**Making Principles Based Decisions**
*A Discussion of The PS&G Model™*

**This article has a two-fold purpose: The first purpose is to remind clients of the overall objective of the strategies and products that have been recommended and implemented. The second purpose of the article is to clarify Unique Advantage's continued role in a client's plan.**

Oftentimes financial discussions are focused on so-called "needs". Most financial planning organizations train their representatives to ask clients these types of questions: "How much money will you need for retirement income… children's education… first home purchase…?" and so on. People are being trained to make financial decisions based on what they think they will need in the future. However, because markets, desires, and situations change constantly, knowing what you will "need" becomes impossible to determine with any amount of accuracy. Needs-based financial plans fail due to constant personal and economic change.

Contrary to the popular needs-based financial planning, our planning is focused on efficiency, both in products and flows of money. The recovery of financial costs, and the protection against forces that are constantly working to erode wealth, are our main focus. Decisions our clients make are solidly founded in time-tested principles, which act as a financial compass throughout their lives. These principles, when followed, give a person the best chance of successfully achieving his/her financial objectives, and help them to avoid the pitfalls of bad financial advice.

Before discussing the principles, let's discuss the foundation upon which the principles are laid.

<u>"Math is not Money" (Robert Castiglione, Founder of LEAP Systems, Inc)</u>

Money is a commodity, not a number (math). Money erodes and changes over time. Its value is not constant, as in the case of numbers. Calculators that are used in financial planning are only accurate for measuring current values, not for measuring what a financial value will be in the future. Financial calculators are good for testing possible situations, not for predicting what a situation will be. However, math can be used to test various sets of possible future circumstances and economic situations. The validity of the testing is limited to the variables a planner considers. No financial model or calculator computes every financial variable that can or will affect your money throughout your lifetime. Therefore, no financial calculation is going to be 100% accurate at predicting financial outcomes.

Financial plans based in math and numbers are limiting, not maximizing. Most of the time, financial plans based upon predetermined needs only assume optimistic circumstances, or "average" circumstances. They almost never demonstrate a downturn in the stock market, or an increase in taxes. A correct plan will not try to predict what the future holds. Instead, it will strive to position the client for the best possible chance of success at all times. In my mind, a person should approach his/her finances as a master chess player would approach his moves in a chess match. A master chess player does not try to predict what his opponent will do. He does, however, make a move that puts him in the best possible situation at all times, while defending against any possible move the opponent could make, maximizing his/her chances of success. An amateur chess player may try to predict what his/her opponent will do, thereby leaving him/her vulnerable to moves that the opponent actually does make.

If needs-based financial plans are such a failure, why are they so popular? Needs-based plans are complex sales pitches, riddled with colorful graphs and mountain charts. Needs-based plans are designed only to motivate the client to buy, with no proof of actual success for clients. The SEC allows sales representatives to show illustrations and charts using up to 12% rates of return, even though no mutual fund or stock has ever consistently performed at that level for any significant period of time. Reps use high returns because they know that as a consumer, you are likely to buy their product if they show you a higher number than the next salesman. Why do people buy into the need-based plans? It is because they appear easy to accomplish on paper and the numbers/math looks good.

Averages, Misleading Indicators

Another foundational problem that people get caught up in is "average" rates of return. Decisions on where to save or invest money is oftentimes based upon rumored or even actual average rates of return. Many like to use the "Rule of 72" to figure out how long it will take for their money to double based upon average rates of return (*see Table 1*). This focus on averages gets them caught up in the mathematics of a financial decision, versus the reality, probability, utility, and functionality of it. In other words, if it shows a bigger number at the end of the equation, then it must be better, right?

*Table 1 – Rule of 72*

| **72 divided by the Average Rate of Return** | **# of years to double the investment** |
|---|---|
| 12% | 6 |
| 10% | 7.2 |
| 9% | 8 |

People that overemphasize the importance of average rates of return oftentimes make poor investment decisions. The tantalizing thought of getting rich quickly overrides the sensibility of researching the investments sufficiently. Also, the thought of getting rich quick often causes people to overlook possible problems and underestimate the "worst case scenario".

The problem is math is not reality when it comes to money, and averages mean almost nothing by themselves. *Table 2* provides an example of how an investment averaging 7.5% return can actually outperform an investment averaging 10.5% return. Using mathematical formulas alone, such as average rates of return, as the sole means of evaluating financial decisions can be a financially devastating mistake, as what really happens is usually very different from the averages.

*Table 2 – Averages Mean Nothing*

| Annual Investment | Account 1 Annual Returns | 7.5% Account balance | Account 2 Annual Returns | 10.5% Account balance |
|---|---|---|---|---|
| $10,000.00 | 10.00% | $11,000.00 | 12.00% | $11,200.00 |
| $10,000.00 | -1.00% | $20,790.00 | -15.00% | $18,020.00 |
| $10,000.00 | 5.00% | $32,329.50 | 25.00% | $35,025.00 |
| $10,000.00 | -3.00% | $41,059.62 | 45.00% | $65,286.25 |
| $10,000.00 | 12.00% | $57,186.77 | 28.00% | $96,366.40 |
| $10,000.00 | 9.00% | $73,233.58 | -12.00% | $93,602.43 |
| $10,000.00 | 1.00% | $84,065.91 | 15.00% | $119,142.80 |
| $10,000.00 | 15.00% | $108,175.80 | 6.00% | $136,891.36 |
| $10,000.00 | 11.00% | $131,175.14 | 14.00% | $167,456.16 |
| $10,000.00 | -2.00% | $138,351.64 | -18.00% | $145,514.05 |
| $10,000.00 | 12.00% | $166,153.83 | 15.00% | $178,841.15 |
| $10,000.00 | 8.00% | $190,246.14 | 30.00% | $245,493.50 |
| $10,000.00 | 16.00% | $232,285.52 | 12.00% | $286,152.72 |
| $10,000.00 | 12.00% | $271,359.78 | -10.00% | $266,537.45 |
| **Totals** | **7.50% Average** | **$271,359.78 ending balance** | **10.50% Average** | **$266,537.45 ending balance** |

Although it can be helpful to use math to evaluate a strategy, knowing and basing financial decisions on solid economic principles provides us with a proper framework upon which to achieve financial success. Also, the emphasis on rate of return should never weigh more heavily than utilization of an asset.

