## **CREATING INCOME**

Now that the paycheck is gone, you will need to have a new stream of steady and reliable income. First, you have to have an idea of how much money you need to pay the bills. Notice we said “need” and not want. There is a big difference. You need food, health care, utilities, transportation, a roof over your head, clothes, etc. You may want to play golf three times a week or travel around the United States in an RV, but those things fall into the “want” category.

Try to create a budget. Gather your credit card bills, your bank statements, gather all the spending you do each month—gather three months’ worth of those bills and expenses. Remember some may only show quarterly or semi-annual expenses like taxes and auto insurance. Don’t forget, TAXES may also come into play and should be a part of your income-planning process.

Once you have gathered your documents, break them down to what you consider necessary versus those that might be more flexible. You need food each week and you may want to buy a new car this year, but the car can wait until next year if the stock market is down.

The amount you need, the amount you must have in order to secure the retirement you envision, that income should be as safe and secure as your paycheck was.

For most of us, we will have Social Security. Social Security is safe and secure, notwithstanding the politicians and the social security lockbox. Unless the United States goes bankrupt, you can be fairly secure in knowing that you are going to get your Social Security check each month. Safe, secure, and reliable.

For some of us, a pension is the second leg of that “three-legged stool” of retirement income. The thing we like about a pension is that we know that each month we are going to get a steady check.

Just like the security of Social Security, we like the consistency of a monthly paycheck. Keep in mind that the pension is only as secure and reliable as the company paying it, and while there is the Pension Benefit Guarantee Corporation (PBGC) as a fall back, frequently the amount they pay is significantly less than what you would have otherwise received. As part of your income planning, you should do a little due diligence and find out how secure your pension truly is. You can go to the website ([www.pbgc.gov](http://www.pbgc.gov)) to learn more about PBGC, and your company should be able to provide you annual reports on the funding status of your pension.

The reason you may want that safe, secure, and reliable income is that if you pull out one of those three legs of the retirement stool, retirement can get a little wobbly. Having Social Security and a pension certainly can provide that security blanket you want during retirement.

Truly, the key is how you handle that third leg. And for those of you who are not part of a company-sponsored pension plan, you have two legs that need to be addressed.

This brings us back to the original question: do you want your income to look more like a pension or Social Security—in other words, coming in safe, secure, and reliably—or are you willing to risk taking a pay cut if the stock market tanks.

Think about the last twenty years or so since January 1st, 2000. We have seen great market returns just as we have seen gut-wrenching drops in the market. Should your income, the money you need to live on, be subject to that volatility during your retirement years? We would suggest that no, it should not.

## CREATING AN INCOME STREAM FOR RETIREMENT



This is what the S&P looks like, going back to January 1, 2000. Notice that from 2000 until 2013, the market is basically up and down and ends up flat...after 14 years?

Let's examine a concept called Sequence of Returns. This example is exactly why many retirees appreciate having reliable income.

Annual Income = None			Starting Value of Portfolio A and Portfolio B = \$500,000		
Age	Annual Return	Portfolio A Year-End Value	Age	Annual Return	Portfolio B Year-End Value
46	N/A	\$500,000	46	N/A	\$500,000
47	-10.1%	\$449,500	47	19.4%	\$597,000
48	-13.0%	\$391,065	48	9.5%	\$653,715
49	-23.4%	\$299,556	49	-0.7%	\$649,139
50	26.4%	\$378,639	50	11.4%	\$723,141
51	9.0%	\$412,716	51	29.6%	\$937,191
52	3.0%	\$425,097	52	13.4%	\$1,062,774
53	13.6%	\$482,911	53	0.0%	\$1,062,774
54	3.5%	\$499,813	54	12.8%	\$1,198,809
55	-38.5%	\$307,385	55	23.5%	\$1,480,529
56	23.5%	\$379,620	56	-38.5%	\$910,526
57	12.8%	\$428,212	57	3.5%	\$942,394
58	0.0%	\$428,212	58	13.6%	\$1,070,559
59	13.4%	\$485,592	59	3.0%	\$1,102,676
60	29.6%	\$629,327	60	9.0%	\$1,201,917
61	11.4%	\$701,070	61	26.4%	\$1,519,223
62	-0.7%	\$696,163	62	-23.4%	\$1,163,725
63	9.5%	\$762,298	63	-13.0%	\$1,012,441
64	19.4%	\$910,184	64	-10.1%	\$910,184
	4.8%	\$910,184		4.8%	\$910,184

⤴
No difference
⤵

During the accumulation phase of our financial lives, investors can accept market volatility because TIME is on their side.

Notice here, we have the same initial investment of \$500K. Same time period for both portfolios: A & B.

The only difference is the sequence of the returns. That is, how much did the portfolio go up or down in any given year. In this scenario, we used the exact same returns, but reversed the order for Portfolio B.

Notice in Portfolio A, the age 47 rate of return was  $-10.1\%$ ? That basically represents the performance of the S&P in the year 2000. Then take a look at Portfolio A at age 64, the portfolio earned  $19.4\%$ . The ending value after that 18-year period was \$910,184 and the portfolio averaged  $4.8\%$ .<sup>29</sup>

Let's compare it to Portfolio B. We used the exact same initial investment of \$500K and the same time period of 18 years. The average return is the exact same  $4.8\%$ . What is the difference? We changed the sequence of returns. Notice at age 47, instead of receiving a  $-10.1\%$  like Portfolio A received, Portfolio B received a  $19.4\%$  return. We just reversed the order: at age 64, Portfolio B received that  $-10.1\%$  instead of the  $19.4\%$  that Portfolio A received.

This is called a sequence of returns. Unfortunately, we don't have a crystal ball when it comes to predicting market returns and the ensuing results can be catastrophic for a retiree, especially when taking withdrawals during retirement. That is why is it so important to CHOOSE a financial planning team that understands the difference between the accumulation phase, the preservation phase, and the distribution phase of our lives. That, and ensuring they are aligned, and that they understand your goals for retirement.

Let's look at the sequence of returns, using the exact same Portfolio A and Portfolio B. The only change this time is that Investor A and Investor B have moved from the accumulation

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<sup>29</sup> These figures are for illustrative purposes only and do not represent any particular investment. The S&P is an index and you cannot directly invest in the S&P500. Returns illustrated do not include dividends, fees, or charges that may be applicable.

phases into the preservation and distribution phases of their lives. This stage is when you need to depend on the money you've saved to provide you with your retirement income.

Annual Income = 5% of first-year value adjusted thereafter for inflation				Starting Value of Portfolio A and Portfolio B = \$500,000			
Age	Annual Return	Annual Withdrawal	Portfolio A Year-End Value	Age	Annual Return	Annual Withdrawal	Portfolio B Year-End Value
65	N/A	\$25,000	\$500,000	65	N/A	\$25,000	\$500,000
66	-10.1%	\$25,000	\$424,300	66	19.4%	\$25,000	\$572,100
67	-13.0%	\$25,000	\$343,971	67	9.5%	\$25,000	\$601,678
68	-23.4%	\$25,000	\$238,585	68	-0.7%	\$25,000	\$572,286
69	26.4%	\$25,000	\$276,524	69	11.4%	\$25,000	\$612,469
70	9.0%	\$25,000	\$276,383	70	29.6%	\$25,000	\$768,760
71	3.0%	\$25,000	\$259,675	71	13.4%	\$25,000	\$846,851
72	13.6%	\$25,000	\$270,043	72	0.0%	\$25,000	\$821,851
73	3.5%	\$25,000	\$254,575	73	12.8%	\$25,000	\$901,884
74	-38.5%	\$25,000	\$131,564	74	23.5%	\$25,000	\$1,088,376
75	23.5%	\$25,000	\$137,415	75	-38.5%	\$25,000	\$644,460
76	12.8%	\$25,000	\$129,977	76	3.5%	\$25,000	\$642,209
77	0.0%	\$25,000	\$104,977	77	13.6%	\$25,000	\$704,678
78	13.4%	\$25,000	\$94,055	78	3.0%	\$25,000	\$700,818
79	29.6%	\$25,000	\$96,895	79	9.0%	\$25,000	\$738,822
80	11.4%	\$25,000	\$82,931	80	26.4%	\$25,000	\$908,723
81	-0.7%	\$25,000	\$57,326	81	-23.4%	\$25,000	\$671,355
82	9.5%	\$25,000	\$37,795	82	-13.0%	\$25,000	\$558,810
83	19.4%	\$25,000	\$20,134	83	-10.1%	\$25,000	\$477,147
	4.8%		\$20,134		4.8%		\$477,147

It is never a good retirement plan, to put yourself in the position of having **EVEN THE REMOTE** possibility of running out of money. All we did here is take \$25,000 per year out of the portfolios. Notice that by age 83, Investor A is almost out of money?

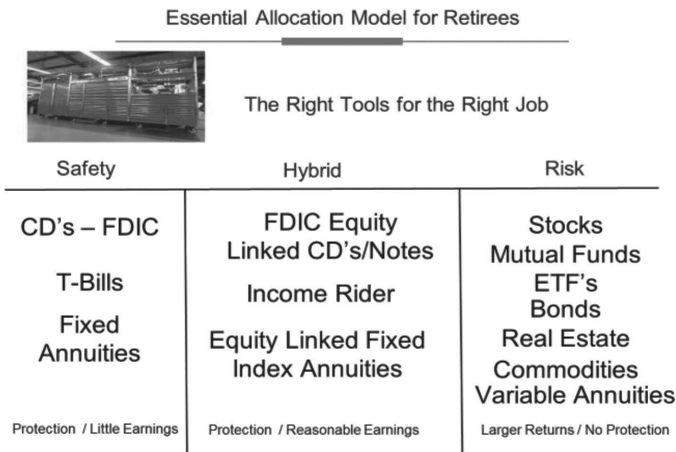
What is the #1 FEAR most retirees have? Running out of Money!!!!

Why would anyone **CHOOSE** this approach? Why opt into using a system that could result in you running out of money during retirement? Why **CHOOSE** to work with an Advisor who doesn't understand and address this very real concern? Shouldn't you at least have the knowledge and **CHOICE** of which approach you want to take during your retirement? It probably doesn't make sense to work with an Advisor who doesn't at least offer you the **CHOICE** of Portfolio A or Portfolio B.

For that third leg, the investment side of your retirement stool, you need a plan that can ensure that your daily income needs are being met. How to best accomplish that goal will be a conversation you want to have with your Advisor; but there are limited options when it comes to creating a safe, secure, and reliable income stream.

Most investors want safety, liquidity, and growth. Typically, you get to pick two.

The diagram below is what is frequently referred to as “the world of money.” While there are other investments available, these options represent the most frequently used investment choices offered to most investors and most retirees.



Discuss all your options with your Advisor, and if your Advisor doesn't have these choices available, perhaps you need a new Advisor.

As you can see, the only truly safe way to create those income streams involve the use of FDIC, the guarantees offered by the United States Government, or the guarantees offered by insurance companies. Pick the one that fits you best; but if you want safe, secure, and reliable income during retirement, these are truly your only choices.

Generally speaking, if you want safe and liquid, you will use CD's, Treasuries, and Fixed Annuities. If you want growth and liquid, then use Stocks, Bonds, Mutual Funds, ETF's, REITs, Commodities, and Variable Annuities. If you want safe and reasonable growth, 4–6%, then use the Fixed Indexed Annuity. Remember, we all want Growth, Safety, and Liquidity. Pick the two that are most important to you for that piece of the portfolio.

We would suggest that the two you want for retirement income is safety and reasonable growth. To be sure, you will want a portion, your emergency money, in the safe and liquid column. And the balance of the rest of your portfolio, (what you don't need for your day-to-day living expenses), might very well go into the growth and liquid column.

How do you then figure out the correct amount of money to earmark? If you choose to allow your income to be based upon the variances of the stock market, the amount you can withdraw each year, adjusted for inflation, is typically based upon your age. It really has nothing to do with your budget because you are limited to a specific dollar amount.

If you go online and use any one of the many withdrawal calculators, they will all ask a few basic questions:

- How much do you have?
- What inflation rate do you want to assume?
- How old are you?
- What return do you want to assume?

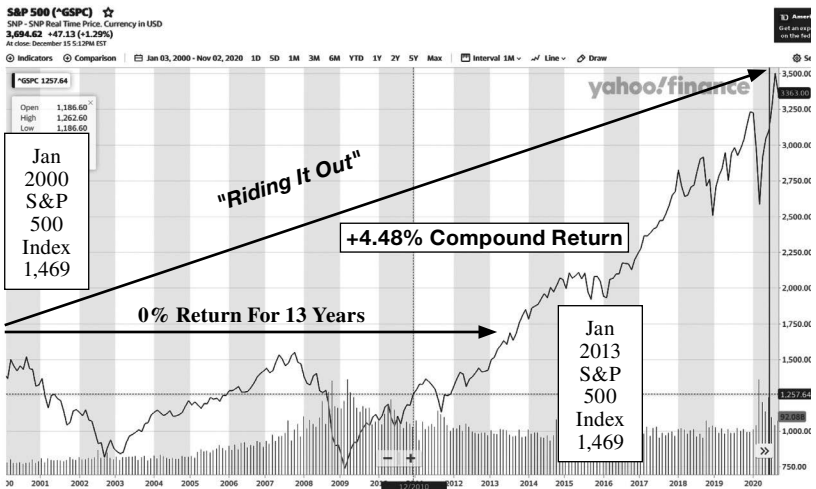
Before you put in “8 percent” because you have heard the market averages 8% over time, please take a look at how that number is calculated and from what time period. It is true that the DOW has averaged more than 8% over the last 90 plus years, but we are pretty sure that none of you are going to wait around 90 years to find out if that trend will continue.

If you take a look at the DOW and S&P, recognizing that these

are just barometers and you can't actually invest directly into them, since 2000 through the end of 2020, the compounded rate of return was under 4.5% per year.

Even if you include another couple of percent for dividends (not all components pay dividends), you are still short of the "8%" average often quoted.

The chart below represents the S&P over the last 20 or so years.



These calculators will frequently tell most retirees (retiring between ages 62–70) that they can withdraw somewhere in the neighborhood of 2.8% to 4.25% of their assets and STATISTICALLY not run out of money. What do statistics tell us? Any lie we want to believe. Do you want your retirement income to be a statistic?

Let's assume for just a minute that you are 62 years old and want to retire. Let's also assume you have \$1M saved for retirement. From a statistical point of view, these calculators are going to give you an income range of \$28,000 to \$35,000 per year. Yes, you get inflationary raises each year, but you have now committed \$1M to be used exclusively to create your income. You can't take out an extra \$50K one year to pay for your daughter's wedding because if you do, you won't have your reliable income anymore

– it will be reduced because you took out part of your principal. And there is no guarantee that you won't run out of money or that there will be any money left for your heirs. The only guarantee that comes with this approach is that “statistically” you won't run out of money. Clearly not safe, secure, or dependable.

Taking the same facts, if you opted instead to use CD's, with current interest rates around 2% for a five-year CD, you would have about \$20K a year in income. While not as much as the variable approach, at least you know that you won't lose the principal. You are subject to interest rate fluctuations so when interest rates go up, you may be able to have an increase in income. Conversely, when interest rates go down, you would suffer a decrease in income. Not very consistent, but certainly safe, secure, and reliable.

What about Treasuries? You would see a similar result as you do with CD's. Treasuries are also subject to interest rate fluctuations; so when interest rates are up, you have more income. When interest rates are down, your income also decreases. Again, not necessarily consistent, but at least safe, secure, and reliable.

Having said that, if your option is to use CD's and/or Treasuries, an approach might be to ladder the allocation. Think of a ladder. There are many rungs in the ladder – steps if you will. Each rung of the ladder is a little higher than the last. This approach can work to help smooth out a period of low interest rates. The idea is that you purchase a certain amount in CDs/Treasuries spread out over a number of years of maturity. You might buy \$100K of CD's maturing in 2 years, \$100K maturing in 3 years, and \$100K maturing in 4 years, etc. The idea is that by spreading out the maturity dates you will receive a more consistent average interest rate. Each “year” a CD or Treasury matures, you go out and buy a new rung of the ladder – going out beyond the longest maturing CD's/Treasuries you have in the portfolio

That leaves us the annuity option. We know, we have all seen the ads by Ken Fisher – “we hate annuities, and you should too!”

More on that investment philosophy later. For right now, our concern is creating a safe, secure, and reliable income stream. We can see that having your income needs met by an allocation in the stock market can be problematic: not safe, not secure, and not reliable. Imagine needing that \$35K from your \$1M investment, and having your portfolio drop 40–50%, like many investors experienced in 2008.

Treasuries and CD's feel great. They are backed by the United States government, and we can feel fairly secure in knowing that unless the USA collapses as a country, the government will be there to guarantee your investments. They are subject to interest rate changes, which can be a little tricky. However, with proper planning, and using a laddering approach with your allocation, you may be able to withstand prolonged periods of low interest rates like the ones we have seen since 2008.

We'll discuss annuities in further detail in later chapters, but good resources may be found at the NAIC Buyer's Guide ([www.naic.org](http://www.naic.org)).

For our income example, there are specific types of annuities where the Insurance Company that issues the annuity will “guarantee” an income stream for you; and if you so choose, your spouse or significant other as well. While it is not a pension or Social Security, it does provide you a safe, secure, and reliable income stream.

Using the same hypothetical example of \$1M, if you used an annuity, you could expect to receive somewhere between \$45,000 and \$60,000 a year in income. That is a significant increase, and the best part is, you have now transferred the **risk of the market** and the **risk of longevity** to the insurance company. You no longer need to be a statistic – whether you live too long or whether the stock market cooperates.

Let's revisit that three-legged stool. That is what Bob and Kim asked us to do when they came into our office.

Bob and Kim had been contemplating retirement for some time and had recently attended a class that we offer at the local college where we teach adult financial literacy; they had lots of questions. During one of the classes, we explained that if you play your cards right, your Social Security Income could be 100% tax free. They wanted to know more.

