Understanding Your Investment Options

~~Boring~~ Important!

The Most Important! Book You'll Read This Year!!

Peter Richon

Peter Richon is a Series 65, Investment Advisor Representative and a licensed life, accident, health, sickness, medicare supplement, and long-term care insurance agent in the state of North Carolina. He offers personal financial and retirement planning services to his clients. Content presented in this book is for informational purposes only and does not constitute investment, tax, or legal advice nor is it intended as a solicitation of any financial product or strategy. Always consult your financial professional before taking any action. The specifics of your situation will always dictate what is an appropriate financial strategy.

This publication contains the opinions and ideas of its author. It is intended to provide helpful and informative material on the subject matter covered. It is sold with the understanding that the author and publisher are not engaged in rendering professional services in the book. The information provided is not intended as tax, investment or legal advice, and should not be relied on as such. If the reader requires personal assistance or advice, you are encouraged to seek tax, investment or legal advice from an independent professional advisor.

The author and publisher specifically disclaim any responsibility for any liability, loss, or risk, personal or otherwise, which is incurred as a consequence, directly or indirectly, of the use and application of any of the contents of this book.

Trademarks: All terms mentioned in this book that are known to be or are suspected of being trademarks or service marks have been appropriately capitalized. The publisher cannot attest to the accuracy of this information. Use of a term in this book should not be regarded as affecting the validity of any trademark or service mark.

The contents of this book should not be taken as financial advice, or as an offer to buy or sell any securities, fund, or financial instruments. Any illustrations or situations presented are hypothetical and do not take into account your particular investment objectives, financial situation or needs and are not suitable for all persons. Any investments and/or investment strategies mentioned involve risk including the possible loss of principal. There is no assurance that any investment strategy will achieve its objectives. No portion of the content should be construed as an offer or solicitation for the purchase or sale of any security. Any insurance products mentioned are guaranteed by the claims paying ability of the issuer and certain limitations and expenses may apply. The contents of this book should not be taken as an endorsement or recommendation of any particular company or individual, and no responsibility can be taken for inaccuracies, omissions, or errors.

The author does not assume any responsibility for actions or non-actions taken by people who have read this book, and no one shall be entitled to a claim for detrimental reliance based upon any information provided or expressed herein. Your use of any information provided does not constitute any type of contractual relationship between yourself and the provider(s) of this information. The author hereby disclaims all responsibility and liability for all use of any information provided in this book. The materials here are not to be interpreted as establishing an attorney-client or any other relationship between the reader and the author or his firm. Although great effort has been expended to ensure that only the most meaningful resources are referenced in these pages, the author does not endorse, guarantee, or warranty the accuracy reliability, or thoroughness of any referenced information, product, or service. Any opinions, advice, statements, services, offers, or other information or content expressed or made available by third parties are those of the author(s) or publisher(s) alone. References to other sources of information does not constitute a referral, endorsement, or recommendation of any product or service. The existence of any particular reference is simply intended to imply potential interest to the reader.

The views expressed herein are exclusively those of the author and do not represent the views of any other person or any organization with which the author is, or may be associated.

Investment advisory services offered through Brookstone Capital Management, LLC (BCM), a registered investment advisor. BCM and Richon Planning, LLC are independent of each other. Insurance products and services are not offered through BCM but are offered through individually licensed and appointed agents with Richon Planning, LLC.

Understanding Your Investment Options by Peter Richon

Published by Richon Planning 600 Stellata Dr., Fuquay Varina, NC 27526

www.RichOnPlanning.com

© 2018 Peter Richon
All rights reserved. No portion of this book may be reproduced in any form without permission from the publisher, except as permitted by U.S. copyright law. For permissions contact: info@RichOnPlanning.com
Cover by Peter Richon. Ebook ISBN: 9781792947469

For my wife, my son,

and my supportive team

Understanding Your Investment Options:

Overview 1

Checking Account 5

Savings Accounts 7

Certificates of Deposit 9

Money Markets 11

Bonds 13

Stocks 31

Market Indexes 37

Mutual Funds 39

Annuities 43

Exchange Traded Funds 57

Real Estate 59

Gold 63

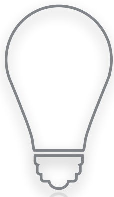
Options & Futures 67

Life Insurance 71

Cryptocurrency 77

Business Ownership 79

Taxation 83



YOUR INVESTMENT OPTIONS

"If it takes money to make money, you need to put your money in places that produce a return."

–

The old saying, "It takes money to make money" is a misunderstood and misused statement. If this were to be taken literally, in the context of how most people use it, no one without assets would ever become wealthy. That's simply not the case. History is filled with people that rose from humble beginnings to become wealthier than they ever imagined.

What this saying really alludes to is the necessity of making your dollars work for you. It is a subtle difference but, here is my understanding of the true moral - if you have the ability to save or invest, those dollars can't just sit idly gathering dust. Your money has to work for you. Money under the mattress (or at low interest) does not provide forward progress and momentum towards financial success. In reality, it even loses ground when you consider your actual purchasing power. Even if you think of this as "safe", you still have risks due to the compounding effects of inflation. What this saying really means is that you need to put your money in places that produce a return. You worked hard for your money. Make sure it is also working hard for you.

It is important to know and recognize the distinction between saving money and investing money. Within each category there are numerous sub-options but, before putting money anywhere, you should know if you are saving it or investing it. You can figure out the answer with one simple question; do I carry the risk of losing principal?

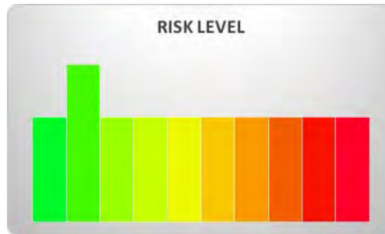
When you “save” money, like in a bank savings account or CD, or certain types of fixed insurance products, there is not a risk of losing principal, so long as you stay under specific FDIC (Federal Deposit Insurance Corporation) limitations or other contractual guarantees on deposit amounts. Now, this is not to say that there may not be some types of risk that even these accounts could be exposed to, such as inflation risk, but your principal investment value is protected and you can typically earn at least a minimal rate of interest.

Investments on the other hand, have risk. An investment typically depicts opportunity. There is an opportunity for higher growth but, there is also a possibility of loss of principal. If there is a risk of loss, you are making an investment.

The content of this book discusses many common options for saving and investing, gives a general indication of their respective level of risk, and evaluates their potential uses in your total planning. This is not a complete or comprehensive list, nor will it cover everything you need to know about each option before depositing or investing capital but, it will cover the majority of what the average saver or investor may

encounter in their lifetime and general, need-to-know information.

CHECKING ACCOUNTS

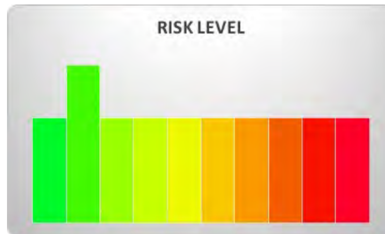


Banks and credit unions provide a safe, convenient way to manage daily cash flow and accessibility. Your checking account is likely the location that sees the most frequent activity and utilization. Paychecks get deposited, while bills & expenses come out on a regular basis. While a convenient place to store money for regular, impending future, and eminent expenses, there are a couple considerations to be cautiously aware of with your checking account.

First, because of the frequent activity, you must remain mindful of the balance of your account and potential expenses. This has certainly become easier with the evolution of technology and digital banking but, overdrafts still occur and accessing your money can come at a fee. Last year, banks charged customers over $6.4 billion dollars for accessing capital through ATM withdrawals and in overdraft protection fees.

You also will receive a very minimal interest rate on deposits and residual account balances. People have the tendency to store capital and build larger balances in these accounts. Excess capital (anything over approximately 3 to 6 months worth of expenses) is not earning what you need in order to keep up with inflation.

SAVINGS ACCOUNTS



If you have capital that you will likely need in the not-too-distant future but, not immediately or, if you have just not decided yet where a better place to put your money would be (to help you work towards alternate goals) you can achieve safety of principal and liquidity in a bank or credit union savings account.

Savings accounts typically do not see the transaction frequency or constant utilization of a checking account and can potentially offer a slightly higher interest rate than checking accounts. For this reason, savings accounts may be a better location for storage of your “emergency funds”.

Like checking accounts, interest earned in savings accounts is generally lower than inflation. Therefore, keeping excess capital in a savings account for too long could result in “losing money safely.” I have also heard this termed “lazy money.” It can be a real problem. Money may not be keeping up purchasing power because savers are in an extended state of fear or indecision. After the Great Recession, I often saw people, sometimes with several hundreds of thousands of dollars that had not only not grown, but that had also

generated a taxable event on the minimal amount of interest that had accrued.

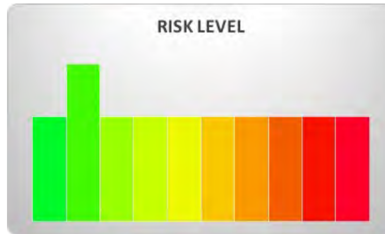
CERTIFICATES OF DEPOSIT

Certificates of deposit (or CD's) offer the promise of a set rate of interest over a specific period of time. Terms generally range from six months to five years. You generally receive higher rates for longer time commitments. At the end of your pre-arranged term, you receive back your original principal plus the interest. You can walk away or roll back into a new CD but, be sure to alert the bank of your decision prior to your maturity date or you may find your certificate automatically renews for a new term and potentially at a different rate.

While principal is protected and rates in CD's are generally higher than that of checking and savings accounts, there are penalties for accessing your capital before the end of your term. The higher the interest rate you are earning, the higher the penalty may be.

There are other forms of CD's that may offer either variable interest rates or longer term periods for even higher, set interest rates. These may be "callable" by the bank (they can chose to pay you off and back out of their long term promised interest rate) or rates may vary during the term. Interest from CD's typically does a better job of keeping up with inflation but, because of the issue of liquidity, do still carry a minimal inherent risk.

MONEY MARKET ACCOUNTS



Money market accounts at banking institutions are similar to savings accounts but, may have higher account minimum requirements, such as $10,000.00. They may also be tiered with additional threshold amounts where you earn even higher interest rates. Money market accounts generally let you write a limited number of checks from the account each month. In this way, it has qualities of both savings and checking accounts. When you reach the limit on checks however, the bank may refuse to allow any further checkbook transactions until after the next monthly period begins. There is also typically a minimum requirement on the amount that a check from your money market may be written for.

There are also money market mutual funds. These are offered through investment institutions, rather than banks. Fund companies attempt to keep the prices of money market mutual funds at an even $1.00 per share but, money market mutual funds are not FDIC insured. Fund companies generally do offer some form of protection but, loss is not impossible. Money markets are often used as temporary holding tanks until alternate decisions of purchase are made.

BONDS

A bond is a loan made by an investor to an entity in need of capital. There are many different types of bonds because many different entities are in need of capital for current and future expenditures that they believe they will be able to repay in the long term. Depending on the financial strength of the underlying entity borrowing the capital and the structure of how they intend to use the borrowed funds, different types of bonds can carry different amounts of risk. Although bonds have generally been viewed as being “safer” or more conservative than broader stock market and equity investments, there are still inherent risks you need to be aware of.

Default or Credit Risk - The risk that the underlying entity will not be able to live up to it’s obligation of repaying the loans and the capital it has borrowed from investors at full value, or at all, is called Default Risk or Credit Risk.

Interest Rate Risk - Technically speaking, bonds values and interest rates have an inverse relationship. When bond issuers borrow capital from investors they promise to pay back only the initial principal at a set future date. Until that date, while they have use of the investor’s capital, the issuer promises to pay a set yield (interest rate) on the borrowed money. The yield you receive on the loan you make is the return on investment in a bond. The amount of yield you receive generally correlates with prevailing interest rates at the time the bond is purchased and the likelihood the issuer will be able to repay the principal investment. So as interest rates decline, the inherent value of bonds paying higher

interest rates increases, and vise-versa. If you bought a 10-year, $1,000 bond at 4% and interest rates remain 4%, theoretically, the value of the bond would remain the same. However, as we stand today, rates have been historically low and the Federal Reserve has announced intentions to raise key interest rates. This would mean that the value of the bond you purchased paying a low yield would decrease as new investors could buy into newer bonds paying higher rates. So, if you owned that same 10-year, 4% bond and a new investor could purchase a newly issued bond paying 6%, and you needed money back before maturity, you would have to lower your asking price to give that investor an equivalent yield to maturity and attract them to buy the 4% bond from you instead of the newer 6% bond available, which would pay them a higher yield. You could wait until the bond matures to get your original principal back but, there are risks associated with that as well.

