CREATIVE
Wealth Maximization Strategies

Certified Financial Services, LLC
52 Forest Avenue
Paramus, New Jersey 07652

MARCH 2005

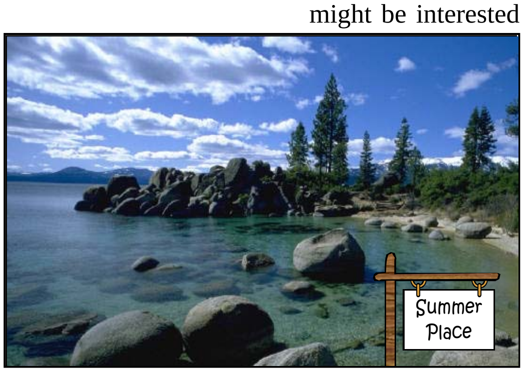
"Wealth is the product of man's capacity to think." ***- Ayn Rand***

Instead Of "Either/Or" Why Not "Both?"

Want to give the typical financial planner a momentary shock? Well, tell him/her that you're going to invest in something that provides immediate gratification!

Then, with apologies to the credit card industry, explain it to the planner like this:

- Monthly payment needed to secure a $300,000, 30-year mortgage at 6% on a fabulous summer home on the waterfront: **$1,800**
- 30 summers of great family memories: **Priceless**



There may be a moment of stunned silence, after which the sputtering will begin.

"But what about your retirement?" he might ask. Pulling out a pocket calculator, he quickly estimates that an $1,800 monthly deposit earning, let's say 6% would amass $1.8 million in 30 years. ***"That's $1.8 million!"*** he shrieks. ***"Do you realize that's a lot of money?"***

Yup. $1.8 million is a lot of money, and you do realize it.

"Well, couldn't you get 30 years of great family memories from something else? Sure, a vacation home is nice, but what will you have for retirement if you don't fund a qualified plan?"

Interesting dilemma. Which to choose, the summer house or the 401(k)? Instant enjoyment or future retirement?

But are those the only two choices? What about instant enjoyment ***and*** future retirement? Is that possible?

Maybe so. Even though everything that follows is hypothetical, there can be plausible arguments for choosing an immediate gratification strategy, even when one of your financial objectives is retirement. Using the example of the summer home, here are some possibilities:

1. The property can appreciate. Assuming the $300,000 mortgage was combined with a 20% down payment, the purchase price would be $375,000. Even allowing for fluctuations in the real estate market, you could reasonably expect the value of the home to appreciate, especially for resort/vacation property. If the average annual rate of appreciation was just 4% over 30 years, the property value would increase to $1.16 million. If the rate of appreciation was 6% – the same number our "shrieking planner" used – the appreciated value would be just over $2 million.

2. Occasional rentals can be a source of additional income. Since this is a summer home, you probably won't occupy it all the time. But because of the location, other parties might be interested in renting your home for periods of time. Most likely these rentals won't make the mortgage payments, but if your family can't enjoy the property, why not pick up a few extra dollars?

Suppose you rented the home just four weeks a year, at $1,500 a week (which most vacationers would find an attractive price). That's another $6,000 a year. Placed in an account earning 6% annually, $6,000 a year for 30 years would add another $500,000 to the pile.

3. There may be tax advantages. Depending on other factors in your financial situation, the interest portion of your monthly mortgage payment may be tax-deductible. In the early years of the mortgage, a large percentage of each payment is interest.

Depending on the frequency with which the property is rented, some expenses related to maintaining or improving the property might be deductible as well. (Remember, this is not a tax advice article. Determining tax benefits or consequences in these types of transactions requires expert assistance.)

4. You may be able to access your property value as an equity loan. As your equity increases, it is possible that a bank may offer you an equity line of credit against a percentage of your accumulated value in the summer home. Using our previous hypothetical projections of the property appreciating at 4% annually while being paid down on a 30-year, 6% mortgage, the following would occur after 10 years:

The property value would be $533,700. The amount owed on the mortgage would be $250,800. Your equity position would be $283,000. If the bank were willing to extend a line of credit based on an 80% loan-to-value ratio, you would have approximately $175,000 available to borrow from the property. Of course, the loan would have to be repaid, but this is a way to access some of the property's value for other purposes while still enjoying the use of it each summer. (And depending on your situation, the interest might be deductible.)

