"In theory, there is no difference between theory and practice. But, in practice, there is."
- Jan L.A. van de Snepscheut

PSST... HERE'S THE INSIDE SCOOP: THERE ARE NO "HIDDEN SECRETS"

Check out the headline from an article in the finance section of a recent newsletter:

"Stock-Picking Secrets From The Little Black Book That Beats The Market"

Wooo… Secrets. Little Black Book. Beating the Market. It's the hint of a magic bullet, with the subtle yet captivating undertone of a conspiracy. Maybe, just maybe, this is your way around the grassy knoll of financial frustration. What could life be like if you had the little black book, knew the secrets, and beat the market? Close your eyes and imagine the possibilities!

Now open your eyes, and take a deep breath. Read the next few paragraphs.

There are no financial secrets. If you read about it in a national newsletter (along with thousands of other subscribers), this "secret" is now public knowledge. If this "inside information" was supposed to give you an edge in the market, it just gave everyone else one too, so the inside advantage is negated.

There is no conspiracy. There's plenty of individual financial ignorance, and there's no doubt that ignorant consumers are often losers in their financial transactions. But ignorance on the part of consumers does not constitute a conspiracy against them. A conspiracy implies there's a deliberate attempt by someone (or a group of someones) to mislead and conceal the true nature of an activity or program. That's not true. The "insider secrets" are readily available for anyone who wants to find them.

Still, even if there are no secrets and no conspiracies, it's true that even in the United States, being "wealthy," however you may define it, is relatively rare. By most measures, the wealthy represent a small percentage of the American population, perhaps as little as 10%. And since almost everyone wants to be wealthy, but only 1 in 10 *is*, it's human nature to conclude that the wealthy must know something, or be part of something special that gives them the inside track.

Actually, the advantage of the wealthy isn't because of what they know, *but what they do.* And while you could get a hundred millionaires to write a hundred different books about their path to financial success, the underlying actions that led to their wealth would be pretty much the same, again and again.

THE FOUR STEPS TO WEALTH

1. **Earn money.**
2. **Save money.**
3. **Acquire assets that make more money.**
4. **Repeat.**

These instructions aren't "secret." Rather, they are as simple as the directions on your shampoo bottle. But while simple, the steps to becoming wealthy aren't easy. The hard part is the execution, the follow-through. And typically, these steps are not accomplished overnight, so perseverance is a factor as well. But the historical evidence is pretty clear: People who do these four things become wealthier.

A few observations about the not-so-secret four steps:

1. The more you earn the easier it is to save. Duh. It's so obvious, but how many "financial plans" begin with a discussion of your earning potential? Since most of us don't begin our financial lives with trust funds, how we choose to earn money is an essential starting point in becoming wealthy.

It's not simply a case of people being able to save more because they earn more. The motivation to save is in constant conflict with the costs of maintaining a standard of living. Sometimes questions like: "New car or retirement account?", or "Mutual fund or vacation?" are answered by addressing immediate wants and needs. But people who earn more money can usually address both short-term wants and long-term goals – with less stress. It's easy for Tiger Woods to buy a Hummer *and* investment property in the Caribbean because he earns so much money he doesn't have to choose.

INSERT PAS DISCLOSURE HERE OR DELETE THIS BOX

2. Saving starts with a commitment, and can be greatly enhanced by managing expenses. The most effective saving strategy is "paying yourself first." While there may be financial factors that affect your ability to save, the biggest challenge is deciding to do it – and following through.

Even the best savers usually have ongoing financial transactions that provide little or no financial benefit. Among these transactions are interest on loans, most taxes (particularly income taxes), and some forms of insurance coverage. These are expenses common to everyone. But once they establish the savings habit, people who are diligent and careful can often increase their savings by using the same discipline to reduce their expenses. Management of expenses is another bedrock component of successful planning.

3. If you have savings, someone will want you to buy their product (retirement plan, insurance policy, mutual fund, time share, etc.). At this point, you must become an informed consumer. Quoting Buddha, columnist Paul Farrell says this means you must "believe nothing, no matter where you read it or who has said it, not even if I have said it, unless it agrees with your own reason and your own common sense."

In general, the potential for a higher return comes with a corresponding increase in financial risk. Anything that appears to contradict this statement merits very close scrutiny.

4. Repetition is the branding iron of success. The more you execute Steps 1 through 3, the better the results. Consistent saving, even in modest amounts, often outpaces the efforts of those who are constantly trying to hit a home run to catch up.

Where does a financial professional fit in the four steps?