At one point there were 567 different iterations on how and when to take Social Security to enable you to get the most value out of the program. Imagine that, 567 different calculations to make – just to determine how to maximize your benefits! To be clear, you do want to know when the best time is because the difference can amount to hundreds of thousands of lost dollars. There are numerous calculators out there that can assist you and certainly most financial advisors have access to some sort of software that can calculate your benefits.

There was a time when you could file for your Social Security benefits at age 62, collecting a reduced amount. You could collect all the way up to age 70. At age 70, you could go to the IRS and ask them to recalculate your benefits and you could then collect the larger amount. Think about that for a minute. If at age 62 your annual benefit was \$2K a month, you could collect that benefit from age 62 until age 70. With eight years of collecting \$24,000 a year, plus cost of living increases each year, and accounting for 25% in taxes, you could then put your after-tax balance of \$18K into the roaring stock market of the 1980's and 1990's. The results after those eight years: over \$204K by just averaging 10% – not unreasonable returns during the 1983–1999 bull market.

When you turned 70, you would pay back the \$192K in benefits you received, get a tax deduction for paying it back, and then start with your new benefit payout of over \$40K a year. While the example using 10% doesn't seem like much, about \$12K, if you used the return on the S&P between Jan 1st, 1990, and Jan 1st, 1998, a full eight years, your returns would have been almost 17% and the benefit of this strategy would have resulted

in almost \$75K remaining in your investments. Not a bad return on using *their* money.

Alas, those good old days of filing, repaying, and reclaiming; file and suspend; and most of the other 567 options are pretty much gone.

Between President's Reagan, Clinton, Bush, and Obama, the real creative strategies have gone by the wayside. Today the real questions are longevity, income sources, and taxes.

And that is why Bob and Kim came into our offices. They had sat down with an Advisor from one of those large broker dealers. The advisor went through their investments and their income sources and recommended that Bob and Kim buy two annuities. The recommendation was to invest \$300K into an annuity for Bob and \$300K into an annuity for Kim. The Advisor explained that this particular annuity produced, at that time, the best income of any annuity available. Bob and Kim were sold – after all, having more income couldn't be a bad thing.

Obviously the first question we wanted to know was how much income they needed? Bob and Kim were perplexed because the Advisor who sold them their annuities, didn't really ask how much income they needed, he just suggested that these two annuities produced the best income in the business. The Advisor explained that with their Social Security Income of \$53K per year and the roughly \$35K per year income from the two annuities, they would have a very comfortable retirement. It made sense to Bob and Kim, after all, they went to an Advisor to help them, and they made the assumption that the Advisor would be looking out for their best interests. And, like the Advisor said, too much income can't be a bad thing.

When we reviewed their Social Security options, the first thing we wanted to know was what their benefits would be at full retirement age (FRA).

We then wanted to know what would happen if instead of claiming SS at age 65 like the annuity salesman suggested, what would happen if they waited until age 70. What Bob and Kim realized, and perhaps the salesman didn't understand, was that the longer they waited to claim their benefits, the higher the payment would be.

Each year a person waits to claim their benefit, the benefit amount grows by almost 8%. Bob and Kim were born in 1955 and therefore their FRA would be 66 years and 2 months. If they elected their SS then, their income benefit would be about \$58K per year.

Their annuity salesman suggested that they take it at age 65, which means they would only get about \$53K. But from his perspective, that \$53K coupled with the \$600K in annuities he sold them, their income would meet and exceed their goal of \$85K per year. In fact, the salesman was excited because they actually had more income than they planned for!

Remember his philosophy? More income is never a bad thing.

**Social Security Election Chart**

Year of Birth	Full Retirement Age (FRA)	Age 62 Benefit Reduction
1937 or earlier	65	20.00%
1938	65 and 2 months	20.83%
1939	65 and 4 months	21.67%
1940	65 and 6 months	22.50%
1941	65 and 8 months	23.33%
1942	65 and 10 months	24.17%
1943 - 1954	66	25.00%
1955	66 and 2 months	25.83%
1956	66 and 4 months	26.67%
1957	66 and 6 months	27.50%
1958	66 and 8 months	28.33%
1959	66 and 10 months	29.17%
1960 or later	67	30.00%

This is the Social Security chart detailing the penalty for electing Social Security benefits before your Full Retirement Age (FRA) compared to the benefits you would receive for waiting until age 70 to elect your benefit.

To Bob and Kim, it seemed strange that their Advisor would suggest they take their SS early rather than wait until they could

maximize their benefits. After all, they were both healthy, had long lifelines, and led a modest lifestyle. As you can see from the chart above, the sooner you elect Social Security, the less you get. If your full retirement age is 66 and you decide to begin collecting SS at age 62, you will lose 25–30% of your benefit. Instead, if you wait to take your benefits until after your FRA, Social Security will add an 8% delayed retirement credit to your eventual monthly payout each year that you hold off, up to age 70. Think about that, an 8% growth, guaranteed by the Federal Government. For Bob and Kim, waiting those extra few years certainly would have resulted in more income.

Even more disturbing is the fact that the Advisor didn't address taxes. Remember, he was excited that Bob and Kim would have \$88K of income. Perhaps he didn't understand that most retirees think of income from the perspective of how much is being deposited into their checking account. Perhaps the Advisor wasn't allowed to talk about taxes. Perhaps the Advisor didn't understand how taxes worked. Maybe the Advisor didn't know that with the strategy he was recommending, it would've made their SS subject to even more taxes.

Bob and Kim wanted to know whether their Social Security benefits would be taxable. You may already know this, but when Social Security was first designed by Roosevelt, his promise was that Social Security would never be taxable. In fact, there were several administrative rulings from the Treasury in the 30's and 40's that exempted Social Security payments from taxes. This was true all the way up to 1983. In 1981, President Reagan and Congress passed the Economic Recovery Tax Act and the ensuing tax changes, including The Equity and Fiscal Responsibility Act of 1982 and the 1983 Amendments to the Social Security Act, resulted in up to 50% of Social Security being exposed to taxes.

In 1993, as part of the Omnibus Budget Reconciliation Act passed by President Clinton and Congress, up to 85% of Social Security was now subject to tax exposure.<sup>30</sup>

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30. <https://www.ssa.gov/history/taxationofbenefits.html>

Here is how the government determines who gets their SS taxed:

First you add up all your provisional income. Your provisional income is basically all your income which will appear on your tax return, except Social Security. The rule requires you to include all the income that will show up on the return but does not allow you to take any of the adjustments that would reduce your income. For example, you do not reduce your provisional income by your IRA contributions, your self-employment health care deductions, or any of those items that are included in calculating your Modified Adjusted Gross Income.

7	Wages, salaries, tips, etc. Attach Form(s) W-2			7	
8a	Taxable interest. Attach Schedule B if required			8a	
b	Tax-exempt interest. Do not include on line 8a	8b			
9a	Ordinary dividends. Attach Schedule B if required			9a	
b	Qualified dividends	9b			
10	Taxable refunds, credits, or offsets of state and local income taxes			10	
11	Alimony received			11	
12	Business income or (loss). Attach Schedule C or C-EZ			12	
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>			13	
14	Other gains or (losses). Attach Form 4797			14	
15a	IRA distributions	15a		b	Taxable amount
15b				15b	
16a	Pensions and annuities	16a		b	Taxable amount
16b				16b	
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E			17	
18	Farm income or (loss). Attach Schedule F			18	
19	Unemployment compensation			19	
20a	Social security benefits	20a		b	Taxable amount
20b				20b	
21	Other income. List type and amount			21	
22	Combine the amounts in the far right column for lines 7 through 21. This is your total income			22	

Provisional income consists of those income items that would normally appear on the "top" of the tax return PLUS amounts found on line 8b: tax-free interest.

Once you have calculated your provisional income (don't forget to include municipal bond and other tax-free interest into the calculation), add that to one-half of your SS income.

23	Educator expenses			23	
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ			24	
25	Health savings account deduction. Attach Form 8889			25	
26	Moving expenses. Attach Form 3903			26	
27	Deductible part of self-employment tax. Attach Schedule SE			27	
28	Self-employed SEP, SIMPLE, and qualified plans			28	
29	Self-employed health insurance deduction			29	
30	Penalty on early withdrawal of savings			30	
31a	Alimony paid	b	Recipient's SSN	31a	
32	IRA deduction			32	
33	Student loan interest deduction			33	
34	Tuition and fees. Attach Form 8917			34	
35	Domestic production activities deduction. Attach Form 8903			35	
36	Add lines 23 through 35				
37	Subtract line 36 from line 22. This is your adjusted gross income				

Provisional income does not allow you to reduce your income by the modifications.

Well, unfortunately for Bob and Kim, that annuity salesman was wrong, having too much of the wrong income can be a bad thing. What he didn't understand was that by selling Bob and Kim an annuity, and creating that additional taxable income, it forced 85% of their Social Security to be taxable...for the rest of their lives!

Had he understood how SS was taxed, instead of Bob and Kim paying over \$5,500 a year in taxes, thereby lowering the actual money going into their checking account each and every month, he may have been able to create a tax-free income stream for them instead.

If the Advisor had taken the time to understand Bob and Kim's actual income needs, their other investments and income sources, and understood that SS grows each and every year they delayed until age 70, he might have suggested another approach.

<b>1</b>	Wages, salaries, tips, etc.	AB <input type="checkbox"/> FB <input type="checkbox"/> DCB <input type="checkbox"/> SNE <input type="checkbox"/> SSHIP <input type="checkbox"/>	0	
	Taxable scholarship not on Form W2		0	
	Household employee income not on Form W2		0	
<b>2 a</b>	Tax-exempt interest		3500	
<b>b</b>	Taxable interest		2250	
<b>3 a</b>	Qualified dividends including qualified dividends from Forms 8814, listed on Schedule B		0	
	Qualified dividends from Schedules K-1 are included on line 3b. amounts on Schedule B		0	
	Do not list these		6250	
<b>b</b>	Ordinary dividends including qualified dividends from Forms 8814, listed on Schedule B		0	6250
<b>4 a</b>	IRA distributions		0	
<b>b</b>	Taxable amount		35000	
<b>c</b>	Pensions and annuities		0	
<b>d</b>	Taxable amount		0	
	Check if rollover: <input type="checkbox"/> and F9 to explain: <input type="checkbox"/>		44500	
<b>5 a</b>	Social security benefits		0	
<b>b</b>	Taxable amount		37825	
	D <input type="checkbox"/> LSE <input type="checkbox"/>		13250	
<b>6</b>	Capital gain or (loss)		0	
	Schedule D not required: <input type="checkbox"/>		0	
<b>7 a</b>	Other income from Schedule 1, line 9		94575	
<b>b</b>	Total income		0	
	Earned income		0	
<b>8 a</b>	Adjustments to income from Schedule 1, line 22		0	
<b>b</b>	Adjusted gross income		94575	
<b>16</b>	Total tax. Add lines 14 and 15		5537	Total tax: \$5537

By waiting until age 70 to begin their SS benefits, their income increased to the \$85K they actually wanted. By eliminating the forced income from the annuities, the salesman suggested, we were able to reduce their tax bill from the \$5,500 each year the salesman evidently felt comfortable having them pay, down to a more comfortable \$274 a year. Their entire income needs were met just from their SS, and because it was done correctly, their SS went from being 85% taxable to only 30% taxable.

1	Wages, salaries, tips, etc.	AB	<input type="checkbox"/>	FB	<input type="checkbox"/>	DCB	<input type="checkbox"/>	SNE	<input type="checkbox"/>	SSHIP	<input type="checkbox"/>	0			
	Taxable scholarship not on Form W2														
	Household employee income not on Form W2														
2a	Tax-exempt interest											3500			
b	Taxable interest											2250			
3a	Qualified dividends including qualified dividends from Forms 8814, listed on Schedule B												0		
	Qualified dividends from Schedules K-1 are included on line 3b. amounts on Schedule B												0	Do not list these	6250
b	Ordinary dividends including qualified dividends from Forms 8814, listed on Schedule B												0		6250
4a	IRA distributions												0		
b	Taxable amount												0	Check if rollover: <input type="checkbox"/> and F9 to explain: <input type="checkbox"/>	0
c	Pensions and annuities												0		
d	Taxable amount												0	Check if any amounts were rolled over: <input type="checkbox"/>	0
5a	Social security benefits												85000		
b	Taxable amount												26188	D <input type="checkbox"/> LSE <input type="checkbox"/>	
6	Capital gain or (loss)												13250	Schedule D not required: <input type="checkbox"/>	
7a	Other income from Schedule 1, line 9												0		
b	Total income												47938		
	Earned income												0		
8a	Adjustments to income from Schedule 1, line 22												0		
b	Adjusted gross income												47938		
16	<b>Total tax.</b> Add lines 14 and 15											274	Total tax: \$274		

With the tax bill being reduced 99.95% they were pretty sure it made sense to wait until age 70 to begin their benefits, but they wanted to understand about that break-even point we discussed in class. The system is designed so that you should receive the same lifetime amount regardless of when you claim. But it doesn't always work out that way, especially since retirees are living longer. If you only live until, say 75, you're probably better off claiming early so you have more years to enjoy your money. But if you live to 100, you'll likely receive far more over a lifetime if you wait until age 70 to claim and receive those bigger checks.

To get a better picture of what the break-even age looks like, here's a hypothetical example. Say your FRA is age 67, and if you claim SS at that age. You'd be receiving \$1,500 per month in benefits. If you were to claim SS early at 62, your benefits would be reduced by 30%, leaving you with only \$1,050 per month. If you wait until age 70 to claim SS, you will make an additional

24%, giving you a monthly total of \$1,860. Here's what your lifetime benefits would look like depending on how long you live:

Living To	Total Lifetime Benefits by Claiming at Age 62	Total Lifetime Benefits by Claiming at Age 67	Total Lifetime Benefits by Claiming at Age 70
62	\$0	\$0	\$0
67	\$63,000	\$0	\$0
70	\$100,800	\$54,000	\$0
75	\$163,800	\$144,000	\$116,600
80	\$226,800	\$234,000	\$223,200
85	\$289,800	\$324,000	\$334,800
90	\$352,800	\$414,000	\$446,400

Fortunately for Bob and Kim, they **CHOSE A *Better Way***.

## CHAPTER 14

# USE THE RIGHT TOOL

*We hate annuities and you should too!*

Finding the right tool for the right job!

### Essential Allocation Model for Retirees



The Right Tools for the Right Job

Safety	Hybrid	Risk
<p>CD's – FDIC</p> <p>T-Bills</p> <p>Fixed Annuities</p> <p>Protection / Little Earnings</p>	<p>FDIC Equity Linked CD's/Notes</p> <p>Income Rider</p> <p>Equity Linked Fixed Index Annuities</p> <p>Protection / Reasonable Earnings</p>	<p>Stocks</p> <p>Mutual Funds</p> <p>ETF's</p> <p>Bonds</p> <p>Real Estate</p> <p>Commodities</p> <p>Variable Annuities</p> <p>Larger Returns / No Protection</p>

This is the standard toolbox ALL financial advisors or planners have at their disposal. Whether they use or are allowed to use each and every tool is based upon their skillset, knowledge, and employer. If they are an employee of a firm, the firm will dictate what tools they're allowed to use for their clients. If they work for you, the only limitation on available tools is their own imposed limits and their own skill sets.

Remember, everybody wants growth, safety, and liquidity. Pick the best two to accomplish any given goal you may have. They are all not the same goals, and therefore they do not require the same tools.

Let's explore those available financial tools a little bit more. It's important to understand not only your options, but the options that are made available to you by your advisor. Remember when we discussed the difference between a broker-dealer relationship and a fiduciary relationship? Which relationship you choose has a significant impact on the financial tools that are made available to you.

Arnold learned this the hard way. Arnold was a long-time listener to our radio show but never picked up the phone to call us. He had never actually sat down with an advisor at any point in his life. Up to this point, he was pretty sure he was secure and doing the right thing for himself, his wife, and their kids. He had accumulated over \$6M in retirement assets by the time he finally realized that working with an annuity salesman might not be in his best interests.

This annuity salesman had worked for an insurance company for almost 50 years. He was what we call a "captured agent." He could only sell products approved by that company and had won many sales contests selling products to his clients. Arnold was one of those clients. Arnold started investing the first month the annuity salesman started working. Year after year, decade after decade, this annuity salesman made hundreds of thousands of dollars selling variable annuities and life insurance to clients just like Arnold. Only when the annuity salesman was almost 75 years old did it occur to Arnold that he should probably have somebody look at what he had been sold over all those years.

Have you ever searched the Internet for "variable annuity" or even just "annuity"? If you have, the first thing that popped up

was probably something like this:

Ad - [www.fisherinvestments.com/adviser](http://www.fisherinvestments.com/adviser) ▾ (888) 989-2742

### Ken Fisher & Annuities - Learn Why He Hates Them

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Beware of this investment vehicle  
Learn Why Many Fail to Deliver

#### Retirement Income Guide

Discover How To Make Your  
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#### 8 Major Investor Mistakes

Learn How to Avoid Them!  
Download Our Free Investing Guide.

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Tips to Avoid Buyers Remorse  
Get Your Free Guide Today

One of the most common thoughts when it comes to annuities is, “We hate annuities, and you should too!” It is a fairly well-known catch phrase, and if you have ever searched the Internet by typing in “annuities,” all sorts of advertising comes up explaining the horror of using annuities.

We would suggest that these advertisements, sometimes disguised as useful information or advice, are actually just tactics used by various salesmen, biased at that, to get you to invest your money in their flavor of investments instead.