<u>Causes of Erosion – It's Why We Focus on Efficiency.</u>

I live in Utah where Arches National Park is located. The rock arches are amazing natural wonders, created by constant erosion from of wind and water. When I was a young visitor to the park I was filled with amazement with what could have possibly cut huge holes through the mountain of stone, forming the arches. While I was there I also visited a place of interest called Dead Horse Point, which provides its visitors with an amazing view of the Colorado River at the bottom of a very deep canyon gorge. Over hundreds of years the eroding force of the river cut through the earth and stone, creating the canyon through which it is still flowing. One of the most amazing sights in the world is the Grand Canyon, one of the Seven Natural Wonders of the World. It too was formed by the amazing erosive force of the Colorado River.

If a person were to visit these places he/she would be able to witness what erosion has done. What goes somewhat unnoticed is that the same erosion that created amazing natural arches and canyons continues to erode the earth and stone to this day, forming new arches and deeper canyons. Just as erosion is constantly affecting and shaping the earth, there are erosive forces constantly affecting money. Identifying what erodes money is the first step to figuring out how to protect against it.

Taxes top the list of erosive forces. It is estimated that in 2008 the average American sent to the government (local, state, and federal) every dollar earned from January 1st through April 30th 2008, to satisfy all of the types of taxes for the year[1]. Tax is the number one cause of wealth erosion. Here is a list of some of the taxes you may pay:

- Federal Ordinary income
- State Ordinary Income
- Alternative Minimum
- Capital Gains
- Estate
- Social Security & Medicare
- Unemployment
- Workers Compensation
- Food
- Fuel
- Sales
- Property
- Filing penalties
- Sur-taxes
- National park user fees
- State park user fees
- Import/export fees
- Business licenses
- Annual Corporate Registration
- Vehicle Registrations
- …and many more

With all of these taxes and the complexity of tax law, it is no wonder that, according to www.firstresearch.com, the accounting industry brings in an annual revenue of nearly $115 billion from individuals and businesses striving to reduce their tax liabilities!

[1] http://www.taxfoundation.org/taxfreedomday/

If taxes are the number one cause of erosion to money, inflation isn't far behind. Simply put, inflation is the result of the decrease in the purchasing power of money. The government prints money in order to add more dollars to the financial system. This is something they do to "loosen credit", or increase lending and borrowing, in order to encourage spending. The problem is, when the Government prints more money, the money in your wallet loses some of its value. Generally, the more rare something is, and the more demand there is for it (usually because of its use), the more valuable it is. The more commonplace something is, and the less demand there is for it, the less valuable it becomes. Thus, more dollars in the system, backed by nothing but a promise from the US Government (dollar bills are actually Federal Reserve promissory notes – look at a dollar bill), the less valuable dollars become.

Inflation is the single largest reason that income deferral programs, like 401(k) retirement plans, generally do not work. At an annual inflation rate of just 3%, a dollar sitting in a retirement account will lose 59% of its purchasing power over a thirty year period. The reason inflation affects 401(k)'s and IRA's more than most other savings strategies is due to the lack of access and use of the money over the time period. Dollars in a 401(k) simply are affected by inflation. Dollars in retirement plans seldom benefit from inflation (unlike real estate or gold). What's worse is that 401(k)'s and other retirement plans provide <u>no other benefit or use</u> during the time that the money is being deferred. I refer to money in retirement plans as being "locked up" (to age 59 ½ or later) due to the lack of use and access of the funds. For example, money in a retirement plan cannot be used to start a business, buy a second home, help a child with major expenses, or anything else without penalties and income taxes being paid. Most employer sponsored plans don't allow access to the money even if a person is willing to pay the taxes and penalties.

There are no sure benefits to the individual when it comes to retirement plans. There are no guarantees of an income tax reduction, higher rates of return, or that the match and employee contributions will be there at the time distributions are allowed (sometime after 59 ½). Retirement plans truly are a gamble of seismic proportions. Referring to the idea of investing in long-term plans/accounts in a government-controlled economy, Richard Maybury, author of <u>The Money Mystery</u>, stated:

> *The moral of the story is: In a government-controlled economy, short-term plans are **the only kind** that involve reasonable risks. They enable you to shift gears quickly if trouble begins to develop. Long-term plans are invitations to financial suicide.*[2]

There are many other eroding factors of wealth, which include planned obsolescence, technology change, propensity to consume, etc[3].

The bottom line is that long-term planning based upon future needs often ignores or minimizes the affects of eroding factors. Plans based upon the four ideals and five

[2] <u>The Money Mystery</u>, by Richard Maybury, p57
[3] <u>LEAP</u>, by Robert Castiglione

principles that follow are designed to recapture costs due to eroding factors. These ideals and principles will give you greater guidance and efficiency in your plan, putting you in the best possible financial situation at any point in time in life.

