JANUARY 2008

"If you can't explain it simply, you don't understand it well enough." – Albert Einstein

KNOWING THE REASONS *NOT* TO

Most common financial strategies and products have broad application and appeal, but they may not be the right fit for your unique situation.

Ever have this experience trying on new clothes? The "fashion consultant" raves over each new garment, saying things like:

"Ooh, I can't believe how good that looks on you!"
or: ***"Wow, I can't decide which one I like better!"***

If you're like most of us, you probably appreciate the compliments and the personal attention. But there's also a part of you that knows some of the enthusiasm is because you're a potential customer. So you take the comments with a grain of salt.

But suppose a salesperson said:

"You know, that style just doesn't suit you. I think this one is a better fit." What would you think?

THE REASONS WHY, AND THE REASONS WHY NOT

When it comes to assessing your relationship with the financial professionals that provide input and products for your financial transactions, one of the things you might want to evaluate is how well these people can explain the reasons ***not*** to do something, especially the things that they most often recommend or support.

Some examples:

An advisor or financial professional who recommends participation in a qualified retirement plan probably knows all of the benefits of participation – contributions are tax-deductible, it's taken from your paycheck automatically, there are loan provisions, etc. Since a retirement plan is a basic form of saving, and saving is good, a qualified retirement plan is something that offers a benefit to everyone.

But is there ever a reason <u>not</u> to participate in a qualified plan? What if you are saving for a down payment on a house? What if you have outstanding credit card balances? What if you don't have six months' of income set aside in an emergency fund? Would any of those circumstances change your advisor's recommendation?

Similarly, a life insurance professional may be very knowledgeable about the ways to use a whole life policy as part of a program for individual financial protection and accumulation. Like the advisor who specializes in qualified retirement plans, a good life insurance professional knows all the ins and outs of working with a cash-value policy – what additional features (such as a disability waiver) should be included, whether to take a loan or partial surrender, how much to add to the contract as paid-up additions, etc. And even though whole life insurance requires larger annual premiums to start a policy, the advisor understands and can effectively explain how the higher initial outlay is worthwhile.

Of course, there's usually another side to the story. With all those great features, can this advisor offer a reason <u>not</u> to buy whole life insurance? What

if there's an immediate need for more insurance protection than you can afford if all the coverage is whole life? Why would someone buy term insurance instead?

From a consumer or client perspective, you want advisors that know both the reasons to participate in a particular strategy or product, and the reasons not to. Because while most common financial strategies and products have broad application and appeal, *they may not be the right fit for your unique situation.*

Ideally, competent advisors mention the reasons "not to" as part of their dialog with you. Either it comes in the course of "discovery" conversations about your objectives, current situation, and financial philosophies, or it is part of the education and explanation provided by the advisor when making a recommendation or offering an idea. But if the advisor doesn't bring up the "not to" reasons, be sure to ask. Getting an answer to the reasons "not to" is like getting a second opinion from the same doctor. It probably won't change the proposal, but it should give you an even clearer understanding as to why the proposal was made in the first place.

TWO CAUTIONARY THOUGHTS ON THE REASONS NOT TO

1. Beware the critic. Getting a second opinion regarding any financial strategy may have merit. But be careful about someone with a narrow perspective or an ax to grind. Some people make a living out of telling people what not to do, and provide very little substance on what to do.

If you've had any exposure to the concept of life insurance, you soon pick up on the philosophical conflict between those who advocate term insurance and those who espouse the values of whole life or similar cash-value policies. In their little corner of the universe, the divide can be as passionate as that between Yankee and Red Sox fans, or "dog" people vs. "cat" people, and the respective sides can be quite dogmatic about their positions.

Historically, both types of policies have a long track record in the marketplace. So regardless of what the critics might say, it appears both types of life insurance have a legitimate place in individual programs. Someone with a one-sided perspective is obviously missing what many consumers find beneficial.

It's the same with the evaluation of qualified retirement plans. Even as they proliferate in the workplace, there's still a lot of "non-qualified" accumulation going on as well. Again, the ongoing existence of several approaches to accumulation should be an indicator that all of them have some validity.