If you really think about it, annuities are just a tool. Like any good tool, used correctly, they can be very beneficial. Used incorrectly, they can be a disaster. A good friend of ours, John, is an electrician. For years, about once a month he would gather up all his wrenches, pliers, and screwdrivers and take them up to Sears and replace them. When we asked him why he was replacing them so often, he explained that it is easier to use his wrenches as a hammer when installing electric boxes than it was to carry around a hammer. He went on to say that rather than carry around several testing wires, because his pliers were insulated, he could test live circuits by just touching the tips to the black and white wires – true, it might blow the tips off the pliers, but it was easier than carrying around a big bucket of tools. Plus, evidently, Sears would guarantee Craftsman tools for life. For John, the short cut and promise of a lifetime supply of tools, meant he could take short-cuts.



We recently ran into John at ABE airport in Allentown. He was working on a new wing of the airport. As we were catching up, we noticed he had a large cart full of tools and devices. We asked him why all the tools? He explained that he recently changed his approach to using his tools. He had been testing, looking for a short in the wiring, and evidently, he found it! As he rubbed the tips of his pliers over the wires, when he hit the live wires, he wasn't grounded properly (he was actually standing three steps up on a ladder), and he was blown off the ladder and against a wall about ten feet away.

He told us that he lay on the ground quivering for about 15 minutes before he had the energy to stand up. His arm was numb for weeks. He still had difficulty gripping tools with his right hand and he had been electrocuted almost a year earlier. Evidently, John now decided that using the correct tool for the job made more sense!

Using annuities is much like John using tools. Using them correctly results in getting the job done right. Using them incorrectly can have disastrous results.

So why does Ken Fisher advertise that he hates annuities, and you should too? The cynic in us points out that he is a fee-based advisor, who wants you to move your assets to his firm so he can charge you a fee to manage them – rather than give them to some other firm who uses annuities – and gets paid a commission.

Having said that, there is some truth to what you read on the Internet about annuities. Let's break down the main complaints that we have heard about annuities:

### **1. They are very expensive to own.**

Annuities can be very expensive to own, depending on the type of

annuity you purchase. Just like any investment vehicle, annuities come in all shapes and sizes. You certainly want to understand the fee schedule and know how those fees could impact your returns.

One type of annuity you can purchase is a fixed annuity. We'll talk more about them later, but basically a fixed annuity smells and acts a lot like a CD. One difference though, is that the CD usually comes with FDIC insurance protection, a fixed annuity is only as strong as the issuing insurance company. More about this topic later.

On the topic of fees, how much does a fixed annuity typically cost to own? Fee wise? Nothing. No fees. Zero. Can't get much cheaper than ZERO.

Conversely, you could also purchase a type of annuity called a variable annuity. Why variable? Because your returns vary up and down – they are based on the performance of the sub accounts you use inside the annuity (we'll talk more about them later as well). These types of annuities can be strapped with all sorts of fees: Mortality & Expense (M&E) fees, Admin Fees, Sub-Acct. Fees (which also can have numerous types of fees inside of them), rider fees, and possibly other fees for too many changes in the portfolio, low balance fees, etc.

While these fees vary...we know, we see the humor ... frequently the fees for M&E are somewhere between 0.8% and 1.6%. The Administrative fee is typically \$25–\$100. The Sub-Account fee (again, you'll understand these more as we refer back to them) can range from approximately 0.9% all the way up to 7–8%, we have even seen higher fees. Then there are rider fees which can range from 0.25% up to 2 or 3%.

These are the type of annuities that are usually the most complained about. After all, if you assume the stock market averages 6–8% over time, if you are being charged 3 to 5% *or more* in fees, how can you possibly expect to make any money? You can understand

why Mr. Fisher would tell you to hate annuities...at least variable annuities.

You can see that there can be fees with annuities, and certainly the fees can be exorbitant, some as high as 5% or more! However, you must examine annuity fees with those that come with using an investment advisor charging fees for advice and using investments like mutual funds, ETFs, and stocks, all of which can carry hefty fees as well.

We are used to paying fees for services, which is nothing new. We pay fees for all sorts of things we find valuable: Netflix, cell phones, Internet, gym and club memberships, and the list goes on and on. There is nothing necessarily wrong with paying a fee, as long as you know what you are paying, so ask. Ask the advisor you are working with and ask the insurance salesman you may be working with. Ask the person or entity selling you the product or investment: *WHAT ARE THE FEES?* Make sure you understand all the fees (not just the ones they want to tell you about, but also the “hidden” fees). We’ll talk more about questions you should ask a financial advisor, planner, or insurance agent PRIOR to making any investments or purchases.

## **2. You can’t make money in them because of the limits in the contract.**

This complaint stems from two different issues: one, the fees greatly reduce the earnings on variable annuities; and two, there are caps/spreads found in fixed indexed annuities.

Let’s look at the Variable Annuity (VA) first. If the goal is to make market returns while taking market risk, then if you are going to use a VA (we’ll discuss why people use VA’s later), you will want to find the cheapest annuity (fee-wise) with the best investment choices.

We have seen variable annuities that have had total fees less than 1% (M&E, investments, and Admin.).

Heck, that's cheaper than most mutual funds, and maybe, just maybe, for the right reason, using a VA might not be so expensive after all. T. Rowe Price also has low-cost VA's. As a matter of fact, there are several very low-cost annuity companies offering variable annuities nowadays.

Clearly, not all VAs are this inexpensive, and we suspect that most insurance agents and financial advisors earning commissions will not be recommending Vanguard VAs. Nevertheless, if you want growth and a VA is the right tool (again, we'll discuss later why it may be the right tool), you can find a very low-cost VA. Keep the fees down and you can make money when the market goes up.

As for Fixed Indexed Annuities, they are incredibly complex, and we are going to go out on a limb to suggest that most advisors/agents selling them really don't understand how the annuity can actually make money.

Without going into all the possible ways fixed indexed annuities "participate" in the stock market (more on that to come), suffice it to say that Fixed Index Annuities (FIAs) are not well suited to see the same potential growth as owning something like an S&P 500 index fund.

FIA's frequently come with caps and/or spreads. Generically, the way these tools work is that if the FIA has a spread, the insurance company gets paid first. For example, if your FIA performance is based upon the performance of the S&P 500, and the FIA has a 3% spread, which would mean that the first 3% that the FIA could possibly earn, would go to the insurance company. If the FIA earned 6% on the underlying strategy, and had a 3% spread, your account would only grow by the difference: 3%.

The FIA could also have caps – these act as limits on how much you can earn. For example, if the FIA has a 6% cap on the underlying strategy, and that strategy earned 17%, you would only be credited the 6%.

If you are going to use an FIA for growth purposes, you certainly need to understand how the caps/spreads are going to impact your ability to make money. The advisor/agent who presents an FIA to you should be able to articulate how you can make money. You certainly will want them to go through the nuances of how the caps and/or spreads are going to impact your potential growth.

You could ask yourself, ‘If it is so hard to understand, why would I purchase one?’... we’ll address that question in later chapters.

### **3. They have huge surrender charges.**

That could be true. Many annuities come with time constraints, and if you cash out, that is, take all your money out within a certain period of time, you could be charged surrender fees. Sometimes these fees are draconian; we have seen fees as low as 1% but also as high as 24%. Most fall into the 1–10% range but still, imagine having to pay 10% surrender fees just to get your own money?

Most of these annuities which carry surrender charges have a sliding scale. For example, if you take 100% of your money in the first year, your surrender charge may cause you to lose 10% of the value of the distribution; in the second year, the charge would be 9%; the third year, 8%; and so on. Obviously, each insurance company has their own surrender schedule and depending on the type of annuity you purchase, the surrender schedule could be as short as 1–4 years or as long as 10–15 years. That is why it is so important to understand how are going to access your money.

Just like investing in the stock market, most annuities are considered long-term vehicles and so you should never make any investment into an annuity or the stock market if you need access to 100% of the funds soon.

If you choose to use an annuity, make sure you understand the liquidity provisions and how you are going to access your money should you need it. Also remember that there are some annuities

out there that carry no surrender charges at all. There are also those that have a “return of premium” feature that allows you to access 100% of your principal within a specified period. You may lose part or all your gains, but you can walk away with your principal.

#### **4. They pay commissions.**

Again, mostly a true statement. Certainly, the majority of annuities out there being used by advisors carry some sort of commission. The argument is whether the advisor/agent recommended the annuity because it was the best tool for you, or because it paid a hefty commission.

How hefty? We have seen annuity products that pay as little as 1% but also have seen them as high as 10%. In years past, there were annuities that would pay upwards of 20% in commissions. As of this writing, most of the annuities paying commissions we have analyzed, pay between 3–7%.

It does beg the question, doesn't it? Does the person recommending the annuity really think it is good for me? Or does he/she just need to meet a sales quota or need to make a mortgage payment?

We all know that if we are working with somebody who is going to provide advice, they are going to get paid for giving that advice. Nobody works for free (and that includes those free dinners and lunches to which you get invited). It is reasonable for them to get paid – they have knowledge, and you are seeking their assistance.

So, should you hate annuities because of the commission? Let's explore that a little more. Let's assume for a minute that we agree that purchasing an annuity is a long-term purchase. Let's assume that you are going to take a “buy-and-hold” approach and are not going to use ALL the money in the next 10 years. And finally, let's assume that you invested \$100,000.

If you use a fee-based advisor, charging you 1%, that means over

the course of 10 years, you would have paid the advisor \$10,000 in fees. That fee by the way, comes out of your money. So, all things being equal, assuming 0% return for the 10-yr. holding, your account balance would be \$90,000 (\$100,000 - initial investment - less the \$10,000 in advisor fees = \$90,000).

Using the same facts with the same return of zero, the annuity would have \$100,000 at the end of the 10-year holding period; because the commission paid to the agent comes out of the insurance company's pocket, not your investment. Your investment is not reduced in any given year for the commission(s) paid to the advisor.

To be fair, we didn't include any underlying investment fees, and such fees, that, if applicable, would clearly have an impact on your balance over that 10-year time. We wanted to show an apples-to-apples comparison to demonstrate how much those commissions actually cost you, the investor.

It is fair to ask about how the advisor gets paid. If an advisor recommends an annuity, it should be to accomplish a very specific goal. Never purchase an annuity just because you can (or make any investment that isn't based upon a goal). The goal should always dictate the investment. Purchase an annuity because it fits your needs. By making sure it fits your needs, you can then judge whether the recommendation was to earn a commission or because it was the right choice for you.

## **5. They are inherently difficult to understand.**

Did you just read the previous pages? These things are inherently confusing, and it is no wonder that regulators are watchful over these vehicles.

Trying to piece together all the moving parts:

- caps
- spreads

- volatility
- fees (some have them, some do not)
- surrender charges
- liquidity
- tax consequences
- safety

... and all the other factors that come with deciding whether an annuity is appropriate can be very overwhelming.

An annuity is just another tool. Don't hate them, make sure you understand them and certainly ask questions:

- An annuity can come in many shapes and sizes. Make sure you understand which type you are buying.
- An annuity *can* come with huge fees. Make sure you understand how much you will be paying for ALL the fees.
- An annuity usually isn't very liquid. Make sure you know when and how you will have access to your money.
- Put in the least amount necessary in order to accomplish the goal the annuity is designed to address.
- And finally, make sure you understand how your annuity is going to make money for you.

Open heart surgery is inherently difficult to understand. That doesn't mean people shouldn't have the surgery. They should have the surgery when it is the right thing for them—just like using an annuity. . . only when it leads to ***A Better Way***.



## CHAPTER 15

# DO YOU STILL HATE ANNUITIES?

*If you observe, people always live forever when there is an annuity to be paid to them.*

Want to know just how confusing they can be?

When Arnold purchased all those annuities over all those years from the annuity salesman, Arnold certainly didn't understand the complexity of the annuities he was buying. By the time we were done explaining the contracts he was sold, he was positive the annuity salesman did not understand them either.

This is the information on one of his numerous contracts:

**AXA Accumulator Plus IRA- Arnold "X"**

Current Value: \$200,749.57

Contract Date: 02/04/2011

Surrender Value: \$196,658.61

Surrender Date: 09/04/2021

Total Contribution: \$183,000

Allocation: 70/30 across multiple funds

Living & Death Benefit: \$231,542.18; 2.2% Fee

Note: Living and death benefit work the same- they have a 5% rollup compounding annually based on total contributions, withdrawals are 4 up to 5%, anything over is pro rata. They also have the ratchet base which cannot be used until the 10<sup>th</sup> year and must be annuitized -- this the highest anniversary up to age 85, all withdrawals are pro rata.

MAX AVAILABLE WITHDRAWAL: \$11,175.68 (4.8%)

SYSTEMATIC WITHDRAWAL: \$8,515.10 (RMD) August each year

Fees: M&E 1.55%, GMIB 1.10%, GMDDB 1.10%, Sub Account 1.0%= Total Fees: 4.75%

Primary Beneficiary: Susan 100%

When Arnold came into the office and allowed us to review the annuities with him, he was shocked to learn that the annuities he purchased were costing him about 4.75% in annual fees. He had a death benefit, an income benefit, the M&E fees, and the underlying sub-account investments. (Think of a sub-account as something like a mutual fund at an insurance company: they are run by mutual fund companies, invest like mutual funds, have costs similar to mutual funds, and act a lot like mutual funds, but with a variable annuity, they are not called mutual funds, they are called sub-accounts). Oh! Did we mention confusing?

Lots of fees were wrapped in these annuities Arnold had purchased from the annuity salesman over the last 50 years. He didn't actually believe us until we got him on the phone with the annuity company and went through the actual costs. They confirmed exactly why Ken Fisher "hates annuities"...at least variable annuities, because of the fees.

Notice on the contract that there is a current value of \$200,749 but if he wanted to take his money out, he would only get \$196,658? Number two reason Ken hates annuities: the surrender charge for early total withdrawal.

The next thing that surprised Arnold was the fact that at age 85, he would be forced to annuitize the contracts or lose the benefits they provided. Again, Arnold didn't believe that he would be forced to annuitize the policy at age 85 or risk losing those benefits he paid so much in fees to have in the first place. We had to get the annuity company on the phone to confirm to Arnold what the annuity salesman had clearly failed to explain.

We pointed out to Arnold that the income and death benefit riders were \$231,542. The contract guaranteed that that number, the \$231K, would grow by 5%, compounding annually until age 85. That was important, that the guaranteed growth ended at age 85. Until then, the death benefit would grow. The income benefit would grow. Arnold understood that.

What Arnold didn't understand, and what the annuity salesperson didn't explain, was that at age 85, the 5% growth stops. At that point, Arnold will have two choices: he could either keep the death benefit intact so that when he passed, the \$231K plus the 5% growth that accumulated until age 85, would go to his heirs, OR he could annuitize the policy and take income. In doing so, by annuitizing the policy, all he was guaranteed at that point would be income. So basically, he would be giving his money to the insurance company all those years, and they would guarantee to pay him "X" amount for the remainder of his life. There would be nothing left to distribute at his death. If he took one payment and then died, nothing would go to his heirs. No do-overs. No changing his mind. Annuitization is final. Income is there. Account value is gone.

So, Arnold was sold a policy that had an income rider on it he didn't need because he had ample sources of other income. It had a death benefit on it that meant if he wanted to use any of that account for anything, he would lose the death benefit value. He had no idea what a disaster this policy was for him. Neither did the annuity salesman!

Remember we mentioned that these things were convoluted?

Now, remember, Arnold had over \$4,000,000 in these types of policies. At age 75, Arnold had so much money tied up in these annuities and he didn't know how to use them. They were sold to him by a captured agent, an annuity salesman who worked for an insurance company, that only allowed the salesman to sell its products. Even at this point, the annuity salesman had no idea on the restrictions and costs associated with the annuities sold to Arnold.

It took us getting on the phone with Arnold and the annuity company to help Arnold see the light. We don't call the annuity salesman to explain the products he/she sold, we call the annuity company, on a recorded line, to ask the questions our clients

would ask, if they knew what questions to ask. Finally, after 50 years of buying these annuities, Arnold realized that he really didn't understand them. He had no idea about the fees he was being charged. He had no idea about the restrictions on access to the cash. He didn't know how the benefit riders worked on his own annuity let alone the annuities he had sold over the years. Yes, that's right: *Arnold was the annuity salesman selling annuities he didn't understand.* Reason number three that Ken Fisher hates annuities!

Being an annuity salesman had allowed Arnold to enjoy a very comfortable lifestyle living off the commissions he earned along the way. He was able to put his kids through school. He had a wonderful home and had an incredible nest egg. He was even in a position to leave an incredible legacy to his kids and grandkids. The problem for Arnold was that he **CHOSE** to work with an annuity salesman instead of a financial planner.

Arnold knew he needed *A Better Way*.

While Arnold didn't need the income from his annuities, using an FIA for Tony and Joyce made perfect sense. They were able to participate in the upside of the S&P 500, capped at 10.25% returns, but without any market risk to their money. They needed market-like growth without market-like exposure. An annuity was the right tool for them.

An annuity was also the right choice for Michael. His advisor had told him he needed to commit 100% of his \$1.6M retirement nest egg toward producing the income that he wanted; and even then, the advisor said that Michael would not be able to create enough income to meet his goals. By using an annuity, we were able to create 100% of the income that Michael desired, guaranteed income for Michael's life, and still leave him over \$300,000 of what we call "wiggle" room. Wiggle room for the extras that always come along with retirement. An annuity was the right tool for him.

“We hate annuities, and you should too!” Hopefully, we have dispelled that myth. You shouldn’t hate annuities. Like any type of investment, you want to make sure if you decide that an annuity is appropriate for you, that you understand why it is the correct choice, and how it is going to meet your goals. If not, continue reading when and why an annuity MIGHT be the right choice.

A great guide to a better understanding of all these issues can be found on the web site of the National Association of Insurance Commissioners: [www.naic.org](http://www.naic.org). While you might think that they are biased, after all, they have the word “insurance” in their name, they are not actually part of the insurance industry. Rather, they represent the insurance commissioners across the United States – commissioners whose job it is to **PROTECT YOU**, the consumer.

A variable annuity is just one of the tools frequently sold by salesmen, registered representatives, and financial advisors. Financial planners may use them, but we suspect that given the other options available, and that most VAs are an expensive option for the client, the number of fiduciary financial planners using them today is quite minimal.