5. If you choose not to sell the property in retirement, it could transfer tax-free to your heirs. Sometime in retirement, you could choose to sell the summer home, perhaps using the proceeds to supplement your income. But if you find you don't have to sell the home, your children and grandchildren might be interested in inheriting the property. Again, you will have to consult with your tax and legal advisors, but with thoughtful estate planning, most individuals can pass real estate on to heirs without tax consequences.

"Yeah, but…"

Even in the best-case scenario, our hypothetical summer home investment does come with some auxiliary costs that cannot be overlooked.

1. There are property taxes, insurance premiums, and maintenance costs. Some of these expenses may be deductible, but they still have to be figured into the equation – you have to pay the expenses out-of-pocket before you get the deduction.

2. A real estate investment is generally less liquid than accumulation held in a savings investment account, and it is also a bigger commitment. When markets change, you can usually reallocate your investment portfolio with a phone call. But if the EPA finds toxic waste in your back yard, it's not going to be easy to "dump" the property and cut your losses.

Likewise, if your cash flow takes a turn for the worse (job loss, health problems, etc.) it's easy to stop deposits into a 401(k). It's not so easy getting out of a mortgage payment. Your only option may be to sell at a discount, forfeiting much of your gain.

So…Summer home or 401(k)? Making a comparison

Given the scenario presented above, is a summer home a better choice for retirement than a 401(k)?

Based on this limited example, you couldn't say. Even though the two alternatives have similarities, it's not an apples-to-apples comparison.

It is possible that both investments might yield comparable returns, but it's unlikely. Real estate and investment accounts are different types of financial assets, and their rates of return often run in different cycles. Depending on the location of the home and the economy, the house might appreciate at a rate higher than 4% or 6% or even 8%. Likewise, depending on the mix of investments and the economy, a 401(k) investment account could top 6% or 8% or 10% -- or more.

While both strategies have tax advantages, they aren't the same. Both options could offer loan provisions, but with different parameters. Each could increase in value by income or capital appreciation, but in markedly different ways. And each plan could provide a retirement income, but the type, frequency and tax consequences could be very different.

Further, there are too many personal variables that could make one option more desirable than the other.

Start with the variable of personal income. $1,800 a month is $21,600 a year. For some households, there's not enough "disposable" income to afford the purchase. And remember, there was a $75,000 down payment that had to come from somewhere. On the other hand, if you could afford to set aside $1,800 a month, it's going to be more than is currently allowed to be deposited into a 401(k).

Even when evaluating the two strategies at an individual level, the tax advantages and tax consequences may often be impossible to fully decipher. The current tax deductions for mortgage interest and other home-related expenses might be more or less than the current pre-tax deduction from income on 401(k) deposits. There are also the unknown future tax costs of spending the assets. What will the ordinary income tax rate be in the future when you take money out of a 401(k)? Will exclusions for the sale of the home still be in effect? No one can say for sure.

Besides, this isn't just a decision between a 401(k) and a summer home. There are other ancillary factors that could play a role. The "risk" of the mortgage commitment could be offset by your savings, disability and life insurance programs. Other assets, both liquid and illiquid, could figure into the decision. Most likely, a prudent financial plan would not rely on either a 401(k) or a summer home as a sole source of retirement. The real decision is not between a summer home and a 401(k). Rather, it's how each strategy might fit in the context of your overall plan that determines which strategy works best for you.

However, there is one big non-financial difference

Go back to the beginning comments, the ones that mimic the credit card advertisement. Remember the "priceless memories?"

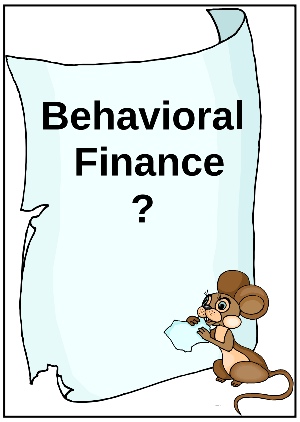
Those memories, or the potential for them, may be financially intangible, but it doesn't mean they aren't extremely valuable. When an accumulation amount is just a number on a piece of paper you can compare it to another number, but that doesn't fully communicate its value. It is only when the accumulation is spent on something that we fully determine its value to us. $20,000 could buy an automobile or a trip to Europe, but not everyone would see those two items as being equal in value in terms of their purchase price.

