$ Investing Basics $

Evergreen Consulting Group Inc. - Richard A. Green, DDS, MBA

Volume 3 No. 1 **June 2004**

Dear Reader: I would enjoy hearing from you. Spread the word about these articles. I think you and your friends will find them helpful.

– *Richard A Green DDS, MBA*

When I last wrote in October of 2003, the Dow stood at 9750...

Markets continued to rise through the end of 2003; the S&P 500 showed up with about 22.5% gains for the year. My market timing friends, who seemed to be out of the market whenever it moved up in 2003, were pretty quiet and not publishing their returns for the year! They became noisy again, printing their percent increases when considering their "great" moves the first three-week period in January – isn't that interesting? The Dow closed at 10,225 on Friday, April 30th.

With all the good economic news, the markets remain somewhat volatile; it almost feels like the old sidewalk game Mother May I. In that game, as in the market, you always wanted to advance toward the goal so you would ask you playmate in charge of the sidewalk, "Mother may I take three steps forward?" The responses would often be something like, "Yes you may take three steps forward, but only after you have taken four steps backward." This was not what you hoped for. You were delighted to hear, "Yes you may take three steps forward, but only after you have taken ONE step backward!" Yes, now you think, "I am making progress!"

With such good quarterly reports, Alan Greenspan is poised to begin the ratcheting up of interest rates. If any of you have been in the mortgage interest rate market you witnessed a move of more than 25 basis points, just in the month of April. Hold on, be a long-term investor.

As of June 17th...

While the Dow has spent some time below the 10,000 mark in the second quarter it now stands at 10,375. Alan Greenspan has been nominated for another term as head of the Federal Reserve. If history has its way, the fact that it is an election year should have a positive impact on the markets for the remainder of the year. Have you noticed all the road construction that is being done all over the country? This is another indication that it is an election year!

Start Tax-Deferred Accumulation Early

The Financial Health Questionnaires at

our C-4 level often reveal a wide spread between those who have developed the discipline of regular saving and investing and those who have yet to get started. Postponing saving will leave a person woefully behind the curve at just about any point in their career. It's a sad day when they wake-up to the truth of their reality but waking up is better than burying their head in the sand.

My past position as Director of Business Systems Development at The Pankey Institute allowed me a privileged view of numerous participants' Personal Balance Sheets. I observed a wide variety in the ability to accumulate wealth. It is difficult for me to not become dogmatic in my words, knowing what I know about the "Magic of Compounding" and witnessing what many are and are not doing.

While there is some need to be emphatic, my intent is not to make anyone feel guilty about the past or to look to others to rescue them. Rather, my intent is to encourage everyone to take the individually appropriate action now to self-correct your financial position over time.

There are many forces that shape our attitudes about money, not the least of which is our own family of origin: real or perceived. These issues become very important in the life and work of a professional. They impact all aspects of communication with your patients, staff, suppliers, family, consultants, and advisors.

I would encourage some reading on the subject – any reading. You pick the book! There are a number of books: The Richest Man in Babylon, The Millionaire Next Door, The Millionaire Mind, Money and the Meaning of Life by Needleman, or for our Canadian friends – Better Happy than Rich: Canadians, Money and the Meaning of Life by Michael Adams. Go to www.amazon.com and pick one out for your summer reading. Start examining what is between your ears – your attitudes, beliefs, and operational directives connected with money.

I am a slow reader. If you are, don't let it be an excuse. Buy a book, read, and start investing on the same day! Do it even if you presently do not have the perfect retirement investment vehicle to invest in. Saving is about discipline. Save regularly starting now so you have something left over when your hands, back, or eyes give out!

Most of you know about the "Rule of 72". That rule states that if you divide 72 by your rate of return you discover the number of years it will take for your investment to double, this assumes a constant rate of return.

If you are 36 years old and reading this now, this is the take-home message. The Rule of 72 teaches us that by waiting to get started until you are 42, you will have half of what you would have had if you would have started today at 36.

Do the calculations yourself. A 36-year-old has 29 years to 65. If you were to place $40K each year into investment vehicles with a constant 12 percent annual return, your total at 65 would be approximately $9.6M. If you start saving the same amount at the same rate beginning at age 42, you would have approximately $4.6M at age 65. While these numbers may sound like a lot of money, when adjusted for just a 3% CPI Inflationary Factor (pull for Greenspan) the totals become $4M and $2.3M, respectively, in today's dollars

I would prefer that you use a tax-deferred retirement investment vehicle because it is harder for you to get at and spend the money. But with today's present tax laws, the difference between after-tax savings and tax-deferred investment accumulation vehicles over time has been minimized. So get started now. Do not let the vehicle get in the way!