Another annuity available is called a SPIA: *Single Premium Immediate Annuity*.

In its simplest form, a SPIA is basically a self-created pension. If you have a company-sponsored retirement plan – 401(k), 403(b), 457, TSP, just to name a few – you may have seen on your investment statements that the value of your account will produce “X” over your lifetime.

This is how they work: again, in simple terms, you give your money (yes, give) to an insurance company. In exchange for you giving them your money, they agree to pay you a certain dollar amount for a specific period of time. How long that guaranteed period is dictates how much that payment will be. The longer

the time period, the smaller the payout will be. The shorter the guaranteed payout period, the larger the payment can be.

Why would you turn your money over to an insurance company and give up your principal? For most people, it's because they want certainty of that income. Think about it from this perspective – you have worked for the last 30 years and now you are retiring. For those 30 years, you received a paycheck every two weeks. You're used to getting money deposited into your bank account every two weeks. You budget according to those deposits. When you retire, those paychecks stop.

Remember that three-legged stool? A pension can be one of those three legs. If you don't have a pension, a SPIA can serve in its place. A SPIA helps replace that lost paycheck, and like your paycheck, it comes in regularly, and you can budget accordingly. Social Security comes in monthly as well; and for many people, it also provides that security of knowing you will have a monthly check coming into your bank account.

What happens when your pension (if in fact you are lucky enough to still have one) and your social security are not enough to meet your monthly bills? That is when a SPIA (or another form of annuity) can help.

Obviously, the idea of turning your money over to an annuity company, in exchange for a lifetime of income, is a scary proposition. First, once you give them your money, it becomes theirs. That is correct, you no longer have any rights to that chunk of money you sent to the insurance company.

So how can that make sense? Give them my money for income? What happens if I die after getting the first check? How does this impact my spouse? What about my heirs? All are great questions and certainly, if you choose to use a SPIA, questions to which you will need answers.

Yes, you will be giving them your money in exchange for income. Keep in mind that you are not required, nor should you give them 100% of your nest egg. While income is important, so is flexibility, especially during the early stages of retirement. You should only use as much of your nest egg necessary to create that income stream required to meet your needs.

## CREATE A BUDGET

We know, it can be difficult, but it is a great exercise, and frankly necessary, as you head into retirement. You need to know how much money you will need. This process can be intimidating. You need to be honest with yourself and your spouse about what is being spent. We always suggest that you take three months of bank and credit card statements and use them for your budget. Pretty much everything you spend will be detailed there. Remember to include the cash you pulled out from the ATM machines!

Now that you have your bank and credit card statements, organize them into categories. We always recommend using a budget worksheet. Numerous websites offer them and here is one example:

HEALTH	AMOUNT
HEALTH INSURANCE	
LONG-TERM CARE INSURANCE	
DOCTOR VISIT CO-PAYS	
MEDICAL SUPPLIES/PRESCRIPTIONS	

<b>HOME &amp; PROPERTY</b>	<b>AMOUNT</b>
MORTGAGE/RENT	
PROPERTY TAXES	
PROPERTY INSURANCE	
HOMEOWNER ASSOCIATION DUES	
HOME/PERSONAL SECURITY	
HOME REPAIRS/MAINTENANCE	
LAWN MAINTENANCE	
EXTERMINATOR FEES	
VACATION HOME MORTGAGE	
VACATION HOME PROPERTY TAXES	
VACATION HOME PROPERTY INSURANCE	
VACATION HOME MAINTENANCE	
WATER	
ELECTRIC	
GAS/HOME	
PHONE/CABLE	
CELL PHONES	
GARBAGE/WASTE DISPOSAL/RECYCLING	
VACATION HOME UTILITIES	

<b>OTHER</b>	<b>AMOUNT</b>
CHURCH TITHE	
CHARITABLE CONTRIBUTIONS	
DEBT SERVICE/CREDIT CARDS	

DO YOU STILL HATE ANNUITIES?

<b>PERSONAL</b>	<b>AMOUNT</b>
FOOD	
CLOTHING	
ENTERTAINMENT	
HOBBIES	
GIFTS	
VACATION	
PERSONAL CARE (HAIR, NAILS, MASSAGE, ETC.)	
CLUB DUES (GYM, SPA, GOLF, TENNIS, ETC.)	
NEWSPAPERS, MAGAZINES, BOOK CLUBS	

<b>AUTOMOBILES</b>	<b>AMOUNT</b>
LEASE/LOAN PAYMENTS	
INSURANCE	
GAS/AUTO(S)	
AUTO MAINTENANCE	
RECREATION VEHICLES & BOATS (PAYMENTS, INSURANCE, MAINTENANCE)	

Next, look at the budget and decide what items are “must items” and what items are “wants.” For most people, the “must items” are such things as: housing, food, utilities, auto expenses, gas, phones, cable, internet, pets, and medical. Of course, there are others, but those are typically the primary items that come up.

The “wants” are considered the extras in life. We “want” to play golf three times a week. We “want” to travel. That is what we thought retirement would look like!

Next, you need to determine your income:

<b>MY ASSETS &amp; EXPENSES</b>	
RETIREMENT INCOME FROM PENSIONS	\$
RETIREMENT INCOME FROM SOCIAL SECURITY	\$
TOTAL RETIREMENT INCOME (A)	(A) \$
MY MONTHLY EXPENSES (B)	(B) \$
AMOUNT OF INCOME NEEDED FROM OTHER SOURCES	(A) – (B) = \$

Once you have determined what your needs are, (not wants), but the needs, total those numbers. From a math equation, that number equals Z. You know what your pension and social security will be and those numbers equal Y. You are solving for X.

$$\mathbf{X = Z - Y}$$

Let's assume for a minute that your needs are \$5,000 a month, and your pensions and social security are \$4,000 a month:

$$\mathbf{Y = \$4,000}$$

$$\mathbf{Z = \$5,000}$$

To solve for X, do simple math:

$$\mathbf{\$5,000 - \$4,000 = \underline{\$1,000}}$$

In this scenario, the shortage you have every month is \$1,000. This means you need to put enough money into a SPIA, or something else that's safe, secure, and reliable, to create \$1,000 a month for life.

The tricky part, of course, is deciding whether to cover just your life or that of you and your spouse. With the above example, the \$1,000, do you want it to last for just your life or for the life of you and your spouse? IF you are trying to cover both lives, you will need to use more of your nest egg, less if you only cover yourself.

There are multiple payment options to choose from as well: period certain, 10 years or life, 20 years or life, and the list goes on. For example, if you chose to have a payment option of 10 years or life, that means you would receive a payment for at least 10 years OR your lifetime, whichever was longer. What this does is ensure that if you should die before 10 years have passed, your heirs would get the same payment for the balance of those 10 years.

If you were receiving the \$1,000 a month for 10 years or life and you died after one year, your heirs would continue getting the \$1,000 a month for the remainder of those 9 years. If you died at the 9-year mark, they would get the payment for one more year. However, if you lived for 30 years, you would still get the \$1,000 a month for 30 years.

This is what makes the SPIA attractive to some people – the guaranteed income for life.

Each SPIA option you choose will require a different amount of your nest egg. IF you choose this route, you should sit down and clearly understand how you, your spouse, and your heirs will be impacted by this type of annuity.

From our experience, this arrangement gives YOU the biggest bang for the buck. IF you have no heirs or spouse, it might make sense. Even if you have a spouse, this approach might be the best solution, especially if leaving a legacy of this money isn't a factor.

When might a SPIA be a better way?

Carol had been a client for many years. She was a retired schoolteacher with a comfortable pension. She also had a survivor's pension from her deceased husband, and along with SS, her income needs were pretty well met. Like most of our clients, she had lived within her means and had managed to amass a fairly large nest egg heading into retirement. One of her

primary goals was to make sure that her nest egg went to her two daughters when she passed away. In fact, her biggest fear wasn't that she would run out of money, it was that a nursing home would consume all her savings.

If you have ever had a family member or loved one go into a nursing home, you know it can be a very traumatic experience. This is especially true when the reason for entering is due to Alzheimer's or dementia. It is perhaps the most vicious of the diseases we encounter as we age. It strips us of control and our dignity, and it is very painful to watch a parent go through that downward spiral. To add to the mental and emotional anguish is the financial cost associated with the around-the-clock care needed. It isn't uncommon to see nursing home costs in the range of \$8K–\$12K a month or the costs of home health aides costing even more. Imagine spending \$144K a year for health care?

For Carol, she had experience with the costs of dementia. Her mother had been in a nursing home, the memory center, for almost 15 years. Carol and her brother had gone through Mom's entire nest egg and finally had to apply for Medicaid to help cover the costs of the nursing home. Her Mom had spent over \$800K of her savings for her medical care. EIGHT HUNDRED THOUSAND DOLLARS. She knew her Mom had been upset and concerned that she would not be leaving anything to her kids or grandkids. She remembers her mom being distraught knowing that she wouldn't be able to give her grandkids cash for Christmas or help with the costs of college. As Mom's mental capacity diminished, she remembers how she became singularly focused on her money – she was afraid of running out!

Carol wanted *A Better Way!*

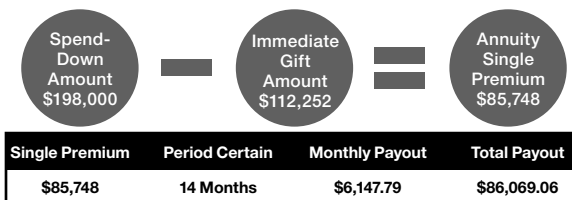
A SPIA can be the right tool when it comes to creditor protection and Medicaid Planning. While an in-depth conversation about Medicaid Planning is not within the scope of this book, it is worth noting that you should have this conversation with your financial planner.

The idea behind Medicaid is that when a person can no longer afford the high costs associated with being in a nursing home, Medicaid will “pick up the tab” and pay for your continuing care. It does require that the person needing the financial assistance, the Medicaid recipient, to basically be impoverished. Medicaid requires you to be broke before they will step in. After all, it makes sense to require you to spend your own money before they spend theirs.

Seems simple enough to qualify: if you have too much money, if you are not impoverished, you have to “spend down” your assets. That is, you have to cover the costs of your nursing home care until such time as you have spent all your money. What if you try to give your money away to your kids first? Can’t do that, Medicaid has what is called a “5-year look-back” period. IF you gave away any of your assets for less than fair market value, then you will not be qualified for assistance, even if you are otherwise broke. This means that if on 1/1/21 you gave away all your money, while you are broke on 1/2/21, Medicaid will not help you. With the current Medicaid rules in place, you would not be eligible for assistance until 1/3/26. That is five full years of private pay, until you would be able to apply for Medicaid assistance.

One solution is using a SPIA. You put enough of your nest egg into the SPIA, that when coupled with your other sources of income (pensions and SS), it meets the costs associated with being in a nursing home. You can then look to “give away” the balance of your assets. Because you have converted the nest egg into an income stream, you no longer have any assets that can be claimed by a nursing home or other creditors.

## Determine the Annuity Single Premium



While Carol wasn't ready to go into a nursing home, she was moving into a retirement community that offered continuing care. She wasn't ready yet, but after seeing Mom run out of money, she wanted to make sure she didn't have the same experience.

For Carol, we set up a specific type of Trust, frequently called a defective grantor trust or a Medicaid Trust. Carol transferred her home and her non-qualified assets to the trust, making it a gift to her daughters. She remained in control of the assets; she just didn't technically own them any longer.

We left enough money in her IRA to cover any needs she may have. We also explained that when the time came when she needed to move from independent living to the memory care center, we would be using the balance of her IRA to purchase a SPIA. By purchasing the SPIA, she wouldn't need to use any of the assets she transferred into the Trust; thereby leaving her children the legacy her mother wasn't able to leave her. She wouldn't have to spend all her IRA immediately, and if she never needed the treatment of a memory care center, the IRA would add to the legacy. If Carol did need that care, she would not use any more of her assets than the \$330K left in her IRA.

Carol found *A Better Way*.

One annuity that Ken Fisher doesn't object to is called a Fixed Annuity. A fixed annuity smells and looks a lot like a CD but is issued by an insurance company instead of a bank. To be clear, a fixed annuity is not FDIC-insured; but still, just like purchasing a CD from a bank, you purchase a fixed insurance contract through an insurance company. You will earn interest on your purchase, a fixed rate of return. At the end of the purchase time (frequently three to five years), you will receive your principal and interest back. Unlike a CD, a fixed annuity isn't taxable as it earns interest, rather, you pay tax on the interest when you actually take it out of the annuity.

A fixed annuity is “guaranteed” by the insurance company that issued the policy. Because the policy is guaranteed by the insurance company, you will want to investigate how strong that guarantee is. You can read about the company’s credit ratings in Moody’s, S&P, AM Best, and others. You can look at their reserves – in theory, the insurance company must have reserves to meet their obligations on the money. For example, if you purchased a fixed annuity in the amount of \$100,000, the annuity company (insurance company) is required by law to have investment grade reserves of \$100,000. Many states also require insurance companies to pay into an insurance pool to protect policy owners from insurance company insolvency. Typically, the state will “insure” up to some dollar amount of your fixed annuity. You can check with your state insurance commissioner to see what is covered in your state.

Just like cashing a CD out early, if you purchase a five-year annuity contract, and you decide to withdraw your money early, you may lose some or all your interest. Depending on the type of fixed annuity, you could also lose some of your principal.

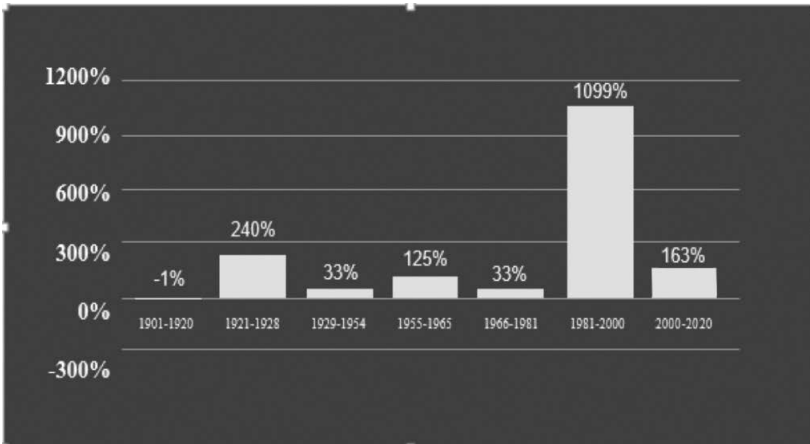
So, how might a Fixed Annuity work in your portfolio? They are considered safe investments – from a market risk point of view. Frequently, when an investor is considering an allocation in the stock market, they will put a portion of their investment in equities (stocks, mutual funds, and/or ETF’s), and a portion in fixed income. Fixed income is made up of investments like bonds, CD’s, Fixed Annuities, preferred stocks, and other vehicles that move with interest rates more than with stock market changes.

Have you ever heard of Suze Orman? She hates variable annuities almost as much as Ken Fisher. What annuity does she find acceptable? The Fixed Index Annuity. A fixed index annuity is often referred to as an FIA. She sees it as a better way to get stock-market-like exposure, without actually taking the risk associated with being in the stock market.<sup>31</sup>

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31. <https://www.suzeorman.com/resources/annuities>

Remember that chart back on pg. 83 (the one that shows no returns for 13 years)? Imagine for just a moment that you retired on January 1, 2000. Imagine if you and your spouse had social security paying \$3,688 a month, and a pension paying \$2,741 a month. Imagine you had made smart choices along the way and had a retirement nest egg of \$860,000 in your 401(k) and another \$524,000 in those annuities that Ken and Suze hate: variable annuities. Imagine what retirement would look like if your income need was \$105,000 a year, after taxes.



This chart represents rolling periods of growth of the DOW. Note the returns investors may have experienced from 1981 through 1999. Almost 1100% cumulative growth over that time period! Notice also, that investors have NEVER experienced anything close to that before or since. [Source YAHOO FINANCE: The DOW is an index. Investors cannot invest directly in the DOW. Does not include dividends. Past performance is no indication of future results.]

At a first look, you might think that 1100% growth is great. You might also be happy with the growth between 2000 and December 31, 2020. The numbers certainly seem pretty good. When Robert and Theresa came into the office to talk about income planning, they were pretty happy with what they had been shown by the guy who worked for a company that also provided them with their favorite credit card: Ameriprise.

The plan that their registered representative suggested was to roll over their 401(k)'s into an Ameriprise Brokerage IRA. That made sense; from our perspective, it almost always makes sense that when you leave your employer, your money should leave with you.

The rollover itself isn't a taxable event. It is just moving from one account to another in what is called a trustee-to-trustee transfer. Usually this can be handled right over the phone by instructing the 401(k) custodian to send it to your new custodian: wherever you open your IRA. So why move it?

Among the numerous reasons, perhaps the ability to have almost unlimited choices is the primary reason. In the typical 401(k), a plan participant may have 10–15 choices of investments, most often just mutual funds. When you roll your 401(k) into an IRA you have thousands of choices: mutual funds, stocks, bonds, exchange traded funds, real estate (yes, you can purchase rental and commercial property inside an IRA), annuities of any sort, and the list goes on and on. Perhaps paralysis by analysis, but still, many more options.

Another reason? Fees. According to Forbes, you can lose almost one-third of your returns to hidden 401(k) fees.<sup>32</sup> Yes, you may be told that there are no fees, but when you dig down into the plan summary, and look at the investment vehicles, there are usually fees, and they can add up.