Duration Risk - The length of time an entity has before it promises to repay your initial loan is a bond's duration. Bond durations can range from as little as a few years to 30 or more years in some cases. If you own a bond or have money in bond funds, you need to understand duration because, this is the length of time the company has promised to pay you the stated yield for borrowing your money and when they promise to pay you back your initial principal. So, let's say you had a longer duration bond, paying today's low rates and over the next several years interest rates do rise. You are essentially trapped facing a tough decision. Do you continue to earn less than available rates of return on your money for many years to come or do you sell out

now, at a lower price in search of higher yields? Some economists believe this is a reality countless bond investors will soon face, many of whom are under the questionable assumptions that bonds are less risky, more conservative, or even unsusceptible to losses.

Call Risk - Let's say the opposite happens, and interest rates fall. Bond issuers give themselves an escape clause. They have the option to get out of their loan if they have borrowed money at higher interest rates and lower rates become available. Issuers who see the opportunity to borrow the same money at lower interest rates can "call" their loans. Calling a bond means they repay investors back their original principal sooner than they promised to do so. If rates have fallen, bond issuers can then go back out and issue new bonds at the then lower available interest rates, saving them money. But, what if you were reliant on the income from the yield on the money you had lent? This could mean that your principal is returned to you and you are forced back into purchasing in a lower interest rate environment. To secure the same yield and cash flow, you may have to take on additional risks.

Rating Bond Risk - Due to the various risks that bonds and bond funds are subject to, and considering the potential likelihood that different issuers of bonds may expose investors to these risks, the safety of bonds are rated by letter grade from national ratings agencies designated by the Securities and Exchange commission. Bonds can be rated from AAA - very strong, not likely to default, to D - no rating and higher risk, much more likely to be subject to default or credit risk. Some investors may be interested in higher risk bonds because, in order

to attract borrowers, entities that have a higher risk of default may offer higher yield on the money they have borrowed. So typically, the higher the yield, the higher the potential risk that investors may not receive back their original principal investment. There are “investment grade” (highly rated and likely safer) bonds and “non-investment grade” or “junk bonds”. Junk bonds can offer higher yields for investors willing to expose their capital to higher degrees of risk in hopes of higher returns. It is important therefore, to consider the financial strength of the issuer of a bond (the entity you are loaning your money to) and weigh this consideration against the expected return you are wanting to achieve.

There are other general risks associated with bonds such as internal events within the issuing entity (corporate buyouts, mergers, investigations of wrong doings, unexpected and unforeseen financial troubles, etc.) and external events (like hyper inflation, global conflict, sudden change in economic environment) that are also to be considered.

There is also a distinct difference between bonds and bond funds. It is very important to know which you own or are considering. A bond is a loan to, and agreement with, a single issuing entity. There is a set purchase price per bond unit that entitles the investor to a set yield and has a maturity date (the specific calendar date in the future the investor will be repaid the principal investment amount).

Bond funds on the other hand, are essentially mutual funds that invest specifically in pooled bond investments. They are managed and internally different

bonds may be bought and sold at the discretion of the bond fund's management. So, an investor does not own any actual, physical bonds. There is no set maturity date at which time the investor is promised repayment of their original principal. Instead, an investor is hoping that the funds managers will offer the ability to benefit from investment in a diversity of different bonds available (as opposed to dedicating capital to one specific issuing entity), and that the actual price of the fund (the "Net Asset Value" or NAV) will increase while capital is invested. Investors are hoping bond fund managers will be able to capture both yield (income while the bond is held) and appreciation in investment value. If this is accomplished, an investor can have the benefit of both an income while the bond fund is owned and a higher return on investment if the NAV increases while the bond is owned.

There are some specific cautions and considerations to be aware of when owning bond funds. Primarily, return of principal is not guaranteed. Capital placed into bond funds is a pooled, managed investment, rather than a loan made by an investor to an individual entity. There is no set maturity date like with ownership of individual bonds, since different bonds may be traded in and out of the bond fund by the fund's managers so, there is no set date when a lender will receive back their principal. The NAV (price of a single share of the bond fund) will fluctuate due to the pricing of the different bonds being traded in the fund. You are still exposed to all the aforementioned risks, including credit risk, default risk, interest rate, and inflation risk, because each bond owned within the bond fund is still individually subject to these risks. There are also costs and expenses within

bond funds that are not associated with ownership of an individual bond. With the professional management (in hopes of diversity and higher potential return) comes fees that will effect your net return on investment. Unlike individual bonds, the income you receive will also fluctuate as different individual bonds are traded in and out of the bond fund.

Bond fund’s main value is that they provide diversification. With an individual bond purchase, you are relying on the strength of one individual issuing entity. With the purchase of a single unit of a bond fund, you are instantly spreading risk across all the bond issuers who's loans are currently owned inside the bond fund. You would have to invest much more capital in order to get this diversity yourself if purchasing individual bonds. Bond funds are also more liquid and can be sold on a daily basis but, would be sold at market value or NAV, which again can fluctuate up and down.

Because of the diversity of different types of bonds held within a bond fund, each fund’s overall risk would have to be gauged based on the strength of the underlying types and issuers of bonds held within the fund. You should understand the stated intention of the funds management philosophy about how they are making decisions on the types of bonds their fund chooses to purchase.

The risks and benefits associated with individual bonds, or types of bonds, can be evaluated more easily, since they are not an ever-changing collection of different borrower’s obligations.

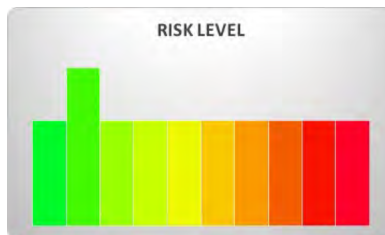
U.S. Treasury Securities or “Treasuries” are issued by the federal government and considered to be among the safest type of investment you can make. There is little, if any, default risk because they are backed by the U.S. Government. They are issued to help the government cover the cost of operating expenses today, with the promise of repayment at a later date. You can purchase directly from the Treasury or on the secondary market, where other bond owners have made their Treasuries available for sale because they need their capital back before their set maturity date. Treasury Securities can be purchased for as little as $100.00 and come in different durations, denoted by their names.

Treasury Bills are short term, ranging from just a few days to up to 1 year maturities. You can purchase Treasury Bills at a price that is less than the capital you will receive at maturity so, instead of a traditional interest payment, the “yield” you receive is in the form of the higher face value you receive compared to the capital you invested. These also potentially have the benefit of being tax-free on certain levels, where there otherwise may be state and local taxes but, are subject to Federal taxation and income is included when determining taxation on Social Security income.

Treasury Notes are medium duration from two to ten years and are also called T-Notes. More like traditional bonds, these are not purchased at a discount. The full maturity price is the cost, interest is paid as a yield, and the purchaser receives the original principal back at maturity. Again, interest is Federally taxable but, exempt from state and local taxes.

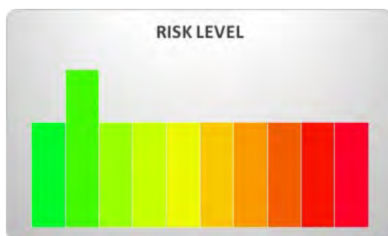
Treasury Bonds are the longest term debt obligation offered by the Federal government. They range from 10 to 30 years. Interest is paid while Treasury Bonds are held and original principal repaid at maturity. These also have the same potential tax benefits as Treasury Bills and Notes. Treasury Bonds have historically offered higher interest payments that comes along with the longer time commitment although, with the current & prolonged low interest rate environment we are in, even a 30 year Treasury Bond doesn't seem to offer significantly higher yield than their shorter term alternative (a "flat yield curve"). Therefore, investors could be hurt by long-term inflation or lose some principal if interest rates rise and they are forced to sell on the secondary market because they need capital prior to the maturity date.

Overall Treasury Security's Risk:



U.S. Savings Bonds are similarly backed by the full faith and credit of the U.S. Government and can be purchased in denominations of as low as $25.00. They cannot be sold or traded and only pay accrued interest upon redemption. So, there is no income or interest paid along the way and liquidity is not available while Savings Bonds are held. I-Series savings bonds are targeted to ensure your investment's value keeps up with inflation, while EE-series savings bonds pay a set interest rate. Keep in mind that I-Bonds track inflation based off of Government calculated inflation numbers. Many believe that Government formula for figuring inflation (the Consumer Price Index - Urban Consumers or CPI-U) does not truly account for the actual increase in total cost of living. But, if taken at face-value and government inflation numbers are accurate, I-Bonds would be subject to very little risk, except the potential for your money to earn more elsewhere, while EE-Bonds would be subject to inflation risk and interest rate risk, as well as this same possible opportunity cost.

Overall Savings Bond Risk:



Mortgage Backed Security Bonds are bonds issued by an entity that holds the mortgage loan notes for homeowners that have financed the purchase of their home. These are complex and can vary in their level of risk depending on the quality and type of borrowers that have taken the end mortgages that are being pooled together in the bond. Mortgage Backed Securities were one of the biggest factors credited with the financial meltdown that initiated the Great Recession that started in 2007. Lenders had collateralized mortgages for individual home owners that ended up being a much greater credit risks than was advertised to the investors that capitalized those loans through investment in the Mortgage Backed Securities. When individual borrowers began defaulting on loan payments in great numbers, the institutions were not collecting the mortgage payment they anticipated and were therefore not able to produce the monthly payments (or original principal) for the investors that had loaned their money to the institutions that had underwritten the mortgages. Confusing? Yes. This may be one of the best examples that illustrates how the banks don't actually have or create money. There is a big circle of debt here and when one piece of that circle was unable to repay the next, the whole circle imploded - the dominoes fell.

Banks make money on a principle known as **arbitrage**. Arbitrage simply means taking advantage of a difference in interest rates. If I have $100,000.00 and walk into my bank to store it, the bank may offer me 1% on my money while they hold it. That is because essentially, I have loaned it to them, and it doesn't just sit in their vault. When the next person walks in and asks to borrow $100,000.00 so that they can purchase a new house,

the bank uses my money but, charges that individual 4% for using my money. The bank has just made a 3% spread (profit) without using any of their own money. That is arbitrage. But, banks don't just do this on a dollar-per-dollar basis. They are allowed to "leverage", or loan my money out many times over, under the expectation that each time they loan out my money, they will make a similar arbitrage on the repayment, which means even more money at some point into the future. This was another major problem. Many financial institutions were over leveraged and therefore, the dominoes fell that much harder.

Many people borrow money to purchase their homes, and promise to make regular, monthly payments of interest and principal back to the banks they borrow from. But, since banks themselves don't have all the money needed to loan out in order to fund the purchase of all those homes, they also borrow it. They borrow money from savers who keep their money in bank accounts as earlier described, and they borrow it from investors (who thought that they were making a low risk investment). Banks raise the additional capital needed to fund these loans by pooling mortgage notes together in Mortgage Back Securities. Once a bank issues a large amount of mortgages, they may sell a package of them together to the government or an investment firm, in order to continue to have the capital to redeem for bank account holders and the ability to continue offering new mortgages. So, the homeowner owes the bank, who funded the purchase of their home by borrowing from investors, and they sell that debt and repayment structure to investment institutions who also look to make a spread and a profit from the arbitrage, and offer

investors a chance to invest to receive that potential return.