Most of the time, people engage a financial professional (registered representative, agent, financial specialist, accountant, etc.) when they are ready to start Step 3. But a good financial professional should probably be considered when you embark on Step 2. Once you have committed to saving, they may be able to help you save more by providing expertise on solutions for lowering expenses.

Yeah, but what about the offers of financial "secrets" that fill my mailbox each week? Are they all bogus?

Well, the e-mail plea from the Nigerian banker to send you money so he can deliver you a big check is definitely a scam. But most "inside information" and "hidden knowledge" isn't a lie, they are just marketing ploys. Remember, one of the features of free-market capitalism is the competition of ideas, products and services. In order to get your attention in a crowded field, advertising people use all sorts of strategies to differentiate their product.

While some advertising is intended to inform prospective buyers about the particular product or service, other advertising is designed to create an emotional impact. When it comes to financial services, the typical emotional appeal plays to the greed and fear of the recipient. What don't you know? Is it costing you money? Look what the other guy made! You better check this out! You can't afford not to!

Once you get past the marketing angle, you can further evaluate the legitimacy of most "financial secrets" by classifying them as either shortcuts or new information. It's human nature to want to look for an easier way to get things done. Offering a quick-and-easy way to get things done is an attention-getter, especially when it comes to obtaining wealth. Because of their background or current financial situation, many people see the four steps to wealth and say "I'll never be able to do that! I don't make enough money. I can't save, I have too much debt." When they don't see themselves able to succeed using a tried-and-true approach, they want to believe there must be a secret shortcut – otherwise they have no hope.

But even legitimate shortcuts are variations on the four basic steps outlined – only riskier. For example…

Can you purchase real estate? Yes. Can you repeat the process? Sure. Can you make money quickly by using inside knowledge to put no money down, and flip the house the next month? Some people have. Can you lose money just as quickly if you make a mistake? Oh yeah.

Is this a "secret?" No. It's just something you haven't done (and may not want to do). Likewise, other "secrets" are usually new variations on existing ideas, products or services. Or they are items that are new to you – the only reason you might think it's a secret is because you haven't heard of it before.

Don't be seduced or distracted by illusory financial secrets. The clearest path to financial success is three simple actions, repeated diligently over a lifetime.

THINGS THAT MAKE YOU GO *"HMMM…"*

THE WAVE OF THE FUTURE:
THE 50-YEAR MORTGAGE & THE 5-YEAR CAR LOAN

As interest rates rise, monthly loan payments will increase. For some consumers, the increased cost of borrowing may mean they cannot afford to buy. Fewer eligible buyers means bad news for sellers as well, since it may result in reduced sales, or reduced prices. Reduced sales and/or reduced prices mean less income for sellers, lower tax revenues for governments, fewer jobs created, etc.

Theoretically, this downward economic spiral can lead to a depression. And while some economists may argue that depressions are actually beneficial "corrections" that cleanse the marketplace of inefficiencies and result in a stronger and better future economy, most people don't really want to go there. "Isn't there anything we can do instead?" they ask.

Hearing this cry for help, lending institutions are offering consumers a simple solution: Just spread out the payments over a longer period of time. And in gratitude (or desperation) consumers are flocking to longer-term payments for high-ticket items like autos and houses.

AP writer Allison Colter notes in a May 8, 2006 article that "last year, for the first time, the majority of auto loans were underwritten for five years or longer." Colter adds that 55 percent of *new car* loans were for terms *longer* than 5 years.

On the mortgage front, many lending companies have begun offering interest-only mortgages and 40-year mortgages as alternatives to the 30-year mortgage. Both options result in lower monthly payments, with the trade-off of limited reduction of loan principal.

Interest-only mortgages allow borrowers to reduce their monthly payments to just interest for the first 10 to 15 years, after which payments increase to reflect a 20- or 15-year payoff schedule. For example, after 10 years of interest-only monthly payments on a $200,000, the borrower still owes $200,000. That might seem to be a deterrent, but according to Ruth Simon of the *Wall Street Journal*, these mortgages, "which barely existed two year ago, now account for roughly 8% of all new residential mortgages taken out"(April 19, 2006).

Taking things one step further, a few lenders have recently begun offering 50-year adjustable-rate mortgage loans. That's 600 scheduled monthly payments! To get an idea of the difference, here's a simple comparison: A 30-year mortgage for $200,000 at 6% interest results in a monthly payment of $1,199. Of the first year's payments, $11,932 is interest and $2,456 is applied to principal. If the borrower wanted to pay the loan in full at the end of one year, the outstanding balance would be $197,544.