With the summer home, there is the opportunity to not only obtain something that stands to appreciate in value, but also ***the chance to enjoy it right now.*** Imagine the satisfaction of sitting with your spouse on the deck of the summer home, watching another beautiful sunset. Imagine seeing your grandchildren play on the lawn, saying, "I love to come here and see you." How much would those experiences be worth to you?

In contrast, can you picture one of your children jumping with expectation, and saying, "Did the 401(k) quarterly statement come yet? Can I look at it? Please, can I?"

The summer home scenario is just a hypothetical example, but it illustrates that, in some circumstances, it is possible to plan for retirement and enjoy some of it right now. It may not be an example that fits your situation, but hopefully it makes you aware of the possibilities for enjoying some of the benefits of your financial planning right now.

ARE YOUR FINANCIAL PLANS STRUCTURED TO TAKE ADVANTAGE OF PROFITABLE OPPORTUNITIES THAT COULD BE ENJOYED TODAY?



THINGS THAT MAKE YOU GO "HMMM…"

Behavioral Finance – How to Protect Yourself *from* Yourself?

"Impulses and gut reactions lead people to act against their best interests."

That's one of the conclusions of an article by Matthew Heimer in the January, 2005 issue of *Smart Money*.

According to "behavioral finance" experts interviewed for the article, humans can blame poor decisions on their limbic systems, "sometimes characterized as a human's 'rat brain,'" according to Heimer. Our rat brains are "hard-wired" to seek mental short cuts by identifying patterns and using them to solve immediate emotional and physical needs. Among the responses that are limbic-driven are things like "fear of loss" and "irrational exuberance." In situations where these "primal" senses are activated, emotional responses often override rational assessments. As a result, individuals often sell low and buy high (instead of the other way around), and make other stupid financial decisions.

Some of the research by these behavioral experts indicated that sometimes the difference of one key word can change decision-making from a rational to emotional process. In a test, respondents were asked one of two questions:

"Would you rather have $15 in two weeks or $20 in four weeks?" or

"Would you rather have $15 now or $20 in two weeks?"

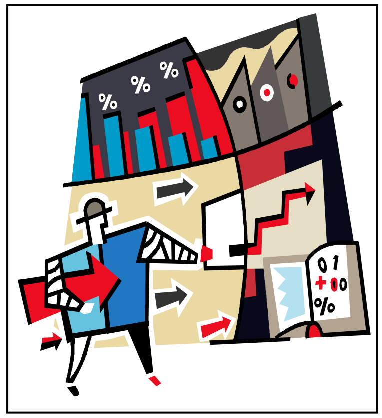
Most respondents to the first question stated they were willing to wait an extra two weeks for more money. But a majority of those answering the second question opted for the $15 immediately. According to the researchers the difference was the word "now." In monitoring the respondents' brain activity through MRI imaging, it was determined that while the first question activated the analytical prefrontal cortex region of the brain, the now-versus-later question also triggered a response from the limbic system and overwhelmed the logical thought processes.

Using this "rat brain" paradigm, Richard Thaler of the University of Chicago has developed a 401(k) program called Save More Tomorrow, which according to Heimer is "slowly catching on within the industry." Thaler's approach calls for:

1. Automatic enrollment in the company 401(k) – unless the employee opts out in writing.
2. Savings invested by default in a pre-set mix of stocks and bonds.
3. Commitment by the employee to automatically increase his/her saving rate, usually with each pay increase.

This approach, says Heimer is a way to "idiot-proof" yourself against your own irrationality.

*Hmmm…*Making saving compulsory might take care of getting money *into* the 401(k), but what about the people who manage the money? Don't they have "rat brains," too? How can we "idiot-proof" them?



COST BASIS:

ANOTHER REASON YOU PROBABLY NEED AN EXPERT TO PREPARE YOUR TAX RETURNS

In the business world, one of the major stories is the consolidation of the telecom industry into two large competitors, SBC Communications and Verizon. Among the discussions of the historical and economic impact from the mergers that have created two communication giants, there are curious ripple effects. One of these oddities is the convoluted tax ramifications to long-term shareholders of AT&T, which SBC Communications is proposing to buy.

