ADVANCED PROOF

THE WEALTH SOLUTION

Bringing Structure to Your Financial Life

Steven Atkinson, Joni Clark, Eric Golberg & Alex Potts

Afterword by DR. HARRY M. MARKOWITZ,
Recipient of the Nobel Prize in Economic Sciences

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For his friendship, his courage and his passion

for empowering investors through education,

this book is dedicated to the memory of

Gordon Murray.

CHAPTER 2

The Key Challenges Facing Today's Investors

To understand how *Structured Wealth Management* may help you achieve financial success, it's necessary to first recognize the most significant issues affecting investors today.

Chances are you're finding it more challenging than ever these days to wrap your arms around your increasingly complex financial life and make good sense of the entire picture. But the sooner you determine where you are now and where you want to be in the future, the sooner you can set out to build a plan that tackles the major issues that impact your life.

For more than two decades, we have worked closely with hundreds of top financial advisors who together serve thousands of investors. Our experience helping advisors help their clients achieve their most important financial goals has taught us that investors today share six major concerns:

Concern 1: Preserving Wealth in Retirement

How are you going to grow and preserve your wealth so that you have the money required to meet your needs and fulfill your goals — not just today, but for decades to come?

It's a huge question — one that investors are asking themselves more and more. The vast majority, regardless of their level of wealth, are concerned about preserving their wealth so they will have enough money throughout retirement.

This makes perfect sense. Few of us want to be forced to downsize our lifestyles. And yet, many investors are not financially positioned to maximize their chances of maintaining their lifestyles during retirement — especially when you consider the challenges that today's pre-retirees and retirees must contend with. For example:

- **Inflation's impact.** Rising prices can decimate your purchasing power, savings and your ability to preserve wealth throughout your golden years. Assuming the long-term historical annual inflation rate of around 3%, an annual fixed income of $100,000 would be worth just $86,000 in five years and only about $40,000 in 30 years. The same purchase that would cost $100,000 today would soar to more than $240,000 in 30 years. And if inflation runs at a much higher rate than normal for an extended period — a real concern given the huge amount of government spending that has occurred in recent years — the goal of wealth preservation and income replacement throughout retirement could become even tougher to achieve.
- **Rising life expectancies.** Thanks to continued advances in health care, American seniors are living 50 percent longer than they were in the 1930s. According to the Centers for Disease Control, a 65-year-old can now expect to live another 18 years, on average.[1] For a 65-year-old married couple, there's a 58% chance that one of them will live to 90 and a 29% chance that one will reach 95.[2] While that is certainly good news, it also means that you must make your money last much longer or risk running out of money before you die.
- **Soaring health care costs.** The cost of health care has been rising at a much faster pace than the overall rate of inflation in recent years. This should be of particular concern to aging investors who are more likely than younger Americans to consume substantial amounts of health care goods and services. What's more, Medicare might only cover about 50% of a typical retiree's medical expenses. Consider that seniors age 65 and over spend an average of $4,888 per person annually for deductibles, copayments, premiums and other health care costs not covered by insurance, according to the most recent National Health Expenditure Survey.[3] That amount is more than two times the amount spent by

average non-elderly adults. And the largest expenditures occurred among those 85 and older. According to the Employee Benefit Research Institute (EBRI), a retired couple age 65 would need approximately $338,000 to have a 90% chance of covering their out-of-pocket health care expenses in retirement.[4]

- **A weakened Social Security system.** It's no secret that Social Security has long been in trouble, but a look at the numbers is particularly sobering. Under current assumptions, Social Security trust fund expenses are expected to exceed income from taxes some time around 2016. By 2024, those expenses are expected to exceed income from taxes plus interest income, and the trust fund is expected to be exhausted by 2037, according to EBRI.[5]
- **The diminished role of pensions.** Retirement has become a largely self-funded venture, as evidenced by the fact that just 32% of workers today participate in some type of defined benefit (pension) plan. That's down from a full 84% in 1980, according to EBRI. These days, the majority of workers (55%) participate in defined contribution plans — 401(k)s and the like.[6]
- **Taking care of kids and parents.** According to the Pew Research Center, one out of every eight Americans, ages 40 to 60, is raising a child while also caring for at least one aged parent at home. In addition, roughly 7 to 10 million Americans are caring for their aging parents from a long distance away.[7]

