*"In the future, it won't be about how much money you have, but how much money you have coming in – and the freedom you create with your money. Cash flow is king. Smart is the new rich."*

-- Steve Jurich, IQ Wealth Management, *Forbes*, January 2013

# SMART IS THE NEW RICH™

## And Smart Retirees C.H.E.A.T.

(Create Highly Effective Alternate Techniques)

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STEVE JURICH

Editor, MyAnnuityGuy.com™


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# Smart Is The New Rich,

## and Smart Retirees C.H.E.A.T.

(Create Highly Effective Alternative Techniques)



7702 E. Doubletree Ranch Road, Suite 300, Scottsdale, AZ 85258

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# POP QUIZ...

We all want it. Most of us feel we don't have enough of it. Those who do have enough, usually want more. What is it?

Financial independence, otherwise known as “wealth.”

That often elusive, typically alluring, sometimes overpowering goal that keeps the world getting up in the morning.

Wealth is defined differently by each person. For some, it is the attainment of an actual numerical goal in terms of dollars and possessions. To others, it is the knowledge that you have provided for loved ones, paid all debts and made good on your promises. Still others measure their progress by their ability to help the less fortunate or their church. A simplified definition might be: "No more money worries, no matter what.” Regardless, getting there and staying there requires a fully integrated financial plan in this “new normal” of puny interest rates and balloon markets floating in mid air.

**“’How could I have been such an idiot?’ If you’ve never yelled that sentence at yourself in a fury, you’re not an investor.”**

-Jason Zweig, author of *Your Money & Your Brain*, editor *The Intelligent Investor*

As a Retirement Coach, it’s my goal to get you to a position of permanent wealth, a feeling of certainty about your finances and the inner sense of well-being that comes from knowing that you are going to get where you want to go.

My plan for you is not based on market “Rules of Thumb,” or the “13 Things You Need to Do with Your Money Now.” It is based on nearly two decades of working with real investors in retirement mode—either in retirement or just before arriving. My typical clients hold portfolios in the six, seven and eight figure ranges.

These are smart people. They are achievers in their careers. Many are engineers, teachers, business owners, managers and technicians. They include physicians, dentists, chiropractors and state government workers. They didn’t need me when they were growing their money. They either handled their own investments or hired accumulation specialists who placed 100 percent of their professional focus on building piles of cash.

I work in the area of building hefty, reliable streams of cash flow, and making sure the right people end up with your money in the right amounts at the right time. I focus on retirement income planning as the beginning step in building a comprehensive retirement plan. Why? Very simply, there is no retirement without income. You don't want an "on again, off again" plan or a hope-so plan. You want a *know-so* plan.

But here's the problem: at least 95 percent of the information you can find about how to invest your hard-earned money is focused on aggressively accumulating dollars for a retirement that is still at least 10 to 20 years away. My clients are retired right now, or will be in the next five years.

As Founder of IQ Wealth Management and host of the popular radio show **MASTERING MONEY on Money Radio**, my priority is creating more informed consumers who understand their entire range of options.

It's been said that "knowledge is power," but only if that knowledge is applied specifically to your situation. Having lots of knowledge about lots of things won't make you or anyone successful. Knowing which knowledge applies to you and your goals—and putting it to work in a smart way can lead to an elusive destination: Lasting Wealth.

Most people reading this book do not have the goal of making a billion dollars in the next ten years. Their goal is a much more important one: eliminating debt, lowering fees, increasing income, and achieving true financial independence.

If you'd like to stop worrying about money and start enjoying life more, this book is for you. We won't spend a lot of time on philosophy or pie in the sky. We'll dig into an action plan that puts you on the right path and keeps you there.

You don't need a billion dollars to be successful or to have more money coming in than you can spend. Let's get to work.

# MAKE RETIREMENT GREAT AGAIN WITH THE IQ WEALTH SAFER BUCKETS SYSTEM™

Relax! Enjoy life. Stop micromanaging pennies and start collecting spendable dollars with the IQ Wealth Retirement System™. Learn why playing the game like a good "doobie" according to the old rules will almost ensure you fall short of your goals in retirement.

Instead, learn the secret to permanent financial success and reliable cash flow. Learn how you, too, can ***C.H.E.A.T.*** (**C**reate **Hi**ghly **E**ffective **A**lternative **T**echniques) to win. In fact, you may be crazy if you don't start C.H.E.A.T.I.N.G soon!

The IQ Wealth System™ is a **S**pecific, **M**easurable, **A**ttainable, **R**eliable and **T**imely path to a **"You-Proof"** Retirement. The plan is based on **L.U.C.K. (L**iquidity, **U**tility, **C**ontrol, **K**nowledge**.)**

Now you can avoid making **D.U.M.B.** money mistakes (**D**iversifying **U**nder **M**isguided **B**eliefs). Here's the good news: Managed correctly, maybe your retirement "Number" need not be as big as you once thought. You're about to learn how to take your "Number," go forth, prosper, and sustain a lifestyle. When you start enjoying more sustainable income with fewer dollars, regardless of the markets, you'll understand why more people are saying:

## Smart *IS* The New Rich.

# ABOUT THE AUTHOR: STEVE JURICH,

## Retirement Coach, Wealth Manager, Radio Personality, Founder of IQ Wealth Management

**RETIREMENT COACH STEVE JURICH SAYS**

**"SMART IS THE NEW RICH" WHEN IT COMES TO BUILDING LASTING INCOME**

Steve Jurich, Retirement Coach and Founder of IQ Wealth Management, speaks more like a favorite professor than an insurance agent, or even a retirement adviser. Unlike the breed of annuity agents who use pressure tactics and tired lures like "free steak dinners" to gain captive audiences, Jurich's priority is creating more informed consumers. He takes time to make sure his clients understand the range of options available to retirees so they become better educated investors on the whole. That investment of time is a significant one for Jurich (pronounced "Jur-itch"), but he believes the results his clients see in their portfolios speak for themselves. It's been said that "knowledge is power," and when that knowledge is applied wisely, Jurich believes it can lead to a desirable destination: lasting wealth.

The amount of conflicting and ever-changing information in the media combined with market volatility and outright fear-mongering has made reliable information on wealth management a rare and valuable commodity. Annuities in particular have come through the media gauntlet battered - at a time when the right annuity might be the best foundation for ensuring lasting income during retirement.

As pensions have become a thing of the past in America, many investors are discovering or re-discovering the benefits of annuities. According to Jurich, annuities are the only regulated financial instrument that can contractually guarantee a lifetime income, and can help save retirees from investment mistakes that could result in income shortfall at the most critical time in their lives.

Yet journalists from *Marketwatch*, *Smart Money*, and the *Wall Street Journal* have portrayed annuity sales people as all but twisting the ends of their mustaches while tying retirees' savings to railroad tracks. *Smart Money's* article "Ten Things Your Variable-Annuity Seller Won't Tell You," quotes an insurance salesman referring to commission as the key reason for selling them. Obviously, every financial product comes with a production and delivery cost.

Compensation for competent professional assistance also has a value. In truth, the compensation on fixed index annuities is far less than the long term costs of many mutual fund portfolios, whose fees never disappear. "It's important to note that compensation on index annuities for the advisor does not reduce the value of the owner's account. No deduction is made and the client does not pay an advisory fee. This is a system of compensation for professional service that is economical." Jurich agrees that variable annuities, with continuous fee deductions and sequence of returns risk, may not be the right fit for truly moderate and conservative investors. Because the compensation for the agent on hybrids does not reduce the account value "One hundred percent of my clients' assets go to work on day one without reduction by fees."

Still, the journalistic attack is relentless. When a popular television financial whiz like Suze Orman declares on CNN Money "I hate variable annuities" - and then shrilly repeats that sentence three more times with increasingly wider grimaces, you know you've hit upon a controversial subject. The danger is that it's too easy for those unfamiliar with annuities to lump them altogether, as in the Kiplinger article, titled "The Great Annuity Rip-Off," in which the writer calls out "unscrupulous agents" who manipulate seniors into overpriced, risky investments.

Jurich says, "I'm always amazed by journalists who place themselves higher on the rung of research knowledge than the Wharton School of Business, Harvard, Stanford, The University of Illinois, Boston University, Boston College, and the U.S. Government Accounting and Budget Office. They've spent years doing actual research studying the subject, not just a few hours on Google™. All of these institutions promote the effectiveness of annuities as being part of the solution rather than the problem in securing dependable and sustainable lifetime income."