2. If you aren't going to do this idea, what are you going to do instead? Isaac Newton's first law of mechanical motion is the Law of Inertia: A body in a state of rest tends to remain in such a state unless acted upon by an external force. The Law of Inertia has application to human psychology as well. Most of us tend to prefer stability and resist change.

When a financial professional challenges you with a new idea, it can be an external force that upsets your status quo. The easiest way to restore your psychological equilibrium is to find a way to dismiss the new idea or strategy. If you're looking for a reason not to do something simply because you don't want to – because you're too busy, or bored, or want to spend the money on something more "fun" – you can always find a reason; a reason to wait, a reason to revisit the issue later, a reason to push the issue aside.

But before you lock in on your reason not to go forward, entertain one more thought: If a trusted advisor gave you the reasons **not** to, but still believes your situation is one where taking action would be the most beneficial, are you sure you want to blow it off?

Go back to the department store example. As you try on several outfits, the fashion consultant steers you away from several lesser choices. But after much review, there's a moment where the fashion consultant says,

"Hey, that's a perfect fit for you."

Are you going to ignore that input?

Asking financial professionals for the reasons not to do something is a way to make their input even more valuable to you. But getting better advice and better understanding doesn't mean much if you don't act on it. The purpose of getting the reasons not to do something is to get a better idea of what **to do**. Don't let not doing be your undoing.

> **"Those who lack knowledge about money usually don't have any."**
> **- Steve Kroening**

HOW DO WE PLAN FOR A TAX THAT WE CAN'T PLAN FOR?

(Note: This is a general discussion, and is not meant to be construed as tax or legal advice. You should consult your tax and/or legal advisor to discuss your specific situation.)

After a short hiatus, the federal estate tax is back in the news. But just because the estate tax is a topic of discussion doesn't mean anyone knows what's going to happen. And since that's the case, it is a bit difficult to make any concrete financial decisions regarding estate planning.

A brief review: Before 2001, a federal estate tax was applied to estates exceeding $675,000. The tax was applied only on the amount above the exemption, but

rates were steep, topping out at 55% as the amount over the $675,000 exemption increased. Reforms passed in 2001 gradually phased out the tax by increasing the exemption (currently at $2 million for 2008) and decreasing the tax rates on the excess (top rate is now 45%). By 2010, the phase-out will be complete – no estate tax whatsoever.

However…in 2011, estate taxes are scheduled to return to their 2001 levels with only a $1 million exemption.

This quirky legislation is the political by-product of significant philosophical differences. The ten-year law was a way to satisfy some constituencies now, but force further debate at a later date.

Life insurance doesn't eliminate the estate tax, it just gives heirs more resources to pay it.

On one side, there are those who declare that imposing any additional tax on assets just because someone dies is unfair. After all, the assets (or the wages earned to acquire them) have already been taxed once. What is it about dying that gives the government a reason to assess more taxes? Opponents of the estate tax further argue that the tax often forces family-owned businesses to close rather than be passed on to successive generations because the estate values are frequently tied to illiquid assets like property and equipment. In order to satisfy the tax, the assets must be sold. Without assets, the business is no longer viable.

On the other side there is the belief that eliminating the estate tax would allow for dangerous "dynasties of wealth" to arise, and this condition would ultimately weaken the country. Surprisingly, one of the most vocal advocates for preserving the estate tax is Warren Buffett, one of the richest individuals in the world. As Buffett sees it, decreasing the amount of wealth that can be transferred to others encourages individual success and ensures that no group of individuals can use their disproportionate wealth to gain an unfair material, social or political advantage. Quoted in a November 19, 2007 *National Underwriter* article, Buffett told a November 14th Senate Finance Committee hearing, "I believe in keeping the equality of opportunity."

Proponents of the tax note that it affects less than 1% of the American population, yet a December 10, 2007 *Wall Street Journal* opinion piece said surveys show "70% of voters favor a full repeal." And Buffet, while supporting the estate tax concept, called the current tax regulations "an abomination."