Mortgage Backed Securities supposedly offered investors a way to lessen the risk of an individual mortgage borrower defaulting by pooling many, many mortgages together and offering the ability to invest in the pool of collateralized debt, rather than backing an individual home owners's mortgage. They were supposedly rated based on the quality of the overall group of borrowers whose mortgages had been pooled. But, the ratings system failed to recognize the potential danger inherent when a much larger percentage of homeowners began to default simultaneously, the value of the homes that collateralized the obligations had fallen, and there were not nearly as many interested buyers ready to recapitalized the cycle as there were mortgage holders defaulting and collapsing it.

It was a systemic problem that was obvious and preventable in hindsight, which is why the passage of the Dodd-Frank Act in 2010 addressed many of the deficiencies in oversight that caused this collapse but, is also the way that many banks and financial institutions make huge portions of their profits. So, while no individual investor has the power to control an issue as wide spread as this, it is certainly something to be aware of if you are considering a Mortgage Backed Security as a potential investment option.

Mortgage Backed Securities can be issued by government agencies, such as Ginnie Mae (who is backed by the full faith and credit of the U.S. Government) or "Government Sponsored Agencies", like

Fannie Mae and Freddie Mac who, while not back by the same “full faith and credit” reassurance, do “guarantee” the principal repayment and payment of interest back to the investor. There is a distinct difference here that should not be overlooked. The government does not obligate itself to bail out or rescue a “Government Sponsored Agency” if they face default. Mortgage Backed Securities can also be offered and issued by private institutions that provide far less certainty than those offered by their government or government sponsored agency counterparts.

Because of how complex these vehicles can be and the different strength of the sources that issue them, gauging the risk on your investment can be difficult. Theoretically, the greater the risk, the higher your return should be but, in a systemic event like 2007, the unforeseen risk certainly outweighed the potential return.

Mortgage Backed Securities behave differently than traditional bonds in the fact that payments back to the investor are both interest and principal repayment so, at the end maturity date, there is no lump sum payment of original deposit. You have been receiving that along the way.

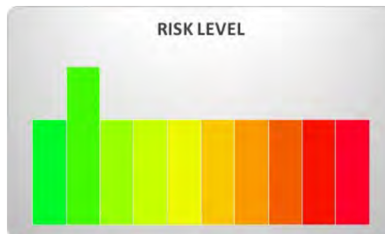
There is default risk, and interest rate risk. Like with other bonds, if rates rise while you hold a Mortgage Backed Security you miss the opportunity to earn higher rates on your investment. If you need the capital sooner than maturity, or want to seek a source offering a higher interest rate and sell before maturity, the value you would receive on the secondary market would fall.

Finally, in a situation like what we encountered leading up to and during the Great Recession, there is systemic risk. The system was flawed fundamentally and caused what otherwise may have still been strong positions to fail as the system collapsed like a game of Jenga.

Overall Mortgage Backed Securities Risk:

Inflation Protected Bonds or TIPS are an alternative type of bond issued by the Treasury. They are meant to keep up with inflation, based on the Consumer Price Index - Urban Consumer. It was previously mentioned that some feel this formula may not reflect the true effect of inflation but, taken at face value these bonds are intended to protect your investment's purchasing power rather than provide for a great return above the potential increase in the cost of goods. Interest therefore can fluctuate during the holding period if the CPI-U changes. Payments of interest are made semiannually and repayment of principal at maturity can also increase to offset inflation. Backed by the Federal Government there is virtually no default risk and by design, no inflation risk. There is an opportunity cost if higher rates are available elsewhere during the bond's duration and interest rate risk if interest rates rise and you need to sell on the secondary market instead of waiting until maturity.

Overall TIPS Bond Risk:



Municipal Bonds or “muni-bonds” are issued by government entities like state, city, county and local governments to support spending on infrastructure, like roads and schools. “Munis” pay a set interest yield until maturity, which can range from relatively short, to very long duration. While considered generally to be relatively safer investments, some government entities have defaulted so, the financial strength of the issuer certainly needs to be considered.

Municipal bonds are attractive to investors because they can be tax-advantaged. Most generate interest income that is tax-free at the Federal level, a quality almost completely exclusive to this type of security. Most are also exempt from state and local taxes as well. When including this as part of your investment considerations however, understand that this may not be the case if you fall into a category where you pay the alternative minimum tax (AMT) and that, while the interest may be tax-free itself, it is still included into the equation that determines whether or not, and to what extent, your Social Security income is taxable.

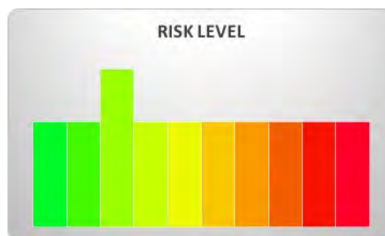
Also, the interest yield on some munis may be lower than that of taxable corporate bonds alternatives. This is in part due to the perception that they may have less inherent risk. But, when considering the net ROI, both yield and tax advantages need to be incorporated in the calculation.

For example, a 4% yield on a tax-free muni bond sounds nice but, if I am in an effective 25% tax bracket on my total income and a corporate bond is available with a similar risk profile that pays 6%, which effectively nets

me a better return on investment? With the tax-free muni, 4% is 4%. I get to keep all the income generated. But, even after I pay the 25% tax on the 6% yield generated by the corporate bond, I still net a higher 4.5%. Income from both sources are also calculated the same way in terms of affect on taxation of Social Security income.

Risks with Municipal Bonds are similar to the risks associate with many other bonds. They can be called. Their default risk depends entirely on the issuing municipalities financial strength and solvency therefore, consider this carefully before making an investment. Your ability to sell depends on demand on the secondary market and, if you do need to sell and interest rates have risen, the price you should expect to sell for would be decreased.

Overall Municipal Bond Risk:



Corporate Bonds are issued by for-profit companies to raise capital for operation and expenditures. It is a loan to the company but, unlike the capital a company raises by offering stock, corporate bonds do not offer the investor an ownership stake in the company. There are different grades of corporate bonds, depending on the financial strength and size of the company that issues them. Those offered by corporations that may carry higher associated risks typically offer higher rates of return. If a company does become insolvent or undergoes bankruptcy or restructuring, bond holders who have lent the company money are in line for complete repayment (if possible) before stockholders (who own a portion of the company) would be repaid anything.

There are several subcategories of corporate bonds that further indicate the order of priority under which bondholders would be repaid when there is a corporate or financial restructuring.

Corporate Bonds therefore hold credit and default risk, interest rate risk like other forms of bonds, and an additional individual corporate risk if there is a financial event within the specific issuing company. If there is financial hardship or turmoil a corporate bond may also become almost illiquid.

Overall Corporate Bond Risk:

STOCKS

Owning a stock is taking a share of ownership in an individual company. Your ultimate return depends on the financial success or failure of that specific company, as well as what is happening in the overall stock market and general economy.

An individual company may be doing well but, if other, similar companies or a sector of the market or the greater economy is suffering, the value of that individual stock may also lose value.

There are privately held stock companies, or close corporations, where an individual, or a small group of private investors own all the stock shares, do not trade or offer them to the general public, and therefore have complete control over the decisions and direction of the company. A publicly traded stock company opens ownership of shares of the company to anyone in the general public through free trade on a stock exchange or other open market. Generally, key decisions makers try and retain a significant share of available stocks in order to continue to have the right to determine the direction of their company. Individual stock holders do have voting rights when it comes to the structure and direction of the company however, shareholders with smaller stakes and those who simply wish to profit off the prosperity of a company rather than influence company decisions tend to not exercise this right, deferring decisions to company corporate officers, managers, and directors.

Publicly traded stock companies are able to raise capital through the sale of company stock on the open market.

If I owned 100% of my company and needed capital to make investment or meet operating expenses, I may invite an investor to purchase a portion of my company, making the capital I needed available and giving them a vested interest in the company's prosperity. Publicly offering stock is the same principle but, a small share is available to any investor with capital. Profits and risk are both shared with stock ownership. If I own 100% of my company, I make all the money and I am responsible for all the debts but, if I only own 50% I share in both profit and only need to pay half of the debt.

The relative size and value of an individual company is related to (but necessarily directly correlated with) its market capitalization. This is the number of outstanding shares of stock multiplied by the price per share. For example, Apple's 4.83 billion outstanding shares, valued at approximately $216.00 per share at the time of this book, give Apple (AAPL) a market capitalization of roughly $1.04 trillion dollars. This gives a reasonable indication of the value of an individual company but, remember that stock prices may be effected minute to minute by forces outside the company as well as by the volume of shares being exchanged on the open market.

Investors in stocks can realize returns as the share price increases or could lose money as the perceived value of a company and its stock decreases. This change in value compared to the initial amount invested is known as a capital gain or capital loss.

Investors also might benefit by sharing in a portion of the revenue and profits generated by the company on a regular basis through dividends. After all, if you own a

company, you want to see the value of the company increase over time but, you also expect to share in the profits it generates. So, stock companies often (but not always) pay shareholders a portion of their profits in the form of a regular dividend. Stockholders may take the dividend as income or reinvest it back to buy more shares of company stock. The latter is known as a DRIP, Dividend ReInvestment Program. This would allow you to have the benefit of more shares of the stock if the stock continues to appreciate in value.

The open stock market itself is truly a capitalistic example of the economic principal of supply and demand. As there are more investors supplying more capital into the market to make more purchases and increasing demand, so too will the prices in the market increase. Conversely, if investors believe the market is overpriced and begin selling to capture profits or demand falls for other reasons, so too will stock prices. It is this principle that economists believe is one of the big contributing factors to regular business and market cycles. “Buy low, sell high” is more than just good advice for making a profit, it is actually a driving force of our overall economic strength.

There are different types of stocks to consider. Preferred Stock is a higher level of company ownership than Common Stock. The value of Preferred Stock typically is not as volatile, which means you may not gain or lose as much as the value of the Common Stock fluctuates. Preferred Stock owners however are often paid higher or more regular dividends. So this may be attractive if you are investing for the purposes of generating income. In the event of financial hardship within a company,

Preferred Stock holders are also to be paid before Common Stock holders, but after bond holders (who lent money to the company rather than purchased ownership).

There are also descriptive terms that may tell you more about the kind of stock you are considering investing in.

A dividend stock is scheduled to pay regular income payments as disbursement of company profits to shareholders. Warning about relying on the income from dividends - they are not guaranteed in amount, frequency, or even to be paid to investors at all. In the Great Recession, many retirees who were reliant on a portfolio of dividend producing stocks to generate income saw that not only did the value of their portfolio sharply decline due to a drop in share prices of the stocks they owned but, dividend were simultaneously slashed as well. So, they had less income and less capital to go out and try to replace that income with. A good selection of dividend producing stocks therefore might be very appropriate for producing returns to reinvest for even further growth potential or for producing discretionary income (not essential to living expenses) but, should not be depended upon to produce the income required to meet monthly obligations.

There are also tech stocks, domestic stocks, international stocks, growth stocks, value stocks, defensive stocks, large cap, small cap, and mid cap stocks. All of these descriptions depict the underlying type of company (their size, sector, or long-term outlook for growth) that is offering the stock.

Stocks offer perhaps the greatest opportunity for invested capital to appreciate quickly and achieve a high potential return on investment. They also come with a great degree of risk, especially if you make an investment with a company that has specific financial trouble, turmoil, difficulty making a profit, doesn't keep up with competition, or if that company happens to focus their business in a specific sector of the economy that loses favor (think Blockbuster Video or Kodak) .

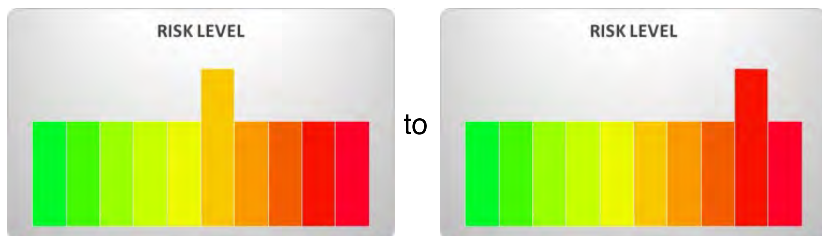
There are also a variety of ways of evaluating the potential strength, risk, and reward of investing in a particular stock, (most commonly by comparing its current price to the company earnings - P/E ratios) as well as different approaches to handling the management of purchasing and holding stocks (tactical, strategic, long-term buy and hold, active trading, reinvesting dividends, etc.).