Once upon a time, AT&T was the nation's most widely-held company, a safe, conservative "widows and orphans" stock with a consistent dividend stream that family members often bequeathed to heirs. But following a government-mandated break-up in 1984, AT&T engaged in a variety of "acquisitions, spinoffs and stock splits," according to a February 3, 2005 *Wall Street Journal* article. "As a result, many of the 2.7 million shareholders have little idea what their shares' initial value is." This initial value is called the "cost basis," and is the starting point for calculating taxes that might result from a sale of the stock.

For example, an investor who owned AT&T before 1984 and did nothing more than keep the stock and cash, the dividend checks would also be likely to find that, as a result of various company transactions, they would have owned, "at one time or another, shares of 20 different companies," according to the *Journal.* And some of those 20 companies have since merged with each other or spun off other companies, thus creating additional shares. The attempt to calculate the value of the AT&T shares is "a train wreck" according to Chuck Carlson, who runs atttaxcalculator.com and sells software programs to help investors decipher their cost basis. And it's even worse for those who reinvested their dividend checks to buy more of the stock.

Also, since much of the value in AT&T was transferred to the spinoff companies, the shares still designated as AT&T have probably dropped in value for long-term owners. An example in the *Journal* article showed that 100 shares of AT&T purchased in 1983 at $60/share would have declined to a holding of 30 shares at $11.33, (with the individual receiving shares in other companies such as Lucent, NCR and AT&T Wireless over the past 22 years). Selling now could actually create a taxable loss, which could be used to offset gains from other stocks.

These complex calculations almost always require expert assistance, and can add a hidden cost to stock market investing for most individuals.

News Digest

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

U.S. WORKERS SAVING MORE, BUT EXPECT TO RETIRE LATER…

People save more for retirement in the U.S. than in any other country, but most Americans expect to work longer than they desire, according to *AXA Retirement Scope*, a unique global survey on life, work and retirement released today.

Americans lead the world in preparing for their retirement. *AXA Retirement Scope* found that 76% of U.S. workers are saving for retirement, compared with less than 40% of workers in Italy, Spain and The Netherlands. Nearly 80% of Americans surveyed have a plan for where they want to live, what they want to do, and how much money they'll need in retirement. Most people started planning for retirement early, in their 30's.

Working Americans are saving, on average, $687 per month toward retirement. (Based on other responses, this figure reflects their investment in such savings vehicles as conventional savings plans, life insurance policies and pension plans.) Retirees save $535 per month, on average.

Retirees, on average, say they are retiring at 58 years old. American workers, however, say they would like to retire at 55, but, in reality, don't expect to retire until they are 63.

PRNewswire, January 19, 2005.

…AND MANY ARE WORRIED ABOUT THEIR SAVING EFFORTS

Nearly nine out of 10 Americans were worried about saving enough for retirement even before President Bush began his recent campaign to change Social Security, according to a new study.

Fifty-seven percent admitted they often or sometimes felt worried about how well prepared they will be for retirement, and 32% said they worried occasionally, according to a survey released by Wachovia Corp.

Women were more concerned about retirement than men, and people who were worried tended to consider themselves inexperienced investors.

People with children living at home were more likely to be saving too little. Some who weren't saving enough said they preferred to enjoy life now rather than save for the future.

Reuters, February 9, 2005.

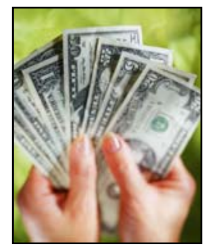
WOMEN ARE TAKING CHARGE OF FAMILY INVESTMENTS AS WELL AS CHECKBOOKS

Women, long the keeper of the household checkbook, are increasingly taking charge of the family investments as well. The evolution to a far more sophisticated and important role – essentially from bookkeeper to portfolio manager – signals a significant change both in the way husbands and wives relate to each other and the way Wall Street does business.