**The Ideal Plan**

The Ideal Plan outlines the four overall objectives we seek to attain when making financial decisions. The four ideals are:

1. Build maximum wealth
2. Be able to enjoy/utilize all of the wealth created
3. Transfer the wealth to your family and charities
4. The plan works under all circumstances

<u>First Ideal: Maximum Wealth</u>

Because you don't know what you "need" in the future, the first ideal is to obtain **Maximum Wealth**. Adopting this objective motivates people towards success, whether economic times are good, bad, or somewhere inbetween.

We've all seen the commercials with people carrying "their number" (their customized financial objective). What happens when people are motivated by a number as the objective? When times are good and investments are moving "ahead of schedule", people tend to relax on their savings and investing. The same thing happens in sports. When a team has a big advantage at some point in the game and begins to pay too much attention to the scoreboard, the human tendency is to stop doing what created the lead. The tendency is to relax versus continuing to give maximum effort. With maximum wealth being the objective, your motivation to save and invest continues no matter what the economy is doing or how your investment portfolio is performing. It doesn't matter what the scorecard (statement) says. You do things out of principle and good habits, not prediction. Comparing that to sports again, you simply continue to play as hard and as well as you can regardless of the score.

Too often people are taught to believe that maximum wealth can only be achieved by putting their money at maximum risk. The truth is that maximum wealth can only be achieved with maximum efficiency, not risk. A focus on efficiency is a question of getting the most use out of every dollar at work and reducing or recovering financial costs. Focus on efficiency requires a conscious awareness of the flows of money (income and expenses), which often requires us to use money management programs in our own personal finances (i.e. Quicken or Quickbooks). Focusing only on rate of return is focusing only on 50% of a balance sheet (the assets side). It's half of the story. Rates of return are something a person has very little control over.

One of the most unfortunate effects of believing that maximum wealth can only be achieved through maximum risk, is that it causes people to either shy away from investing entirely, or causes people to take unnecessary risks in their finances by sacrificing their financial protection for hopeful short-term gains.

Risk does not equal return. If high risk were the only path to achieving high returns, then everyone should be playing the lottery instead of investing. Belief in the idea that high risk equals high returns leads people to gamble with their futures. As the great majority of gamblers know, risk usually equals loss.

How is maximum return achieved if risk isn't the measure? The level of consistent rates of return is actually based more upon a person's knowledge of the investment, his/her control over the money, the efficiency of it, and the use (or velocity) of the money.

For example: A dentist, running a successful practice, may choose to add an examination chair in his office. Although this may have some risk associated with it (the cost of the chair and the equipment), the dentist may evaluate that he has sufficient clientele and demand for the additional chair. This would likely lead to a very high rate of return for the investment, with little risk involved.

Instead of striving for higher rates of return by taking on higher risk investments, people should strive to find ways of increasing their plans' returns through efficiency and multiple uses (velocity). These risk-free ways of increasing wealth are created through coordination of products, strategies, and the recapture of costs, facilitated by a macro-economic view of their financial situation. Unfortunately, people are taught to make individual product decisions, instead of coordinated strategic decisions.

Now that Maximum Wealth (not risk-based) is established as the first overall objective, here is a warning: Too often people think that financial success is solely the result of having more money. However, true financial success is dependent upon the successful realization and combination of all four of the characteristics of an Ideal Plan.

For example: A captain of an airplane wants to arrive at his destination as quickly, SAFELY, and EFFICIENTLY as possible. If his only concern was how fast he would get to a destination, then inevitably he'll endanger himself or others due to the lack of focus on safety. A prudent pilot would take ALL possible precautions necessary. He realizes that everyone on board is depending on him to get to the destination quickly, as well as make it there safely. In the end, it's arriving safely to the destination that matters most.

Efficiency is also of utmost importance because a pilot knows that he only has so much fuel in the tank. Because he has limited fuel and precious cargo, he must make sure he doesn't take a lot of detours in getting to his destination. He must be efficient with his resources.

This analogy can be applied to your finances. Very few of us have an unlimited money supply (fuel). Therefore, being efficient with our money and avoiding unnecessary financial detours is essential.

Economist Robert Castiglione emphasized the importance of the safety and protection of money by stating that "If people spent more time trying to hold onto their money instead of spending so much time trying to find an investment to make money, they would be much better off."[4]

The bottom line is, getting to your financial destination as safely and efficiently as possible is more important than how quickly you get there. Simply focusing on rates of return, or how fast you are trying to get to your destination, is almost always a cause of financial problems. Financial success depends upon the creation of wealth, the use or value you derive from it, and the successful protection and transfer of your wealth.

Second Ideal: Ability to Utilize/Enjoy All of the Wealth Created

What value is there in money, other than what you can trade it for? Without the ability to utilize or trade money for something else, it is worthless. Therefore, the value people receive in return for the use of their money is where money derives its worth.

The common definition for the word "cost", as being "what you give for something", or the amount of money you put into it (input), is incomplete. The real definition for cost is "the difference between what I give and what I get back", or the difference between input and output. A quick example of this is if you were to see two movies and the price for each movie ticket was the same. Let's say you enjoyed the experience of one movie and really disliked the other. Even though you paid the same amount of money for each movie, the cost of each one would be different, because of the value you received. In fact, you may feel that not only did the movie you disliked cost you money, it also cost you an irreplaceable amount of time. If you can agree that cost is related to the value or lack of value you receive in return for your money, then it is true that until you receive value for your money, there is a 100% cost to the money.