This section in no way intends to be a comprehensive guide to the stock market. Instead, I hope this provides enough information for you to have an understanding of stocks and stock ownership so that you could have an informed conversation with an investment professional to determine if stock ownership is appropriate for your situation and, if so, what types of stocks to to consider, as well as an understanding of how that ownership might be managed.

The risks involved with owning a specific stock are varied depending on the specific company's stock you own and the condition of the wider market and economy in general. Prices are volatile and will fluctuate day to day, minute by minute while the market is open, based

not only on the individual company, but also the volume of buyers and sellers trading at any given moment. Before deciding to purchase a stock, there are some basic considerations you should make. You should have an understanding of the products or services it provides, the potential future demand for these products, how the company generates a profit, what the outlook is for their particular industry, do they produce just one product or a variety of different products, are they generally managed by good, smart people who understand their business, and what is the current asking price compared to the realistic future value and historical range the stock price has traded in. A generally good approach to decreasing potential risk is also to diversify and spread ownership across many different companies as opposed to counting on just one company to remain financial stable and increase in value.

<u>Overall stock risk</u>:



THE STOCK MARKET INDEXES

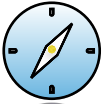
There are many general gauges of stocks and stock market strength and direction. Some of the most well known and prevalent measures of market and economic strength are the stock market indexes. The most commonly discussed and relevant to the American public are the Dow Jones Industrial Average (DJIA), the Standard & Poor's 500 (S&P 500) and the NASDAQ. These are mathematical composites of different sectors of the market. There are many other indices that measure either specific sectors, broader ranges of stocks throughout the markets, or markets strength and direction in other countries.

You cannot invest directly in an index but, there are many investment options that attempt to mirror the performance of a specific index and individual investment picks and performance are often compared against the performance of an index or against the general indexes. I discuss this as a point of reference to understand that any one stock will never exactly mirror the performance of a broader index. Also, an index may not necessarily be indicative of the wider economy. For example, the most widely referenced index, the Dow Jones Industrial Average, is an index that tracks a composite of only 30 individual companies. An individual stock may carry the potential for far more risk and reward than an index indicates, since each index tracks a broad group of multiple stocks, not one individual company. Having said that, your overall portfolio management, for which you are paying a professional's fee for their assistance in managing, should not

continually underperform the market in both good times and bad, or else, what are you paying them for?

If you have an aggressive mentality and a high tolerance for risk, your portfolio may outperform a market index, even in periods of high growth. Expect though, that if this is the case, you probably also stand to lose more, and more rapidly, than that the same index would indicate during periods of contraction and market downturns. If your goal is to be more conservative, and you have little tolerance for risk, you may not see your portfolio outperforming the indexes during bull markets but, you should also have an expectation not to lose as much in bear market downturns. As long as you have discussed your specific goals and risk tolerance, understand what this means you should expect from your performance and returns, and are seeing your stated intentions being met, it may be worth the price of guidance of an investment professional. If you simply want to track along with the market and are ok with fluctuations that come with good times and bad, you may be better off simply buying a low cost fund that aims to mirror the performance of a specific market index and saving the money that would otherwise come out of your account to pay an investment manager’s fee.

There is an old saying that, “The bull takes the stairs, the bear rides the elevator” indicating that it typically takes a longer time to see real growth and appreciation, while downturns tend to occur quickly and sometimes without warning.



MUTUAL FUNDS

Mutual funds are a managed collection of individual stocks and/or bonds. Investors are allowed to pool their capital with the capital of many other investors to allow the fund to own a wider variety of holdings than any single investors would be able to purchase with their individual investment. Investors own shares of the fund and their return tracks with the fund's performance but, they do not actually own any of the individual stocks or bonds held within the fund. Overall performance of the fund does not necessarily depend on the performance of an individual holding within the fund, because the variety of holdings owned allows investors with less capital to benefit from diversity within a single investment.

If a stock is like betting on a single horse to win the race, mutual funds are like betting that eventually, several of these horses will finish the race. The risk is lower and therefore, so may be the potential payoff.

Mutual funds are essentially socialism in investment form. Investors get a little bit of everything for their contribution and all investors share in the gains and in the losses. Many investors are surprised when they incur a taxable event when their mutual fund investment has lost value. Now, this doesn't always happen but, it certainly can and does occur. Mutual funds are the only asset that may cause you to owe taxes when you have lost money, because of the way they work and their "from each according to his ability, to each according to his need" behavior. Current investors are responsible for enabling the ability of investors who want their capital liquidated to receive it. So, if the fund suffers losses, and

some investors want to liquidate and pull their money out, what may happen is that the appreciated stocks held within the fund could potentially be liquidated first, creating a realized capital gain within the fund. The tax responsibility for that gain is then spread across all shareholders, even though the total value of the fund is down. Just one of the potential surprises to be aware of when investing in mutual funds.

Mutual funds have professional money managers responsible for picking and choosing the individual stocks the fund purchases and sells. There is an internal expense for this professional management. Fees for this management are assessed to the shareholders, affecting the net return on investment. Fees in mutual funds can range significantly. The prospectus outlines the fees and costs associated with share ownership but again, “From each according to their ability…” investors pay the same fee percentage (expense ratio) whether they have invested $10.00 or $1,000,000.00.

The prospectus of a mutual fund details the investment philosophy that the fund adheres to, and must abide by, when fund managers are choosing individual stocks for the fund to own.

This is another interesting quality of mutual funds. The fund must stay invested as the prospectus details. Therefore, even though the fund is managed, managers do not have the ability to significantly alter the philosophy for how capital will remain invested, even if they see a dramatic shift in market conditions that would indicate a change in approach is appropriate.

As an analogy, imagine driving down the highway on a warm, sunny day. The skies are clear, the road is dry, the posted speed limit is 70 miles per hour. You feel confident of your cars ability to handle the roadway in such conditions and don't question the safety of going the speed limit, maybe even a couple extra miles per hour over.

Now, picture driving down that same road in winter with a sheet of snow and ice on it. The speed limit sign still reads 70 miles per hour. Do you still feel like doing 70 is the best, safest thing for you? Probably not. Well, if driving were a mutual fund, you would still be doing 70.

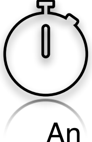
No matter what the economic conditions (the weather) may indicate, the prospectus (the speed limit sign) dictates how the mutual fund must stay invested (your speed). So, even when going full steam ahead may not be appropriate, or may even be detrimental, if you stay invested in a mutual fund, your money will be invested with the same approach and mentality. The fund manager only has so much ability and control as to pick which stocks fit the stated profile of the mutual fund.

Be aware also that, since owners of a share of a mutual fund do not actually own the individual stocks held by the mutual fund, they may not receive the dividends that they would be entitled to if they purchased the individual stocks.

The strategy behind investments in mutual funds will vary from fund to fund. Some are all stocks, some are all bonds, some have a combination of both. There are funds that concentrate on a specific sector or asset

class and others adjust their level of risk exposure set to a specific date into the future that they intend to meet a target objective for risk tolerance. Beware however, in 2008, there were funds that had a target date of 2010 (meaning the investment was intended for those whose objective it was to retire in just two years) that lost nearly 40%. Imagine watching your nest egg lose almost half its value just two years before you intend to retire.

Overall mutual fund risk:



ANNUITIES

An annuity is a savings or investment account offered through an insurance company. There are several different types of annuities. As a result, there is also a lot of confusion and misconception about them. If you understand the purpose and the pros and cons of each type of annuity, and it fits the goals you are trying to achieve, then an annuity can certainly add value and strength to your overall portfolio. If not understood or misused, it can just as easily decrease value and potential for growth.

The simplest definition of an annuity is “life insurance in reverse.” With life insurance, you make small payments during your life and when you pass away, someone receives a large lump sum. You are betting with the insurance company that you may die sooner than they believe (and actuarial tables indicate) you will die. With an annuity, you are essentially making a bet with the insurance company that you will live longer than those actuarial tables indicate. So, you deposit a lump sum for the promise of a payout over a specific period of time, or your lifetime, even if that is longer than your money would have lasted.

Annuities are unique in that aspect. If you drain a bank account down to zero, or if your brokerage account declines to zero due to market losses and withdrawals, that’s it. You are out of money. There will be no more income. An annuity is specifically designed to continue paying you, even past the point that your account balance reaches zero. Because of this specific quality, and the lack of pensions which used to offer retirees the

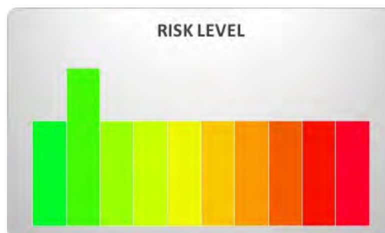
same kind of protection, annuities have received a lot of publicity and interest as the largely pensionless Baby-Boomer generation enters their retirement years with concerns of outliving their money in investment accounts.

Now, not all annuities are created equally. Some payout immediately. Some have a waiting period. Some have a fixed rate of return. Some have the ability to make gains but, not a guaranteed interest rate. Some allow you to share in the gains of the market without the risk of loss. Some have market risk and reward that will determine your account value and ultimate payout. It is important for you to understand the particular structure and protections of any annuity you may consider.

Immediate annuities, as the name indicates, payout an income to the owner (or annuitant) immediately, or within a very short duration after the time of deposit. These are most often compared to Social Security or pension payments. The income is reliable but, typically a permanent decision. After payout is elected, there is very limited or no access to the underlying lump sum. Also, if you pass away soon after making the initial deposit, your beneficiaries may stand to lose out on the money you have deposited. There can be options for payouts that would provide for continuation of payments or some amount of inheritance but, these options often pay out less while the owner is alive. Payouts are also typically based on prevailing interest rates so, if rates are low at the time of purchase, it will take a much longer period to become profitable and receive a return over your initial investment.

The benefit of an immediate annuity is the predictability and reliability of the income it generates. The main disadvantage is the lack of access and liquidity. As long as you are fully aware of the permanence of your decision, and creating income is your goal, immediate annuities are comparably very low risk.

Immediate Annuity Risk:



As oppose to immediate annuities, the following types of annuities can all be classified as styles of deferred annuities, or annuities that allow for tax-deferred growth prior to taking an income or lump sum withdrawal into the future.

Fixed annuities are often compared to CD's because they earn a fixed rate of return over a set amount of time. While annuities do not have the protection that the FDIC (Federal Deposit Insurance Corporation) provides for bank account holders, the insurance corporations themselves do have a couple layers of protections in place for investors. First are the specific guarantees provided for in the contract. Legal Reserve requirements (requirements that an insurance company hold capital sufficient to meet their issued contractual obligations) back the company's ability to meet these terms. As oppose to other types of annuities, fixed annuities are not focused or intended as much for producing income, they are more geared for safely accruing tax-deferred interest.

As a side note, all annuities have the advantage of growing tax-deferred while being held. However, income and distributions of any growth taken from annuities is typically 100% taxable as income.

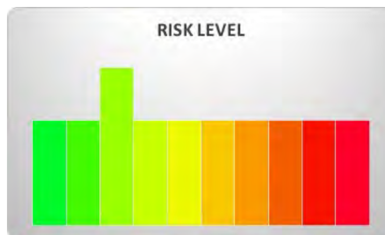
Fixed annuities can offer slightly higher interest rates than CD's but, also tend to have higher penalties for early withdrawal or surrender. If a 5 year CD is offering 2%, a 5 year fixed annuity may be offering 3 to 4% but, if you need your money back out after only 2 years, a CD would charge a small portion of the interest you had

been promised. Surrender of a fixed annuity may result in the loss of a noticeably higher percentage of original principal.

You also need to be very aware of teaser rates when considering a fixed annuity. With a CD, the rate you receive the first year is typically the same rate for the entire term. With some fixed annuities, there can be a higher advertised first year rate to lure investors in that can decline dramatically into subsequent years.