Comedian John Oliver did a “colorful” expose on the 401(k) he tried to set up for his employees. (You can watch it on YouTube: <https://www.youtube.com/watch?v=gvZSpET11ZY>)

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32. <https://www.forbes.com/sites/brianmenickella/2018/02/23/are-401k-fees-shrinking-your-retirement-returns-heres-what-you-need-to-know/?sh=3101b3c15d95>



In summary, in his exposé, John's team interviews the advisor on the plan and also talks to the plan provider and not one of them can actually tell his team what the fees are associated with the plan. In fact, only after his team dissects the plan summary do they find out the true hidden costs associated with 401(k)'s. So with the hidden costs, and lack of transparency, it may make sense to roll your 401(k) over as soon as you possibly can.

Some other reasons to move your 401(k) into an IRA that you control: the ability to work with a financial professional and seek investment advice, as well as options on how you can take your money out, AND how your heirs will inherit any money left when you pass on.

And those were exactly the reasons Robert and Theresa were speaking with the registered representative. They wanted financial advice and they wanted options.

They told the registered rep that they wanted \$8,750 a month of income, after taxes, in retirement.

They had slightly more than \$6,400 coming in from pensions and SS and they had almost \$1.4M in investments. The rep's recommendation: surrender the annuities because they cost too much to own (they were out of those surrender charge periods, so there wouldn't be a fee to leave). He then recommended that they put their money into a straight-up equity portfolio. According to him, they should be able to withdraw the roughly \$63,000 a year they needed, from their \$1.4M and hopefully not run out of money.

Robert and Theresa voiced some concerns about the volatility

in the markets; but they were assured that the market does fine over time, and that they should expect somewhere around an 8% average rate of return. He went on to explain that they really only needed to take out about 4% (remember that antiquated 4% rule?) to meet their income needs. With the difference, about 4%, they could adjust their income each year for inflation and cover some of the inevitable “honey-do lists”, the “bucket list” and the “round-to-it lists” that always comes up during retirement.

It all made sense to Robert and Theresa. They liked the representative. After all, they had worked with him in the past and felt comfortable. Nevertheless, they wanted a second opinion.

The first thing we did when we spoke with Robert and Theresa was explain the difference between average returns and actual returns. It’s important to understand that when you are just letting the money grow and not using it, like during the accumulation phase of life, averages are ok. When you have 10 to 20 years or longer before you need to use the money, the ups and downs of the markets tend to flatten out, and so averages work fine. It is a different story when you need to use the money during retirement and your goal is to make sure you never run short.

Think about this for a minute: if you invest \$100,000 into the stock market, and the first year you invest, the market drops 50%. The next year, the market goes up 50%. What is the average return? ZERO. Ok, that made sense to Robert and Theresa. But, when you apply those returns to actual numbers, it feels a little different.

<u>Average vs. Actual returns</u>		
<u>AVERAGE RETURN</u>	VS	<u>ACTUAL RETURN</u>
Yr 1    ↓    50%		\$100,000 ↓ 50% = \$50,000
Yr 2    ↑    50%		\$50,000 ↑ 50% = \$25,000
Average Return? 0%		Ending Value: \$75,000

How can it be that you have a zero percent average rate of return, but you lost \$25K? When we showed this to Robert, his initial reaction was that it was only two years and that they were going to be long-term investors. It was a true statement; they would be using their money for the next 30 years of their retirement. Robert didn't realize that he had actually answered his own question. They weren't going to be "buying and holding" any longer; but rather, they were going to be systematically withdrawing their money. It is that withdrawing of money that requires a better way of investing during this period of your life. Remember our example of sequence of returns?

At the time when Robert and Theresa came into our office, the S&P 500 was on the uptick from the March and April lows of 2020's pandemic.

The market was down just over 25%. We showed Robert what a "buy-and-hold" strategy might look like:

	<i>Beginning</i>		<i>Historical</i>
<i>Year</i>	<i>Balance</i>		<i>Return</i>
2000	\$ 1,400,000		-10.14%
2001	\$ 1,258,040		-13.04%
2002	\$ 1,093,992		-23.37%
2003	\$ 838,326		26.38%
2004	\$ 1,059,476		8.99%
2005	\$ 1,154,723		3.00%
2006	\$ 1,189,365		13.62%
2007	\$ 1,351,356		3.55%
2008	\$ 1,399,329		-36.99%
2009	\$ 881,717		26.45%
2010	\$ 1,114,932		15.05%
2011	\$ 1,282,729		2.12%
2012	\$ 1,309,923		16.00%
2013	\$ 1,519,510		29.60%
2014	\$ 1,969,285		11.39%
2015	\$ 2,193,587		-0.73%
2016	\$ 2,177,574		9.54%
2017	\$ 2,385,314		19.42%
2018	\$ 2,848,542		-6.24%
2019	\$ 2,670,793		28.88%
YTD	\$ 3,442,118		-26.51%
	\$ 2,529,682		4.62%

Robert was pretty happy looking at the market's sequence of returns during that time frame we showed him. He had \$1.4M, and assuming he invested in an index tracking the S&P 500, his returns were not bad over the last 20+ years: 4.62%. (Keep in mind that these numbers didn't include dividends). So, if we include another 2% for dividends, Robert would be averaging about 6–7%.<sup>30</sup> It also doesn't include any fees that he might

otherwise incur. This is slightly less than what they were told the market averaged, but within reason.

He was actually pretty happy with the idea that his \$1.4M could grow to \$2.5M over time.

We then showed him what would happen if he withdrew the 4% that the advisor suggested would work. That didn't work out quite as well as he thought!

	<i>Beginning</i>		<i>Historical</i>	<i>Annual</i>
<i>Year</i>	<i>Balance</i>		<i>Return</i>	<i>Withdrawal</i>
2000	\$ 1,400,000		-10.14%	\$ 56,000
2001	\$ 1,202,040		-13.04%	\$ 56,000
2002	\$ 989,294		-23.37%	\$ 56,000
2003	\$ 702,096		26.38%	\$ 56,000
2004	\$ 831,309		8.99%	\$ 56,000
2005	\$ 850,044		3.00%	\$ 56,000
2006	\$ 819,545		13.62%	\$ 56,000
2007	\$ 875,167		3.55%	\$ 56,000
2008	\$ 850,235		-36.99%	\$ 56,000
2009	\$ 479,733		26.45%	\$ 56,000
2010	\$ 550,623		15.05%	\$ 56,000
2011	\$ 577,491		2.12%	\$ 56,000
2012	\$ 533,734		16.00%	\$ 56,000
2013	\$ 563,132		29.60%	\$ 56,000
2014	\$ 673,819		11.39%	\$ 56,000
2015	\$ 694,567		-0.73%	\$ 56,000
2016	\$ 633,496		9.54%	\$ 56,000
2017	\$ 637,932		19.42%	\$ 56,000
2018	\$ 705,818		-6.24%	\$ 56,000
2019	\$ 605,775		28.88%	\$ 56,000
YTD	\$ 724,723		-26.51%	\$ 56,000
	\$ 476,614		4.62%	\$ 1,120,000

You can see that Robert would have the same average rate of return that seemed so reasonable before (4.62%), plus any dividend. The problem was that after 20 years or so, Robert and Theresa were running out of money...certainly before they intended to run out of life.

We explained to Robert that the sequence of returns, what your returns are during your retirement, EACH YEAR of returns matters. It isn't how well you do over time, because when you are retired, time is no longer your friend. Average rates of returns no longer matter. What matters during the distribution phase of life is *actual* returns.

It wasn't just the risk of running out of money, Robert realized that if they wanted to be certain, or at least reduce their chances of running out, they would have to commit 100% of their nest egg to their retirement income.

This meant there wasn't any flexibility for the "honey-do list", the "bucket list" or even the "round-to-it list". They would need to keep 100% of their retirement nest egg 100% committed to creating their day-to-day income needs.

Robert and Theresa wanted *A Better Way*.

We then showed Robert and Theresa why Suze Orman actually likes Fixed Index Annuities.

Stock Market based upon S&P vs Fixed Index Annuity with 50% Participation								
	<i>Beginning</i>		<i>Historical</i>	<i>Annual</i>		<i>Beginning</i>	<i>Historical</i>	<i>Annual</i>
<i>Year</i>	<i>Balance</i>		<i>Return</i>	<i>Withdrawal</i>		<i>Balance</i>	<i>Return</i>	<i>Withdrawal</i>
2000	\$ 1,400,000		-10.14%	\$ 56,000		\$ 1,400,000	0.00%	\$ 56,000
2001	\$ 1,202,040		-13.04%	\$ 56,000		\$ 1,344,000	0.00%	\$ 56,000
2002	\$ 989,294		-23.37%	\$ 56,000		\$ 1,288,000	0.00%	\$ 56,000
2003	\$ 702,096		26.38%	\$ 56,000		\$ 1,232,000	13.19%	\$ 56,000
2004	\$ 831,309		8.99%	\$ 56,000		\$ 1,338,501	4.50%	\$ 56,000
2005	\$ 850,044		3.00%	\$ 56,000		\$ 1,342,666	1.50%	\$ 56,000
2006	\$ 819,545		13.62%	\$ 56,000		\$ 1,306,806	6.81%	\$ 56,000
2007	\$ 875,167		3.55%	\$ 56,000		\$ 1,339,800	1.78%	\$ 56,000
2008	\$ 850,235		-36.99%	\$ 56,000		\$ 1,307,581	0.00%	\$ 56,000
2009	\$ 479,733		26.45%	\$ 56,000		\$ 1,251,581	13.23%	\$ 56,000
2010	\$ 550,623		15.05%	\$ 56,000		\$ 1,361,103	7.53%	\$ 56,000
2011	\$ 577,491		2.12%	\$ 56,000		\$ 1,407,526	1.06%	\$ 56,000
2012	\$ 533,734		16.00%	\$ 56,000		\$ 1,366,446	8.00%	\$ 56,000
2013	\$ 563,132		29.60%	\$ 56,000		\$ 1,419,761	14.80%	\$ 56,000
2014	\$ 673,819		11.39%	\$ 56,000		\$ 1,573,886	5.70%	\$ 56,000
2015	\$ 694,567		-0.73%	\$ 56,000		\$ 1,607,519	0.00%	\$ 56,000
2016	\$ 633,496		9.54%	\$ 56,000		\$ 1,551,519	4.77%	\$ 56,000
2017	\$ 637,932		19.42%	\$ 56,000		\$ 1,569,526	9.71%	\$ 56,000
2018	\$ 705,818		-6.24%	\$ 56,000		\$ 1,665,927	0.00%	\$ 56,000
2019	\$ 605,775		28.88%	\$ 56,000		\$ 1,609,927	14.44%	\$ 56,000
YTD	\$ 724,723		-26.51%	\$ 56,000		\$ 1,786,401	0.00%	\$ 56,000
	\$ 476,614		4.62%	\$ 1,120,000		\$ 1,730,401	5.10%	\$ 1,120,000

What immediately caught Theresa's eye was that by using a Fixed Index Annuity, they had better returns and more money after the exact same 20+ year period: with their market-based portfolio, their retirement account balance was only \$476,614. By using the FIA, they actually had over \$1.7M left after that same period of time. More is better.

In fact, we explained to them that instead of committing 100% of their nest egg to ensure their income needs were being met, and still risk running out, we could use an FIA and only invest 75% of their nest egg to fund it – leaving them over \$400k of

“wiggle room” for their bucket list. You might notice that we have a consistent “wiggle room” number in our book. What you should actually take away is that in using an annuity, it frequently requires about 75% of your nest egg to secure the same income that 100% of your nest egg in the stock market would secure.

Fixed Index Annuities can be very convoluted, and certainly, if you are going to use one, you really need an advisor who can explain the various moving parts:

- indexes and how you are credited so you can make money
- caps
- spreads
- fees (if there are any)
- surrender charges
- withdrawal options
- riders

. . . and all the other features that come with using an FIA.

If we haven't dispelled the myth surrounding “we-hate-annuities-and-you-should-too” then perhaps an annuity will not be the right solution for you. That is ok. There are lots of tools in the retirement toolbox, and part of finding *the right advice-giver* is finding an advisor who can use ALL the tools in the box. The advisors know not every tool will be used; you just want them to have every tool available to them. Between the two of you, you will find the right tools for your retirement journey.

We always suggest that before you purchase an FIA, you read the following guide (at the top of the following page), provided by the National Association of Insurance Commissioners. As we have said before, the NAIC is an association of state insurance regulatory officials and therefore has no incentive to “sell” you an annuity, rather their job is to protect you, the consumer.



[https://www.naic.org/documents/prod\\_serv\\_consumer\\_anb\\_le.pdf](https://www.naic.org/documents/prod_serv_consumer_anb_le.pdf)

As a general rule of thumb, these types of annuities allow you to “participate” in the upside of the stock market. You are not actually invested in the stock market, rather, your account is *LINKED* to a specific index like the S&P 500 or the NASDAQ. When the index goes up, your account is credited with a percentage of that increase. How much is credited is controlled by your participation rate or the caps on the credit you receive.

With Robert and Theresa, we showed them how an FIA with a 50% participation rate would work. If you look at the column for 2003, you will see that the S&P had a return of slightly more than 26%. If you then look at how much the FIA was credited, (how much it “made”), you’ll notice it only earned 50% or slightly more than 13%. This FIA had what is called a participation rate on it. Each FIA has its own rules when it comes to participation and/or caps.

Also notice that in the years the S&P was negative, Robert and Theresa would be credited with ZERO losses. That is correct, they get to participate in the upside of the market but not the downside. This is exactly why Suze says if you want to have stock market potential, but you don’t want the risk associated with the stock market, an FIA might be the right tool for you. For Theresa, the ability to have the income they wanted, guaranteed by the insurance company, and never risk losing a dollar in the stock market, was a better way.

Many FIA’s also come with surrender charges and surrender periods. You will want to understand these constraints and charges and how they may impact you. For Robert and Theresa, when they decided to use the FIA for their retirement income needs, they understood that they could take money out each year to supplement their income, but that if they took out more

than 10% in any given year, they would be charged a fee for any amount above that 10%. With this particular FIA, if they wanted to take 100% of their money out within the first year, there would be a 10% penalty. Each year thereafter the penalty would be reduced by 1%, namely: 9%; 8%; 7%, etc.

Robert was a little concerned about the restrictions and lack of liquidity by using the FIA. What would happen if they needed extra money? We reminded Robert that if he opted for the old approach of taking 4% withdrawals, he would have to commit 100% of his \$1.4M. This meant that they could never touch the actual principal, because if they used any of the money for anything other than producing income, their income would drop.

In addition, we pointed out that the FIA only required slightly more than \$1M commitment to guarantee the income they wanted, leaving over \$300K in liquid wiggle room. With that knowledge, Robert felt comfortable that they would have enough flexibility for those life events and still have the income they wanted.

It was *A Better Way*.



## CHAPTER 16

# **PULLING THE PLAN TOGETHER**

*Everybody loves when a plan comes together.*

When should you start your retirement planning? Hopefully as you have read through this book you know that it is never too early to start the process. Obviously, the process changes as we get older, and we get near the “retirement red zone.” Typically, when you are about ten to fifteen years out from your desired retirement date, you should sit down and get your retirement plan in order.

Think about what your retirement will look like: what are you doing TODAY, where are you going on vacation this year, what does your day-to-day life look like? Remember, when you are in retirement, every day is Saturday. If you are married or have a significant other in your life, talk it over with that person. His or her idea of retirement might not be the same as yours. Mike often jokes that he thought retirement meant traveling and playing golf three days a week. His wife explained that they were going to live next to the daughter-in-law they liked best and hang out with the grandkids! One of the great things about planning for retirement is: you make the rules, it just will take conversations and good planning to make it exactly what you want it to be.

Once you have an idea of what you hope your retirement will be, create the plan. You should be able to answer some of the following questions:

- How are you going to create the income?
- How much income do you need, how much risk do you want to assume, and how much do you want to transfer to an insurance company?
- What will your taxes look like?
- How will you address any long-term-care issues?
- And what about all those other life decisions that include a dollar sign?

And perhaps, even abstractly, one question you are ultimately asking is: what about your own legacy? Once you come up with this plan, put it down *in writing*.

Our client's written retirement plans look something like this:

## **CRAIG & ROSE – A BETTER WAY TO RETIREMENT** **ALLOCATION**

**INCOME GOAL: \$10,500 a month, after taxes.**

Expenses are partially covered by SS and Pensions.

### **First 5 Years of Retirement**

**Years 1–5:** Pension is generating \$18,600/year in income. Need to generate \$106,400/year, plus taxes, from investable assets to cover the shortfall. Taxes are estimated to be \$15,000 per year.

– **Income will come from investments: taxes paid with cash in checking/savings.**

– **Withdrawals from Risk Bucket when markets are positive.**

**–Withdrawals from Safe Bucket when markets are negative.**

**After Year 5:** Adjusting for inflation, income needs at year 6 will be \$138,000 per year. Elect SS at age 62, generating a total of \$57,250/year. Pension is generating \$18,600/year in income. Between Pension and SS, a total income of \$75,850 is generated. Shortfall of \$62,150 needs to be generated from investable assets to meet income goals.

- **Safe Approach:** Purchase annuity with Income Rider in the amount of \$824,205 if you want the insurance company to take the risk of you not outliving your money. This money should be considered non-liquid because you need it for income. If you use any of your income account for anything other than producing the income you want, you will no longer have that income.

- Leaves \$1,475,795 “wiggle” room for extras in life

OR

- **Risk Approach:** Earmark \$1,463,519 into balanced portfolio. You assume the risk of not outliving your money. This money should be considered non-liquid because you need it for income. If you use any of your income account for anything other than producing the income you want, you will no longer have that income.