Today's retirees have had enough of self-serving and out of date advisors who still sell the same ideas that worked in the Bull markets of the 1980's and 1990's. Instead of seeking professional advice, 50 percent of middle-income retirees choose to turn to the internet for guidance on retirement planning – and 38 percent would rather ask family or friends than a professional, according to a study released by the Bankers Life and Casualty Company Center for a Secure Retirement. Jurich doesn't blame investors for looking to other resources. Because of the poor experiences they may have had with advisors in the past and so many publicized corporate misdeeds, trust is the rarest of all commodities.

Finding a trusted advisor is more difficult than ever. A key reason is that the consumer can't always be certain about just who the advisor is working for. Stock

brokers work for a broker dealer. Insurance agents represent the insurance company. Advisers who pass the Series 65 exam are licensed as fiduciaries, meaning they are required to act in the client's best interest. Jurich takes his responsibility as an advisor very seriously. It is an important difference that consumers are wise to consider. In fact, he says there are three types of annuity agents whom retirees have seen all too often. He strives to be the fourth kind.

"There's the agent who believes he's doing a good job, but hasn't done enough research to give full financial advice, and might not even have a securities license – an insurance-only agent shouldn't look at your securities portfolio. Then there's the agent who understands how annuities work, but cares more about commissions and sales awards. They're not willing to take the time to compare the best companies and payouts for you," he says. The third type of agent is frequently seen in brokerage firms, and is the most dangerous to retirement funds –one that Jurich describes as "the agent whose cheese has been moved." This agent thrived in the good old days, says Jurich, when variable annuities and REITS were the greatest things to hit investors since the rise of tech companies. "They're well-spoken, articulate, even funny, but have done little or no research on the new annuity options, which doesn't stop them from giving you their opinions on them. What they're saying is 'I hope you buy a variable annuity instead of the hybrid one that I don't completely understand,'" he says. "Annuities are not primary accumulation vehicles. At their best they are income and preservation vehicles. The new buzzword is 'decumulation.' That's where annuities shine."

Besides his role as a Wealth Manager (www.IQWealthManagement.com), Jurich is a leading expert on Next Generation principal protected Index Annuities (sometimes referred to as "hybrid" annuities) and Index Universal Life Insurance (www.MyIndexLifeGuy.com) . He is the Editor-in-Chief of MyAnnuityGuy.com, and host of the popular radio show, MASTERING MONEY, on Money Radio. In fact, he's a little like the Hybrid Annuities he favors – a strong blend of virtues. He acknowledges that while retirees want the secure income fixed annuities may provide, they're rightly wary of the hard sell, hidden fees, penalties and surrender charges. "Annuities aren't investments, they're appliances. Used properly, there's no reason to pay a surrender charge. There can be ample liquidity options."

Part of Jurich's work is to educate retirees on all their annuity options, both strengths and weaknesses. "Annuities are only one piece of the puzzle, but a piece that can no longer be ignored. Immediate annuities in magazines look good in the ad, until you learn your money is gone if you die– that's not acceptable for most people," says Jurich.

One of the main concerns keeping retirees up at night is the dilemma of choosing between risk investments that can turn south or interest rates that don't even match inflation. While immediate annuities can promise as much as a 9.56 percent income payout, the problem is this: "If you put your life savings into that and die early, your money is gone," says Jurich. Another option is a Joint Immediate Annuity, which reduces income to 6.2 percent, but continues if there is one surviving spouse. If both spouses die, however, the heirs are left with the same problem – the money tied up in that annuity is gone. Then along came hybrid annuities with advanced income riders, blending the virtues of the immediate annuity, the sense of safety found in old fashioned bonds, that "allow you to be a little bit pregnant or a little bit married" to the lifetime income. Modern income riders on fixed index annuities can create a pensionized lifetime income stream, without the irrevocability of the immediate annuity.

The fixed annuity is one of the central branches near the trunk of the annuity tree. It acts similar to a savings account at a bank. It can be used to save capital, and is accessible via penalty free withdrawals within limits. It accrues interest, tax deferred like an IRA. Safety, security, and the option of lifelong income are the selling points. Still, with interest rates so low, variable annuities have appeal.

Five years ago, variable annuities offered what appeared to be attractive programs: "They would guarantee whatever the stock market did on the upside, or 7 percent, whichever was higher," says Jurich. "But this was a play on words for some agents." Jurich is quick to point out that the so called "7" percent was misunderstood by many and possibly misrepresented by many.

"Some consumers wrongly assumed they were earning 7% on their money--or the gains of the market whichever was better. False. Variable annuities place the principal investment risk on the investor, which is why they are sold via prospectus under securities law, outlining risks and fees." ( Conversely, Hybrid index annuities are built on a fixed annuity chassis, whose interest is linked to upward market movements. They are not securities driven, but rather savings vehicles.) "With a variable annuity, your return is based on the performance of the mutual funds within the variable annuity, known as 'sub accounts.'" Jurich continues, " Here's where the danger starts for many investors. The 7%, or 6% or 5% you hear about is a mathematical income base from which to calculate a lifetime income stream guaranteed by the life insurance company. It is not a guarantee of your principal or in any way a guarantee of a return on that principal. In fact, the income base is not even money. It is a slide rule income calculator.

The typical variable annuity has an a la carte menu of fees that can buy benefits and guarantees. You get what you pay for, but you keep paying. I don't want to be overly harsh on variable annuities. The fees actually do buy benefits, and the benefits can be very useful. The key for the consumer is understanding what they are buying, and making sure the feature applies to their situation. I think you get in trouble when you view an annuity as investment. It is more of a financial appliance. You can add a lot of bells and whistles to stoves and refrigerators, some you may not need."

Jurich points out that the sub accounts provide the fee base for the insurance carrier on a variable annuity. Unlike fixed and hybrid annuities, when the account values drop across the board on a trillion dollars worth of assets, the general fee revenue of the variable annuity industry gets decimated. "The insurance company, when it did its math to give the '7%', assumed the stock market would perform at a range of 6% to 12%. The other assumption was that treasuries would keep paying 5% to 6%. Woops. Shift happens."

According to Jurich, what makes Hybrid Index Annuities a different breed from the rest is a calibrated blend of interest earnings linked to upward movements of market indexes, combined with a base of mathematically assured income. "Inexperienced agents try to sell them as stock market alternatives. They are not. Hybrid annuities are more akin to the bond component in a portfolio. They bring more to the table, however, that bonds can't begin to touch: an actuarially sound pensionized income that can be turned on or turned off at will. In a turbulent world like we now face, the protection of principal values cannot be overlooked" he says. Listening to Jurich, one senses that Hybrid annuities may be either a missing link, or part of the next phase in the evolution of income planning.

"No matter how aggressive you are, you still have to manage your money. Skilled investors and traders don't gamble their own money. They stack their winnings and play with the house's money. An annuity strategy protects you from your own worst enemy: You. One part of your portfolio should be protected against market risk, interest rate risk, and systematic risk. You need a truly non-correlated income holding to offset the risks you are taking in other parts of your portfolio; Not something that zigs or zags, but rather sits still when turmoil arises. A rock. You can spend years searching for the "ideal" investment, but the time you lose could be costly. The Hybrid annuity is like a durable luxury car built on a rugged SUV chassis, ready for you to turn the key." Unlike variable annuities, there are no annual fees for management. In fact there are no upfront or annual fees except for the income or death benefit riders, which Jurich is highly in favor of.

"Underneath every annuity is an immediate annuity waiting to happen. If you preserve your principal with a deferred annuity, you retain the ability to "annuitize" at a later date when your payout will be so much higher. Annuitizing may be premature at younger ages prior to age 70 or 75." Jurich says. That's where income riders solve the problem by providing a 'lighter version' of annuitizing, but with all the heavy artillery to back them up. The Guaranteed Lifetime Income Rider (GLIR) has revolutionized income planning. The Hybrid earns acceptable indexed interest, while not being actually in the market. Under the microscope, the yields are bond-like, not equity-like, which is fine. Especially when actual investment grade bonds are paying microscopic interest and the dividends on the S & P are only around 2%. Annuity critics forget that most retirees want a floor under their money."