This idea brings an important point to emphasize: The greater the number of uses and the greater the level of use you receive from your money, the more valuable it is to you. This concept is called velocity of money multiplier, which is derived from the number and level of use you get from your money. Here is a quick example: If someone had the choice between $100 twenty years in the future and $50 now, what would most people choose? Most would choose the $50 now. Why? Because it means more, it does more for the person. There is more potential use. The $100 in the future has no "velocity", until after the twenty years is over. The $100 would erode due to inflation. In fact, with an inflation of only 3% per year, after twenty years the value of the $100 would be reduced to $55.37. The real question is: would you want $50 today or $55.37 twenty years from now? People intuitively know they would rather have the $50 now, they just have a difficult time pointing out the reasons why.

[4] LEAP, by Robert Castiglione (p19)

Financial institutions want you to do the exact opposite of the second Ideal. They want you to be afraid to use it. They want you to make deposits and leave it alone. If possible they want to penalize you for using it. Their objective is for you to never touch your money. Why? The longer you leave your money with the financial institution, the more they get to velocitize it for their own benefit, and the more uses they get from it. They understand that they would rather have a useful $50 now, versus an unusable $100 at some point in the future. They understand velocity.

Contrary to what the financial institutions would like planners to teach, we show you how to best utilize your money today and have the most for tomorrow. We show you how to get velocity on your money. Although saving in products that financial institutions create is essential to the success of a plan, people should choose products that do not lock up their money or penalize them for using it. It should be in places where the client retains control and access, with minimal taxation and penalties where possible.

Bottom line: Referring to money, Robert Castiglione likes to say, “If you can’t use it, it’s just dots on a page.”

<u>Third Ideal: Transfer of Wealth</u>

The third characteristic of the Ideal Plan has to do with the transfer of wealth, or more specifically, where you would like your wealth to go throughout your life, and upon your death.

Like a river, money is always moving. At times a river is moving fast over the river bed and is easily noticed. Other times the movement of the river is difficult to perceive because the surface is so smooth. The flow of money is this way, sometimes the flow is easily perceived, and other times it is difficult to notice.

It is important to analyze the flows of money, to see if there are any leaks (inefficiencies) in the plan. We evaluate flows of money to make sure there aren’t any unnecessary transfers of wealth to undesired locations (i.e. unnecessary taxes, or other costs), and to recapture “leaks” where possible. An example of the importance of this analysis is as follows: If a person making $50,000/yr paid 1/3 of his income to the government over a 30 year period, that person would have paid nearly $500,000 in taxes. At an opportunity cost of only 5% per year, that tax and opportunity cost would be well over $1 million! In this example the flow of money, or transfer of wealth to the government, is so significant that it’s very likely that this person would never accumulate as much money over his lifetime as he would lose in taxes and opportunity costs. Even though this transfer is significant, this flow of money to the government goes relatively unnoticed (due to how it’s taken – various forms of taxation and inflation). The role Unique Advantage provides is in uncovering and identifying the smooth, usually unnoticed, transfers of wealth. Once the inefficiencies are discovered, we assist in creating and implementing strategies designed to minimize and/or recapture as much of the future transfer of wealth as legally possible.

Some people express to me their lack of desire to transfer their wealth to anyone or anything. The fact of the matter is, at some point your wealth will be transferred. Whether you are single, married, rich, poor, or middle class, the simple fact is your wealth will be transferred. Upon your death, your remaining wealth will, by law, go somewhere, to someone, or some entity. Your choice pertains to where it will go and how it will get there.

Many people put off end of life decisions. They think they're too young, too poor, or have a myriad of other excuses as to why they don't want to take care of these issues. In the end, if you want your plan to be Ideal, you must take care of your estate planning. You must also make sure the beneficiaries of your assets and insurances are in line with your desires. This is another reason 401(k)'s and IRA's usually are not a part of the Ideal Plan. 401(k)'s maximize the transfer of wealth to the government. Not only are they included in the deceased person's estate for estate tax purposes, but their proceeds are also taxed as ordinary income upon the death of the surviving spouse. The total taxation on a 401(k), upon the death of the participant, can be as high as 85%[5] (based on current law).

To accomplish the Third Ideal, which is to be **Able to Transfer Your Wealth to Your Family and Charities of Your Choice**, you must be proactive in your approach. You must have the most effective products and strategies in place, which will minimize your exposure to taxation and maximize your transfer of wealth to the recipients of your choice.

<u>Fourth Ideal: Plan works under all circumstances</u>

The final characteristic of the Ideal Plan is that **The Plan Works Under All Circumstances**. Money is an essential part of living. You need money for food. You need money for heat and air conditioning in your home. You need money for clothes. You need money for healthcare, education, transportation, and nearly every other aspect of your life. Being that money is so essential, why should we leave the success of our financial futures up to chance? Bottom line, the plan has got to work.

We approach this Ideal as an engineer would in building a bridge. The engineer must consider any potential problem or stress on the bridge. He must consider the extremes in temperature and weather and its effect on the bridge's materials. He must use materials that have been tested under those extremes in pressure and temperature. He must have a master plan, from which all of the contractors and sub-contractors are working. He must also consider the cost to build the bridge. With that said, cost cannot be the overriding factor. Imagine if the cost of the bridge was the major driving factor. If it was, isn't it more likely that the bridge would be made of lower quality materials, that

[5] Based upon income tax brackets of 35% Fed, 5% State, and 45% Fed Estate Tax

the bridge may work under less circumstances, that corners would be cut to get the job done? Although cost should be an important consideration, when cost is overemphasized mistakes are made and plans fail.