The advantages of fix annuities are higher growth and tax deferral. The disadvantages are the lack of liquidity and the potential penalties involved with accessing capital prior to the maturity date. They are most appropriate for capital that you can identify you will not need for an extended period of time, that you would like a steady, stated interest rate of growth on, and that you do not wish to expose to market volatility.

Fixed Annuity Risk:



Variable Annuities are the only type of annuities that have the risk of loss of principal due to poor market performance. Every annuity has some potential for loss if surrendered early but, market risk resulting in loss of capital is exclusive to variable annuities. They are investments rather than savings accounts or income sources however, can be turned into income through "annuitization" or through an additional income rider. The potential advantage is the tax-deferred growth and investment like returns. Disadvantages may include market risk, lack of liquidity, and higher internal fees and expenses.

Variable annuities are essentially mutual funds wrapped inside of an insurance account. The mutual funds are known as "sub-accounts." Each sub account carries an internal fee and the insurance company also charges a fee for the variable annuity. There are also some bells and whistles added to these accounts that carry additional fees.

A death benefit protection is a very common additional feature with a variable annuity. This feature protects a specific death benefit amount (usually the original deposit plus credited gains) even if market downturns and losses result in a lower balance when the owner passes away.

For example, if Jim deposited $100,000.00 into a variable annuity and the market was up after the first year and Jim had a balance of $120,000.00 but, then the market and his account lost 50%, Jim's death benefit may still be $100,000.00 or $120,000.00 depending on the specifics of the death benefit protection provided

however, Jim may only be able to pull out the $60,000 in a lump sum if he needed money.

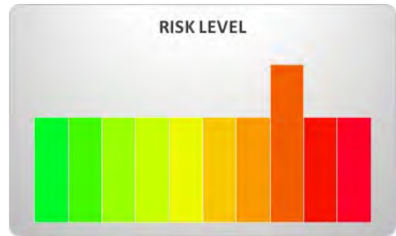
An Income Rider may also be added to some Variable Annuities. Income Riders protect a certain value (and potentially growth on that value) while an annuity is in deferral for the purpose of the income that it is intended to provide into the future. The specific way income riders are structured in variable annuities does need to be carefully examined. Some require "annuitization" (turning your account into an immediate annuity and losing control of principal) and others may change the amount of income you are guaranteed once the account balance reaches zero.

With fees for sub accounts, administration, mortality & expense, and death benefit and income riders all stacking on top of each other, variable annuities are notorious for their high expense and for the negative result these fees will have on net returns. Some variable annuities have reasonable fees. Some have fees exceeding 5%. Remember when a fee is assessed to your account, it hurts positive returns and compounds losses.

The final potential disadvantage of variable annuities that I will discuss here is that, often times neither the fees nor the risk of loss are appropriately disclosed or directly discussed. I have frequently met with annuity owners that asked for safety, were sold an annuity, and believe their principal is guaranteed. I often call the company directly to verify that they own a variable annuity and have 100% of the risk of the market on their investment performance results. Also, a very high

percentage of variable annuity owners I have met with are completely in the dark as to the amount they are paying in fees. Many times I have shown people that they were paying fees 3 to 5 times higher than they thought.

<u>Variable Annuity Risk:</u>



Fixed Index Annuities are a blend of a protected, savings-like account without risk of market loss but, with the ability to make gains tied to a market index. Investors in fixed index annuities typically are attracted to the safety and the conservative upside potential, along the ability to have the future guarantee of lifetime income that annuities are designed to provide.

As a general caution, the allure of safety in fixed index annuities in down markets can be offset by the limited amount of gains that will be realized in up markets. They will not make aggressive gains and are more appropriate for investors looking for preservation of principal rather than investors with even a moderate tolerance for risk. However, they can certainly make gains above and beyond prevailing bank interest rates on savings. It should again be noted that annuities do not have the protection provided by the Federal Deposit Insurance Corporation (FDIC). Insurance corporations offer contracts with internal guarantees and are backed by the claims paying ability of the issuing company.

As with all annuities, the trade off is the time commitment you enter into when making your deposit. Typically, fixed index annuities will range anywhere from 7-10 years. You can usually access some portion of your money within this time but, your full lump sum will not be available until the end of the initial time period, or "Surrender Period." Some surrender periods can be shorter, some are much longer. I usually recommend 10 years as the maximum time you would want to make a commitment with your money before having at least an option to walk away. Ten years is a long time. A lot can change in your life and in conditions around us in a

decade. It is always important to have the ability to change course if goals or conditions change.

Many people do not understand how fixed index annuities allow you to make gains based on the market without the associated risk of loss. This is because you have transferred the risk onto the insurance company. They are responsible for backing the guarantees provided in the contractual obligations they have offered and made to you. They also therefore, do not provide contract holders with ALL of the gains when the market moves upward. There are several ways that the insurance company keeps a portion of the profits as they allow you to have a risk-free opportunity to grow with the market. Typically, there are several different “Index Options” the company will allow you to choose from or spread your money out over. An Index Option is essential an equation that calculates how much of the gains from a specific market index you stand to benefit from. The insurance company will limit your gains (and make their profits) using one or more of several limiting factors. These are “Caps,” “Spreads,” and “Participation rates”.

A Cap is a glass ceiling. It gives you a maximum amount you could possibly gain. For instance, let’s say there is an index option for an annually crediting capped S&P allocation, with a cap of 5%. Each year, the company would look at where the S&P started and where it finished. If the S&P lost value, you would have benefited by keeping your money safe and protected. If the S&P moved up, you could make gains. However, your gains are limited by the cap of 5%. So, if the S&P moved up 4%, you would make a 4% gain. However, if the S&P

moved up 20% over that year, you would only make up to the cap rate, or 5%.

A Spread is like a haircut; a little off the top. This can potentially give more upside potential than a cap but, can also mean that you potentially would not make a gain, even if the index did move up slightly. This is because the first portion of gains is going to go to the insurance company. Using the previous example, if the S&P moved up 4% and there is a 3% spread, you would only be credited with 1% gains. This is because with a 3% spread, the company will take the first 3% of gains the index makes. But, in a year where the S&P moves up 20%, with only a 3% spread, you stand to make significantly more than if you were capped. In this example, you stand to have a year where you make 17% returns while taking no risk with your principal.

A Participation Rate says that only a portion of our money is sharing in the gains of the market. A 50% participation rate may be typical. What that means is that, if the S&P moved up 4%, you would only make 2%. When the S&P moves up 20%, you are credited with 10% because, only half of your money is participating.

You need to understand the index options and the equations for how you stand to gain interest and what it is based on. Many companies have complex equations that may tie into lesser known indexes or may combine caps, spreads and participation rates. Keep in mind that how interest is credited will effect how much you have available to you in a lump sum once the surrender period ends or how much is left behind if you pass away and leave your remaining money to beneficiaries.

The index options however, many times have little or nothing to do with the income you can expect to generate from your fixed index annuity, if you have an additional Income Rider.

Income Riders are an additional component you can add on top of several types of annuities. The income rider is often the most valuable component of an annuity and potentially the reason why an annuity should even be considered in many cases.

Income riders can vary dramatically from company to company and product to product. These also can be complex. At their base, income riders are designed to offer certain guarantees for the amount of lifetime income the annuity will generate for an owner's (and potentially their spouse's) lifetime(s), without the requirement of permanently giving up control of and access to the underlying lump sum (annuitization).

An income rider may offer certain guarantees for specific increases in an Income Account Value, while you defer taking income for several years, and then guarantee a specific payout rate at a specific time or date into the future. It is important to note that the value of this income rider is simply used as part of an equation to calculate the future income. It may not be withdrawn in a lump sum. It is a separate value used in the calculation of the systematic payments the owner will receive. Your goal in considering and purchasing an annuity with an income rider should be to find a stable company that provides a maximum amount of income when you intend to start creating income from the deposit you are

making. Some income riders will offer higher income within the first year or two of making a deposit while others may offer a higher income if you wait to start withdrawal for 5 or 10 years. Some will even offer the ability to have an increasing amount of income over the course of your lifetime. These can be valuable to offset the potential effects of inflation.

Fixed Index Annuity Risk:

Annuities can be appropriate or completely inappropriate for your situation, based upon your specific goals. The lack of immediate and full liquidity certainly is a drawback to be considered carefully and a reason why you should never put all your money into an annuity. The lifetime income that an annuity can provide however, can be very beneficial as we face the risk of longevity over retirement. Annuities can do something that no other personal investment or financial vehicle has the ability to do. An annuity has a contractual guarantee to continue providing an income, even after you have reached a zero balance in your account. In a bank account or brokerage account, if you reach a zero balance, you are broke. You are out of asset and out of income. With an annuity, if you reach a zero balance, this is when you reach a different level of “profitability”

with an additional kind of return on investment. It is counter to how we think of most investments but, with an annuity, the ultimate goal should be to draw it down to zero, and then continue to receive the income that it will provide.

ETFs - EXCHANGE-TRADED FUNDS

ETFs (or Exchange-Traded Funds) are part of a wider family of investment options, ETPs (Exchange Traded Products). ETFs are the most discussed and utilized by investors today but, there are several additional sub-categories of ETCs (Exchange Trade Commodities or Currencies) and ETNs (Exchange Traded Notes). They are all very similar and we will examine them under the most well known acronym, ETF.

ETFs kind of feel like the natural evolution of the mutual fund. They offer diversification in a single investment like a mutual fund but, additionally can be bought and sold within the trading day at real-time pricing and typically at much lower internal expense and transactional cost. An ETF offers a collection of stocks and/or bonds in a single investment.

You can buy a single ETF and achieve the result and returns of the entire S&P, a specific sector of the market, certain commodities, or even the results of a foreign country's market returns. The choice and selection of available ETFs seems to be growing rapidly and not showing signs of slowing.

Rather than trying to pick individual winners out of the market, an ETF essentially allows you to own the entire market in a single purchase.

The real-time pricing allows ETFs to be liquid within the trading day. One of the drawbacks of owning mutual funds is the inability to sell in the middle of the day. When you order the sale of a mutual fund, your position

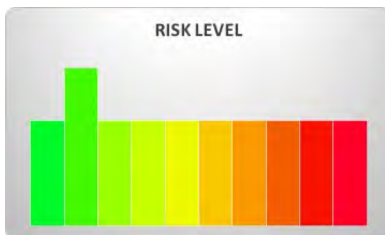
is not actually sold until the fund is priced at the end of the day. Therefore, if the market takes a dive after you give the sale order, you would still suffer those losses. An ETF allows you to execute a trade as soon as the order is given.

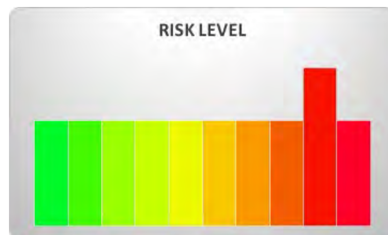
In taxable accounts, ETFs can potentially be more tax-efficient than mutual funds as well, since the capital gains for sales within the fund are not passed onto individual investors. Only the gains or losses the individual investors has actually realized create a taxable event.

Investors also are entitled to the dividends paid on any of the underlying assets held within the ETF. Typically dividends are held within the fund and then paid out quarterly to investors.

Each individual ETF is going to have a unique risk exposure associated with the underlying assets it holds. They can range from relatively conservative to very aggressive. For this reason, you should be sure to educate yourself on the goal, objective, and underlying assets held within the ETF you purchase.

Exchange-Traded Fund Risk:





REAL ESTATE

For most, the real estate portion of our “investment portfolio” consists of the roof over our heads. Properly utilized however, real estate has been credited with playing a role in creating the wealth of 90% of the world’s millionaires.

Real estate can be a very valuable asset to hold. There are many ways to invest in real estate, raw land, personal family homes, individual rental properties, duplexes, apartments, residential, commercial, or through investment in a real estate based equity like a REIT (Real Estate Investment Trust). Real estate investment therefore, should likely be a part of most people’s total, diversified investment portfolios. Like any other investment class, it should never be the place you put all your money.