Jurich advises that one shouldn't expect to hit home runs with an index annuity, just as you wouldn't expect a bond portfolio to double overnight. Purpose dictates placement. "Preservation matters," he says. "Preservation has value. If you can simultaneously preserve value while building future income benefits similar to a pension, that's a home run today. Joe Di Maggio has passed away, Mrs. Robinson. We aren't living in an era of spectacular gains. The goal is to avoid spectacular losses, keep money flowing in, and do the things you want to do while you have time—preferably with your shirt on." Jurich explains, "One part of your portfolio needs to be a rock. When it can build akin to a pension at work, when you can turn the income on and off at will, and when you can lay your head on your pillow at night knowing your money will be there when you wake up in the morning,—fully intact—this may become your most prized possession."

But what happens to your money if the worst should happen to you? "I don't necessarily like 98% of Hybrid annuities. The 2% I do like waive surrender charges upon death, allowing spouses and children to inherit without paying to get the money out. But let's say there's a medical emergency requiring long term, or at-home care. You can build in "Assisted Care" payouts to provide extra income to help pay for long term care costs. It's that kind of flexibility, in addition to protection from losses plus sustainable income that completes the package. Jurich calls it a "SWAN" strategy, an acronym for "Sleep Well At Night."

But this all probably sounds like the sales pitch we've heard about variable and lifetime annuities. Jurich is very frank when he lays out the most common concerns: "Retirees are worried about the loss of control that came with older style annuities.

Specifically, they were concerned about the inability to take out money without paying penalties, about the inability to change the income stream, and about the possibility that when they died, the insurance company might keep the remaining value of their annuity." "The new generation of hybrid index annuities addresses these concerns," says Jurich.

Jurich sees hybrid annuities in a new light: not as an accumulation vehicle but as a power tool for income and preservation in a balanced portfolio. Although not officially an asset class, the case is strong. Here is an asset that can provide preservation and income, sitting outside the typical pie chart of stock and bond mutual funds and ETFs. Hybrid index annuities can provide resistance to interest rate risk. They protect against longevity risk in the way that immediate annuities can with a key difference: Using a guaranteed lifetime income rider (GLIR), a retiree can avoid the irreversible decision of the immediate annuity.

Asked what he views as a key reason to consider Hybrid annuities, he answers: "While many risks can be diversified using a 'pie chart' mutual fund portfolio, systematic risk cannot. Systematic risk is the lowering of all boats. Fund managers have to meet redemptions in a market crash, including your best stuff." He refers to the new generation of hybrid index annuities as "Luxury Hybrids", providing a non-correlated secure income foundation. Income will determine your future. I can help someone with an income that can last two lifetimes – yours, and your spouse's. It's that search for stability that has driven the demand for annuities as first class alternatives for IRA, 401k, and 403b rollovers, including Roth rollovers. Jurich says "The Baby Boom generation cannot stand to see another 2008." He summarizes: "The strategy that gets you *to* retirement may be a poor one *in* retirement. The IQ Wealth Safer Buckets Retirement System™ can put you on a safe journey to wealth, with your life savings intact, to help you retire and stay retired."

As Steve likes to say "Don't just manage your money, MASTER your money."®

WEBSITES: www.MyAnnuityGuy.com™ , www.IQWealthManagement.com

www.MasteringMoneyRadio.com Contact: (888)310-1776

# WALL STREET AND MAIN STREET

It's said on Wall Street that when a man with money meets a man with experience, the man with experience ends up with money and the man with money ends up with experience

Over on Main Street it's said that an ounce of prevention is worth a pound of cure. They're both right.

You're no longer in a race to die with the most toys, you're in a fight to live the way you've always dreamed. Let's do this.

# CHAPTER 1: KEEPING IT SIMPLE ISN'T STUPID WELCOME TO THE NEW NORMAL

ONCE UPON A TIME, a million dollars in a 401(k) and a free-and-clear home meant your money worries were over. You could retire, turn on your pension, collect $60,000 a year in interest, and still pass on a million to your loved ones. (Bonds paid 6% back then.)

That was then; this is now.

Today, after the "dot-com" crash, 9-11 and the 2008 "Black Swan," Americans are not sure where they stand. Is Wall Street on their side? Or is it a rigged game? As 78 million Baby Boomers march into retirement at a pace of 10,000 per day, they aren't worrying about the same things anymore. A recent MetLife study, confirmed by Cerulli Associates of Boston, found that the number-one fear of retiring Americans is no longer dying – it's running out of money.

It wasn't too long ago that Frank, a prospective client, walked into my office looking kind of miffed and depressed. At first, I couldn't understand why. He seemed to be a bright man in pretty good health, and, as it turned out, he was sitting on a portfolio of roughly a million dollars and change. "What could be bad?" I wondered.

He had worked as an engineer for a major Fortune 500 company and owned both company stock and a 401(k) that he had rolled over into an IRA. He was a 68-year-old happily married guy with three grown kids and two grandkids who had taken early retirement at age 58. His dad had passed away, but his mom was still alive at age 90. We shook hands, exchanged pleasantries, and sat down at my desk. The sunlight shone in a little bright at that time of the day, so I skewed the blinds and asked how I could be of help.

"I just can't seem to get a handle on it," he said, with a facial expression that I could only read as fatigue. "When I had my 401(k) in the '80s and '90s, it seemed I could do no wrong. I picked a lot of different kinds of sector funds and almost all of them seemed to go up. If they fell, I would switch funds and still see nice gains. My bond funds all made money and seemed solid. I figured one day, they would be my retirement. I spent an hour a day on Morningstar and Yahoo, studying different fund managers and philosophies. I contributed the max every year to my 401(k).

Honestly, it was kind of fun, and I felt pretty confident about my grip on the markets. Before I knew it, I was sitting on a million and then the statements went up to over $1.6 million before I finally retired. Then came the dot-com bubble." I could see a microcosm of joy turned into frustration in his eyes—telling a story I've heard before from people like Frank.

It turned out, we were just getting warmed up. I encouraged him to continue and listened intently as he opened a meticulously organized book of monthly financial statements going back 12 months. Frank, I perceived, was an orderly person who enjoyed some risk, but also required symmetry and a level of precision in his affairs. His investments weren't cooperating.

He continued. "Since then, I've hired the best advisors money can buy—big name brokers--and have never really recovered. In fact, according to the plan my advisor created for me before retiring, I should be sitting on somewhere between $2.4 million and $3.5 million right now, sipping margaritas. Hell, I never thought it was going to be like this. The guy I hired was a pretty sharp CFP with a big company logo standing behind him. I felt like I had stepped up to the big leagues, and was on cloud nine for a while. I was impressed with the level of research on each stock that I asked about, and I enjoyed seeing projections of my portfolio values into the future. Everything was crisp, just like I like it. Besides, I liked the guy personally and he convinced me I needed long term care insurance. Of course, seeing my dad develop some dementia probably sealed that deal. Most of all, he showed me a Monte Carlo simulation of a thousand possible outcomes for my investments and eventual income withdrawals. No one had ever done that for me before."

His brow started to clear. It became obvious that Frank was a math guy with a flair for speculation. He liked to see spreadsheets and really didn't like the idea of guessing about things that were important to his future plans. The Monte Carlo simulations added a sense of science being applied to calculated risk projections. The calculations justified some of the risk he was taking. From an investor profile perspective, Frank could be described as a combination of a Family Steward, which comprise about 20.7 percent of high net worth investors according to studies, and an Independent, which comprise approximately 12.9 percent of higher net worth investors. It's a fairly common pairing actually.

To the Family Steward, taking care of family and making wise financial decisions go hand in hand. Their personal senses of worth and self-images are tied to how well they manage their nest eggs. They aren't just thinking of themselves when they make their carefully thought-out decisions; they feel they are making them for their spouses, kids, parents, and even the U.S. economy.

They supported their kids' high school projects and may tithe regularly at church if they are church goers; however, it is not a requirement of a Family Steward to go to church—it's just inbred.

The Independent is the person who enjoys investing and is optimistic that their decisions today will lead to a better life tomorrow. They have confidence in themselves, bordering on overconfidence at times. They don't mind taking advice from a source they truly put on a pedestal; otherwise, get out of their way—they can do it themselves. In most areas of life, especially at work, this trait helps them to succeed. In the investment world, the irrationality of markets simply doesn't make sense to them (as if it ever could!). The Independent can be his or her own best friend, or worst enemy, depending on the circumstances. To the Independent, successful investing creates a sense of personal freedom. They regard investing as a means to a greater end and believe that simply knowing more statistics should lead to greater success. To them, retiring early is the evidence—the scoreboard--of how well they handled their money. They won't admit to being competitive about their "number" (their net worth) and wondering how other investors are doing. But it drives them crazy, if they let it.