The same is true in finances. While in some financial decisions, such as choice of a mutual fund, costs may play a larger role, there are others that simply must be done right, with less regard to cost. Most of the protection component of your finances falls into that category. The possible cost of not having perfect protection far outweighs the cost of having it. The protection component must be perfect in order to have an Ideal Plan.

The use of a macro-economic model allows us to test any financial idea and strategy under any imaginable set of circumstances. When we test a strategy, we use math, financial calculators, in conjunction with the model. We don't state that the results of the tests are predictions of what will be, as we have already come to an agreement that no test or calculation can possibly consider all variables. We simply state that the results of the test are true for that set of circumstances. We do not make predictions.

Commonly we first test a given strategy in an optimistic set of circumstances. If the strategy fails under optimistic scenario, we can know for certain that the strategy will not work under less optimistic conditions, and can thereby discard the strategy. Going back to the idea of bridge building, if the materials used to build a bridge were tested to be too weak for a small car to pass over it, then the bridge architect would know for certain that the bridge would also not work for heavier stresses. He could effectively discard the idea/strategy before implementing it, before wasting more time and money on it.

In essence, through the use of the macro-economic model we play the "What if?" game. When engineers build a bridge, they play the "What if?" game. Here are a few of the financial "what if's?" we can test on the model:

- What if I become disabled?
- What if the stock/real estate market doesn't get the "historical" rate of return?
- What if taxes increase?
- What if I get sued?
- What if Social Security benefits go away?
- What if interest rates drop?
- What if lose my job?
- What if my retirement plan doesn't get 10% return per year?
- What if there's an earthquake? Will my insurance strategies protect me?
- What if I lose my income for a period of time?
- What if a great investment opportunity comes up? Will I have liquidity to participate?
- What if my employer stops offering health insurance?
- What if my employer stops providing a pension benefit?
- What if my employer stops matching contributions on the 401(k)?

If we know that things will work out under the worst extremes, we will also know that things will work out if nothing goes wrong (under ideal circumstances). Engineers who build bridges know their plans will work, before implementing them, because they have tested their ideas and strategies beforehand.

The process of testing financial ideas and strategies on a macro-economic model saves valuable time and money for our clients. The model provides a means by which you can make sound financial decisions based in factual test results. That also means you don't have to depend quite so heavily on opinions of others when making financial decisions.

<u>Principles of the Ideal Plan</u>

1- Save at least 15% of gross income into WCA
2- Maximum Protection
3- As Much Permanent Life Insurance as Possible
4- Six Months to One Year of Income Storage
5- Velocity of Money

<u>First Principle: Save At least 15% of Income into WCA</u>

Now that we have set up The Ideal Plan, the overall objectives for your money, let's talk about some of the principles associated with the Ideal plan. The first principle to properly building, protecting, utilizing, and transferring wealth is to save at least 15% of gross income into the WCA. People that don't save, still spend. Unexpected life events still happen. Without savings a person has to borrow money for most irregular and unplanned expenses, thereby losing interest and opportunity costs that go instead to financial institutions over his lifetime. He will never be in a position to invest in the very best opportunities that come about throughout his lifetime. He'll have no cushion for the day he loses his income, due to job loss or sickness. This is where the old adage applies, "he who fails to plan, plans to fail".

The first question relating to savings is, how much should a person save? We teach that people should save 15% or more of their income. For many people this step seems nearly impossible. Why? Most people have poor habits when it comes to managing their money. They have the habit of spending everything, and sometimes more, than they earn. If you don't already have the habit of saving at least 15% of your income, commit to improving that area of your plan today. Commit to increasing your percent of income saved. Any time you have the opportunity to increase it, do so.

*The Wealth Coordination Account (WCA)*

We recommend our clients open a separate checking account, separate from the account they use to pay the bills and buy groceries. We designate this separate checking account as the Wealth Coordination Account (WCA). The WCA is where all money dedicated to long-term savings and investing should begin. The WCA is where the 15% savings begins.

There are several benefits to having a separate account designated for this purpose. The first benefit is that you have a single starting point where all savings money and investing money begins. It provides you with a simple way to track where your money is going. The account can be linked up with money management programs, which further facilitate tracking and the creation of reports (i.e. Microsoft Money or Quicken). One of the issues, which we see time and time again, is that people have difficulty telling us how much money they have invested in certain things. The reason is, they don't have an easy way to track their cash flow (except for many of our engineer clients, who do their tracking on Excel spreadsheets). Knowing how much money has been invested in anything is essential to evaluating the performance of that investment.

The second major benefit to having the savings begin in the WCA is to make the use of the money in the account very conscious. If your surplus money (savings) you have is placed in the same account that is used to pay all the bills, it becomes much easier to lose track and spend.

As with any enduring successful program, effective tracking and ability to measure is essential.

<u>Principle 2: Maximum Protection</u>

Maximum Protection is the second vital principle. The protection area of people's finances is often overlooked, misunderstood, taken for granted, and minimized. Part of the problem is found in understanding the legal language of the contracts/policies/documents. People get frustrated when their insurances, entities, and estate planning documents don't do what they thought they were supposed to do at the time they need it. The frustration stems from misguided expectations and lack of understanding of the legal documents. No part of a person's plan is more important than getting this area of your finances in order, maximized, and understood. This is an area of your finances that cannot be left to opinion. Insurance products are contractual, and if understood a person can base insurance decisions on facts. Opinions about different insurance products do not change the facts regarding them.