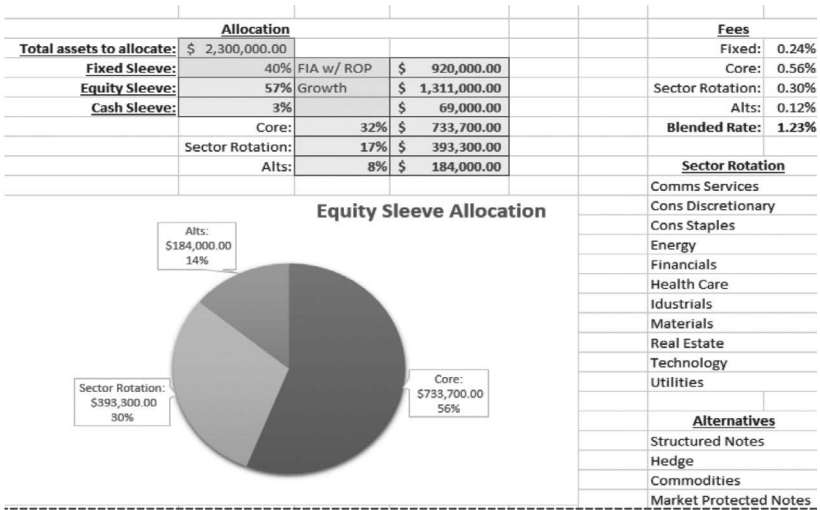
- Leaves \$836,481 “wiggle” room for extras in life

**EQUITY ALLOCATION: \$2,300,000 outside of Checking/  
Savings**

Allocation is the same percentage. However, the amount will change based upon which of the following: Safe Approach for retirement income or the Risk Approach.

- \$1,380,000 into an *Equity Growth Portfolio (Risk Bucket)*
  - Expected returns 6-8%, 100% liquid

- **\$920,000** into **Fixed Income** and/or **ROP FIA (Safe bucket)**
  - Split into separate contracts for Roth Conv. and to use withdrawals to make up shortfalls.
  - Expected returns 4–5%, liquid after 3 years.
  - Principal and growth/earnings are all 100% guaranteed not to lose money in the stock market or with interest rate fluctuations.
- Anticipated maximum loss in any given year: 5.76% vs. S&P loss of 20%; 14.4 vs S&P loss of 50%.
  - Equity portion of allocation captures about 40% of the downside and 100% of the upside of the overall market.



## TAX STRATEGY:

### **Convert 401(k) accounts into Roth IRA accounts over 4 years**

- 2017-2021: Convert \$406,000–\$518,300,000/year for 4 years, based on the current tax brackets then.
- Allows you to pay minimal taxes in Retirement.

**CURRENT STRATEGY**

Lifetime Estimated Tax Bill:  
**\$1,494,662 +/-**

Estimated Tax Bill for Daughter  
under Secure Act: **\$1,097,453 +/-**  
*(Lump sum withdrawal of  
portfolio assets)*

OR

Maximize 10-Year tax deferral:  
Additional **\$1,148,686 +/-** in  
taxes

**ROTH CONVERSION STRATEGY**

Lifetime Estimated Tax Bill w/  
Conversion and LIFT Strategy:  
**\$702,511 +/-**

Estimated Tax Bill for Daughter  
under Secure Act: **\$0**

**Estimated Annual Taxes**  
**years 6+: \$1,100 +/- per yr**  
**on the inflation adjusted**  
**income of \$125,000 per year.**

Roth Conversion strategy results in overall estimated Savings to YOUR of \$792,151 +/- and overall estimated Savings to your Daughter of \$1,097,453 +/- . **Combined Tax Savings: \$1,889,604 +/-.**

**LEGACY STRATEGY:**

*Use \$15,000/year from Roth Conversions over the next 7 years to fund a LIFT Policies to benefit your daughter. Total invested in this strategy over 7 years is \$105,000.*

Your daughter will inherit the cash value upon your death to use as income during her retirement:

**\$32,220/year** from age 67 to 95;

Total Income Received: **\$934,380 TAX-FREE**

**MULTI-GENERATIONAL LEGACY:**

Daughter's IUL Policy Death Benefit to her heirs at age 95:  
**\$1,016,440 TAX-FREE** or **\$2,831,026 Cash Value** if income not needed.

## TOTAL ESTATE TO CHILDREN:

No Conversions: **\$3,585,010** (Investments)

With Conversions & LIFT Strategy: **\$3,914,798** (Investments, Cash Value Life Insurance)

- Does not include the additional **\$1,016,440** death benefit or **\$2,831,026** cash value to grandkids

What we were able to do with the plan created for Craig and Rose was provide them almost tax-free income for 32 out of the 37 years of retirement. They would be receiving over \$10,000 a month by the time they turned 63 years old, and their tax bill would be just under \$1,000 a year. Their plan was designed to ensure that they paid the least amount of taxes legally possible. Because of their pension, we couldn't get them to zero, but we made a significant dent in their taxes:

<p>1 Wages, salaries, tips, etc. <input type="checkbox"/> AB <input type="checkbox"/> FB <input type="checkbox"/> DCB <input type="checkbox"/> SNE <input type="checkbox"/> SSHIP <input type="checkbox"/> 0                  Taxable scholarship not on Form W-2                  Household employee income not on Form W-2</p> <p>2a Tax-exempt interest 0                  b Taxable interest 0</p> <p>3a Qualified dividends including qualified dividends from Forms 8814, listed on Schedule B 0                  Qualified dividends from Schedules K-1 are included on line 3b, amounts on Schedule B Do not list these 5000                  b Ordinary dividends including qualified dividends from Forms 8814, listed on Schedule B 0                  c Total 5000</p> <p>4a IRA distributions                  b Taxable amount <input type="checkbox"/> and F9 to explain: <input type="checkbox"/> 100000</p> <p>5a Pensions and annuities                  b Taxable amount <input type="checkbox"/> Check if any amounts were rolled over: <input type="checkbox"/> 18000</p> <p>6a Social security benefits                  b Taxable amount <input type="checkbox"/> LSE <input type="checkbox"/> 0                  Schedule D not required: <input type="checkbox"/> 20000</p> <p>7 Capital gain or (loss) 0                  8 Other income from Schedule 1, line 9 0                  9 Total income 148000                  Earned income 0</p> <p>0 a Adjustments to income from Schedule 1, line 22                  b Charitable contributions if you claim the standard deduction but not more than \$300 (\$150 if married filing separately)                  c Total adjustments to income 0                  1 Adjusted gross income 148000</p>	<p>Name: CRAIG &amp; ROSE SSN: 123-45-6789</p> <p>Tax</p> <p>16 Tax. From <input type="checkbox"/> the tax table or schedule <input type="checkbox"/> Form 8615  <input checked="" type="checkbox"/> Schedule D Tax Worksheet <input type="checkbox"/> Schedule J  <input type="checkbox"/> Foreign earned income tax worksheet: 15488</p> <p>Check if any tax is from:  <input type="checkbox"/> Form(s) 8814  <input type="checkbox"/> Form 4872  <input type="checkbox"/> 962 election. Link from the checkbox to access the required explanation                  Recipients of advance payments from Form 6885                  Education credit recipients amount: 0</p> <p>17 Tax including amounts from Forms 8814, 4872, etc. 15488                  18 Amount from Schedule 2, line 3 0                  19 Add lines 16 and 17 15488                  20 Child tax credit or credit for other dependents 0                  21 Amount from Schedule 3, line 7 0                  21 Add lines 18 and 20 15488                  22 Subtract line 21 from line 19 15488                  23 Other taxes, including self-employment tax, from Schedule 2, line 10 0                  24 Total tax. Add lines 22 and 23 15488</p>
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Notice that before they were taking SS, their taxes were about \$15k a year. Once they elected SS and their Required Minimum Distributions (RMD's) kicked in at age 72, they would be paying an incredible amount of taxes: \$38,000+.

Once we implemented all the tax strategies, their tax bill was less than \$1000 a year and they had over \$165k a year income. See line 4a? We created tax free income using ROTH IRA's and Cash Value Life Insurance (LIFTs). Significantly more income and significantly less taxes. Not a bad combination.

## PULLING THE PLAN TOGETHER

<table border="0" style="width: 100%;"> <tr> <td style="width: 50%;">                 1 Wages, salaries, tips, etc. <input type="checkbox"/> AB <input type="checkbox"/> FB <input type="checkbox"/> OCB <input type="checkbox"/> SNE <input type="checkbox"/> SCHIP <input type="checkbox"/> 0                  Taxable scholarship not on Form W-2                  Household employee income not on Form W-2                  2a Tax-exempt interest 0                  2b Taxable interest 1000                  3a Qualified dividends including qualified dividends from Forms 8814, listed on Schedule B 0                  Qualified dividends from Schedules K-1 are included on line 3b, amounts on Schedule B 0                  Do not list these 1000                  3b Ordinary dividends including qualified dividends from Forms 8814, listed on Schedule B 0                  4a IRA distributions 50000                  Taxable amount 0                  Check if rollover: <input type="checkbox"/> and F9 to explain: <input type="checkbox"/> 0                  5a Pensions and annuities 0                  Taxable amount 18000                  Check if any amounts were rolled over: <input type="checkbox"/> 0                  6a Social security benefits 37250                  Taxable amount 14181  <input type="checkbox"/> LSE <input type="checkbox"/> 0                  Schedule D not required: <input type="checkbox"/> 0                  7 Capital gain or (loss) 5000                  8 Other income from Schedule 1, line 9 0                  9 Total income 39181                  Earned income 0                  10 a Adjustments to income from Schedule 1, line 22 0                  b Charitable contributions if you claim the standard deduction but not more than \$300 (\$150 if married filing separately) 0                  c Total adjustments to income 0                  11 Adjusted gross income 39181             </td> <td style="width: 50%; vertical-align: top;">                 Name: CRAIG &amp; ROSE SSN: 123-45-6789  <b>Tax</b>                  16 Tax: From <input type="checkbox"/> the tax table or schedule <input checked="" type="checkbox"/> Form 8615  <input checked="" type="checkbox"/> Schedule D Tax Worksheet <input type="checkbox"/> Schedule J  <input type="checkbox"/> Foreign earned income tax worksheet                  Check if any tax is from  <input type="checkbox"/> Form(s) 8814 0  <input type="checkbox"/> Form 4972 0  <input type="checkbox"/> REC election. Link from the checkbox to access the required explanation 0                  Recapture of advance payments from Form 8885 0                  Education credit recapture amount 0                  Tax including amounts from Forms 8814, 4972, etc. 578                  17 Amount from Schedule 2, line 3 0                  18 Add lines 16 and 17 578                  19 Child tax credit or credit for other dependents 0                  20 Amount from Schedule 3, line 7 0                  21 Add lines 19 and 20 0                  22 Subtract line 21 from line 18 578                  23 Other taxes, including self-employment tax, from Schedule 2, line 10 0                  24 Total tax. Add lines 22 and 23 578             </td> </tr> </table>	1 Wages, salaries, tips, etc. <input type="checkbox"/> AB <input type="checkbox"/> FB <input type="checkbox"/> OCB <input type="checkbox"/> SNE <input type="checkbox"/> SCHIP <input type="checkbox"/> 0 Taxable scholarship not on Form W-2 Household employee income not on Form W-2 2a Tax-exempt interest 0 2b Taxable interest 1000 3a Qualified dividends including qualified dividends from Forms 8814, listed on Schedule B 0 Qualified dividends from Schedules K-1 are included on line 3b, amounts on Schedule B 0 Do not list these 1000 3b Ordinary dividends including qualified dividends from Forms 8814, listed on Schedule B 0 4a IRA distributions 50000 Taxable amount 0 Check if rollover: <input type="checkbox"/> and F9 to explain: <input type="checkbox"/> 0 5a Pensions and annuities 0 Taxable amount 18000 Check if any amounts were rolled over: <input type="checkbox"/> 0 6a Social security benefits 37250 Taxable amount 14181 <input type="checkbox"/> LSE <input type="checkbox"/> 0 Schedule D not required: <input type="checkbox"/> 0 7 Capital gain or (loss) 5000 8 Other income from Schedule 1, line 9 0 9 Total income 39181 Earned income 0 10 a Adjustments to income from Schedule 1, line 22 0 b Charitable contributions if you claim the standard deduction but not more than \$300 (\$150 if married filing separately) 0 c Total adjustments to income 0 11 Adjusted gross income 39181	Name: CRAIG & ROSE SSN: 123-45-6789 <b>Tax</b> 16 Tax: From <input type="checkbox"/> the tax table or schedule <input checked="" type="checkbox"/> Form 8615 <input checked="" type="checkbox"/> Schedule D Tax Worksheet <input type="checkbox"/> Schedule J <input type="checkbox"/> Foreign earned income tax worksheet Check if any tax is from <input type="checkbox"/> Form(s) 8814 0 <input type="checkbox"/> Form 4972 0 <input type="checkbox"/> REC election. Link from the checkbox to access the required explanation 0 Recapture of advance payments from Form 8885 0 Education credit recapture amount 0 Tax including amounts from Forms 8814, 4972, etc. 578 17 Amount from Schedule 2, line 3 0 18 Add lines 16 and 17 578 19 Child tax credit or credit for other dependents 0 20 Amount from Schedule 3, line 7 0 21 Add lines 19 and 20 0 22 Subtract line 21 from line 18 578 23 Other taxes, including self-employment tax, from Schedule 2, line 10 0 24 Total tax. Add lines 22 and 23 578
1 Wages, salaries, tips, etc. <input type="checkbox"/> AB <input type="checkbox"/> FB <input type="checkbox"/> OCB <input type="checkbox"/> SNE <input type="checkbox"/> SCHIP <input type="checkbox"/> 0 Taxable scholarship not on Form W-2 Household employee income not on Form W-2 2a Tax-exempt interest 0 2b Taxable interest 1000 3a Qualified dividends including qualified dividends from Forms 8814, listed on Schedule B 0 Qualified dividends from Schedules K-1 are included on line 3b, amounts on Schedule B 0 Do not list these 1000 3b Ordinary dividends including qualified dividends from Forms 8814, listed on Schedule B 0 4a IRA distributions 50000 Taxable amount 0 Check if rollover: <input type="checkbox"/> and F9 to explain: <input type="checkbox"/> 0 5a Pensions and annuities 0 Taxable amount 18000 Check if any amounts were rolled over: <input type="checkbox"/> 0 6a Social security benefits 37250 Taxable amount 14181 <input type="checkbox"/> LSE <input type="checkbox"/> 0 Schedule D not required: <input type="checkbox"/> 0 7 Capital gain or (loss) 5000 8 Other income from Schedule 1, line 9 0 9 Total income 39181 Earned income 0 10 a Adjustments to income from Schedule 1, line 22 0 b Charitable contributions if you claim the standard deduction but not more than \$300 (\$150 if married filing separately) 0 c Total adjustments to income 0 11 Adjusted gross income 39181	Name: CRAIG & ROSE SSN: 123-45-6789 <b>Tax</b> 16 Tax: From <input type="checkbox"/> the tax table or schedule <input checked="" type="checkbox"/> Form 8615 <input checked="" type="checkbox"/> Schedule D Tax Worksheet <input type="checkbox"/> Schedule J <input type="checkbox"/> Foreign earned income tax worksheet Check if any tax is from <input type="checkbox"/> Form(s) 8814 0 <input type="checkbox"/> Form 4972 0 <input type="checkbox"/> REC election. Link from the checkbox to access the required explanation 0 Recapture of advance payments from Form 8885 0 Education credit recapture amount 0 Tax including amounts from Forms 8814, 4972, etc. 578 17 Amount from Schedule 2, line 3 0 18 Add lines 16 and 17 578 19 Child tax credit or credit for other dependents 0 20 Amount from Schedule 3, line 7 0 21 Add lines 19 and 20 0 22 Subtract line 21 from line 18 578 23 Other taxes, including self-employment tax, from Schedule 2, line 10 0 24 Total tax. Add lines 22 and 23 578	

Rose also wanted to make sure that they had enough flexibility, and it was important to her to not have to worry about what was happening in the stock market, or in politics. She wanted a safe and secure retirement income. She agreed with the Buffet Rule, and she agreed that she never wanted to run out of income. They chose to use an annuity because it met their income needs. They were comfortable with transferring the risk of running out of money to an insurance company and they wanted to dedicate the least amount of their investment resources to creating that lifetime income stream.

They were also able to achieve their goal of providing for their daughter. They had access and control of 100% of their money during their lifetime; but upon their death, their daughter would continue to receive tax-free income for her lifetime and then their grandchildren would also receive a tax-free legacy.

For Craig and Rose, it was *A Better Way*.

### PLAN SUMMARY

Keep in mind that a plan is only that, a plan. It is a road map helping to guide you from one time in life to another. It is not etched in stone nor is it permanent. This means that as you go down that road into and through retirement, you can make adjustments as life happens.

Believe us, life does happen, and there will usually be unexpected

twists and turns along the way. By knowing that you have a plan that includes securing your income during retirement, you will be in a place to embrace those twists and turns and not have to worry about running out of money.

The best part of having a written plan in place is that it does give you guidance to refer back to, so that you can have the retirement you have always dreamed about. . .

*A Better Way*

## CHAPTER 17

# A LAST WORD ON TAXES

*...taxes matter.*

We alluded to a “LIFT” in Craig and Rose’s retirement plan in the previous chapter. What exactly is that? It is the strategy some financial planners who understand the tax nature of Life Insurance use to leverage Life Insurance as a Financial Tool. Sometimes it may also be referred to as a Life Insurance Retirement Plan (LIRP).

What counts as truly tax free? We have discussed the use of a ROTH and/or ROTH 401(k) extensively. There is another tax-free option for people. If you have a weak stomach or are easily frightened, you may want to skip this approach to tax planning. Most ranking articles out there put Members of Congress, Politicians, and Lawyers at the bottom of the trustworthy list. Used car salesmen are frequently on that list. And guess who else? Life insurance agents. Whenever somebody mentions life insurance, the room goes silent, and people wait for the ‘hard sell.’ Many people assume the only reason an agent sells life insurance is to get the commission associated with selling insurance. It may be true. Life insurance agents do get paid a commission when they sell a life policy. Frequently agents don’t understand the policy they are selling, misrepresent how the policy works, and sell insurance to people who really don’t benefit from the coverage.

All that adds to the negative perception of life insurance. That doesn't mean properly structured life insurance can't be a viable tool in your toolbox, especially when it comes to tax planning.