1 Center for Disease Control and Prevention, "National Vital Statistics Reports," Vol. 56, No. 10, 2008

2 American Academy of Actuaries, 2008.

3 "National Health Expenditure Data: Personal Health Care Spending by Age Group and Source Of Payment, Calendar Year 2004," Centers for Medicare and Medicaid Services

4 "Savings Needed for Health Expenses in Retirement: An Examination of Persons Ages 55 and 65 in 2009," June 2009, Vol. 30, No. 6, Employee Benefit Research Institute, 2009

5 "The Basics of Social Security Updated with the 2009 Board of Trustees Report," July 2009, Employee Benefit Research Institute

6 EBRI Databook on Employee Benefits, updated April 2010, Employee Benefits Research Institute

7 "From The Age of Aquarius to the Age of Responsibility," Pew Research Center, 2005.

The end result: Too many investors saving for retirement today face a higher level of uncertainty about their future prospects than their parents and grandparents did. In the wake of that uncertainty, you simply have to be smarter, plan better and question many of the assumptions long-held by previous generations and many in the financial services industry. We believe that traditional "rules of thumb" advice such as needing 70% of your working income during retirement cannot be taken as gospel anymore. Your retirement plan needs to reflect the realities of the world today and going forward. In chapters five through nine, we will explore how you can position your portfolio to capture the growth and profits that the financial markets generate, while minimizing downside risk through proper portfolio allocation and ongoing risk maintenance and rebalancing.

Concern 2: Minimizing Taxes

You've probably heard the adage that "it's not what you make, it's what you keep that counts." Not surprisingly, mitigating income taxes is a major concern for most investors. No one enjoys paying taxes and income taxes are typically the most obvious and onerous taxes investors face. In addition, mitigating estate taxes and capital gains taxes also ranks high on the list of many investors' concerns.

Such concerns are well founded, as taxes can significantly erode your ability to grow and preserve wealth. From 1926 through 2009, for example, stocks as represented by the S&P 500 Index, gained 9.8% annually. After taxes, however, that return fell to just 7.7%. Bonds' 5.4% annual return dropped to a mere 3.4% once taxes were taken into account. In real terms, a $1 investment in stocks back in 1926 would have grown, before taxes, to $2,592 at the end of 2009 — but just $510 on an after-tax basis.[8]

There's cause for additional concern. Taxes during the past decade or so have been hovering at relatively low levels — but may be set to rise. Trying to predict tax code changes is a risky bet, of course. But you need to be aware that higher taxes across the board could be on their way — and at the very least, build flexibility into your plan so you can make adjustments should your tax situation change. The good news: You can take steps to minimize the taxes you pay and keep more of what is yours by using a variety of wealth management techniques, such as tax efficient investment vehicles and smart asset location strategies that will be explored later.

Concern 3: Effective Estate and Gift Transfer

The ancient Chinese adage that "wealth never survives three generations" seems equally applicable today. A major concern for many investors is ensuring that their heirs, parents, children and grandchildren are well provided for in accordance with their wishes. And yet, our experience is that most investors don't have an estate plan — and many of those who do, have outdated plans. Even more troubling: 65% of all American adults don't even have a will, according to a 2009 Harris Interactive study.[9]

Many investors don't take the appropriate actions in this key area of their financial lives because they assume they don't possess enough wealth to necessitate an estate plan. Regardless of your net worth, the ability to ensure that your assets go to where you want them to has numerous and important potential implications — from being able to help a child or grandchild go to college to ensuring the continuity of a family-owned business to simply avoiding probate. Take college tuition, for example. College education expenses have risen at a rate of more than 5% annually during the past decade, according to the College Board.[10] That means a child born today could need over $220,000 to attend a four-year public college in 2028 — more than triple today's college costs.