With a 50-year mortgage for same amount at the same rate, the monthly payment is $1,053, 13% less than the 30-year loan. But of the first year's payments, $11,982 is interest and only $654 is applied to principal. If the borrower wanted to pay the loan in full at the end of one year, the outstanding balance would be 199,346. And after 10 years of payments (a total of $126,360), the outstanding balance is still $192,068!

Hmmm… Do you think you would ever see a mortgage-burning party for a 50-year mortgage? Almost certainly not. Especially if home property values stagnate or decrease, most "homeowners" will in reality become "renters with a tax deduction." They will have little or no equity accumulation, with their only advantage being the tax break on the mortgage interest paid.

US SENIOR CITIZENS: THE "GREATEST GENERATION" FOR RETIREMENT?

Tom Brokaw's 1998 bestseller *The Greatest Generation* was a tribute to those Americans who "came of age during the Great Depression and the Second World War and went on to build modern America." While Brokaw lauded them for their accomplishments as young adults, it turns out this generation might also be the "greatest" in retirement as well.

Citing statistics from a Census Bureau study, Timothy Lamer of *World* commented, "A quiet revolution in aging has occurred in this country over the past half-century, raising the quality of life for American seniors in almost every way imaginable. Seniors today are healthier, wealthier, and wiser than any previous generation could have envisioned." (April 1, 2006.)

Comparing statistics from the 2000 census to those culled from the 1950 survey, some of the statistics are quite stunning. Today's seniors…

Live longer.

In 1950, life expectancy was 68.2. The last half-century has seen a steady increase, and in 2003, the number was 76.9, an increase of almost 13 percent over 1950 – and expected to continue climbing in the future.

Have more money.

The median net worth of Americans over age 65 in 2000 was calculated to be $108,885. Even excluding home equity, the typical American senior's net worth was higher than the typical American 45-year-old. In 1950, it was estimated that 35% of Americans over 65 lived in poverty. Today, the number is only 10%.

Are better educated.

72% of today's senior citizens earned a high school diploma. By comparison, only 17% of seniors alive in 1950 graduated from high school. The difference in who held college degrees was just as great: 17% in 2000, only 3% in 1950.

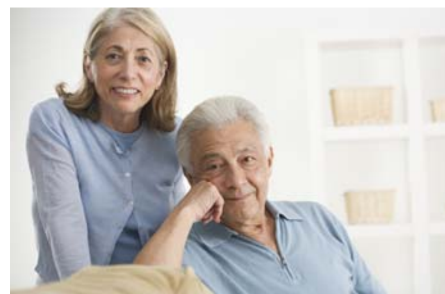
Work less.

In 2003, only 19% of American males over 65 were in the full-time work force. In 1950, nearly half of senior American men (46%) were still working.

Considered in the context of the 1950s, the lives of today's senior Americans represent great progress. But if they truly are the "greatest generation," what are the retirement prospects for Baby Boomers, the "largest generation?" It may depend on your perspective.

The glass-is-half-empty prognosticators will point to the population demographics that make both Social Security and Medicare unsustainable, meaning Boomers won't be able to rely on government programs in retirement. They will also note that longer life expectancies are usually accompanied by higher medical costs, and the issue of long-term care looms ever larger as an emotional and financial challenge. These factors could easily diminish the quality of life for many Boomers in their senior years.

However, the glass-is-half-full advocates have reason to be optimistic. First, a lot of the wealth accumulated by the Greatest Generation will be passed on, and most of the beneficiaries will be Boomers. Second, much of the improvement in senior quality of life over the past 50 years has been the result of technological innovations, and there is no evidence that technological innovation is decelerating. Just as a 65-year old in 1950 couldn't have anticipated the Internet or arthroscopic surgery, we cannot fully anticipate the technology of tomorrow or the impact it might have.



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.)

HEALTHY EMPLOYEES MAY NOT WANT SOME GROUP BENEFITS

Group life insurance may not be best for healthy employees. Group policies offered through employers are based on the average employee's health, which means healthier workers pay higher rates to subsidize coverage for those who don't follow a healthful lifestyle. Premiums for healthy individuals have fallen in the past five years – so someone who is healthy should compare the cost of the employer's policy with the cost of one he/she can buy as an individual. Many variables can lower premium costs for healthy individuals.

Patty Reiners, *Bottom Line Personal*, June 1, 2006.

DID YOU CELEBRATE TAX FREEDOM DAY?

Tax Freedom Day [fell] on April 26 in 2006, according to the Tax Foundation's annual calculation using the latest government data on income and taxes. The Foundation's report compares the number of days Americans work to pay taxes to the number of days they work to support themselves.