## FRANK WAS BEGINNING TO FEEL LIKE HE WAS A FAILURE, NOT HIS PLAN

"Frankly, looking back, the only lines on the Monte Carlo that got my attention were the ones leading toward the $3 million range and above. I've never considered failure as an option. The spreadsheets we're impressive also. They showed me going all the way to age 85. It looked like a $7 million net worth, taking $50,000 a year from investments was not unrealistic at all. I confirmed it on the internet with several other calculators. Everything on the internet and in the money magazines said the moderate range of 10 percent to 12.8 percent was reasonable. Bonds were always paying 6 percent to 7 percent, so Plan B, if things got drastic, was always there."

"The financial plan I paid for was pretty intricate. I was told I could withdraw 5 percent a year safely back then, which turned out to be poor advice, but I don't hold a grudge—I believed it myself. My funds took a hit in '01 and '02, and I started taking income at the same time. The statements kept going down by thousands every month and really started to dwindle, so I cut back and even postponed a trip my wife and I had planned. My wife was getting upset and it even was affecting our relationship.

It wasn't supposed to be like this. I went to a couple of investment dinner seminars and the people giving the presentations seemed to be pretty sharp. They all seemed to be pointing to the same thing: variable annuities and managed accounts. I went with one of the advisors. She recommended a natural gas partnership and some TICs (Tenant In Common Real Estate Investments). Those haven't done so well. In fact, I have to put money into the TICs to keep them afloat. I have a number of stocks and a REIT that are just sitting there doing nothing. I can't sell them; I can't really do anything with them. It is just lost money."

I asked Frank who was managing his money currently.

"Been doing it myself for four years, and I'm not doing much better, but at least I don't have to pay someone for poor results."

## FRANK FOUND THAT GOOD INFORMATION IS AVAILABLE EVERYWHERE, BUT APPLIED KNOWLEDGE IS THE REAL KEY TO LASTING SUCCESS.

We were half way through our meeting, as Frank began to summarize, "Honestly, the prospect of making only 8 percent or so was off my radar. I would have considered it failing. I truly believed the 12 percent to 16 percent range was where everything was heading and was not at all unrealistic." (A Gallup poll from 1999 confirms Frank's thesis. Today, I would take 8 percent and kiss the advisor that could give it to me, man or woman!) "Looking back now," Frank said, "I can say that the real reason I had chosen that company and that CFP I was because I thought they knew things about the market that I didn't. My sense was that I could make 10 percent to 12 percent on my own—I had done it already. I wanted to move up. With the help of a serious professional with a serious research department, I thought I could move my results to the next level. Secretly, I was expecting 16 percent. We both said out loud that it was a bit of a reach, but not totally unrealistic, and even had a little laugh about it. After all, the markets had averaged an 18.5 percent return since 1983—we were being realists; not expecting to ride a gravy train."

As exaggerated as Frank's confession might sound, I can assure you that it reflects common beliefs at the time. Frank is only one of many.

Frank continued, "This was late 1998, so in retrospect, I would have to admit that I pretty much got used to the 20 percent and 30 percent returns. They felt good. I felt good. Down deep, I knew it couldn't last, but the market just kept going up. Who was I to argue with it? Besides, the research I was doing, the research from the brokerage, and the Monte Carlo simulator all just seemed to confirm what I believed. It was flashing green for me."

I use Monte Carlo simulation in my practice and it is a valuable tool, but it is only a source of information, not applied knowledge. It is a map of the territory, but as the saying goes, the map is *not* the territory. Life and markets are what happens when you're making other plans.

We continued to talk as he encouraged me to look through his holdings. His statement was at least nine pages. He had page after page, double sided, of mutual funds and ETFs that I recognized as overlapping. I searched for a trend in his investment strategy, hoping to find a pattern. None was apparent. He had at least 70 different holdings on his statements, mixed between stock and bond funds and ETFs.

I began to ask him why he owned some of them. Each item had its own justification. He felt like he was not being haphazard at all. In fact, he told a compelling story on almost every one.

The recurring theme was an article he read, or a newsletter guru offering special reports with the "5 Can't Miss Stocks," etc. He was a fan of both CNBC and Fox and bought favorite picks he heard about on those shows. I noticed several buy and sell entries for the SPY ETF. Clearly, he was floundering. Was he investing, or trading?

His portfolio reminded me of a lady my mom used to know who bet on every horse at each horse race. My mom was a hard-working realtor and entrepreneur who would never risk a dime in stocks, but took plenty of flyers on vacant land, and some panned out nicely. She also loved Las Vegas and the horse track, but never gambled more than a few hundred dollars. She actually was practicing good asset allocation without knowing it—bucketing most of her money into safe assets, investing in what she understood (real estate), and saving pure speculation for Las Vegas, rather than her income money. Her friend was a systems thinker who apparently believed in diversification. Why bet on one horse when you can bet on 'em all? True, she had a winner in every race, but she soon learned the cost of broad diversification is a very low return, and that the odds are not in favor of the amateur better.

Both the stock market and the track are zero sum games. All the money will be paid out after the house takes its cut. In both arenas, Pareto's Law applies: 20 percent of participants make 80 percent of the gains, while 80 percent of participants must live with the remaining 20 percent. It seems to work in all areas of life, actually.

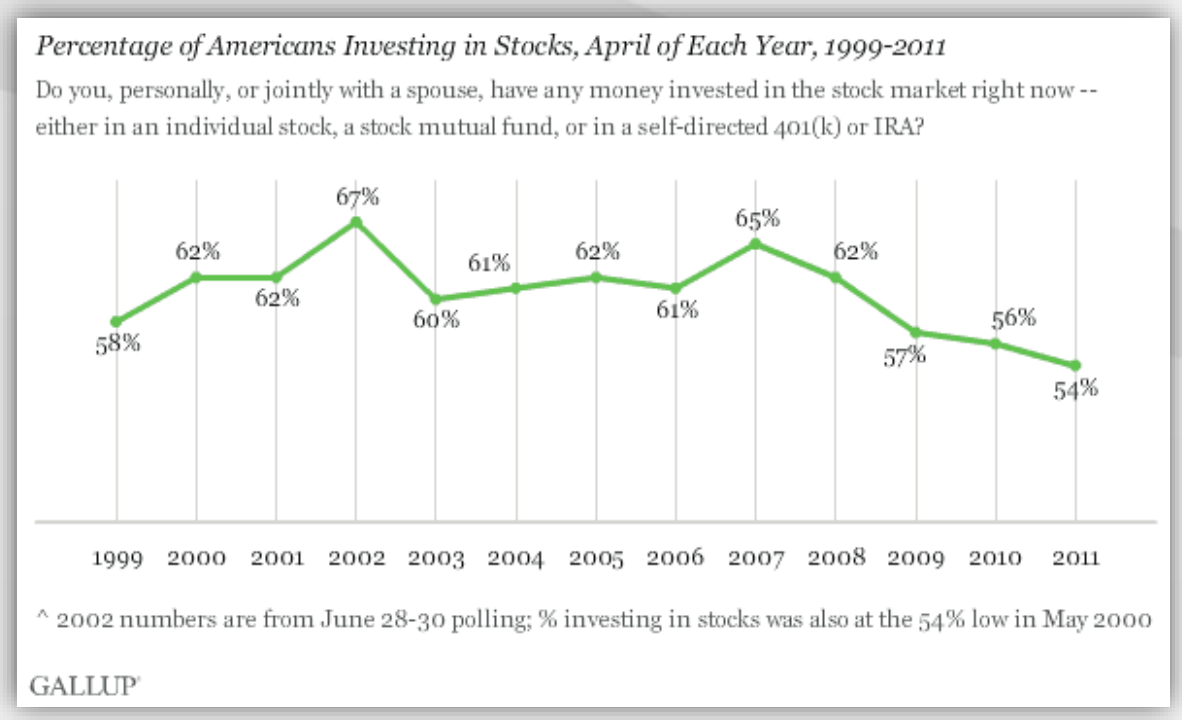
The lesson that Frank was learning--with hard won dollars-- is the lesson of Secular Bear and Bull Markets mixed in with a little of Pareto's Law. Bubbles have a way of skewing Pareto's Law, for a while. All markets move in cycles and the numbers eventually right themselves. There are small cycles with short durations of a month to a year that are like a storm that can be handled with a raincoat and an umbrella. And then there are large cycles that are very powerful, based on dynamic forces of supply and demand that can last from 10 to 20 years. These are more like long-term hurricanes. I recommend staying out of their paths. The Fed might have you thinking that we are in a new Bull phase, but real analysis says we are in a shorter cyclical Bull market within a long term secular bear. Stay on the right side of regression to the mean, and the right side of history.