Real estate tends to be safer, in the fact that typically values do not fluctuate wildly as widely as pricing in equities. History has shown that the value of most real estate tends to trend upward and appreciate over time. This is not always true however, and is certainly not guaranteed. Many investors saw significant losses in their real estate investments in the Great Recession from 2006-2009. Even people whose only exposure to real estate was the home they lived in may have lost significant value if they were forced to sell during this period or the many years after while the economy slowly recovered. How much value was lost and how quickly that value recovered was also very specifically regional. Different areas of the country saw different effects on the values in their real estate markets so, the risks and

rewards of investing in real estate can be hyper localized as compared to an investment in the stock market.

If investing in rentals, commercial real estate, or REITS, additional risk falls on how properties are being managed. Even in a good area, with a booming economy, if a commercial property or a REIT is not being well managed, investors can lose a significant portion of their investment. Upkeep and dependable, quality tenancy are additional concerns.

Capital tied up in real estate investment also is not liquid and readily available. If you need to get your out money immediately, you stand a high likelihood of suffering a loss and not being able to sell for fair market value. If money is needed immediately, you are forced into a fire sale and selling at whatever value someone is willing to give you that day, instead of waiting for a buyer willing to purchase at a reasonable market price.

That being said, real estate is typically more stable in value, can offer potential appreciation and can provide an income for the investor. It is one asset class that can potentially break the rules on money not being an effective multi-tasker. CAN…break the rules. It also can just as easily NOT accomplish any of these goals.

While we certainly hope that our personal residence appreciates in value, and we eventually make money when we sell, your home should be considered outside of the scope of your real estate investment exposure, and outside of your total investment portfolio for that

matter. Your home has its own set of criteria that will determine if it has served as a good investment.

Other than your personal residence, real estate investment should be considered carefully. Don't take on excessive debt (risk) to jump into becoming a real estate investor. In fact, aside from your personal residence or to purchase a commercial location for a business that you own and operate, you may not want to take on debt to invest in real estate.

There are many books and schools of thought on the idea of "using other people's money" to become rich. It is this author and advisor's opinion that the borrower is slave to (and has more to lose than) the lender. When you borrow money, the only one that has any guarantees on return is the one that lent the money at interest so, not borrowing to make a purchase is like an additional return on your investment. The investment is going to make or lose money whether the money to fund it was borrowed or not. It may take a little more work to start from scratch, or you may need to start smaller than you envision but, why not save the money you would pay on interest and use it to build your own wealth?

Just like you should never borrow money to invest in the stock market, never borrow to invest in real estate. Real estate has its own complexities and is not to be jumped into without careful consideration. There are two rules I emphasize when discussing these considerations; the law of large numbers and the Newton's Second Law of Motion.

The law of large numbers says that we have little to no idea what one individual rental home may bring. A single renter may destroy a home by abusing and mistreating the property or worse. I have heard horror stories of squatters, properties where renters manufactured illegal drugs, and a litany of other unforeseen risks that cost owners dearly. The homes themselves deteriorate. Mold, faulty plumbing or electricity, or even costly routine maintenance may offset any hopes for investment returns.

Newton's Second Law of Motion states, "Objects in motion tend to stay in motion. Objects at rest stay at rest." This rule applies to real estate investment as well. Once you have started in real estate investment, it is easy to build equity and momentum to purchase additional properties; to "stay in motion." But, if you have never had experience with being a land lord or owning rental properties, I would caution you to "stay at rest" and avoid sinking any significant portion of your retirement assets into buying real estate or rental properties. It takes great effort to start momentum. What could be a stable, secure retirement can turn south quickly if you have over exposed yourself to real estate thinking it is an easy way to generate retirement income. If owning rentals has not been in your wheelhouse as you made your way to retirement, it probably is not something that will help you make it through retirement.

<u>Real Estate Risk:</u>

GOLD

Gold and precious metals are all the rage. You can't watch tv, listen to the radio, or surf the web without encountering ads pitching gold as the savior against the collapse of paper currency. Now, there may be some legitimacy to this. Gold could be an insurance against the slim chance that society, and the full faith and credit of the US Government has a complete collapse. Gold will likely never completely lose its value. It never has since antiquity. However historically, since time began, gold has also never provided returns much higher than simple inflation. There have been spikes but, there have also been times where it has lost significant value.

Further, if society and the currency did collapse, and you were one of the less than 1% of the population that privately held real gold or silver, how would you protect it? How would you use it to trade or barter? What would be the real value, and the very real risk, of owning gold when the majority of the population no longer had a way to purchase bread, milk, meat, vegetables, gasoline, or electricity? Where would you hide your gold and how would you use it? Are you going to store it in a safety deposit box when banks are collapsing or inaccessible? Do you store it in your house when there are roaming mobs looting for food and valuables? Do you even actually hold the physical gold, or do you hold a inherently worthless paper certificate saying that you are entitled to ownership of shares in gold somewhere?

Under the very circumstances that the sellers of gold warn against in order to create panic, gold and precious metal may be as much a liability as they are of value. In

this advisor’s opinion, under those circumstances, brass and lead may be equally precious metals.

And, if those that hock gold are so certain that the collapse of the currency is imminent, why, when they have the gold, are they willing to sell it to you and take your dollars for it? Aren't they telling you to buy it because those dollars are going to be worthless, or at least lose value as compared to the dollars that you hold?

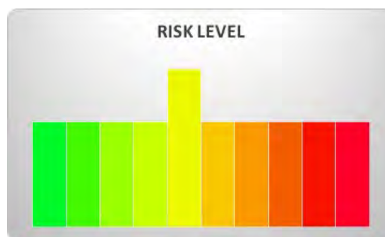
Remember that there is a huge amount of marketing that goes into selling a product. Financial products are no exception. There is a commission made when gold is bought and a premium you will pay when it is sold. You lose money on both sides of that transaction. Filter through the noise. If gold is an insurance, then the total amount that you invest in gold should be approximately the same as any other asset you choose to insure. If your house is worth $250,000.00, you don’t spend $250,000.00 to insure it against fire. If your family needs $1,000,000.00 of life insurance in case you die, you don’t spend $1,000,000.00 to insure yourself. If your portfolio is worth $1,000,000.00, you should not put $1,000,000.00 into gold or precious metals, or even $500,000.00 or $100,000.00. If you are going to hold gold or other precious metals, consider it as an insurance and treat it as such. 1-5% of your total portfolio value is probably the most exposure to gold it is appropriate to have.

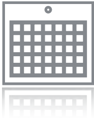
I do believe that holding the actual, physical bullion is the way to go. I do also believe that when we see shake ups in the market, the devaluation of the American

dollar, inflation, or rising commodity prices, we will see the value of gold rise again.

Once upon a time, you could actually convert your dollar to the gold that it was backed by. The price of gold to dollars was set by the government. Today, our dollars are not backed by actual, physical gold. We left the gold standard in phases under Presidents Roosevelt and Nixon. Despite the US and most other countries leaving the gold standard, gold has remained an asset of tangible value and probably always will. Many currencies have come and gone while gold has remained a medium of value, exchange, and commerce. The price of gold into the future will continue to be speculative and effected by trade and currency manipulation.

<u>Gold Risk:</u>





OPTIONS, FUTURES & MARGIN

It is possible to increase the potential rewards when investing in equities or to profit even when stock prices fall with advanced trading tactics like options, futures, and margin. However, this can also substantially increase the risk you expose your investment to.

Buying on margin is essentially borrowing money to purchase a stock with the promise of selling it to pay a financial institution back (plus interest) later. The advantage is that you can make much larger purchases than your own available cash would allow however, it can also multiple the losses you suffer, because you are responsible to pay the borrowed amount plus interest back even if the market and stock price doesn't go in the direction you anticipate. Imagine losing money that you have borrowed with interest. If you do initially lose and try to wait for the stock price to rebound, you would be charged more in interest for the longer period the broker has lent you the money. If the price drops far enough, the institution can call the loan and require you to either make an additional deposit or force liquidation of the position at a loss.

Short selling anticipates a drop in stock prices. Essentially, you agree to buy stock that you do not own at a later date and you borrow those shares from a financial institution to sell today. If the stock price does indeed fall, you will have sold today for a higher price than you must buy the shares back for in the future and will have made a profit. If share prices increase however, you are still responsible to buy the shares you promised to purchase, paying more in the future for

them than you sold the borrowed shares for and will suffer a loss. There are also costs associated with fees and interest to consider.

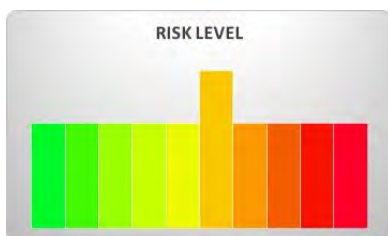
Buying puts and calls is yet another way to hedge your bets. These are forms of derivatives. You are purchasing the right to buy or sell a security at a certain price at a set date into the future. This is a way to potentially limit your losses or get out when you have realized a pre-determined gain. This strategy has been heavily marketed as a way to prosper without risk however, there is always inherent risk with any investment. If you purchase this protection (the right to sell at a certain price) for a premium, and the stock never reaches that price, you have lost the premium you paid to have that right to sell.

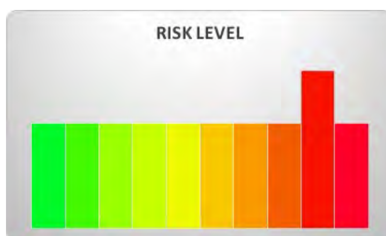
For example, if you bought 100 shares of XYZ company at $100.00 per share and wanted to limit your potential loss to $500.00, you could pay a premium for the right to sell those shares in the future at a price of $95.00. The cost for this right might be $200.00. If the stock goes up to at least $102.00, you have broken even and could sell for a profit. If the stock begins to decline, your trigger kicks in and you recoup $9,500.00 of your initial $10,000.00 investment and got the downside protection you paid for (minus the additional $200.00 price you paid to hedge your bet) but, what if the stock neither appreciates enough to break even nor depreciates enough to trigger your preset sale? Many stocks hover around certain pricing for extended periods. XYZ company may go from $100.00 to $96.00, back to $100.00 and back down to $96.00. If the trigger price has not been hit by a specific date, your option to sell

may expire and be worthless. You have lost the premium you paid to protect yourself from more significant losses. Then, you may also still hold the stock. What if it begins to decline rapidly after your option has expired? You no longer have the limited-time protection you paid for.

Despite all the marketing that is put behind these concepts, there are no guarantees and no get rich quick systems that work consistently without risk. In fact, the higher the potential reward of gains, typically also is the potential risk of greater losses and vice-versa. If you have limited your losses, then you also are probably limiting potential gains.

<u>Options & Derivative Risk:</u>





LIFE INSURANCE

There are many different types of insurance: automobile, home, health, disability. Insurance, particularly life insurance, is absolutely an integral component of a solid financial plan. Life insurance comes in many forms: term, permanent, whole life, universal, indexed, and variable are all examples. There are many schools of thought and a lot of spin in the marketing of various types and forms of life insurance, which adds to the confusion. One thing that you should not be confused about is your need for, and appropriate coverage of, protecting your family or loved ones from debt and loss of income.

We insure ourselves from a great many things that may or may not ever happen. Life insurance protects against something that has 100% certainty of happening, we just don’t know when. Therefore, so long as we have life insurance in place when (not if) the inevitable happens, it is the only form of insurance that has a 100% realization of benefit from the expense you pay.

That being said, term insurance is the most common and least expensive form of insurance. That is because it does not guarantee that you are covered when the inevitable happens. In fact, this is why term insurance is the most profitable form of life insurance that the insurance companies offer. They can control who they issue it to and generally don’t issue it if you are statistically likely to collect (die during the duration of the initial term). Statistics on that decrease significantly if the payoff percentage is 100%. So does the potential return in the risk you are taking.

All forms of life insurance, as with all insurance, have the highest return if you are correct (unlucky) on the odds with the wager you are making. If you die early, you win…

You can “buy term and invest the rest” but, there is no certainty of any payoff from the money you have wagered on your insurance. So, did you “invest the rest…?”