Know enough about Money and Markets (and the instruments of investment) to make them work for you. As I survey the many Financial Health Questionnaires at our C-4 level, I am reminded of the many times Dr. Pankey encouraged dentists to become informed concerning Money and Markets. When you are informed, the probability of making a wise decision goes up! Often the topic of life insurance is raised alongside retirement planning and investment. While every situation is uniquely individual, life insurance is about Risk Management and not about retirement planning or investment, no matter what the salespersons says.

Know the Basics about Annuities...

While many have signed up for this vehicle, knowing the basics might prevent some costly mistakes. Annuities are a retirement plan and insurance policies combined into one package, sort of the Leatherman Tool of investment, but not nearly as useful. At times, the options and add-ons to the basic annuity can be bewildering; let's look at the basics.

Annuities have a lot in common with other retirement vehicles, such as a traditional IRA, 401(k), 403(b), or Keogh. Your investments grow tax-deferred, withdrawals may begin at 59-1/2 years, and when money is withdrawn, most of it is taxed as ordinary income, not long-term capital

gains. But that is where the similarities end. Some of the differences follow. (1) Unlike the money you put into your retirement, contributions to annuities are not tax deductible. (2) In most situations, retirees must begin withdrawing money from their traditional IRA's, Keogh, and other qualified retirement accounts at age 70-1/2, where annuities allow withdrawal to be delayed to age 85 or later. (3) Contributions to most retirement accounts are limited at a set amount, but contributions to annuities may be any amount. (4) Annuities can guarantee income for life.

The most common type of annuities is the "deferred" annuity, which is used for retirement savings. It starts with an accumulation period and ends when you begin to withdraw money. Each time you send a check to the insurance company that sold you the annuity, you purchase accumulation units. The value of the units depends on the investment returns, and the returns are calculated on whether you have a fixed or variable annuity. Don't go to sleep on me now!

Fixed Annuities pay a guaranteed rate of interest on your investment, usually a bit higher than a certificate of deposit (CD) for a specified period of time. They typically offer a "come-on" rate for the first year, but after that they do not guarantee the rate will beat the CD rate. Most contracts have a guaranteed minimum interest rate and a guarantee of the principle. Beyond that they come in many varieties. Buyer beware. Read the fine print.

Variable Annuities allow money to be invested in the insurance company's separate account of mutual funds. Each accumulation unit's price is determined by the value of the fund divided by the number of units outstanding. In that way, you own a piece of the portfolio and not the mutual fund shares as such. You are purchasing professionally managed portfolios of stocks, bonds, and money market instruments. The return is variable, which may offer more growth at a higher risk, perhaps, even the loss of principal.

Payouts are done is a variety of ways: lump sum, monthly payment for a specified period of time, or lifetime payment (annuitization). Annuitization is heavily promoted but very inflexible; once you select this option, you cannot collect a lump sum of cash. At death, a portion of your investment remains with the insurer. The payout can be fixed to a certain amount per month or tied to a rate of return of the underlying accounts. That means it can go up, and it can go down. And, the payout can come in the form of a death benefit which would be the value of your account assets in the annuity at death minus your moneys withdrawn.

The Bad News...

At first glance annuities seem to have a lot going for them. Who wouldn't like tax-deferred growth and guaranteed income for life? The costs of owning an annuity are the biggest drawback, for example: (1) Surrender Charges which amount to a back-end sales load for wanting out of the contract. (2) A Mortality and Expense Risk Charge against your portfolio value in the neighborhood of 1.25% of value. (3) Administrative Fees charged to cover record keeping and administrative expenses. (4) Investment Management Fees to pay the fees of the mutual funds you hold in your annuity, usually 1.5% per year on average. (5) High sales commissions paid to the broker who recommended the annuity to you – as much as 5% of the total value of the annuity. (And you wonder why they have such a positive attitude about annuities!?)

Add these all together, and you could be paying in excess of 3% for the privilege of owning an annuity, which doesn't make sense when there are lower costs and higher return opportunities available with greater flexibility. Should you still be interested in pursuing annuities, let me suggest you inquire with Vanguard or T. Rowe Price.

Should you be unlucky enough to own a high-fee one, consider the Section 1035 of the U.S. tax code exchange that can allow for a tax-fee exchange from your old contract to a new one with lower costs. Just be careful of the surrender charges, so study and get an unbiased consult prior to taking action.

The Take-Home Message is that while annuities have some attractive characteristics, they come at a big price. The inflexibility and high management fees make them much less attractive, in most situations, than typical retirement vehicles like 401(k)s, 403(b)s, IRAs, Keoghs and the like. Advice: Fully fund the latter to the full extent of the law prior to considering the deferred annuity!

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