So what's going to happen?

Probably nothing for awhile. Given the strong feelings on both sides of the argument and the legislative majorities required to change the law, a lot of discussion would very likely result in heated comments, but no action. As a result of the philosophical stalemate, Senator Max Baucus (D-Mont) the chairman of the committee believes the estate tax will remain in some fashion. "I think everyone in this room knows we're not going to repeal the estate tax. It's not going to happen in the foreseeable future." But since there's no political upside to acting earlier than 2011, it's unlikely the debate will result in a definitive estate tax standard which individuals can use to solidify their estate plans.

Under the current estate tax structure, life insurance is often used to either preserve or pass on assets that might have been lost due to taxes. Owning life insurance doesn't eliminate the estate tax, it just gives heirs more resources to pay it. At death, the proceeds from a life insurance policy can provide an immediate source of liquidity. This infusion of cash may be used to pay the tax, preserve other real assets for the heirs, or gives heirs the time to liquidate assets from a position of strength, rather than at a discount as a result of a tax deadline.

While a complete repeal of the estate tax could theoretically eliminate the value of life insurance in estate planning, the prudent approach would be, at minimum, to continue policies already in force. Additionally, it is important to understand that the positioning and ownership of policies in the estate plan can affect their use. If you're attempting to use life insurance as a contingency plan for an uncertain tax, you must consult with knowledgeable advisors.

A cynic might say that the estate-tax uncertainty represents an ideal government arrangement. Because no one knows what the tax structure will be, no one can plan to avoid it. Lawmakers have the latitude to include or exempt assets based on current conditions, so even the "best-guess" estate plans of today could be thwarted tomorrow. Indeed, the harsher critics of the current estate tax have noted that the financially workable solution for those with estates is to plan on dying in 2010. But that's a rationale no one can rationally accept.

THE UGLY MATH OF ONE BAD YEAR

Here's an easy riddle:

Up.
Down.
Down some more.
Up.
Down – in a hurry.
Up.
Up again.
Down, then up in the same day.

Who am I?

a. a schizophrenic

b. the stock market
c. a roller coaster
d. all of the above

Those answering "a" or "d" may want to consider professional help. Those answering "c" are having more fun than the rest of us. But for all those who quickly identified with "b," keep reading.

You may not be aware of the exact numbers, but you probably understand stock markets have been somewhat erratic in the past few months. They move up, they move down; there's no significant trend. Combined with the fall-out from the sub-prime mortgage situation, some people warn that investors may be on the verge of sustaining some substantial losses.

Historically, this would not be an unusual occurrence. Recessions, depressions, and bear markets have been a regular part of the financial landscape just as much as upward trends, booms and bull markets. History suggests that even with the ups and downs, the long-term returns are worth it (see the "*Buy-And-Hold Works Best – When The Hold Is For 30 Years*" article in this issue), so we have been conditioned to accept some losses along the way. But that doesn't mean that financial losses – from any financial decision – are trivial things.

> the losses you incur may have a greater impact on your total wealth than the gains you make.

Losing money is a concept that perhaps doesn't get as much attention as it should in financial programs, but in many ways, the losses you incur may have a greater impact on your total wealth than the gains you make. There are a number of mathematical examples to illustrate this idea.

Here's a simple illustration. Suppose you have $10,000 in some non-guaranteed financial vehicle (i.e., the account values may fluctuate). For three years in a row, the account delivers a 10% annual return. At the end of the third year, your account would have grown to $13,280. Here's the progression:

Beginning balance:	$10,000	Annual Return
End of Year 1:	$11,000	+ 10%
End of Year 2:	$12,100	+ 10%
End of Year 3:	$13,310	+ 10%

So far, so good.

But let's assume that in the fourth year you experience a loss, which while not desired, was not wholly unexpected. The loss is 10%. Your account balance drops to $11,979.