Another problem in the area of Protection is the misconception that protection comes at the expense of building wealth or vice versa. Our experience has been that nearly every person we meet with is able to improve his/her protection in some way without any additional out-of-pocket expense. And, with very little expense, clients are usually able to make vast improvement in their financial protection. The key to this improved efficiency and protection is in knowing how and having the right tools to evaluate the options.

Examples of what our clients are usually able to do as a result of going through our planning process include: Improvement in liability protection by more than ten times, with very little additional expense. Validation of the personal property coverage in the homeowners insurance through documenting personal belongings is another change clients make without additional cost. Tax and opportunity cost savings generated from our planning makes the purchase of life and disability insurance practically zero cost. Many times we are able to find ways for our clients to save a greater percentage of their incomes simply by evaluating strategies on the model with no additional cost to their budgets.

Often I get asked “How much do I need?” when it comes to levels of protection. The answer to that question is “the level you would want if the event you are insuring against actually were to happen.” In liability, you should have what you would want if you knew you were going to get sued. In property insurance, you should have the level and quality of coverage you would want if your home and personal belongings were totally destroyed. In disability insurance, you should have the maximum allowed by the insurance companies, with the very best definitions available to you. Combined disability benefits are limited. It is impossible to “over-insure” in these areas. In health insurance, you should have the level of coverage you would want if you or someone in your family had major ongoing medical issues. For those who are underinsured, the out of pocket costs could destroy their financial future.

In your estate plan, you should have all of the legal documents in place that would protect your survivors from financial ruin due to medical costs, or other disabling or end of life scenarios. You should have legal documents that would make sure your children have the guardians you feel would be best for them. You should have legal documents that would make sure your loved ones are the beneficiaries of everything you would want them to have in the event of your passing. In your life insurance, you should have the level of coverage that would replace your income throughout your working years (based on a conservative interest rate). When retired, you should have one times your net worth in life insurance, which would allow you to enjoy what you’ve created while you’re alive, guaranteeing replacement of those assets to your heirs (namely your spouse, if you are married) when you die. The potential difference in income that could be generated from assets in a plan with life insurance versus one without is phenomenal[6].

The reason we are so clear and emphatic regarding the protection part of your finances is because you have to be satisfied with what you have at the time of the event (i.e. death, disability, lawsuit). You must be satisfied with your choices in your protection because once the event occurs, you cannot change your coverage. It is what it is. There is no backwards planning, there is no rewind button. For the most part, current popular financial planning negates and minimizes the importance of protection, and liquidity for that matter. Their sole objective is to get as much of your money in the stock market as possible. Then, their objective is to put your money in as much risk as your “tolerance” allows. Those financial planners can see that their plans have failed, and that stock market investors do not receive anywhere near the 12% they were telling

[6] See Person A Person B Calculator (LEAP)

them they would[7]. When their clients come to them to find out what they can do now that they've lost so much money, the planners' response is: "work longer", "save more", "reallocate".

Plans based upon preconceived needs and goals are simply based upon complex guesswork and mathematical formulas. They are not strategic and are far from efficient. They have no room for error. Wouldn't you rather have a plan that protects you from anything that can go wrong, thereby giving you the freedom not to worry? Of course you would. People would love to have a plan that works anyway, even if the stock market drops. They want a plan that works even if tax rates skyrocket. They want a plan that works in the event of a disability, lawsuit, and a decrease or increase in interest rates. People want their plans to work no matter what. Why? Money is an essential aspect to their way of life. The way to make sure your finances will work under any circumstance is to have products and strategies in place designed to do so, and the discipline to follow the five principles outlined.

By perfecting the protection component of your finances we are not trying to predict what will happen, we are recommending doing everything you have power to do to protect against what may be. We want the best possible chance of success under any circumstance.

## Third Principle: Get as Much Whole Life as Possible

There is only one financial product in the world that can provide you with a guaranteed death benefit, tax free growth of equity, no penalties for use, 100% protection from creditors, is not subject to stock market fluctuations, and self-completes in the event of a total disability. That product is Whole Life insurance. The biggest problem with whole life insurance is that there is a limit to how much you can purchase (based upon age, income, and level of assets). The next hurdle related to whole life insurance is that you must have sufficient health to qualify for it. However, as long as you have an insurable interest in someone who is in good health (i.e. family member, business partner), you can still get the product and make it work for you.

The death benefit of whole life insurance is the most valuable aspect of the product. The payment of the death benefit is not conditioned upon the performance of the stock market, or interest rates. The only condition is the payment of the premium, which is guaranteed level for life. The certainty of the payment of the death benefit can be used to greatly improve the efficacy of income-producing and non-income producing assets in retirement. The death benefit can guarantee that an amount of money/assets you spend and enjoy while alive will then be replaced upon your death. It is your "license" to utilize and enjoy your wealth more fully than you would have without it. The more guaranteed life insurance death benefit you own, the more of your assets you get to enjoy and use during your lifetime, knowing it will be replaced upon your death. This is the reason I recommend owning as much as you can own.

[7] Dalbar Study on Investor Returns (2003)

As a side note, you cannot own more life insurance than the life insurance companies will underwrite. Therefore, the amount you can own is finite, not infinite. The amount you can qualify for is based upon several factors, including your age, earned income, and/or net worth. Qualifying for the life insurance is also dependent on your health. Therefore, it is wise to purchase the life insurance as soon as you are able, thereby minimizing the affect of negative health issues on underwriting later in life. Also, the younger you are when you buy whole life insurance, the lower the premium, which stays level for your entire life.