"Tax freedom will come three days later in 2006 than it did in 2005," said Tax Foundation President Scott A. Hodge, "and fully 10 days later than in 2003 and 2004 when a combination of slower income growth and tax cuts cause Tax Freedom day to arrive comparatively early, on April16."

However, 2006's Tax Freedom Day is still considerably earlier than it was in 2000, when the economic boom, tech bubble and higher tax rates pushed tax burdens to a record high, and Tax Freedom Day was postponed until May 3.

Press release for *Tax Foundation Special Report N. 140*, April 2006.

SOCIAL SECURITY AND MEDICARE: STILL GOING BROKE, STILL NO GOOD FIXES

Retire late and die early.

That might be the new retirement plan for baby boomers after a new report confirms that Social Security and Medicare are sprinting toward insolvency.

The 2006 annual report of the trustees of the Social Security and Medicare trust funds tells how the two funds are on a collision course with insolvency. The funds have promised $37 trillion more in benefits than they will be able to pay.

Something will have to give. Benefits will have to be cut, taxes increased or increasingly large raids on general revenues will be required to keep Social Security and Medicare on life support.

Rowland Nethaway, *Waco Tribune-Herald*, May 5, 2006.

MORTGAGE RATES INCHING UP

Rates on 30-year mortgages climbed this week to their highest point in nearly four years, helping take the exuberance out of the housing market.

Freddie Mac, the mortgage company, reported Thursday that for the week ending May 18 rates on 30-year fixed rate mortgages averaged 6.60%, up from 6.58% last week. This week's rate was the highest since the week ending June 20, 2002, when 30-year mortgages stood at 6.63%. A year ago, 30-year mortgages averaged 5.71%, 15-year mortgages stood at 5.27%, one-year ARMS were at 4.26% and five-year ARMs averaged 5.07%.

Jeanine Aversa, Associated Press, May 19, 2006.

LONG-TERM CARE INSURANCE MARKET HEATING UP

Insurers are ramping up efforts to sell long-term care insurance, offering new products and forging alliances with employers to make the policies more widely available in the workplace. Congress helped boost these efforts last week when it passed new rules that tighten eligibility for Medicaid coverage of nursing-home costs. That means more middle-class Americans will likely be on their own later in life when it comes to paying for long-term-care needs, which can run into the tens of thousands of dollars for even a relatively short period.

These initiatives come as the costs of long-term care – which include nursing-home and assisted-living-center bills and the price of home health care – are increasing at a rate nearly twice that of overall inflation. The average cost for one year in a nursing home is nearly $70,000, while the average hourly rate for a home-health aide tops $18 an hour, equivalent to more than $37,000 a year. Those costs are sharply higher in metropolitan areas. Traditional health insurance and Medicare generally do not cover these expenses.

Jeff Opdyke, *Wall Street Journal*, December 27, 2005.

TWO WAYS TO MESS UP A WHOLE LIFE INSURANCE POLICY

Another true story, with some identifying details changed to protect the innocent:

At age 30, a self-employed carpenter takes out two whole-life insurance policies; one for himself, one on his wife. For ten years, he makes regular premium payments, building a sizable amount of cash values.

Once, after about seven years of payments, he borrows $10,000 from the policy for an investment opportunity. The investment doesn't pay off right away, so he lets the loan interest accumulate.

A year later, the carpenter's financial representative, who helped set up the whole life plan, takes a new position in management, and turns over his book of policyholders to the agency. The carpenter doesn't make a connection with another financial representative at the agency, or review his policy's status with anyone.

Two years later, the economy starts to cool down, and the carpenter's cash flow becomes irregular. One month, a few checks for payment to the carpenter are returned "NSF," and as a result, the scheduled automatic withdrawal for the insurance premium payment doesn't go through.

Because the policy has an automatic loan provision, the insurance company uses some of the cash value to keep the policy in force. The carpenter receives a notice of this transaction, but since he is preoccupied with drumming up work in a tight market, he doesn't get around to making sure he knows what's going on. A week later, the issue is "out of sight, out of mind" – until the annual review statement arrives six months later, and he notices his loan balance is over $18,000!

For the first time in 15 years, work is so scarce the carpenter isn't meeting his monthly expenses and has to dip into reserves. In desperation, he contacts the life insurance agency to find out how much he can withdraw from the cash values. He meets with a new representative assigned to review the current status of the policies, but the lack of familiarity hampers communication, especially when he realizes a whole year's cash value has been "wasted" (the carpenter's words) by policy loans to keep the coverage in force.

"I can't afford this!" he sputters. "I might as well just cash out and find some term insurance."