If you don’t, then you have significantly overpaid for the risk you are taking while simultaneously under protecting your family, because the lower initial cost of the potential return (dying and collecting the death benefit) is built into the assumption that you have appropriately risked an additional amount of money to represent the additional risk of you outliving the term.

When the term expires, if you have not invested (with return) at least a lump sum equivalent to the cost of you NOT dying, then you have overpaid for the associated risk.

Now, there is a great deal of legitimacy in the philosophy of only buy term but, that does not mean that there is not also an argument for the use, in the right time and place, for permanent forms of life insurance. There is no financial vehicle that is exclusively the only option you should ever consider and no vehicle that is always inappropriate and never to be considered. Otherwise, there would only be one option and others would not exist.

Term insurance is absolutely a vital component of a plan but, various forms of more permanent insurance can present a tremendous value as well. This is unfortunately sometimes most painfully apparent in retirement, after term insurance expires, prices begin to rise rapidly, and age and health make it difficult to secure more insurance.

It's easy to fool yourself into a false sense of confidence and security once you have built up your retirement accounts to the highest point they have ever been, especially while still earning even more and continuing to add to it. This may even be compounded by the fact that you no longer have to protect your children from the possibility of your unfortunate and untimely death. Hey, you even have the house paid off. What could go wrong?

Well, retirement can last a very long time and, between two spouses, it usually lasts longer for one than it does the other. What if you use that lump sum you have saved for the income you need throughout retirement? When you withdrawal money, balance sometimes have the habit of declining. What if these withdrawals are compounded by a year or two of poor market performance here or there? What if suddenly in your 80's that lump sum that convinced you that you didn't need to continue to carry life insurance when you were in your 60's is significantly less significant? How confident will you be aging together watching your spouse's ability to financially support themselves without you be depleted? Would you spend more confidently, do more, and enjoy your time together knowing that they

had a way to replace the assets that you were using together throughout retirement?

Compounding on the issue of a potential decline in assets throughout life is the certainty of a drop in income that a widow or widower will experience after the passing of their spouse in retirement. Many couples do not consider the loss of their Social Security check (the lower Social Security disappears when the first spouse dies) and how that will effect their surviving spouse when they choose to forgo insuring themselves through retirement.

Potential long-term or end of life medical expenses further exacerbate this issue. Even if there are sizable assets throughout many years of retirement, spouses and caretakers can still be left impoverished by covering the expenses of extenuating medical needs. Life insurance can protect against this in two ways. Loved ones can either receive a lump sum upon our passing or we can accelerate our own death benefit to offset the cost of care.

The problem is that many don't think about what benefits life insurance will provide when it is used. Instead, they focus on the additional cost insurance poses in the early years of retirement. If you do find yourself with diminished assets in your later years, your family will probably find some comfort in being protected. Even if you are lucky enough to die wealthy, you may realize you could have leveraged your dollars more effectively and created an even bigger legacy.

In addition, there are some distinct qualities that certain forms of life insurance can offer that are not available in other assets. Certain forms of life insurance have the ability to not only provide death benefit protection but, also build a cash value that can produce investment linked returns. Like most forms of life insurance, the death benefit passes to beneficiaries tax-free but, the cash value also has several tax-advantaged qualities.

The cash value in life insurance grows tax-free and within the policy, can be borrowed against tax-free. This can make overfunding life insurance a potential option to build an additional pool of available assets that won't effect your income tax returns. This has been a strategy for funding large expenses, like college tuition or a tax-free income in retirement. Business owners often use this as a means to cover operating costs of their business, to meet payroll and overhead, or even as an advance form of pension-like defined benefit retirement plan. It also can be a substitute of sorts for the tax-free benefits provided by a Roth IRA, especially for higher income earners, who may be eliminated from making Roth contributions due to their income. Many wealthy families utilize life insurance as part of their family's financial planning.

Remember however that before cash value can build up or produce returns, there is always going to be a cost for the insurance itself. Often these costs are front-loaded and much higher in the first five to ten years, making the growth very slow until you have over funded the policy for many years. Also, with variable universal life insurance, where cash value is dependent on market returns, there is a possibility of losing cash value just as

there is the possibility of making gains in cash value when the market (and the sub-accounts the cash value is invested in) is down.

There are several styles of life insurance where cash value builds in different ways. Mutual companies insurance policy owners are actually also owners of the company and are paid dividends into their policy's cash value as part of their ownership share of company profits. This is also known as dividend paying whole life insurance. Variable universal life's cash value investment return is directly tied to the ebb and flow of the stock market. Fixed index universal life (or indexed universal life) can negate losses of cash value in down markets and offer a share in a portion of the gains when markets rise.

It can sometimes seem like the cost of insuring against the possibilities of the worst happening costs more than the worst happening, until it does. All forms of insurance play an important role in planning. It is up to you and your financial professional to determine the type and amount of insurance necessary to protect you and your family from all of the what-ifs in life (and death). While there is little risk in purchasing most standard forms of insurance (other than the lost opportunity costs with the money you are using to protect yourself), the cost of not being insured is the real potential risk.

Life Insurance Risk:

CRYPTOCURRENCIES

Cryptocurrencies are a digital asset, also known as virtual currency or alternative currency. They are a medium of exchange that theoretically provides a high level of security. Transfers of assets are verified using strong cryptography. The allure of cryptocurrencies mostly centers around decentralized control, as opposed to the centralized government and banking systems. Typically, a blockchain works to record transactions on many computer systems throughout the world, providing redundancy and validation.

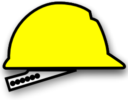
Bitcoin was released in 2009. It is an open source software and is generally considered the first truly decentralized cryptocurrency. Many thousand variants of cryptocurrencies have been created. Many have also disappeared and are worthless. There have been hefty fines and jail time levied against individuals that have fraudulently promoted alternative cryptocurrencies to inflate the price for personal gain.

Keep in mind, the inception and primary uses of crypto-currencies were to be off the radar and untraceable. Therefore, they have been commonly utilized for illicit activities. Where a currency or any asset is specifically designed to be "off the radar" what happens to the money you have invested when it goes off your radar and disappears completely?

There is likely some future in cryptocurrency. Specifically, the handful of "major players" in the cryptocurrency industry do seem to have resilience and staying power. However, be careful about speculative

investment and over exposure. Also, be mindful that not all cryptocurrencies are created equally and some may be inflated, subject to pricing scams, or even altogether fraudulent.

Even with sound, legitimate currencies, prices still fluctuate widely. In 2018 Bitcoin was as low as just over $2,000.00, rose to over $19,200.00, and then fell back below $3,000.00. Where there is the possibility of making 10 times your money, there is also the possibility of losing 2/3rds of it, or maybe even all of it.



YOUR BUSINESS

Business owners are a special breed. They make the world function and take on substantial risk in doing so. When the doors of a business open, the success or failure is not just of the business but, of the lifestyle and livelihood of the business owner too. As they hire on employees, the owner takes on the additional risk and responsibility of providing for and supporting their employees lifestyle as well.

It has been said that an investment in yourself has the highest payoff. This can be true but, it is not without serious risk in the case of owning your own business. Business owners often take on debt, liability, and obligations when running their business. Many businesses are not profitable for several years, if ever, or may be profitable for a short time and then fall into the red if not run effectively. Business owners must therefore always be cognizant of profitability and the bottom line.

Often times, the majority of a business owner's "investment capital" is dumped right back into business operation, overhead, and expenses. It is important for business owners to remember a fundamental rule critical to all investment success, "Don't put all your eggs in one basket." Business owners must diversify as well, pay themselves first, and put some investment capital away in standard investment options outside of their business.

Business owners also often view their business as their eventual retirement plan. They tend to see the revenue and income of their business as their profit center and believe it will be attractive to buyers or investors when

they want to retire. They forget just how much their own sweat equity is worth and how much it would cost to replace them (their know-how and work ethic) when they step away.

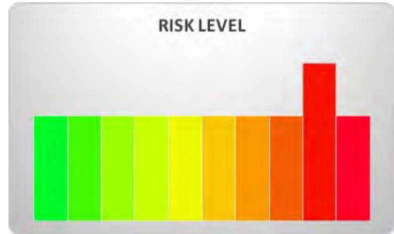
Selling a business to retire off of is not a shoe in. You often have to wait an extended period to find a serious investor willing to pay a reasonable price for your business and, a “reasonable” price isn’t always as reasonable as a business owner might like to think. Typical valuation of a business is often a low multiple (2-3 times) the business’ annual profit. Profit, not revenue. It can be a serious undertaking calculating, validating, and then negotiating a fair sale price reflective of the true value of a business.

Business owners therefore need a retirement plan too. In fact, with the amount of living expenses that business owners are able to cash flow and with their many legitimate business expense write offs, their true cost of living is often underestimated. Along with the potentially lower than expected sale price of their business, this can leave some business owners short on retirement funds or working much longer than they anticipated.

In other cases, business owners have idealistic expectations of family succession. However, just like depending on children to provide care in the event of long-term medical needs, children might not be able to be completely relied upon to provide your business with the same standard of care you would expect to provide yourself. Plus, when passing a business to a family member, the ultimate sale price might be even lower than selling to a detached, third-party investor.

In order to retire how they want, when they want, business owners need to be just as aggressive, if not even more, than the rank and file employees they help support with funding their retirement savings and investment accounts.

Business Owner Risk:



TAX STATUS

The final portion of this guide doesn't actually have to do with a particular investment vehicle, rather understanding the tax status, and ultimate tax ramifications, of the classification you chose to put your investments into.

There are over 75,000 pages of tax code. Some deal with how to calculate the taxes we owe. Many detail how we can reduce or eliminate paying excessive taxation. One of the most influential judges never to have served on the Supreme Court, Judge Learned Hand once said, "Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes. Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands."

There are lots of sections of the Internal Revenue Code that detail different forms of tax-advantaged savings, investment mechanisms, and options. When it all boils down, there are essentially three tax classifications; taxable (or non-qualified), tax-deferred, and tax-free.

Many understand and appreciate the benefits of deferring taxation on their investments and retirement savings. In fact, this is the method by which the majority of Americans are saving the majority of their retirement dollars. The benefits are numerous. You get a deduction

today and the dollars that would have been lost to taxation are retained to grow and compound in retirement accounts. The drawback is that taxation is not avoided completely. The can is only kicked down the road so far. Once we reach retirement, and withdrawal money to live off of, taxes are due on withdrawals from tax-deferred accounts as if those dollars were newly earned income. Also, even if we don't need to pull the money out for income, because the government has allowed us to defer paying tax, they have the ability to require us to pull that money out so that they can collect the deferred tax payment. This begins at 70½ and is called your Required Minimum Distribution.

Many are under the impression (because we have been told it will be so) that we will be paying lower taxes in retirement. Many are also finding out that this accepted premise isn't necessarily universally true. Crunching the numbers, Americans are not continuing to save the expected amount of tax dollars in retirement, especially when you factor in inflation, cost of living, increased activity, and the lack of deductions throughout the retirement years. And what if taxes go up into the future?

Non-qualified, or taxable accounts have already had the taxes deducted when the money was originally earned and saved. Once it was invested, those dollars were not placed under any specific section of the tax code, therefore they are "non-qualified". What this means is that when those dollars achieve growth or loss, it is a taxable event when it occurs, when gains or losses are realized. If there are losses, it is possible to deduct a limited amount from your current years taxable income,

or use it to offset gains realized in other investments. When there are gains realized, taxes will be due although, not at standard taxes rates. Generally gains in non-qualified investment accounts are taxed at a more favorable Capital Gains rate. This is one of the reasons why Warren Buffet said he effectively pays less in tax than his secretary. Most of his taxes are on growth on money he already paid tax on once when he earned it and is now paying tax on for a second time, while his secretary is paying taxes on money she just earned for the first time.