## IS FRANK'S STORY OUT OF THE ORDINARY? NOT ACCORDING TO GALLUP POLLS

On April 20, 2011 Gallup's headline read: "In U.S., 54% Have Stock Market Investments, Lowest Since 1999." The average American did not necessarily own stocks in the 1960s or 1970s. Stock market participation increased dramatically in the 1980s and steadily progressed and hit full bloom in 2002, the worst year of the Millennial Crash, when 67 percent of Americans owned stock in some form.

Moreover, Frank is a member of the six figure income club, meaning that he had a nearly 90 percent chance of considering the stock market a safe place for money, and the best long term investment.

It IS a good long term investment—unless you are dipping in for income Gallup reported that "Eighty-seven percent of upper-income Americans -- those making $75,000 or more annually -- own stocks, as do 83 percent of postgraduates and 73 percent of college graduates. Sixty-four percent of Republicans hold stocks, compared with half of Democrats and independents. Men are more likely than women to be stock owners. Those aged 50 to 64 are the most likely of any age group to say they have money invested in the stock market."



## ACCORDING TO POLLS, FRANK WAS SUFFERING FROM A CASE OF THE "NORMALS"

Frank was clearly not out of the ordinary; in fact, he was part of the mainstream. Go back and view the literature of the times. If you go back to 1999, investors had a love affair with the stock market. Warren Buffett explained at the Allen and Co. gathering in Sun Valley, Idaho that year that the Fortune 500 index of common stocks was trading at 30 times earnings and was dooming U.S. large caps to 17 years of sub-par performance. Stocks had performed spectacularly from August of 1982 to that summer day in 1999. After 17 years of only occasional and mostly mild market corrections and years of prosperity, common stock investors were in love with stocks. There was no telling them otherwise. Paraphrasing Buffett, "Picking common stocks was the national pastime."

Frank is an intelligent man, and he was steeped in research from the internet. He read the investment books, magazines, charts, and graphs. His decisions were all rational in his mind.

As good as his information seemed, as many times as he corroborated the story and confirmed his calculations, he was still dealing with an imperfect knowledge of future outcomes, using imperfect financial tools, taking on an imperfect system known as the market. The real problem is that he was trying to do all of that with finite time and finite resources. Not a good combination for Frank.

**Frank's New Challenge Was Not Trying To Make His Accounts Grow—It Was Trying To Secure More Income With Fewer Dollars and Keep The Market From Eating His Money.**

Frank and I moved our discussion from his current investments to the real reason he had come to see me: Income. His plan had always been built around accumulation. Strategies for income and strategies for accumulation are radically opposed. The math is completely different. De-accumulation is an opposite science and discipline from accumulation.

**His game plan had broken down. He was in plan B territory, but kept trying to get to his destination with Plan A.**

Frank's long-held and well-considered strategy was to invest very aggressively through about age 54, then get a little more moderate through retirement age at 58, and then put at least half his money into bonds earning 6 percent or 7 percent at some point.

His next words shocked me:

"Ten years ago, if you had talked to me about an annuity, I would have figured you were a full-fledged member of the Flat Earth Society. Five years ago, if you mentioned it, I still might have laughed, but not quite as hard. Today, I'm suddenly looking to sign up. Is it me, or is it everybody?"

## WHEN IT COMES TO YOUR INVESTMENTS, ARE YOU STILL FIGHTING THE LAST WAR?

Recall the 1980s and 1990s when Baby Boomers in their 30s, 40s and 50s poured money into their 401(k)s with every paycheck, driving the demand for stocks. They created a long, slow hurricane.

Those same 78 million Baby Boomers are now in their 50s, 60s, and 70s--and naturally scaling back on risk and consumption. Rather than pouring money into the markets with every paycheck – they're taking money out to replace their paychecks. The hurricane has reversed. And it might also be long and slow.

This isn't a minor blip on the screen; it is a major reversal of a mega-trend. Fighting a new high-tech war with conventional weapons may result in heavy casualties. Any investor expecting the same results with pie chart investments that worked in a different era is asking for the law of supply and demand to be repealed. This is a seismic demographic shift and one that is making its way to both Wall Street and Wal-Mart. Wall *Street* is feeling the pinch. Wal-*Mart* is opening 24 hour mega-plexes.

If the slowdown and reversal affected just the Baby Boomers, that would be powerful enough. But realize that the Silent Generation, also called the Lucky Few who grew up in the 1930s and 1940s are still kicking and going strong. They were part of the tidal wave of innovation and investing that turned the 1980s into the biggest innovation and monetary expansion in the history of capitalism. It isn't just their population that matters; it's their system of buying behaviors.

When younger, Baby Boomers drove the markets and drove big SUVs to fancy malls. Now they're downshifting, driving smaller hybrid SUVs, and driving past the malls. They're staying on the job longer and taking a few jobs from Generations X and Y. The younger generations, who should be our hope for sustained growth, are suffering from 25 percent underemployment.

They're not stuffing money into Wall Street's coffers for several reasons: A) They don't have the money; B) They don't trust Wall Street - or the economy for that matter. And, they don't believe social security will be there for them in any form. They may carry a fresh memory of their parents' stock market accounts getting crushed twice and maybe even saw mom and dad's house go into short-sale. These generations are going to wait to see how things go. To many of them, Apple is the stock market, which means they are repeating the same mistakes their parents made.

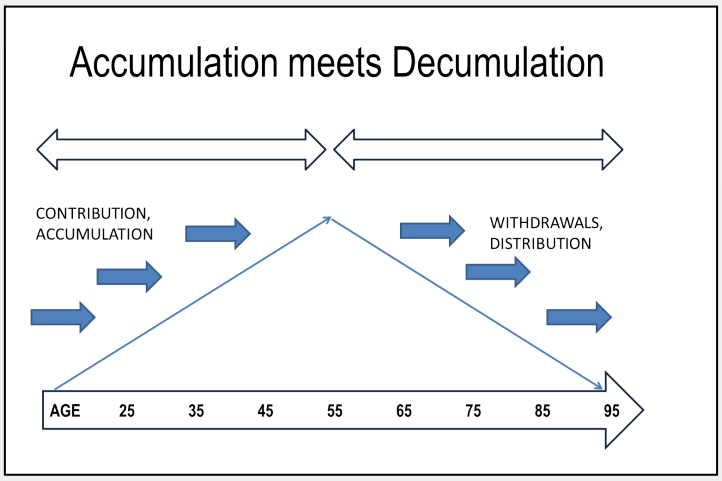
Along with the rest of the country, Frank was realizing that the market is not always a profit machine. From age 25 to 55, you are in the Accumulation and Contribution Phase. Once you cross the 55 mark, you enter a more moderate phase where the plan should be to start moving to preservation in order to preserve your position. On the day you retire and officially stop receiving a pay check, you enter a new phase which financial planners call the "De-accumulation Phase." This is a 50-dollar word which simply means that you are no longer contributing and growing your money - you are living off of it.

**Key Math Principle:**

**In retirement, your withdrawals replace your contributions. The same compounding effect that can make you rich in the accumulation phase can make you poor in the "de-cumulation" phase.**

**It is known as "reverse compounding", and is the enemy of any retirement portfolio. Unfortunately, it is overlooked by most investors.**

**This book is dedicated to helping you combat the problem.**



**The measure of intelligence is not the amount of money in your account; it is the act of adapting to changes in a timely manner.**

If you are frustrated like Frank, go easy on yourself. Not only are you entering a *new normal* like the rest of the world, you are entering one that is custom-made for you, based on your age and circumstances.

I could just say, "man up," but I know how hard it can be to change and I have seen many intelligent people wrestle with the idea of knowing it's time to get more conservative. Getting more conservative is not a reflection on your abilities as an investor. Every military general, every athlete, male or female, gets more conservative when they are ahead and the game is virtually won. In fact, not getting more conservative would be foolish.

You have a certain amount of money right now. What advice would you give your best friend in the same situation? Don't blow it, right? When Serena Williams is at game point, she remains keenly alert, aware and even aggressive, but she may not take the same chances she took in the opening set. When Joe Flacco or Payton Manning have the lead with three minutes to go in a playoff game, they don't pass on every down.