In addition to the value generated by a permanent death benefit, whole life insurance builds liquid and accessible cash value, which is guaranteed not only by the insurance company, but also by each state's Life and Health Insurance Guarantee Association[8]. Cash values of whole life insurance are liquid and accessible, without penalty. They grow tax-free (unless surrendered – policy cancelled or becomes a modified endowment contract) at a rate of no less than 4% per year[9]. Cash values of life insurance can be used for any purpose, and at any time after the first year of the policy.

## Fourth Principle: Six Months' to One Year of Income Storage

Your level of savings has to do with the pressure you put on your plan, and in particular your investments. The more you save, the less pressure you put on your investments, the less likely you'll choose "get rich quick schemes". Too often people invest in "get rich quick" investments because they have a lack of savings and good habits. They can see that if they don't strike it rich in something, that they'll never be able to retire. These people usually fall for the idea that risk equals return. In their mind they only have one swing, and because of that, they're going for the fence.

People with healthy levels of savings, and good saving habits, do not put as much pressure on their investments as people without those good habits. Financially successful people tend to invest more conservatively, because they do have a lot to lose. They aren't extremely dependent on one investment working out, because they have multiple investments going on. They know they have more than one swing and more than one out. They understand that building wealth has more to do with hard work, good habits, and efficiency than getting high rates of return.

Just a quick note on the overall level of liquid savings a person should have: A person should have at least six months of income stored in liquid, accessible, and guaranteed accounts. The reason for this is simply that most disability insurance plans (including Social Security Disability) do not begin to pay benefits until after 6 months of a disability. This level of liquidity also provides a safety net for six months, should a person lose his job.

[8] Each state has its own limit as to the level of protection.

[9] Each insurance company creates their own contractually guaranteed interest rate. 4% is based upon companies we are appointed to do business with.

Oftentimes people ask me "when are we going to talk about investment opportunities?" The answer is: it depends. A successful financial plan has priorities. For example, it's a higher priority to have health insurance than to buy whole life insurance. If you are married, it is a higher priority to have your Wills and Advanced Health Care Directive and other estate planning documents than saving for retirement. It is a higher priority to have six months of savings than it is to invest. This doesn't mean that a person cannot work towards all of the priorities at the same time, but it does mean that the emphasis (usually meaning more money) should be placed on certain areas of finance over others. Investing is usually close to the last priority. The macro-economic model's structure outlines the priority by placing the Protection Component above the Savings Component, and the Growth Component on the bottom.

It is a huge mistake to skip over or cheaply structure your protection component and savings just to get to the growth component. Again, people who skip over the priorities, may reach great heights financially, but usually crash without the proper safety net in place. They are the foolish and imprudent pilot. If you don't already have six months of income stored in a guaranteed, liquid, and accessible account, make it a priority in your finances and place more emphasis and more dollars towards obtaining it.

## Fifth Principle: Velocity of Money

Money should start in the WCA account, get invested, and end up in the WCA again. Once you have adopted the idea of starting your money in the WCA account, and having a large portion of it going towards whole life insurance and your six months' income storage, you are ready to begin using your money for other purposes (i.e. investing).

Robert Kiyosaki once stated that he was less concerned about the amount of his money and more concerned with the velocity of his money. In that statement there is profound truth.

The best way to understand the principle of velocity is to consider a grocery store. A grocery store buys goods and places them on shelves. However, that isn't the final objective of the store. Its objective is to sell everything on the shelves, take the money earned and buy more. Stock the shelves again and sell them again. This process is performed over and over. Grocery stores call this velocity "turnover". An owner of a grocery store understands that he is not in the business of accumulating goods on the shelves. He understands that his real business is one of creating velocity of money.

Velocity of Money Multiplier is an economic term meaning the movement and multiple uses of the same dollar. This is a principle that all successful financial institutions in the world use to create wealth. Ironically, financial institutions teach us one thing, but practice another. They teach us to accumulate our money in their accounts (stack goods on the shelf). They teach us that we should never touch the money, and that we're "in it for the long haul". In other words, they are teaching us not to use our money. If financial institutions can convince us to stack money on their shelves to let it "compound", then they will have gained the use and velocity of our money.

A quick example of this is the banking system. Banks rely upon us believing our money is always there, ready for us to withdraw at any time. The truth is, our money is not there. Only a small portion is. When we deposit money in the bank, the bank turns around and leverages the majority of our dollars by borrowing more from the Federal Reserve (the bank's ability to borrow is based upon amounts of deposits – which we increase their ability to borrow every time we deposit more). Then the bank turns around and lends our dollars, as well as leveraged dollars from the Fed, to borrowers. As banks get payments from borrowers, they borrow more from the Fed. They then lend more to more people. This cycle creates extremely high rates of return ("margins") for the banks and lending institutions because of the number of uses they get, or the velocity of money. The bank's overall return is not as dependent upon the percentage they charge each individual borrower, as it is upon the number of times they can lend the same dollar.