Beginning balance:	$10,000	Annual Return
End of Year 1:	**$11,000**	**+ 10%**
End of Year 2:	**$12,100**	**+ 10%**
End of Year 3:	**$13,310**	**+ 10%**
End of Year 4:	**$11,979**	**– 10%**

Three out of four years you gained 10%, right? But consider the impact of the one bad year:

The average annual return was more than halved. Through the first three years, the average annual return was 10%. But the one bad year reduces the average annual return for the four-year period to just 4.62%!

In order to get back to averaging 10% a year, your investment must earn over 34% in the fifth year! Look at the math.

Here's what comes from five years of steady 10% annual returns:

Beginning balance:	$10,000	Annual Return
End of Year 1:	**$11,000**	**+ 10%**
End of Year 2:	**$12,100**	**+ 10%**
End of Year 3:	**$13,310**	**+ 10%**
End of Year 4:	**$14,641**	**+ 10%**
End of Year 5:	**$16,105**	**+ 10%**

But if there's a blip in the fourth year, making up for it in one year requires a steep increase.

Beginning balance:	$10,000	Annual Return
End of Year 1:	**$11,000**	**+ 10%**
End of Year 2:	**$12,100**	**+ 10%**
End of Year 3:	**$13,310**	**+ 10%**
End of Year 4:	**$11,979**	**– 10%**
End of Year 5:	**$16,111**	**+ 34.5%**

Even if you don't try to recover the loss in one year, it would take six years of earning 13.5% each year to average 10% for 10 years – all because of one bad year.

Beginning balance:	$10,000	Annual Return
End of Year 1:	**$11,000**	**+ 10%**
End of Year 2:	**$12,100**	**+ 10%**
End of Year 3:	**$13,310**	**+ 10%**
End of Year 4:	**$14,641**	**+ 10%**
End of Year 5:	**$16,105**	**+ 10%**
End of Year 6:	**$17,716**	**+ 10%**
End of Year 7:	**$19,487**	**+ 10%**
End of Year 8:	**$21,436**	**+ 10%**
End of Year 9:	**$23,579**	**+ 10%**
End of Year 10:	**$25,937**	**+ 10%**

Beginning balance:	$10,000	Annual Return
End of Year 1:	**$11,000**	**+ 10%**
End of Year 2:	**$12,100**	**+ 10%**
End of Year 3:	**$13,310**	**+ 10%**
End of Year 4:	**$11,979**	**– 10%**
End of Year 5:	**$13,626**	**+ 13.5%**
End of Year 6:	**$15,500**	**+ 13.5%**
End of Year 7:	**$17,631**	**+ 13.5%**
End of Year 8:	**$20,055**	**+ 13.5%**
End of Year 9:	**$22,813**	**+ 13.5%**
End of Year 10:	**$25,950**	**+ 13.5%**

In the conventional paradigm, the opportunity for increased return comes with increased risk. Thus, you could argue that increasing your annual return to 13.5% from 10% means increasing the risk by 35%.

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Remember, this is all the result of one bad year!

Frankly, there's very little market appeal to "loss prevention" – high rates of return grab headlines. (In today's economic climate, how interested would you be in an accumulation vehicle that averaged only 4.62% over four years?) But if you really care about maximizing your wealth, you should expend some planning energy on avoiding losses. The fewer setbacks, the less you have to "catch up."

HOW GOOD IS YOUR LOSS PREVENTION STRATEGY? HOW MUCH IS IT COSTING YOU IF YOU DON'T PAY CLOSER ATTENTION TO LOSSES – BEFORE THEY OCCUR!

BUY-AND-HOLD WORKS BEST – WHEN THE HOLD IS FOR 30 YEARS

With all the turmoil from the sub-prime mortgage crisis and fluctuating interest rates, stock market price have been rather volatile in the past year. When prices start going up and down, up and down, the natural tendency is to try to figure when to get out. But according to Jonathan Clements in a November 21, 2007 column in the *Wall Street Journal*, "even as investors grow more restless, the big money continues to be made by those who stay the course."