Until recently, the focus of much of these efforts has been on high-earning working women, or "suddenly single" widowed and divorced women, who may not have the confidence or experience to manage money… But planners, brokers and others in the financial industry are now starting to notice a far more active involvement among younger married women, including those who have left the work force to raise children. "Women are deciding not to wait for one of life's big transition events like divorce, [or] widowhood to develop a financial plan," says Lisa Caputo, president of Citigroup's Women & Co. division.

Hilary Stout, *Wall Street Journal*, February 10, 2005.

LIFE INSURANCE COMPANIES AMONG THE LARGEST HOLDERS OF UNCLAIMED ASSETS



The government has more than $30 billion in cash and other assets that belong to millions of Americans – including investments and bank accounts…Social Security payments and tax refunds…insurance proceeds…and more.

Life insurers are among the largest holders of unclaimed money. Hundreds of millions of dollars in policy benefits go unclaimed every year because beneficiaries aren't aware that policies exist.

In addition to policy benefits, many policyholders and heirs are entitled to an unexpected windfall. As more mutual life insurance companies have demutualized, millions of current and former policyholders have become entitled to receive stock, cash and policy credits.

Mark Tofal, *Bottom Line Personal*, February 15, 2005.

BOOMER ENTITLEMENTS, EQUALING 10% OF US GDP, WILL STRAIN U.S. BUDGET

The aging Baby Boomer generation will strain the federal budget in the coming decade, with Medicare and Medicaid entitlement programs posing the biggest fiscal challenge, the chief of the Congressional Budget Office told lawmakers on Tuesday.

"In particular, the rising cost of health care will contribute to the growth of programs for the elderly and low-income beneficiaries," CBO Director Douglas Holtz-Eakin said in prepared testimony before the Senate Budget Committee.

Along with Social Security, the entitlement programs will grow by about 25 percent over the next 10 years relative to the size of the overall economy, rising from 8.4 percent of the gross domestic product in 2004 to 10.4 percent in 2015, he said.

William L. Watts, *CBSMarketWatch*, February 1, 2005.

WILL YOU HAVE TO BUY "RETIREMENT LIFE INSURANCE?"

One of the oft-repeated adages of conventional financial planning is to only buy as much life insurance as you require for current income obligations. Then, as your accumulations increase and your obligations decrease, you can drop the life insurance coverage because you are "self-insured" by virtue of your accumulation.

However, one could argue that the self-insurance strategies most people end up choosing are more costly and less effective than the life insurance they surrendered. The following is an overview of two common "self-insuring" strategies, and their consequences.

Strategy #1: Live On The Interest, Conserve Principal

It's simple, and easy to understand. Build a nest egg large enough to live on the earnings (interest, dividends, etc.) and never touch the principal.

Using this approach alleviates several old-age anxieties. First, you don't know how long you will live, and if you spend/enjoy too much now, there's always the unpleasant thought of running out of money later. That's a real concern, and it's scary. Living on interest takes away some of the worry, because the principal is never used up.

Living on interest also ensures there will be an inheritance. Many of us not only see our savings in terms of what enjoyment we can derive from it, but also what it could mean for our children and grandchildren. So while we want to have enough to enjoy life, we don't necessarily want to spend it all on ourselves.

Living on interest is a legitimate attempt to provide security and inheritance. However, as is sometimes the case with "conventional" strategies, it's not the intention that is flawed, but the method used to achieve it. Here's why:

The untouched principal is one very expensive insurance policy. It's true that living on interest provides security against outliving your assets, but it does so by assuming you will live forever, and that's not going to happen. Essentially, not touching the principal each year is the "premium" required to provide "old age security." Acting as insurance, it's very expensive. With most insurance you pay a small premium to get a large benefit when, or if, something unexpected occurs. But with living on interest, the principal is the premium *and* the benefit. There's no leverage from this type of insurance.

When you decide to live on the interest, a major "beneficiary" of your retirement insurance plan is the financial institution that holds your assets. Let's use a simple illustration:

If you have accumulated $2 million, earning 6% annually, living on interest would produce a $120,000 annual income stream and never eat away at the principal. Depending on how you evaluate your retirement future, $120,000 could sound like a nice number. But that's not the point!

The financial institution (a bank, insurance company, investment company, etc.) gives you $120,000 annually while it uses the $2 million you've left in reserve. The institution will put your money to work, primarily to make more money for the institution, not you! Year by year, you get $120,000 to work with, and they get $2 million to work with. Who receives the largest benefit from your account?