What happened?

Regular readers of this newsletter know we have a favorable opinion of whole life insurance. Correctly used in an integrated financial plan, a whole life insurance policy provides significant financial and intangible benefits. But mishandled, the same policy has the potential to leave its owners dissatisfied, perhaps even regretting their purchase.

Here's the issue: A whole life policy isn't a "set-it-and-forget-it" financial instrument. Although it's conceivable that a policyholder could do nothing but pay premiums for their entire life with no additional transactions other than the distribution of the death benefit to beneficiaries, it's unlikely. Because the contract is designed for one's "whole life," options for loans, withdrawals and premium payments can be used to respond to changes that may occur during the course of an individual's life. These options can be very advantageous to the policy owner, but through neglect or misuse, they also have the potential to unravel the policy and make the plan of limited value. That's not good.

Here are two ways to mess up a whole life policy:

Don't pay premiums.

One of the analogies occasionally used to describe the characteristics of a whole life policy is that it is a contract like a "mortgage for money." Just as a regular monthly mortgage payment allows you to secure a home, a regular premium allows the policy owner to ensure that a guaranteed amount of money will be available at death – not just for a period of time, but for one's entire life. Ownership is secured through ongoing payments; if you don't pay the mortgage, you'll eventually lose the house. Don't pay premiums…well, you get the idea.

Most whole life contracts are priced on the assumption that a "whole life" is to age 100. Thus, actuaries determine premiums based on the age when one establishes the policy in relation to age 100. For a 30-year-old, the policy is a "70-year mortgage" plan (100-30). For a 45-year-old, the plan is 55 years (with a comparatively higher premium than the 30-year-old). In theory, the policy owner must plan to pay premiums for his/her entire life to guarantee receipt of all promised benefits.

The prospect of paying premiums for 70 years might seem like a daunting task. After all, who does *anything* for 70 years, beside breathe and eat?

In all likelihood, most policyholders will not pay premiums for the entire life of the policy, even if they live to 100. To ensure that the insurance company will always be able to meet its contractual promises, actuaries set premiums based on extremely conservative estimates. As the insurance company experiences results more favorable than those guaranteed in the policy, dividend distributions are made to policy owners. These dividends can be used in a variety of ways. Depending on the specifics of the individual contract, these options may allow the policy owner to reduce or suspend premium payments, purchase paid-up insurance, or even provide a regular stream of income. In addition, many contracts will allow policy owners to make "extra" premium payments to shorten the payment period. This process can be compared to making extra principal payments on a 30-year mortgage to pay off the loan in 15 years.

All of these options afford great flexibility to the policy owner. As a result, once a solid whole life insurance program is established, the benefits can remain intact even as one's financial circumstances change. But in order for all these benefits to be available, premiums must be paid – from income, from savings, from gains in the stock market, from dividends, from somewhere. Like any other financial transaction, there must be an equitable exchange of value between the two parties. There might be a lot of ways to pay premiums, but remember: you can't get a lifetime insurance program for free.

(“**…Ways to Mess up a Whole Life Insurance Policy**”, ***continued***)

Don’t talk to your life insurance representative/agent. While all whole life policies are developed from the same fundamental concepts, every insurance company issues contracts with unique features (riders, dividend options) and regulations (minimum premiums, surrender charges). If you want to maximize the benefits you receive from your policy, the devil is often in the details. You can’t expect to get the most out of your policy unless you work with a knowledgeable insurance representative.

But even the best representative – one who schedules annual reviews, and calls or e-mails every few months – isn’t a mind-reader. When something comes up in your world, you need to take the initiative and make the call! Every time you contemplate a change to your whole life policy, and don’t contact the representative assigned to your policy, you run the risk of ending up with a less-than-the-best result.

In fact, the representative you select to work with you in developing a whole life insurance program may be almost as important as the company and contract you choose. A whole life program needs tending, and unless you are going to become an agent yourself, you need to find a competent “manager/advisor” for your life insurance plan. When it comes to making a whole life decision, don’t settle for just a contract. Make sure the policy comes with a good representative.

There’s turnover in the financial services field. For a variety of reasons, people leave the business, and in the process, policy owners may be left untended. If that happens to you, find somebody else! Don’t let your policy become an “orphan,” re-assigned randomly to another representative. In the end, no one has a greater interest in the success of your insurance program than you. And no one can help you more than a good insurance representative.

A whole life insurance policy can deliver a range of significant financial benefits. But since it is designed to function for all of your life, you need to make sure it comes with a “maintenance program” so it can be retooled to match the ever-changing pieces of your financial world.

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