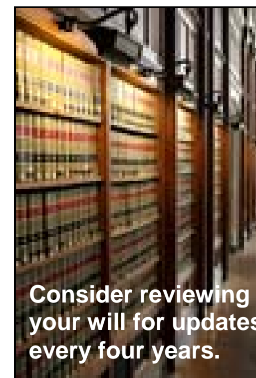
> 68% of the gain came in the last 10 years of the 30-year period.

Clements cites a study by Charles Farrell, using data from Morningstar's Ibbotson Associates that analyzed stock market returns of 52 rolling 30-year periods beginning with 1926 to 1965, and ending with 1977 to 2006. In each case, $10,000 was deposited into a hypothetical portfolio consisting of a 70-30% mix of blue chip stocks and intermediate government bonds. While all portfolios made money, the gains varied widely for the 30-year periods, ranging from an inflation-adjusted $900,000 for the period 1928-1957 to $1.6 million for 1970-1999.

However, the most interesting finding from the study was *when* the growth occurred. Mr. Farrell concluded that, on average, 68% of the gain came in the last 10 years of the 30-year period. This was not so much a matter of timing, but rather the mathematical nature of compounding. "Once you get to a certain portfolio size," says Farrell, "the dollar gains are just huge."

In reality, the report isn't so much about the stock market as it is the ability to have a long time horizon for accumulation. Slow and steady accumulation yields solid results, but in vehicles which often fluctuate in value, the length of "hold time" may be the ultimate determiner of profitability.

ONE OF THOSE DETAILS THAT NEEDS REGULAR ATTENTION


Consider reviewing your will for updates every four years.

Perhaps you noticed an item from the week of December 3, 2007 that appeared in the major wire services…

A wealthy London widow who had outlived both her husband and lone son, repaid the kindness shown to her by a family that owned a Chinese restaurant by leaving them a $21 million inheritance. The woman, Golda Bechal, had stated in a 1994 will that she wanted Kim Sing Man and his wife, Bee Lian to be the beneficiaries of her estate upon her death.

Sad and alone following the deaths of her husband and son, Ms. Bechal became close friends with the couple that operated a Chinese restaurant in her neighborhood. The three of them not only met regularly at the restaurant and Ms. Bechal's apartment, but also traveled together on vacations to other countries.

When Ms. Bechal died at age 88 in January 2004, her five nephews and nieces contested the will, asking the British courts to declare it invalid, claiming Ms. Bechal suffered from dementia. However, after more than three years of deliberations the court awarded the inheritance to Kim Sing Man and his wife, saying, "it was not irrational to leave the bulk of her estate to Mrs. Man, the daughter she would dearly wished to have had, and her husband."

You may never have $21 million to pass on, but the above story illustrates the challenges of settling an estate, especially when significant assets are involved. While it is possible to contest almost every will, there are several things you can do to make it less contestable.

Have it drafted by a professional. A hand-written will, although it may be valid, is not recommended. A handwritten will is called a "holographic will." It is valid in about 25 states so long as all material provisions and clauses are entirely handwritten. However, because most handwritten wills are not as in-depth as a professionally drafted will and because they are oftentimes not properly written, they are not recommended. Courts can be unusually strict in determining whether a holographic will is authentic.

Have all changes and updates prepared by a professional. A will may often contain a provision or schedule, listing specific assets and their intended beneficiaries. Some people may might try to amend this section by hand at a later date. In general, any handwritten annotation is much easier to challenge, even if witness signatures are present. Revisions (generally called codicils or amendments) should be made with the same care and attention to procedure as was given the original document.

Make a will review a regular part of your financial check-up. If it's on the list, you'll get used to doing it. If you do it regularly, it won't take much time.

Checklist:

- **Have your will drafted by a professional.**
- **Have all changes and updates prepared by a professional.**
- **Make a will review a regular part of your financial check-up.**

Material discussed is meant for general illustration and/or informational purposes only and it is not to be construed as tax, legal or investment advice. Although the information has been gathered from sources believed reliable, please note that individual situations can vary, therefore the information should be relied upon when coordinated with individual professional advice.

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