We have a doctor who recently sold his practice for \$3,500,000. You know how we feel about many CPA's. His was no different. His CPA did the tax calculations and gave the doctor estimated tax payment coupons so he could send the IRS \$986,000 for the tax bill based upon the gain on the sale. That was the recommendation of the CPA – the person who the doctor trusted to give him the best tax planning advice – send in a check.

Form 1040 (2018)		Frank & Sally Jones		123-45-6789		Page 2	
1	Wages, salaries, tips, etc. Attach Form(s) W-2.	1	1,500,000	1	1,500,000		
2a	Tax-exempt interest	2a		b	Taxable interest	2b	22,484
2b	Qualified dividends	2b	114,952	b	Ordinary dividends	2b	23,185
4a	IRA, pension, and annuities	4a		b	Taxable amount	4b	
5a	Social security benefits	5a	56,825	b	Taxable amount	5b	48,301
6	Total income. Add lines 1 through 5. Add any amount from Schedule 1, line 22	6	3,500,000	6	5,093,970		
7	Adjusted gross income. If you have no adjustments to income, enter the amount from line 6; otherwise, subtract Schedule 1, line 28, from line 6.	7	3,500,000	7	3,500,000		
8	Standard deduction or itemized deductions (see instructions)	8	26,600	8	26,600		
9	Qualified business income deduction (see instructions)	9	0	9	0		
10	Taxable income. Subtract lines 8 and 9 from line 7. If zero or less, enter -0-	10	5,067,370	10	5,067,370		
11	Tax (see instructions) 59,764 (check if any from: 1 Form(s) 8814 2 Form 4972 3 )	11	1,199,764	11	1,199,764		
12	Child tax credit/credit for other dependents	12		12			
13	Subtract line 12 from line 11. If zero or less, enter -0-	13	1,199,764	13	1,199,764		
14	Other taxes. Attach Schedule 4.	14	145,985	14	145,985		
15	Total tax. Add lines 13 and 14.	15	1,345,749	15	1,345,749		
16	Federal income tax withheld from Forms W-2 and 1099.	16		16			
17	Refundable credits: a EIC (see inst.) b Sch 8812 c Form 8863	17		17			
18	Add lines 16 and 17. These are your total payments.	18		18			
19	If line 18 is more than line 15, subtract line 15 from line 18. This is the amount you overpaid.	19		19			
20a	Amount of line 19 you want refunded to you. If Form 8888 is attached, check here	20a		20a			
b	Routing number	b		c	Checking Savings		
d	Account number	d					
21	Amount of line 19 you want applied to your 2019 estimated tax	21		21			
22	Amount you owe. Subtract line 18 from line 15. For details on how to pay, see instructions.	22	1,346,145	22	1,346,145		

Sale of the practice \$3.5M  
Total taxes on sale and the rest of his income was \$1.346M.

Because tax-planning matters, we created a different solution for the doctor. The doctor had made smart money choices along the way and had an ample retirement and investment portfolio to meet most of his needs. The sale of the practice would fund his legacy planning, his charitable giving, and help offset those bucket-list/honey-do/ and round-to-it items. What was the solution? Life Insurance—properly designed cash value life insurance. The operative words here are “properly designed.”

When properly designing a life insurance contract, you need to understand what the goal of the policy is. For some people the goal is to protect their family should they die with young children: replacing the lost income. For some, it is to pay off debt related to a mortgage. For others, it is to leave a legacy, that is, make somebody “rich.” For this doctor, the goal was three-fold:

first, he wanted to leave a legacy for his kids, second, he wanted to contribute to his favorite charities, and third, he wanted to reduce his tax exposure.

The first step was to attack the current tax bill. The CPA had calculated that \$986,000 tax bill. To reduce this tax bite, the solution was for him to donate \$1,000,000 to a specific type of charitable trust. This allowed him to immediately write off \$1,000,000 as a tax deduction. With this simple step, he was able to reduce his taxable income by \$1,000,000. That in turn saved him over \$350,000 in taxes

Form 1040 (2018)		Frank & Sally Jones		123-45-6789		Page 2	
1	Wages, salaries, tips, etc. Attach Form(s) W-2			1		1,500,000	
2a	Tax-exempt interest	2a		b	Taxable interest	2b	22,484
3a	Qualified dividends	3a	114,952	b	Ordinary dividends	3b	23,185
4a	IRAs, pensions, and annuities	4a		b	Taxable amount	4b	
5a	Social security benefits	5a	56,825	b	Taxable amount	5b	48,301
6	Total income. Add lines 1 through 5. Add any amount from Schedule 1, line 22			6		3,500,000	
7	Adjusted gross income. If you have no adjustments to income, enter the amount from line 6, otherwise, subtract Schedule 1, line 36, from line 6.			7		5,093,970	
8	Standard deduction or itemized deductions (from Schedule A)			8		1,046,500	
9	Qualified business income deduction (see instructions)			9		0	
10	Taxable income. Subtract lines 8 and 9 from line 7. If zero or less, enter -0-			10		4,047,470	
11	a Tax (see inst.) 23,426 (check if any from: 1 <input type="checkbox"/> Form(s) 9814 2 <input type="checkbox"/> Form 4072 3 <input type="checkbox"/> <input checked="" type="checkbox"/> ) b Add any amount from Schedule 2 and check here <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>			11		840,749	
12	a Child tax credit/credit for other dependents b Add any amount from Schedule 3 and check here <input type="checkbox"/>			12			
13	Subtract line 12 from line 11. If zero or less, enter -0-			13		840,749	
14	Other taxes. Attach Schedule 4.			14		145,985	
15	Total tax. Add lines 13 and 14.			15		986,734	
16	Federal income tax withheld from Forms W-2 and 1099. See instructions.			16			
17	Refundable credits: a EIC (see inst.) b Sch 8812 c Form 8863			17			
18	Add any amount from Schedule 5			18			
19	Add lines 16 and 17. These are your total payments			19			
20a	Amount of line 19 you want refunded to you. If Form 8888 is attached, check here. <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>			20a			
21	Amount of line 19 you want applied to your 2018 estimated tax.			21			
22	Amount you owe. Subtract line 18 from line 15. For details on how to owe, see instructions.			22		987,130	

The charitable deduction reduced his income by almost \$1M. This in turn reduced his taxes from \$1.346M to \$987k; Savings of \$350,000.

The \$1,000,000 went into the charitable trust and each year, a portion of the money in the trust goes to his charities, and a portion of the trust is used to fund a \$1,000,000 life insurance policy. He was able to accomplish two of his goals using one tax strategy: a lifetime of charitable giving and a legacy for his children. He was able to use what would have otherwise been spent on taxes to accomplish his goals. Every year he is able to donate more than \$58,000 to charity. That makes a difference, which is what his goal was: as a doctor he made a difference in his patients' lives, and as a retiree, he would still be able to make a difference in people's lives.

That is how much tax planning matters.

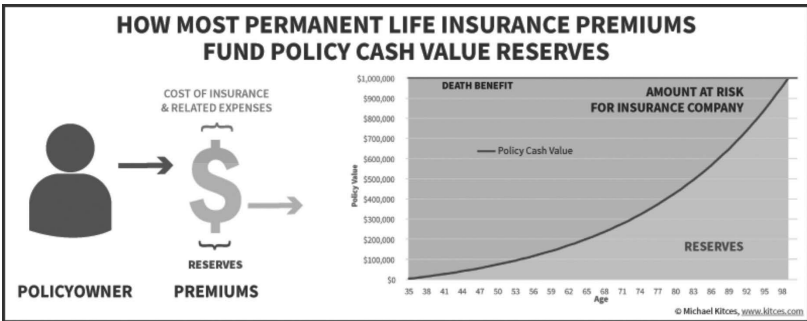


The next step in planning for the doctor was to use life insurance, properly structured life insurance. For five years, the doctor funded a properly designed life insurance policy. He took the \$162,500 he was receiving from his 1031 exchange and was adding it to the proceeds from withdrawals from his IRA. The goal was to almost deplete his IRA accounts completely by the time he reached age 72. At the time of the sale of his practice, the doctor had about \$1.5M saved in his 401(k). At retirement, he rolled his 401(k), a tax-free transfer, into an IRA.

The goal was to leave about \$300,000 in the IRA and deplete the balance over the course of five years. Strategically, he withdrew \$250,000 each year. He paid the taxes out of his savings accounts—remember from his tax return, he was earning over \$22,000 a year in interest, and had just under \$1M in cash... earning almost nothing. It made better sense to pay taxes with those “lazy” dollars than to use his other investments making market returns. After taxes, combined with the 1031 income, the doctor paid a premium into a properly designed life insurance policy, to the tune of \$400,000 a year, for the full five years.

What is a properly designed life insurance policy? A properly designed policy (LIRP or LIFT) allows for a policy owner to fund the life policy for a term of years. The policy grows based upon a contractually agreed amount: it could be a fixed interest rate, a variable interest rate, or even participating in stock market returns. Based upon the returns, less fees associated with owning insurance, the policy will grow to a specified amount. The beauty of life insurance is that under IRS code 7702(g) earnings in a life insurance policy are not taxable. Under IRC Section 72, any distributions are treated as a withdrawal of principal first. And finally, most life insurance contracts allow for the owner of the policy to “borrow” money from the contract, and under IRC 7702 and IRC 72, such loans are not included in your taxable income.

In simple English? We can get money out tax-free!



The doctor's policy was designed to front load the cash, by making excessive premium payments in the amount of \$400,000 a year for five years. This in turn would allow the doctor to subsequently take tax-free withdrawals during his retirement.

Net After Tax Outlay	Annualized Surrender	Annualized Policy Loan	Annualized Loan Interest	Gross Cash Value	Total Outstanding Loan	Net Cash Value	Net Death Benefit	Reduced Paid-up Death Benefit
400,000	0	0	0	49,001	0	49,001	5,869,589	111,238
400,000	0	0	0	359,911	0	359,911	5,953,066	792,879
400,000	0	0	0	724,540	0	724,540	6,035,149	1,549,420
400,000	0	0	0	1,172,662	0	1,172,662	6,249,778	2,435,335
400,000	0	0	0	1,664,343	0	1,664,343	6,505,427	3,358,778
-162,000†	0	524,398	0	2,130,457	524,398	1,586,952	6,141,022	3,113,380
-162,000†	0	543,506	19,108	2,614,199	1,067,904	1,504,088	5,755,713	2,870,946
-162,000†	0	566,605	42,207	3,121,885	1,634,509	1,421,089	5,348,876	2,640,743
-162,000†	0	590,686	66,287	3,656,391	2,225,195	1,339,805	4,924,460	2,425,295
-162,000†	0	615,790	91,391	4,220,739	2,840,984	1,262,192	4,485,964	2,226,796
-162,000†	0	279,563	117,563	4,444,533	3,120,547	1,194,542	4,388,734	2,054,773
-162,000†	0	291,444	129,444	4,674,991	3,411,991	1,121,170	4,280,349	1,881,095
-162,000†	0	303,830	141,830	4,906,671	3,715,821	1,036,107	4,160,471	1,696,117
-162,000†	0	316,743	154,743	5,151,435	4,032,564	950,667	4,029,103	1,519,098
-162,000†	0	330,205	168,205	5,403,786	4,362,769	858,779	3,886,021	1,340,147
-162,000†	0	344,238	182,238	5,735,824	4,707,007	831,948	3,841,202	1,268,833
-162,000†	0	358,868	196,868	6,088,930	5,065,875	810,934	3,799,213	1,209,574
-162,000†	0	374,120	212,120	6,463,712	5,439,996	795,696	3,759,030	1,161,414
-162,000†	0	390,020	228,020	6,855,050	5,830,016	780,437	3,720,034	1,115,389
-162,000†	0	406,596	244,596	7,274,989	6,236,613	776,499	3,681,237	1,087,230

The policy was designed for the Doctor to make five payments of \$400,000. In the 6th year, the Doctor was able to withdraw \$162,000 a year, TAX FREE

By designing the policy correctly, the cash value was maximized in order to provide tax-free income to the doctor, and the death benefit was reduced down to the smallest amount possible while allowing the policy to still distribute the \$162,000 to the doctor in tax-free income each year. With a life expectancy of 90 years, the doctor will have invested approximately \$2M into the policy, and upon his death at age 90, he will have withdrawn over \$3.8M tax-free and still have a death benefit going to his heirs of over \$1.1M.

It is important to understand how the cash values, death benefits, and policy loans all work together to ensure that you don't end up violating IRC Section 7702 and 72, which would result in everything coming unraveled and a huge tax bill.

**That is why tax planning matters.**

Look at this example of what a well-planned, tax efficient, retirement plan looks like when it comes together:

Income:

Social Security		\$ 56,825
Dividends and Interest		47,571
1031 Income	\$162,500	162,500
<b>40% tax-free</b>	<u>65,000</u>	
Taxable	97,500	
IRA Distributions		10,949
Capital Gains		<u>41,823</u>
 Total Income		 <u>\$319,668</u>

Taxes? **ZERO! NONE! NOTHING!**

So, what happens to this doctor when the tax rates go up in the future, like so many have predicted they will? If tax rates double in the future, the doctor still will remain in the zero percent tax bracket.

Clearly *A Better Way!*



## CHAPTER 18

# OTHER IMPORTANT INFORMATION FOR RETIRES

*...every day is now Saturday.*

### **OTHER IMPORTANT INFORMATION FOR A BETTER WAY**

(I). Fees Matter. You should understand how they work. We touched on this important issue when we discussed 401(k)'s, Variable Annuities, and Mutual Funds. These are not the only places fees will show up. You will want to understand how fees will impact your investments as well as how your planner or advisor is paid. Some questions you should ask, and they should be able to answer in a clear and understandable manner:

- How are you paid?
  - ◆ Fee based: 1–2% annual fee based upon the value of the accounts being managed is the typical range. These fees may be negotiable.

- ◆ Commission based: insurance vehicles including health, life, auto, annuities, and long-term-care typically pay a commission. Some registered representatives and financial advisors sell mutual funds for a commission. Many Limited Partnerships pay a commission. There is nothing inherently wrong with earning a commission on a transaction, as long as you are aware that there is a commission being paid.
  - ◆ Do they receive incentives, including trips, reimbursements, etc., for selling certain products or vehicles? Again, not necessarily a problem, but you do want to know if they are selling you that annuity, because it is the best vehicle to accomplish your goals or because if the insurance agent sells enough of it, he/she gets a cruise.
  - ◆ Do they actually work for their employer, or do they work for you as the investor and client:
    - Remember, when you work with a fiduciary, in theory they work for you, not their employer.
    - IF they are receiving their paycheck from their employer, who actually controls their decisions?
- What are the fees in the investment vehicle being offered?
- ◆ Mutual Funds have 12b-1 fees, advertising and administrative fees, management fees, turnover/transaction fees, and cash drag. All these fees can be hefty. We recommend that if your advisor suggests you use mutual funds in your portfolio, he or she provides a breakdown of the actual fees. ([www.personalfunds.com](http://www.personalfunds.com) is a good resource.)
  - ◆ Variable and other Annuities
    - We already know that ‘Ken Fisher hates annuities, and you should too!’ As discussed, his concern is over the fees that many of these variable annuities charge: Admin Fee, M&E

fee, Sub Account fee – and don't settle for that "about 1% on average," because that only addresses the management fee. What about those other fees that mutual funds carry (see above), including rider fees for income benefits and death benefits, surrender fees, long-term care rider fees, and liquidity fees.

Choose the right fee structure that meets your needs.

(II). Asset Allocation Matters. You will want to understand how they are designing your portfolio. What asset classes are being used and how are they going to protect you from extreme market fluctuations? There is a concept called Modern Portfolio Theory... from the 1950's, so not so modern in today's economy. This suggests that if you diversify your investments along non-correlated assets classes, you will increase your overall returns, while reducing your overall risk. Basically, don't put all your eggs in one basket.

Remember that the market does go up and the market goes down. Yes, it tends to trend upwards over time, but as you enter into retirement and go through it, time is no longer your friend.

Choose an allocation strategy that takes the least amount of risk to accomplish your retirement and legacy goals.

(III). Taxes Matter. It doesn't matter how much you **make** that counts, it is how much you get to **keep**, that counts. If you are going to lose 20 – 40% of your income to taxes each and every year, you need to find a better way.

Choose to work with a planner who will make sure you pay the least amount of taxes each year, including upon your death.

## **FINAL THOUGHTS**

There are so many thoughts and ideas that we wanted to incorporate into this book. Between us and our collective team, we have over a century of financial planning experience and knowledge to share. As you can probably imagine, trying to cram it all into a book in such a fashion that you, our typical client, can understand, is a monumental task. It can't be done.

We have shared some of what we thought were the most pressing issues for retirees and those soon to be retired. We wanted to make sure you have a clear understanding that you get to **CHOOSE** whether to work with a salesman selling you products and investments, working for some company, or you can choose a fiduciary. **CHOOSE** a fiduciary who works for you and provides you the guidance and tools you need to accomplish your goals. **CHOOSE** a financial planner who looks out for your interests first to make sure you are taking the least amount of risk necessary to accomplish your goals, making sure you are paying the smallest amount of taxes legally possible throughout your lifetime, and making sure that your estate passes to your heirs quickly and efficiently, upon your death. You have that **CHOICE**.

**There is *A Better Way*. You choose.**



## About Frank

Frank Guida is an experienced financial planner respected throughout the country. He has contributed to multiple published financial advice articles and insightful radio shows throughout his 35+ years in the Financial Services industry. Frank works closely with a multitude of clients, other financial planners, and organizations, while also sharing his financial acumen within his local community. Frank is a current host of the radio program, *A Better Way Financial Radio Show™*, which may be heard on iHeartRadio, locally on WAEB 790 AM radio, or streaming online at: [www.iheart.com](http://www.iheart.com).