They adapt, and move to the strategy with the highest percentage chance of winning. They run out the clock on the real enemy: failure. They take what the opposition is willing to give. They win because they adapt. So can you.

> "The measure of intelligence is the ability to change."
>
> — Albert Einstein

## LOOK MA, NO PENSION! A SYMPTOM OF THE NEW NORMAL

People spend the first half of their lives accumulating money and paying into savings. They spend the second half of their lives trying to preserve their money and taking out of savings. In the past, 30 years on the job was rewarded with a pension. Today, the 401(k) and 403b has taken over. If you are going to have a pension, you will have to buy one on your own.

Research by the Center for A Secure Retirement found that two-thirds of middle-income Boomers believe their retirements will be different from that of previous generations. What will cause the difference? Pensions for one, debt for the other. Pensions and guaranteed income are what 60 percent of middle-income Boomers say they envy most about the retirement of previous generations.

In retirement, achieving a sustainable, reliable, guaranteed income is the most important goal of the investor.

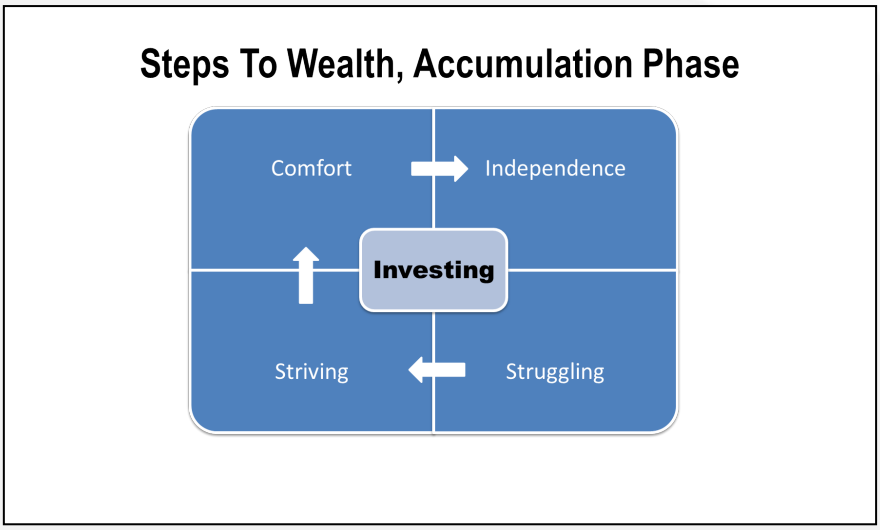
## INVESTING FOR INCOME: IT'S DIFFERENT

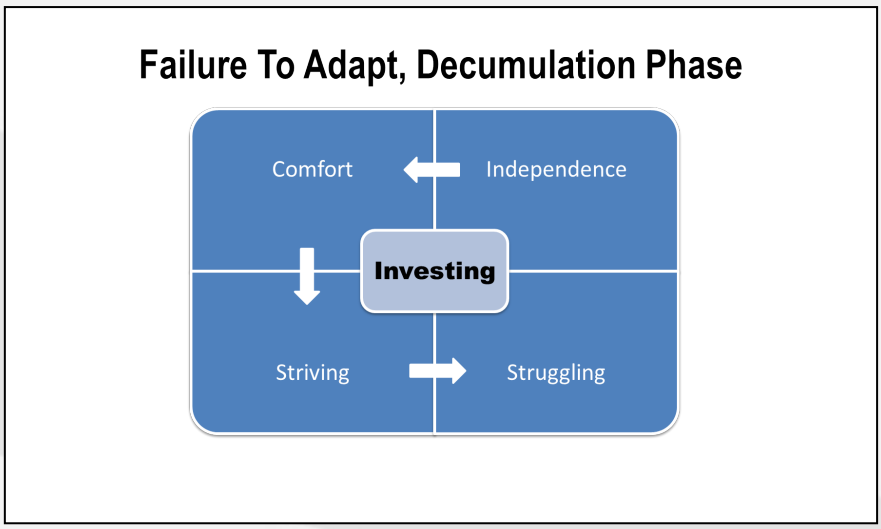
Here's the problem: Most traditional investments are based on the concept of capital appreciation. You buy assets, such as shares of stock, and hope they appreciate in value so you can sell them later for a profit. Cash-flow investing works differently. With cash flow, you buy an asset not for its future value but for its ability to generate income. This income gives you flexibility: You can spend it if you want to or you can reinvest it. Cash flow reinvested is compounding growth. It is a stabilizer for your entire investment plan.

## THE NEED FOR A GUARANTEED LIFETIME INCOME HAS NEVER BEEN GREATER

Some retirees will go back to working a job during retirement and like the idea. Others may be forced to do so because finances are running thin, but it is unlikely they will find the kind of work and kind of money they are hoping for. If 25 and 35-year-olds are having trouble finding work, 65 and 70-year-olds won't fare much better.

Your money has to last and it has to work hard. But what income-generating product can be counted on to be there, come what may, good markets and bad?




## FRANK WAS IN DANGER OF BECOMING A MIDDLE CLASS MILLIONAIRE—AND HE KNEW IT.

Frank had an advantage: He was an engineer with a math background. Even though he was self-admittedly in denial for nearly eight years, after losing a half million dollars, he finally "got it." Money disappears fast when you are no longer making contributions but instead withdrawing. It is alarming. It is surprising. And when the money is gone, there is nothing you can do but adapt. At that point, you have a big decision to make:

1. Dial up the risk as some in the popular media suggest (it's always easier to risk others' money!).

2. Move to safer, income generating assets. Sometimes the only way to deal with a risk is to avoid it completely. It's not a sign of a bad investor, it's the sign of a good one, and it's called adapting. You're calling an audible at the line of scrimmage.

Unfortunately, many investors remain in denial and are shocked when they find that half a million or a million dollars does not provide automatic security. Income and preservation are not just worthy goals, they are the weaponry of financial survivors and thrivers.

The IQ Wealth Safer Buckets Retirement System™ can restore precision and predictability to your permanent retirement plan and can work in any economy—up, down, or sideways.

# CHAPTER 2: WHEN YOU'RE READY FOR RETIREMENT, WILL RETIREMENT BE READY FOR YOU? HOW TO RETIRE AND STAY RETIRED

When Baby Boomers were growing up and growing their hair, people said that "these kids don't know what they want." Today, Baby Boomers are becoming very clear about what they want in their financial plans: No BS, guaranteed sustainable income, simplified plans that are easy to understand, reduced fees, low risk, and upside growth potential. Did I mention *no BS?*

They want to retire and stay retired. This generation told their parents to quit worrying so much and enjoy life a little. Now, it's their turn-- they want to stop worrying and stop relying solely on the market. They're ready for a new vehicle: a hybrid financial vehicle that can perform more than one task.

Like a hybrid car, hybrid "next generation" annuities combine the best of both worlds for a smoother ride in retirement with reliable performance. Hybrid vehicles and electric vehicles are no longer slow pokes.

Don't necessarily think "Prius" when you think hybrid. There just so happen to be Altima's, and Honda's and Tesla's that you can compare from. You just need to know where to look, and what to look for.

Retirees are looking at themselves in the mirror and realizing that two things are true: their time on this planet is limited, and, ironically, their time could last another 20, 30, or 40 years.

It has to be financed without failure.

For upper-middle-class couples in their 60s today, there's a 43% chance that one or both will survive to at least age 95, according to the Society of Actuaries, which recently updated its mortality tables. By 2029, the odds of a 65-year-old reaching 95 climb to 50%.

Therefore, an asset that costs you no more to own than a bond on an annual basis, but which can pay a reliable and steady income up to three or four times that of government bonds, can suddenly make it easier to plan a retirement of 25 to 40 years—with confidence.

## MURPHY'S LAW

Retirement strategies fail when they fail to anticipate or account for the worst-case scenario.

We've all heard of Murphy's Law, "if things can go wrong, they will." When it comes to your money, accounting for the worst case is a law of survival. I don't see it as negative thinking whatsoever. It's practical advice: "hope for the best, but plan for the worst." If the best happens, you're golden. Take an extra trip to Europe or that cross country road trip you've been dreaming of. But if the worst happens, your dreams don't blow up.

I look at this way: my job is to make sure you have more money coming in than going out, from now on, no matter what. Our trademarked phrase at IQ Wealth Management says it all: "Insure your income, insure your outcomes, (then) invest the rest with purpose."®

I work with clients who think for a living, or did when they were still working. They are not pessimists they are optimists AND realists. I create plans that take care of my clients, now and in the future. Yes, we can help you grow your money, but first things first. Let's get the income thing right.