Also, any significant amount of money left for the next generation has to be filtered through the government, which could result in either estate taxes or income taxes on the unspent principal. In our $2 million example, the transfer costs at death could easily reduce the amount passed on to your heirs by 30%, and maybe more. By using the living-on-interest approach, you are not receiving full enjoyment from the money while you are alive, and thanks to the IRS, neither will your heirs after you are gone.

Strategy #2: Take The "Life And Joint Survivor" Annuity Option

This strategy is particularly relevant for those who have company pension plans, but could also apply to individuals who want to turn lump-sum accumulations into a guaranteed stream of payments. Let's start with the pension recipients first.

A standard pension promises a regular retirement income to the recipient. The amount of the payment is usually based on a formula derived from a combination of years of service and average salary with the employer. This formula will calculate a monthly benefit for the retiree, to be paid as long as the retiree is alive.

Survivorship benefits are a form of life insurance. However, many retirees are married, and desire that pension payments will not only continue as long as they are alive, but will also continue for the life of their spouse, should their spouse outlive them. To ensure benefits for the lifetimes of two people instead of one, the pension will adjust the monthly payments downward. This difference, used to provide "survivorship benefits" is a form of life insurance (and in most cases, the pension administrator will require a married retiree to choose the joint survivor option unless the spouse agrees to waive it). Here's an example:

A 65-year-old male retires after 35 years of service with the company. Using their pension formula, the company is obligated to pay the retiree $3,000 a month, as long as he is alive. This is sometimes called the "life only" option because it is based on providing a guaranteed pension for one lifetime only.

But our retiree is married. His wife is 63. Knowing that women often outlive men, and considering some of his own health issues, he wants to be sure his wife will continue to receive a monthly pension check. He tells the company he wants the "life and joint survivor option." After a recalculation based on his wife's age and gender, the company adjusts the monthly payment to $2,500. The cost to provide the joint survivor option? $500 a month.

Selecting a joint and survivor option in an individual annuity is also retirement insurance. The same computations and consequences are in play if you decide to use a portion of your retirement accumulation and buy an immediate annuity from an insurance company. Based on the amount deposited and your age, the company will determine a guaranteed payment for life, or any specific period. If you want to obtain a joint and survivor guarantee from the same lump sum, the monthly payment will diminish according to the age and gender of the joint party. The difference between the two options is the insurance premium for providing payments to a beneficiary.

The Benefits From These "Retirement Insurance" Strategies Don't Match Up To "Real" Life Insurance.

If you obtained life insurance early in life and kept it in force, its features would probably be more advantageous in comparison to the self-insurance or joint and survivor strategies. Consider the following:

– The conserved principal may face income tax and estate tax assessments and probate hurdles. But a life insurance benefit is usually delivered tax-free directly to the beneficiaries without probate delays.

– For the surviving spouse in a joint pension or annuity situation, the benefits continue only as monthly payments, and usually as taxable income. Life insurance proceeds may be received as a tax-free lump-sum, or as a series of payments, according to the wishes of the beneficiary.

– If the retiree outlives his/her spouse, a pension recipient usually will not be able to designate a second beneficiary, so the cost of the joint survivor option will never return a benefit (although some pensions do allow retirees to change to a "life only" option for the rest of their life). The policy owner of a life insurance policy can change the beneficiary at any time, guaranteeing that if the policy is in force, someone will be a beneficiary of the policy.

– Keeping life insurance in force might allow a retiree to increase his/her retirement income by spending some principal – and still provide an inheritance. Likewise, a pension recipient might select the higher "life only" monthly payment, knowing the life insurance would still provide a guaranteed survivorship benefit for the spouse.

These pseudo-life insurance strategies may "save" money by eliminating life insurance premiums, but their shortcomings also provide some persuasive arguments for keeping life insurance in force, even if you don't "need it." Don't surrender life insurance without careful consideration of the possible "leverage" that can be generated in your financial plans by keeping life insurance in force. (Not sure how this might work? That's what your financial advisors are for!)

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Certified Financial Services, LLC
52 Forest Avenue
Paramus, New Jersey 07652
Tel. (201) 843-7700
Fax (201) 843-6333
Cfsllc.com