As a finance veteran, Frank's experience, education, and philosophy have allowed him to develop a unique money-planning method. He uses this formula to help his clients reach their goals and support a stress-free and prosperous retirement. Using a variety of platforms, Frank shares his perspective and learnings with Americans on the most fruitful ways to prepare for their retirement, while taking everything into account that may impact or influence one's retirement.

Frank is also the co-author of *THE BOOK ON RETIREMENT: A Better Way to Stretch Your Retirement Dollars While Living the Lifestyle You've Always Dreamed of Living*.

You can find Frank's articles in various publications in print and online, including *Fox Business™*, *Forbes™* and *Money™* websites. Frank began in the Financial Services industry in 1985. Today, he is the President and founder of **A Better Way Financial**, a firm that manages upwards of \$100 million in assets for its clients. He is also the president and founder of Connected in the Lehigh Valley (a network of 4,000+ local Lehigh Valley professionals on LinkedIn™).

Frank received his LUTCF designation from The American College and the National Association of Insurance and Financial Advisors in 1988. Frank is a Registered Investment Advisor with **A Better Way Financial**. Frank sits on the esteemed Advisory Board of the Impact Partnership, LLC, a national marketing organization supporting the top financial planning firms in the industry. In this role, Frank serves with other successful financial advisors

to bring his knowledge and expertise to the organization, with a goal of helping to better serve the entire industry.

Frank is grateful to call the beautiful state of Pennsylvania home – where he lives in the Lehigh Valley – which consists of the Allentown, Bethlehem, and Easton areas. His greatest joys in life are spending time with his beautiful wife, Kimberly and his wonderful family, while helping others achieve their financial retirement goals.

For more information, go to:

- [www.abetterwayfinancial.com](http://www.abetterwayfinancial.com)



## About Nick

Nick Guida entered the financial services industry in 2011 with one goal in mind: being the Go-To Financial Planner for professionals wanting to retire successfully. His dedication to being a lifelong learner has equipped him with a wide array of financial strategies that have turned his passion for helping others into a successful career.

In the highly dynamic industry of finance, his proven track record in investment management and holistic approach to retirement planning, has led him to become one of the Lehigh Valley's most recognized financial planners. He also shares his expertise and take on current events to a wider audience through his weekly radio show broadcasted on 790AM WAEB and his Podcast: ***A Better Way Financial***.

He believes in a retirement planning experience that empowers people to take control of their lives while cultivating relationships anchored in honesty, integrity, and ethics.

Nick Guida is a licensed insurance agent for life, health, long-term care, and annuities in the state of Pennsylvania. He is also a Series 65 securities licensee who operates at the fiduciary standard. He is an alumnus of the University of Illinois at Champaign-Urbana, graduated with Dean's List Honors, and is a published author for *Fortune*<sup>™</sup>, *Money*<sup>™</sup>, and *Annuity 123*<sup>™</sup>.



## About Michael

Michael Canet JD, LLM, also known as "Mike" Canet, helps people create and grow wealth, protect and preserve it, and distribute it in the most tax-efficient manner. Whether an average American just entering retirement, or a complex multi-generational family looking into protecting wealth, Michael helps clients maximize their assets and plan for the future using advanced tax planning. He uses retirement and estate-planning techniques to carefully allocate clients' assets so they can retire with added confidence, income, and tax-deferred wealth protection. He reminds his clients that it doesn't matter how much you make, rather it is how much you keep at the end of the day that really counts.

Michael is an active industry contributor to television, radio, and print. His numerous publications can be found in 100 different periodicals and journals across the country, including *WSJ*<sup>™</sup>, *Forbes*<sup>™</sup>, and *USA Today*<sup>™</sup>. He has contributed to a variety of periodicals, journals, and books, including *SUCCESSONOMICS* by Steve Forbes, the Amazon #1 Best Seller: *Surviving the Perfect Storm: How to Create a Financial Plan That Will Withstand Any Crisis*, and *DEATH & TAXES*. He has been seen on every major network as a financial commentator and has hosted a nationally syndicated television and radio show, *The Savvy Investor*. You can find his talks and interviews on a variety of major network shows in Baltimore, including on FOX, NBC, CBS, and ABC.

Michael is quick to share his personal history, and how his upbringing influenced his approach to business and philanthropy. Mike grew up living in children's shelters and in the foster care system, experiencing various highs and dysfunctional lows. As he moved within the social welfare system, he recognized the many incredible people who provided him the stability and encouragement he needed to thrive. Today, Michael commits to giving back as much as he can by helping those less fortunate. These causes include the Maryland Volunteer Lawyer Service (where Michael was named Volunteer of the Year). Additionally, his position on the UB President Advisory Board helped them raise and donate over \$150K to causes like Make-A-Wish, Ronald McDonald House, Ray's Summer Days, MD Food Bank, Generosity Global, Animal Welfare Society, Back to School Supply Programs, and a host of others.

Michael continues to put his family and loved ones front and center for himself, his firm, and his clients. He has been married for 39 years and has two incredible sons. Michael takes great pride in the stability he has been able to provide to his own family, stating that he wanted to make sure they never experienced what he went through. A devoted family man and husband, he counts his blessings while at home, where he enjoys entertaining, cooking, and his avid wine collection. Michael splits his time between Ellicott City, MD and Melbourne, FL, and is an enthusiastic world traveler, exploring food and culture on five (and counting!) continents with his favorite travel partner, his wife.

For more information:

- <https://prostatisfinancial.com/>



# GLOSSARY

## Investment Terms Definitions

*The following terms and definitions are meant to be helpful in understating various investment and financial terms. The definitions provided are general in nature and are not intended to be a definitive explanation of the various financial terms contained herein. For a comprehensive and exhaustive explanation and understanding of the following terms, please consider using a dictionary or the Internet for a more thorough and detailed explanation.*

**401(k) Plan:**

Employer-sponsored, qualified plan that permits employees to make pre-tax contributions from their salaries to a profit-sharing plan, a target benefit plan, or a stock bonus plan. The great news is contributions and earnings grow tax-deferred until withdrawn.

**403(b) Plan:**

A retirement plan for employees of non-profit organizations, public schools, and churches where employees can contribute a portion of their salary into a mutual fund or annuity. As with a 401(k) plan, the great news here is contributions and earnings grow tax-deferred until withdrawn.

**Adjusted gross income (AGI):**

This is the income amount on which a person computes deductions that are based on, or limited by, a percentage of his or her income in order to figure out federal taxable income. AGI is determined by subtracting from gross income any deductible business expenses and other allowable adjustments (some traditional Individual Retirement Account annual contributions, SEP and Keogh annual contributions, and alimony payments).

**Administrator:**

A person appointed by a probate court to handle the estate of a person who died intestate (without a will). They have the same duties as an executor.

**Advisor:**

See definitions for Financial Advisor and Investment Advisor.

**Annuity:**

A contract that provides for a series of payments to be made or received at regular intervals. An annuity may be immediate, starting as soon as the premium has been paid, or deferred, starting at a designated later date. Annuities are commonly used to fund retirement. See fixed annuity or variable annuity.

**Asset:**

Property and tangible resources, such as cash and investments. Examples include stocks, bonds, real estate, bank accounts, and jewelry.

**Asset allocation:**

Investment strategy whose purpose is to enhance total return and/or reduce risk by diversifying assets among different types of stocks, bonds, and money market investments.

**Beneficiary:**

An individual, institution, trustee, or estate that receives, or may become eligible to receive, benefits under a will, insurance policy, retirement plan, annuity, trust, or other contract.

**Bond:**

Basically an IOU or promissory note of a corporation, usually issued in multiples of \$1,000. A bond is evidence of a debt on which the issuing company usually promises to pay the bondholders a specified amount of interest for a specified length of time, and to repay the loan on the expiration date. In every case, a bond represents debt, its holder is a creditor of the corporation and not a part owner, as is the shareholder.

**Brokerage:**

Security transaction executed through a “brokerage firm” or “broker/dealer” in stocks, bonds, mutual funds, options, or other investment securities. This term is often mistakenly used for the brokerage firm itself but is referring to the transaction.

**Certified Public Accountant (CPA):**

An individual who has received state certification to practice accounting.

**Commission:**

The broker’s basic fee for purchasing or selling securities or property as a registered representative.

**Death benefit:**

The payment made to a beneficiary from an annuity or life insurance policy when the policyholder dies. Also called face amount or face value.

**Deductible:**

Relating to health insurance, a predetermined amount the insured person pays for medical treatment before the health insurance coverage kicks in.

**Defined benefit plan:**

A company retirement plan, such as a defined benefit pension plan, in which a retired employee receives a specific benefit based on salary history and years of service, and in which the employer bears the investment risk. Contributions may be made by the employee, the employer, or both.

**Defined contribution plan:**

A company retirement plan, such as profit sharing, money purchase pension, 401(k) or 403(b), in which each participant has an individual account within the plan with benefits based solely upon amounts contributed and the past performance of that account. The participant bears the investment risk.

**Diversification:**

Spreading investments among different companies in different fields. Another type of diversification is offered by the securities of many individual companies because of the wide range of their activities.

**Dividend:**

The payment designated by the board of directors to be distributed pro rata among the shares outstanding. Preferred shares generally pay a fixed dividend, while common shares pay a dividend that varies with the earnings of the company and the amount of cash on hand. Dividends may be omitted if business is poor, or the directors withhold earnings to invest in plant and equipment. Sometimes a company will pay a dividend out of past earnings even if it is not currently operating at a profit.

**Equity:**

The ownership interest of common and preferred stockholders in a company. Also refers to excess of value of securities over the debit balance in a margin account. Also, the value of a property that remains after all liens and other charges against the property are paid. A property owner's equity generally consists of his or her monetary interest in property in excess of the mortgage indebtedness. In the case of a long-term mortgage, the owner's equity builds up quite gradually during the first several years because the bulk of each monthly payment is applied, not to the principal amount of the loan, but to the interest.

**Exchange Traded Funds:**

An investment vehicle traded on stock exchanges, much like stocks. An ETF holds assets such as stocks or bonds and trades at approximately the same price as the net asset value of its underlying assets over the course of the trading day. Most ETFs track an index, such as the S&P 500 or MSCI EAFE. ETFs may be attractive as investments because of their low costs, tax efficiency, and stock-like features.

**Financial Advisor:**

An advisor employed to provide advice on subjects related to investing and personal financial decisions.

**Financial Plan:**

A plan with stated goals and objectives pertaining to current and long-term investment needs of the individual(s).

**Financial Planning:**

Creating a plan with stated goals and objectives pertaining to the current and long-term investment needs of the individual.

**FINRA:**

FINRA is an independent regulatory organization empowered by the federal government to ensure that America's investors are protected. Also see NASD.

**Health insurance:**

Insurance that provides protection against financial losses resulting from illness, injury, and disability. In general, any insurance program covering medical expenses and/or income lost owing to illness or accidental injury.

**Heir:**

Individual who will receive assets upon the death of another.

**Income taxes:**

Taxes on income, both earned (salaries, wages, tips, commissions) and unearned (interest from savings accounts, dividends if you hold stock). Individuals and businesses are subject to income taxes.

**Individual retirement account (IRA):**

A tax-advantaged personal retirement account that allows a person to invest each year. Your contribution may be tax deductible depending on your adjusted gross income, whether you're married and whether your employer offers a retirement plan at work. A Rollover IRA accepts eligible employer-sponsored retirement plan assets.

**Interest:**

Amount charged by a lender to a borrower for the use of money. Interest rates are normally expressed on an annual basis.

**Internal Revenue Service (IRS):**

The federal agency responsible for administering and enforcing the Treasury Department's revenue laws, through the assessment and collection of taxes, determination of pension plan qualification, and related activities.

**Investment:**

A current commitment of money for a period of time, to obtain future payments or wealth to compensate the investor for the time the funds were committed, for the inflation that may affect them, and for the uncertainty of repayment.

**Investment Advisor:**

A person employed to render advice or analysis about securities/investments for compensation, registered with the SEC under the Adviser's Act of 1940 or their respective state. Does not include attorneys and accountants who give advice as a part of their professional practice.

**Investment company:**

A company owning a diversified portfolio of securities that are professionally chosen and managed on the basis of certain investment criteria. The most common type of investment company is the mutual fund.

**Investor:**

An individual whose principal concerns in the purchase of a security are regular dividend income and/or capital appreciation without unnecessary risk.

**Liabilities:**

A broadly defined term implying legal or financial responsibilities to others.

**Life insurance:**

Insurance coverage against death of a person to be paid to a

beneficiary when the insured dies. See term insurance, whole life insurance, universal life insurance, variable life insurance, or survivorship life insurance.

**Liquid:**

Description of the condition in which an individual has adequate cash and near-cash assets to meet current debt.

**Long-term care:**

Physical, mental, and social assistance provided to people who are unable to provide for themselves as a result of disability or a prolonged illness. Care ranges from providing personal care at home, such as bathing and dressing, to skilled nursing services in a nursing home.

**Medicaid:**

A program, funded by the federal and state governments, which pays medical costs for the poor. If your financial assets and monthly income are below certain allowed levels, Medicaid will pay nursing home and some home care costs if you are disabled.

**Medicare:**

A federal program that pays for certain health care expenses for people 65 years old or older.

**Morningstar:**

A leading provider of mutual fund, stock, and variable-insurance investment information. An independent company, Morningstar™ does not own, operate, or hold any interest in mutual funds, stocks, or insurance products.

**Mutual fund:**

An open-end investment company that continuously offers new shares to the public in addition to redeeming shares on demand as required by law.

**NASD:**

Refers to the National Association of Securities Dealers, Inc. An association of brokers and dealers in the over-the-counter securities business. The association has the power to expel

members who have been declared guilty of unethical practices. The NASD is dedicated, among other objectives, “to adopt, administer, and enforce rules of fair practice and rules to prevent fraudulent and manipulative acts and practices and, in general, to promote just and equitable principles of trade for the protection of investors.” The NASD has been replaced by FINRA.

**Net worth:**

The amount by which a person’s total assets exceeds total liabilities.

**Online:**

A technology service provided over computers that are networked together. Usually refers to the Internet. Allows for interaction between people via computer.

**Planning:**

The act of contemplating objectives, desires, and variables to accomplish an objective. Example would be current investments, rates of returns and retirement income desired for an individual’s financial plan.

**Portfolio:**

A group of securities held by an investor. They might include stocks, bonds, preferred stock, and cash.

**Principal:**

As it relates to power of attorney, a principal is the person who is no longer able to make decisions so the attorney-of-fact is granted the power to make those decisions.

**Retirement Income:**

The amount of income needed, on an annual basis, to live once the investor has retired. Can be pre-tax (the amount needed for spending plus the taxes due on that amount) or after-tax (the amount needed for spending to meet his/her lifestyle excluding taxes).

**Retirement Plan:**

A person's unique plan for meeting his or her retirement obligations or an employer-sponsored tax advantaged program to accumulate assets for retirement of the plan's participants.

**Return:**

The dividends or interest paid by a company expressed as a percentage of the current price. A stock with a current market value of \$20 a share, which has paid \$1 in dividends in the preceding 12 months, is said to return 5 percent ( $\$1/\$20$ ). The current return on a bond is figured the same way. Another term for yield.

**Rider:**

It's an amendment to an insurance policy that modifies the policy by expanding or restricting its benefits or excluding certain conditions from coverage.

**Risk:**

Uncertainty that an asset will earn its expected rate of return, and is generally measured using standard deviation.

**Risk Tolerance:**

Technically, it's the measure of an investor's ability to accept risk. Investors are often categorized as risk-indifferent, risk averse or risk-seeking.

**Roth IRA:**

A personal retirement savings vehicle created by the Taxpayer Relief Act of 1997 available for certain investors beginning in 1998. A Roth IRA allows certain investors to make non-deductible contributions annually, and provided certain requirements are met, offers (after owning the Roth IRA for 5 years) tax-free and penalty-free withdrawals for important specified financial needs as qualified distributions. Distributions after age 59½ are tax-free provided you have had the Roth IRA for five years before you withdraw funds.

**Savings account:**

A bank account established for the purpose of putting aside money for future spending goals. Savings accounts normally earn a competitive rate of interest and are insured by the Federal Deposit Insurance Corporation.

**Share:**

Certificate representing one unit of ownership in a corporation, mutual fund, or limited partnership.

**Social Security:**

The government-sponsored program which is designed to provide basic pensions and disability income for U.S. citizens.

**Standard deduction:**

The amount a taxpayer who does not itemize his or her federal tax deductions can deduct in determining taxable income.

**Stock:**

Ownership shares of a corporation that provides the lender with a claim on a company's earnings and assets. Stock may be issued in different forms, including common and preferred. Holders of common stock are the last to be paid any profits from the company but are likely to profit most from the company's growth. Owners of preferred stock are paid a fixed dividend before owners of common stock, but the amount of the dividend doesn't usually grow if the company grows.

**Tax deductible:**

An item or expense subtracted from adjusted gross income to reduce the amount of income subject to tax. Examples include mortgage interest, state and local taxes, un-reimbursed business expenses, and charitable contributions.

**Tax-deferral:**

Paying taxes in the future for income earned in the current year, such as through an IRA, 401(k), SEP IRA or Keogh Plan.

**Tax-deferred retirement plans:**

A retirement plan in which you get to postpone current income taxes on pre-tax money invested or any earnings in an account until you withdraw it from the plan. Such a plan may allow you to set aside part of your pay for retirement. Tax-deferred accounts include traditional and rollover IRAs and 401(k)s.

**Trusts:**

A legal arrangement in which an individual (the trustor) gives fiduciary control of property to a person or institution (the trustee) for the benefit of beneficiaries.

**Vested:**

The rights of an individual to receive benefits from employment, such as pension, sick leave, and vacation. Pension benefits are vested when the employee has worked a specified number of years. The person may then leave the employer for another job and still collect the accumulated amount at retirement.

**Volatility:**

The extent to which the value of an investment changes. Often used as a description of risk and measured as Standard Deviation.