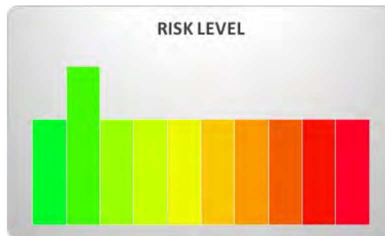
The final status is tax-free. This one is my favorite. The Roth IRA, Roth 401(k), and certain types of cash value building life insurance give us the ability to pay tax once and only once. We can pay the tax today, at rates we know, and then all growth and income on those dollars are tax-free to us forever.

Think of the tax status like a roof on a structure. Once your roof is built, you can put any other the many investment options underneath it. There are a few limitations but, remember that the tax status you chose to place your investments in may be just as important to your results as the investment itself.

<u>Risk of Tax-Deferral</u>:

Risk of Non-Qualified:

Risk of Tax-Free:



I hope that you have found this guide educational and informative. It may be helpful to refer to into the future when making investment decisions or in evaluating current holdings. Remember that any investment you choose to hold is essentially saying that you would buy that investment today for the equivalent amount of cash it represents. So, ask yourself, if I had the cash in my hand today, would I purchase this same investment or go a different direction? This should help simplify your financial decision making. I am glad that you are taking your financial future seriously. All the best for your continued financial success!

Request Your Full Copy of “Countdown To Retirement” Today:

INCLUDING…

7 Financial Myths

Common Planning Mistakes And Misconceptions To Reconsider

1. THE MARKET ALWAYS GOES UP

You've probably heard the saying, "The market always goes up over time." Well, if this were actually true, would we also need another common saying that we hear when the market goes down, "Don't worry, the market always comes back"?

The market has gone up over history but, it does not ALWAYS go up. In fact, if you look back through history, the market has experienced several time periods of high growth, often followed by prolonged periods where it essentially moved sideways. There were up's and down's within these periods but, there have been decades where investors took considerable risk without much reward if dependent on positive market movements.

The most recent example has even been referred to as "the lost decade." This is the period from 2000-2012 where the major market indexes took two major downturns. Markets recovered but, this 10 year period shows that even if markets have historically gone up over time, they don't ALWAYS go up.

In retirement, it is not a matter of the market going up "over time." If you are reliant on the market for your retirement, it only matters if the market goes up when you need it to. How do you know?

2. THE 10% AVERAGE MARKET RETURN

Many market proponents quote a mythical 10% average return over the history of the stock market. Many funds advertise an even shorter past 10 year history of returns. And many investors fall victim to the thinking that this means that they will achieve these rates of return and should be able to count and rely on them consistently for their investment performance throughout retirement.

However, even if there are 10% average returns, this doesn't mean you can count on 10% growth on your money consistently. Let's examine a 3 year example with a 10% average rate of return.

If you have 3 years of returns of 60%, -50%, and 20% in any order, what is your average rate of return? 60 + (-50) + 20 = 30. 30 divided by 3 = 10. These returns give you an average rate of return of 10%. But, what if you had invested $100,000.00 and these were your returns? How much would you have?

$100,000 x 160% = $160,000 x 50% = $80,000 x 120% = $96,000.00

So, you started with $100,000, you had 3 years with a 10% average rate of return but, you have less than you started with. If you are reliant on average rates of return for your financial stability throughout retirement, you should reconsider your plan.

3. A 4% RETIREMENT CASHFLOW

For almost a quarter century, most investment driven retirement planning has been based on a theory dubbed “The 4% Rule.” This so called rule however, has always left an acceptable probability of failure.

The theory goes that, upon retirement, you SHOULD be able to pull 4% from your lump sum to create an income, adjust 3% for inflation, and HOPEFULLY not run out of money over a 30 year retirement.

There are several problems with this theory in application. First, the words SHOULD and HOPEFULLY are not concrete. You may not feel comfortable basing your plan for retirement on hope. Second, under many market conditions, especially with down years early on in retirement, a 4% cash flow is unsustainable and increases the probability of running out of money. Third, the “4% Rule” was only designed for a 30 year retirement. Even in that time it has failed some retirees. But, today we are living even longer and retirees need a plan that will last as long as they do. Finally, it leaves a tremendous amount of doubt and worry. If the weatherman says there is a 10% chance of rain, you may feel comfortable leaving your house without your umbrella. If it does end up raining, it won’t ruin your life. It probably won’t even stop you from going about your day. But, if your plan for retirement is based projections, using a theory with an excepted 10% probability of failure, how comfortable are you leaving your paycheck behind.

Here is the real problem - most people don’t realize that they have a retirement plan that relies on the good

fortune of falling on the right side of statistical outcomes. How many advisors have sat with their clients and discussed the chances (however small they may be) of the plan they have designed to support their lifestyle failing in retirement? If they have, how many of those clients were comfortable with those odds? Are you comfortable basing your lifestyle on a plan with a probability of failure?

The "4% Rule" was incepted during the mist of the greatest bull run in stock market history - while the Baby Boomer population was stacking away retirement dollars and contributing to fund the pensions, Social Security, Medicare, and Medicaid benefits of retirees relying on these systems. How stable will a hypothetically "safe" cash flow rate (that studies have already indicated is too high) be over the next 30 years as the Baby Boomers move from contributing to support these systems to depending on them?

4. TAXES WILL BE LOWER IN RETIREMENT

Nowhere is it written in stone (or in the tax code) that retirees will be paying lower taxes in retirement. If you plan to live on approximately the same net income (if your expenses will stay about the same), then there is a good chance you won't change tax brackets dramatically.

In retirement some of your biggest deductions are gone. The house might be paid off. The kids are gone. Even your Social Security can potentially be taxable.

Here is the problem - most of us are saving under the pretense that we WILL be paying lower taxes in retirement. What if we are wrong? What if they just stay the same? That means we have less money to live off of than we thought. This means we could use up more and run out sooner than we would like. Now, what if taxes go up? How are you planning?

5. I DON'T NEED LIFE INSURANCE ONCE I RETIRE

It's easy to fool yourself into a false sense of confidence and security once you have built up your retirement accounts to the highest point they have ever been, especially while still earning even more and continuing to add to it. This may even be compounded by the fact that you no longer have to protect your children from the possibility of your unfortunate and untimely death. Hey, you even have the house paid off. What could go wrong?

Well, retirement can last a very long time and, between two spouses, it usually lasts longer for one than it does the other. What if you use that lump sum you have saved for the income you need throughout retirement? When you withdrawal money, balance sometimes have the habit of declining. What if these withdrawals are compounded by a year or two of poor market performance here or there? What if suddenly in your 80's that lump sum that convinced you that you didn't need to continue to carry life insurance when you were in your 60's is significantly less significant? How confident will you be aging together watching your spouse's ability to financially support themselves without you be depleted? Would you spend more confidently, do more, and enjoy your time together knowing that they had a way to replace the assets that you were using together throughout retirement?

Compounding on the issue of a potential decline in assets throughout life is the certainty of a drop in income that a widow or widower will experience after the

passing of their spouse in retirement. Many couples do not consider the loss of their Social Security check and how that will affect their surviving spouse when they choose to forgo insuring themselves through retirement.

Potential long-term or end of life medical expenses further exacerbate this issue. Even if there are sizable assets throughout many years of retirement, spouses and caretakers can still be left impoverished by covering the expenses of extenuating medical needs. Life insurance can protect against this in two ways. Loved ones can either receive a lump sum upon our passing or we can accelerate our own death benefit to offset the cost of care.

The problem is that many don't think about what benefits life insurance will provide when it is used. Instead, they focus on the additional cost insurance poses in the early years of retirement. If you do find yourself with diminished assets in your later years, your family will probably find some comfort in being protected. Even if you are lucky enough to die wealthy, you may realize you could have leveraged your dollars more effectively and created an even bigger legacy.

6. I CAN RELY ON MY INVESTMENT PLAN FOR RETIREMENT

The single biggest factor that helps an investment plan to work effectively is that it is supported by an income plan. Your paycheck is what allowed you to initiate, sustain, and grow your retirement investments. What will happen what opposite forces and demands begin being placed upon your investments, when you start pulling money from it instead of putting money into it?

We typically do just about anything we can not to touch our retirement investments during our working career. Even bad markets can be survived, so long as we continue to have a paycheck to support ourselves. But, taking withdrawals for income, especially during periods of market decline, can dramatically increase the likelihood of running out of money in retirement.

7. IT'S TOO LATE TO PLAN, I DON'T HAVE ENOUGH

"Better late than never", "No time like the present", "If not now, when?"… It's never too early, and it's never too late to formulate a plan for retirement. True, some plans will be better than others. But, success doesn't have to be defined by wealth and opulence. Success can be achieved through planning and execution.

It may not be easier. There may be some tough choices to face. But, knowing your options and your likely outcome can be comforting. At the very least, you might get some ideas of some action items or steps that you could take to improve your financial outlook.

We have a retirement crisis in America. The crisis is that the majority of Americans are not adequately prepared for retirement. At the root of this issue is that most of these people have never sat down and formulated a plan. Many of them never will.

Unfortunately, people tend to stick their heads in the sand and not face difficult issues. Often painfully, many come to the realization that they have still left their backside exposed. Hard issues are made simpler if we understand our options. There will always be decisions we can make that can either improve or advance the decline of our financial situation.

Simply understanding some of the mistakes that have been outlined here could be a start. While some of these myths are widely accepted, relying on their logic could leave us in worse financial shape than we would otherwise find ourselves. One of the habits that most

significantly impacts financial progress and success is procrastination. Your plan is reliant upon you and your initiative. Whether you believe you can or you believe you can't, you're right.

Mistakes are made with money everyday and at any age. Over spending, running up credit debt, making poor investment decisions, not capturing a match on our 401(k), poorly timing Social Security…by far the biggest mistake made with money is the decision not to make any decisions at all. By not formulating a plan, we are not controlling our money. If we are not controlling our money, we are not controlling out future.

You future is determined by your plan. Goals are just wishes without a plan for how to achieve them. If you don't know where to start, how to make transitions, or where your plan is taking you, consult with a qualified financial professional who can provide assistance.

To request the full "Countdown To Retirement" visit
www.RichOnPlanning.com

You can also listen to our podcasts
"Planning Matters Radio" from our site or on iTunes, iHeart, Soundcloud, & Spotify

To review your plan and make sure you are not relying on flawed principles for your financial future, call Richon Planning today and request a complimentary review and retirement planning strategy session.
(919) 300-5886 or visit www.richonplanning.com.

Peter Richon is the founder and principle advisor of Richon Planning LLC, a full-service investment, retirement and insurance planning firm. For the past 15 years, Peter has mentored some of the nation's leading independent financial advisors on how to manage their practices to grow and maintain their client relationships. He has been a featured commentator on countless financial radio shows across the nation, providing guidance and insight on the strategies savers and investors should be implementing to achieve their financial and retirement goals. He is an experienced, independent and fiduciary investment advisor with a focus on retirement planning. Peter is a licensed insurance agent and a Series 65 Investment Advisor Representative, serving clients serious about achieving lifetime financial security and independence.

Peter began his career in radio, hosting daily informational financial programs with many financial firms located throughout the Research Triangle Park in North Carolina, then throughout the country. He became an advisor himself and rose to a position of vice-president of a firm in Apex, North Carolina before forming his own firm.

Over the last decade Peter Richon personally managed retirement planning for hundreds of families across North Carolina and has been heard on many national financial radio programs. He has been a regular, featured commentator on shows broadcast on more than 150 stations, to millions of listeners across the country. His goal is to help spread financial literacy and the importance of education to gain true financial success and freedom. Peter Richon personally serves listeners and clients spanning North Carolina. Each week, he meets individually with clients and listeners from his radio show to help them evaluate their financial goals, objectives and direction. Peter also helps personally assist individuals, couples and business owners in formulating, implementing and achieving their own visions of retirement including preservation, growth, income, tax reduction and legacy planning.

Peter's educational style and common-sense approach to finding the best methods to build financial security, as well as his knowledge of how to best utilize the complex products and strategies available to today's retiree, are just a few of the reasons that so many in the Carolinas turn to Richon Planning for guidance on their journey to and through retirement. His knowledge and straight forward approach to delivering this message to the investing public is why so many clients and fellow advisors trust him to assist in their planning efforts.