That means coordinating your social security, pensions, annuities, dividends, and required minimum distributions. We're ready to get to work when you are.

# CHAPTER 3: WHAT THE HEAVYWEIGHTS ARE SAYING

**The old 'normal' was about things going up in value-- buying high and selling higher. That train has left the station.**

Bill Gross and Mohammed El Erian of the $2 trillion dollar investment company, PIMCO, have dubbed this era of regressing back to the mean as the "New Normal." They point out that numbers don't lie: Half growth in the economy can only lead to half growth in investments over the long haul, regardless of shorter term bubbles created by the Fed. John Bogle of Vanguard and Warren Buffet also used the term "New Normal" with low, slow growth back in 2002 after the S&P lost 48 percent of its value. The term fell on deaf ears.

> "It is not the strongest of the species that survives, nor the most intelligent, but the one most responsive to change."
>
> --Charles Darwin

In 2012, *Time Magazine* economics editor, Rana Foroohar, summarized the historic shift in a timely column "Why Stocks Are Dead and Bonds Are Deader," after reviewing the math with Gross and El Erian. Here is a summary of their key points:

(1) America fell in love with the Goldilocks Economy.

(2) Economists predicting 3 percent to 4 percent growth are misleading America

(3) Warning: Too many investors, banks, politicians are still in denial.

(4) Investing is like surfing and the money wave will soon hit the shore.

(5) The stock market is a Ponzi scheme...investors will not see 6 percent returns any time soon, and will be lucky to get 3 percent.

(6) Bernanke's cheap money is killing our long term recovery...in fact, central bankers worldwide are using low interest rates to stretch, rather than cure, the current cycles of borrow and spend.

(7) Politicians (both parties) are clueless economists, working from fear and looking for quick fixes.

(8) The Congressional Budget Office is predicting no greater growth than 2.4 percent as far out as 2022.

(9) "Almost anything you do in the future won't be as high-returning as what you are used to", says Gross.

## BABY BOOMERS EARN ANOTHER FIRST: "THE FIRST GENERATION SERIOUSLY AT RISK OF DOING LESS WELL THAN THEIR PARENTS."

Gross compares the shift to a feast-and-famine type situation and even refers to the Bible, "and we've been feasting for 20 and 30 years." The nonpartisan Congressional Budget Office predicts a maximum of 2.4 percent annual growth through at least 2022, far below the 4 percent benchmark. The negative growth for fourth quarter 2012 was the first negative quarter since 2009. El Erian summarized as follows: "Growth under 3 percent limits our national wealth and well-being in the long term. This the first generation that's seriously at risk of doing less well than their parents."

## JOHN BOGLE WEIGHS IN

1. When John Bogle enters a room and wants to talk about how the stock market works, I zip it and listen. Lots of people made money in the stock market during the 1990s, and John Bogle, did too, but he has the distinction of making money in the decades prior to the 1990s also. Bogle is the founder of the Vanguard Group, one of the nation's largest mutual fund aggregators. He created the Vanguard 500 Index fund, the first fund that skips the fund manager and tracks a stock index — considered to be a low-cost, tax-efficient way to invest that has been embraced by institutions and individuals alike. He was also the brains behind the world-famous Wellington Fund for many years, one of the few mutual funds that survived and endured for decades. (Many mutual funds die quiet deaths, never to be heard from again.)

An outspoken critic of the mutual fund industry, Bogle has written several no-nonsense books about how to invest, including *Common Sense on Mutual Funds: New Imperatives for the Intelligent Investor* (1999) and *Bogle on Mutual funds: New Perspectives for the Intelligent Investor* (1993). His latest book, *The Clash of the Cultures: Investment vs. Speculation*, came out in August of 2012. In an Aug. 31st, 2012 interview seen in *USA Today* he repeated comments he has made consistently in other forums:

***Q. Speaking of speculation, have exchange-traded funds (ETFs) gotten out of hand?***

*A. No question about that. It's typical of what happens when you have marketing people instead of investment fiduciaries running money... The ETF is the magic word of the day, the greatest marketing innovation of the 21st century. But the data shows an awful lot of ETF trading, a huge amount every day... It's absolute speculation, and it's hurt a lot of people.*

***Q. A number of commodity-based ETFs aren't covered by the Investment Company Act of 1940, which regulates most mutual funds, and so don't have the same protections that most funds do. Do you think investors understand that?***

*A. Less than 1 percent understands that. The same is true with exchange-traded notes, which are credit notes. Investors should invest and not speculate.*

***Q. What worries you most going forward?***

*A. The coming train wreck in the financial system. A 401(k) is a thrift plan trying to be a retirement plan. It was never designed to be a retirement. To be a retirement plan, you have to keep putting money in and can't be allowed to take money out, and you can't be allowed to borrow from it.*

***Q. How significant a risk do you think money funds pose to the overall financial system?***

***A.*** *It's hard for me to put in the context of the overall economy. It's certainly one of the major risks in the mutual fund industry.*

***Q. The expectation that you can always get at least a dollar back for each dollar invested is a key reason why money funds are appealing to investors. What will happen if a floating standard is established?***

***A:*** *The asset values already float, but we just hide it. There is not the kind of safety that people assume there is.*

***Q. The industry is already challenged because money fund returns are currently tiny, and investors have been pulling cash out as a result. Returns have recently averaged 0.02% — $2 a year for each $10,000 invested. Might tighter restrictions make things worse?***

***A.*** *The industry isn't providing a competitive return now, but that will change over time. ...After what happened in 2008, we now know that there's an immediate contagion if something happens to a money-market fund. Even though only one of the funds gets pneumonia, every money fund gets a cold.*

**How stock market math really works, and why you may feel the cards are stacked against you (they are):**

Bogle has always been a consistent, serious, no-nonsense mathematician when it comes to stocks, rather than another talking head making predictions. He is known as one of the hardest working money managers ever, and got it done in the trenches. E.F. Hutton is long gone, but when Bogle talks, people still listen.

While it could be disastrous for a retiree to plop their money into a pie chart of mutual funds in search of permanent income right now, and I certainly don't recommend it, Bogle can offer timely lessons to investors seeking clarity about today's markets.

After the crash from 2000 to 2002 carved 48 percent from the S&P, many people turned to him for sober insight. He pointed out that in the early 1980s, when bank CDs were paying 13 percent, the growth of the economy were both purring along at about 4 ½ percent annually. Things were very different then, and a bit more predictable. Annual earnings growth for blue chip stocks was at 6 percent. Bogle adds these two figures together - the 4.5 percent dividend yield plus the earnings growth of 6 percent - to arrive at a 10.5 percent *investment* return through 1999. To that figure, he adds the *speculative* return—which most people spend too much time concentrating on. The speculative return is simply the rise in price of the stocks. As the price of the stock rises, the price-to-earnings ratio (PE) rises in tandem because you are paying more dollars for every dollar of earnings. The lower the PE ratio, the less an investor is paying for a dollar's worth of earnings. The higher the PE ratio, the more an investor is paying for a dollar of earnings.

Using the formula of "buy low, sell high," it follows that when investing for capital growth, we should always be looking to buy when PE ratios are historically low. Low is less than 10, meaning the price we pay for the stock today would give us our money back from pure earnings per share within 10 years. (Buffett concurs that 10 or less is low, and prefers seven, as did his mentor Benjamin Graham). In 1983, "the PE ratio of the S&P was around seven. Today, it is at 21," points out another well-known analyst, Ed Easterling of Crestmont Research (www.CrestmontResearch.com ) who has appeared on my radio show a number of times.

Bogle continues to point out that from 1980 to 1999, the price-earnings multiple took a giant leap from a fairly low level of 7 or 8 times earnings to fully 32 times earnings, the highest level in history. That change in valuations—a 300 percent increase—produced 7 ½ percent of *pure speculative return* per year. Added to the 10 ½ percent investment return (from earnings and dividends), "the total return on stocks came to almost 18 percent—the highest two-decade return on stocks in all recorded history. Literally, we never had it so good," said Bogle.

**Stocks are a supply and demand, zero sum game. Clearly, in 1999, the demand for stocks was at a fever pitch, driven by the 401(k) and IRA contributions of the Baby Boomers and the Silent Generation. Even those born prior to 1925 were in on the game.**

Now let's look ahead. We know that the present dividend yield ranges between slightly less than 2 percent to slightly more than 2 percent (Source: Standard & Poors). In fact, dividend yields of more than 4 percent have not been seen since 1990, and were largely responsible for the mythical "stocks always make 10 percent" Rule of Thumb.