Passing on wealth and using it to benefit your heirs as you see fit doesn't happen automatically — it requires the implementation of the right strategies for your goals and situation. As you'll see later, those strategies might include everything from correct titling of assets to smart gifting strategies and trusts designed to provide maximum benefits to a spouse, family members or charities.

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8 Morningstar, Inc. 2010

9 www.lawyers.com/understand-your-legal-issue/press-room/2010-Will-Survey-Press-Release.html

10 "Trends in College Pricing 2009," The College Board

Concern 4: Wealth and Income Protection

A significant number of investors today are worried about keeping wealth safe from potential creditors, litigants, children's spouses and potential ex-spouses, as well as from catastrophic loss. They also want to be sure that their loved ones are protected in the wake of major health problems or other unforeseen events. Certainly many professionals (such as attorneys and physicians), business owners and entrepreneurs need to focus on protecting their hard-earned wealth. And in today's highly litigious culture, nearly everyone needs to consider the possibility of having their wealth unjustly taken from them. Increasingly, investors are realizing the importance of confronting some tough and potentially uncomfortable questions:

- What would happen if I was the victim of a frivolous lawsuit?
- What would happen if one of my children married a "gold digger," then divorced and was sued for a large sum?
- What would happen if one of my children was in an accident in my car or someone suffered an injury in my home?
- What if a major disability prevented me from working and generating an income for my family?
- What if I end up needing to live in a nursing home or require home health care services?

Wealth management strategies aimed at wealth protection can motivate creditors to settle, mitigate the possibility of being sued or minimize the financial impact of a judgment. Various trusts and business structures can work effectively in this area. Trusts and insurance can also play a role in protecting your wealth and income from an unexpected hardship. We'll examine some of these strategies in Chapter 10.

Concern 5: Charitable Gifting

Helping to facilitate and increase the effectiveness of their charitable intentions is also very important to many investors. From direct gifts to formal gifting structures like donor advised funds and private family foundations, many investors are looking to ensure that their money is being used by their chosen charities to generate the maximum impact on the social and economic issues they care about most.

Simultaneously, these investors want to make sure that their philanthropic goals don't conflict with or endanger their own financial futures and their ability to secure a comfortable retirement for themselves and leave a legacy for their families.

Concern 6: Finding High-Quality Financial Advice

Many investors have long been concerned about working with capable financial professionals. It's little wonder. For decades, much of the financial services industry has been driven by a sales-oriented culture that stressed pushing products instead of providing comprehensive wealth management services.

This concern reached a peak during the market downturn of 2008 and 2009 fueled by enormous market volatility, the revelation of the largest Ponzi scheme in history, and the fact that the largest investment firms in the world suffered tremendous losses from bad investment decisions they made on their own behalf. All of this created a significant and still-growing sense of dissatisfaction in and distrust of the financial services industry among many investors. Consider the following from a 2008 Survey:

- 81 percent of investors said that they planned to take money away from their current advisor.
- 86 percent of investors planned to tell other investors to avoid their advisor.
- A mere 2 percent planned to recommend their advisor to other investors.[11]

We recognize that many of you are looking for guidance and assistance in managing your financial life. With that in mind, we've included a chapter in this book to help you find professionals who offer objective advice and who would act as a true fiduciary on your behalf. The good news is that during the past decade or so, more and more advisors have begun implementing a true wealth management process and acting as

11 Prince and Associates, 2008

fiduciaries to their clients. If you choose to work with an advisor, you may find great benefit in using the guidelines and best practices in this book.

You most likely share at least some or possibly all of the aforementioned financial concerns. Each one is a sizable challenge on its own — and taken together, they present you with a potentially enormous hurdle on your path to a comfortable, secure and meaningful financial life. This is where the wealth management process brings tremendous value. By helping you develop integrated solutions to these concerns and creating a plan that strikes the optimal balance between them, you can simplify your financial picture and achieve greater overall financial success than you could by dealing with these challenges on a case-by-case basis.

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