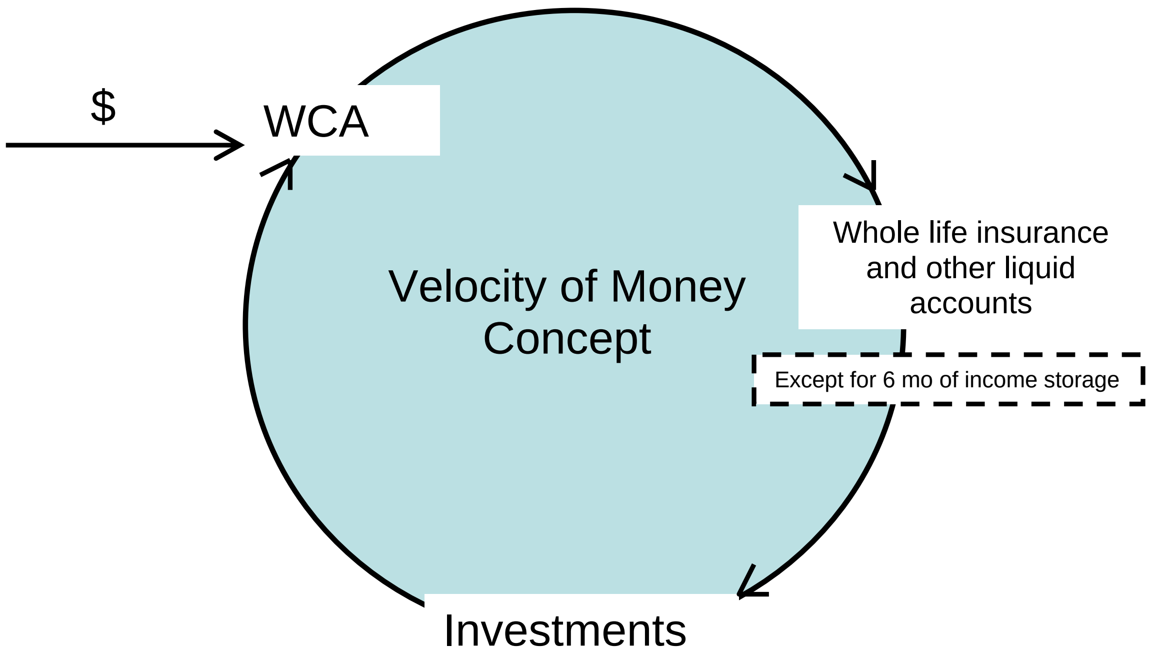
You can create a similar process of velocity in your own finances. We're not necessarily referring to the borrowing and lending that banks do, but to creating movement and gaining multiple uses of your own money. Money moving and its use is what creates benefits and reduces your exposure to loss (such as inflation and market fluctuation).

Contrary to velocity of money are plans such as 401(k)'s. 401(k)'s and other "retirement accounts" create stagnation in your money by limiting your freedom of movement, making the money more vulnerable to financial predators, such as management fees, losses in financial markets, and inflation. These plans are designed fulfill the financial institutions' deepest desire, which is to get your money, use it to create more money, and never give it back. These plans are marketed as a key part of the "nest egg" idea. The idea is that a person should put away some of their money into long-term savings accounts (i.e. IRA's) and leave it there to compound over long periods of time, to build a nest egg. All the while the money in the accounts never produces any income that can be paid out to the investor (another point for the financial institutions). Then, supposedly, at some point an investor will know he has "enough" money in his account to live on for the rest of his life. This seems to me to be a very scary jumping point for the individual. How does he really know he has enough? Has he ever received income from the account that he will depend upon for the rest of his life? No. There is no velocity, no use, and no income from IRA's and other retirement plans, until the retiree moves it all into something that will produce income. Unfortunately, the retiree can't move the money into something that will produce income until he retires, which seems a little backwards. And even then, the retiree has to do something he's never done up to that point, turn a block of money into an income stream.

If the investor invested in assets that produced streams of income throughout his working career instead of "retirement plans" and the nest egg idea, then knowing whether or not he has invested "enough" will be clear. He'll know because the streams of income that he HAS BEEN RECEIVING up to that point are more than enough to continue his lifestyle even if he stopped working for pay.

The flow of money should be: Money saved, is then invested (except for the six months of savings). As investments produce income, the income goes back into the WCA. We encourage investments that provide income, where the income is paid out to the investor. See diagram 1.

Diagram 1:




Robert Kiyosaki stated that "investors *receive* money from their investments on a regular basis. Until you begin receiving money, you may be investing…but you're not an investor"[10]. Why is "receiving" so vital? When income/interest is compounded in the account that produced the interest, there is no velocity. No additional uses or benefits are created without the money leaving the account that generated it, and returning to you. Compounding is exactly what the financial institutions want you to do with your interest. Compounding allows the financial institutions to continue to velocitize your money and the interest it creates, for their benefit, not yours.

Striving to get multiple uses and movement on your money will accelerate your ability create and enjoy the maximum wealth.

[10] Rich Dad's Prophesy, by Robert Kiyosaki

## Conclusion

In conclusion what people need are not “investment ideas”. They need principles that they can follow, ones that work under any circumstance. People need the ability to become experts at something in the investment world, and therefore create greater control and use for themselves and those they care about, versus giving that control away. People need to realize that the best investments, the ones that actually work, are ones that require effort and specialized knowledge. The idea of being taken care of by someone else and not needing to know much is a failure strategy. The focus of financial planning should be based in helping peoples’ plans become more efficient and effective, as well as increasing their protection from financial predators and erosion. People need a team of advisors that are on the same page with them, who communicate with one another and are all working towards helping the client fulfill his/her agenda, not the advisor’s. People need advisors that they can trust and can call anytime with their money decisions, without being inhibited by fees. Who has all of that? Our clients do. That’s what Unique Advantage provides.

- Kyle J Christensen

*Owner, Unique Advantage, LLC*