If we back out the 4.5 percent dividend yields from the 75 year average of the S&P, and replace it with 2 percent dividends, there is no such thing as a 10 percent return in stocks.

While we don't know what future earnings growth will be, let's assume that the past trend of about 6 percent growth per year will continue. **Result: Reasonable expectations suggest an annual investment return of about 8 percent in the coming decade**, or about 2 ½ points less than the earlier decades—all accounted for by the simple fact that the initial dividend yield is 2 ½ points less. It is simple.

What about speculative return? Of course, we have no idea what it will be. But we do know that when stocks are selling at about 22 times forward earnings there has never been a 10 year period where an 8 percent decade has been achieved. The long-term average PE is 16 times earnings.

Bogle continues, "I'm guessing that the P/E ratio is more likely to remain around present levels or even to ease downward to say 18 times than to rise meaningfully higher during the coming decade." **Result: no speculative return—or perhaps a modestly negative one in the 1 percentage point range**. "Combining investment and speculative return, then, the expected total stock market return in the next 10 years should be between 7 percent and 8 percent per year. Let's be conservative and assume 7 percent," Bogle says.

**The one group of investors who need to avoid losses is fixed income investors.**

Retired investors are dealing with finite resources and finite time. They may have been extremely successful investing their money in the accumulation phase. They may develop their own set of "rules of thumb."

The key to remember is that in retirement, you are no longer contributing money regularly. In fact, you are withdrawing it, meaning you are spending the dividends rather than reinvesting them. This violates the formula for making the traditional returns on stocks that most people crave, i.e. 10 percent and should give you pause about a pie chart approach to income. When market losses are added to income withdrawals, math and time are not your friends.

## BOGLE SUMMARIZES:

"What does that 7 percent average return imply for your accumulation of wealth? Above all, caution! Don't expect history to repeat. And expect far less wealth accumulation. Consider that an investment in stocks of $10,000 that earned 17 percent during the 1990s grew five-times-over, to $52,000. At 7 percent, on the other hand, that $10,000 investment would not quite double, to just $19,700. But the reduction is really much larger. At the higher return, the profit on the $10,000 investment is $40,000; at the lower return it is less than $10,000."

Bogle's math is a cold reminder that markets travel in long secular trends that may not match your timeline for income. When planning a retirement of 20, 30, or 40 years, the investor needs to have the long view in mind, and choose an income plan that works without depleting whether the markets go up, down, or sideways—because that's exactly what they are going to do.

> "The 401(k) was never intended to be a retirement (all by itself). To be a retirement plan, you have to keep putting money in and can't be allowed to take money out"
>
> --John Bogle
>
> 08/31/2012

## RESEARCH SAYS YOU MAY BE YOUR OWN WORST ENEMY

Dalbar, Inc. is the nation's leading financial services market research firm. They carefully track inflows and outflows of mutual funds.

Each year, Dalbar tallies the score on how investors are actually performing versus how the markets are performing. Investors always lose the battle.

Recently, Lou Harvey, the president and CEO of Dalbar, pointed out that investors routinely buy too high and hang on to losers too long, trying to avert a loss and then hoping the loss recovers itself. Harvey says, "We've looked at the effects of market timing for the last 20 years and on average these days [the cost to investors] is around 4 percentage points." In fact, his research shows that during particularly volatile periods such as 2011, the average hit to a market timer's performance nearly doubled to 7 percent. It's no wonder Harvey calls the problem "huge" and "very expensive."

Most of Bogle's 7 percent calculations came in the mid-2000s, prior to 2008, the Fed reaction, and the proliferation of high-frequency trading now engulfing 3/4ths of the NYSE and Euro markets. But in 2012, with his launch of "Clash of the Cultures," he gave a chilling update, warning of a slow "financial train wreck," pointing to a 2.5 percent return in stocks for the next decade rather than 6 percent to 7 percent. I'm sure he'd love to be proven wrong. But he's always made his living by letting the numbers do the talking. Jason Hsu, chief investment officer at Research Affiliates points out that market earnings forecasts aren't useful either. His research shows that even the top analysts move in herds, and are overly optimistic when tracked closely. They don't want to veer too far from the crowd, or be the oddball.

When you add Dalbar's math to Bogle's, with a touch of Gross and El Erian, there isn't much left for the investor trying to make a living by living off his or her portfolio. Big growth may be a mirage. The smart money will think "big income", not big growth. Preserve your lifestyle first and foremost.

## BREAKING IT DOWN: THE FOUR THINGS YOU CAN DO WITH YOUR MONEY

Think about it: Other than spending, there are only four things you can do with your money:

**(1) Save (2) Invest (3) Speculate (4) Insure**

- **Saving** merely means to take money out of circulation, thereby eliminating threats to your capital. While many risks are eliminated by saving, inflation risk is amplified. There is an opportunity cost (i.e., you could have made money with it somewhere else). A tin can in the back yard is saving, but no interest is earned. A guarantee of the capital is more important than a return on the capital. The justification for accepting a low interest rate is that there is value in knowing your money is there and it is safe.
- **Investing** implies a somewhat more probable return of capital than speculating, but inherent in any investment is the fact that there are no contractual guarantees. A high quality investment would be one that includes cash flow in the form of dividends or rental revenue combined with a rise in value. Investing involves risk, and the outcome is uncertain, but the risk may be mitigated by the value returned in the form of dividends, royalties, or rental income. Investing by definition involves some speculation, but is not pure speculation.

A 24 year old person placing most of her money in small cap stocks with the intent of holding for 40 years could be said to be investing.

- **Speculation** is much simpler: it is buying an asset with the intent of reselling it later at a higher price. The purpose of speculation is simply to buy low today and sell high tomorrow. Those who engage in speculation have no reason for buying the asset, other than resale at a later time. A 64 year old person placing most of her money in small cap stocks with the intent of selling in a year, could be said to be speculating.
- **Insuring** is different. Insurance is a contract for payment in the event of a mishap. Home owner's insurance is gladly bought by every home owner to be made whole in case of a fire or storm damage. Auto insurance is purchased for similar reasons—to handle the "what if" of a mishap. The potential expense of the mishap is big enough to motivate the insurance buyer--and infrequent enough to the insurer--that a sound and equitable policy of insurance results. The insurance company, in fact, applies actuarial science to the decision of whether or not to accept the risk. Once the risk is accepted, the state regulated and audited insurance company must show evidence of sufficient capital reserves and surplus reserves for the payment of the potential mishap. The insurance policy is a contract between you and the insurance company that spells out exactly what will be paid under which circumstances.
- **Annuities fall under the insurance category.**
- **An annuity** is a contract for payment issued by a legal reserve life insurance company. You don't invest in an annuity, you acquire an interest in it--you buy it. It is in some ways the opposite of life insurance. In fact, it could be aptly described as "living" insurance or income insurance, rather than life insurance. No health exam is required. The annuity contract provides you with a guarantee that you will always have income until your date of death, virtually identical to a pension. Therefore, the term "pensionizing" is used to describe the income that may come from an annuity. It is a contract, which is a good thing--you certainly wouldn't want to wing it.
- **Immediate annuities are pure income.**
- **Fixed and fixed index annuities** can be both savings vehicles and an can turn into pure income at a date you select later (or, you can just settle for having your principal plus interest returned, like a bond)

- **Variable annuities** are not as certain. You can invest, speculate, and receive a lifetime income with a variable annuity; however, there is no floor under your principal. Absent an income and death benefit rider on the variable annuity, you are at risk of substantially reducing the amount of income you receive and the amount of money for beneficiaries.

As a smart retiree, it is important to understand when you are saving, investing, speculating, or protecting yourself with a contract that has audited financial reserves and regulations standing behind it.

It may be helpful to relate your retirement planning to home ownership. When people were buying homes in 2006 at the peak of the market, they thought they were "investing." It turns out, they were speculating.

Today, both stocks and bonds are priced high in relative terms. You may be speculating when you think you are investing. At IQ Wealth Management, we use a "bucketing" system to keep your assets working their hardest, and to separate your milk cows (sources of income) from your beef cattle (sources of lump sum capital.) By using fewer dollars to achieve more income for life in your income bucket, we believe we can show you how to grow more capital over time in your growth bucket, using annuities for income and quality stocks for growth.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