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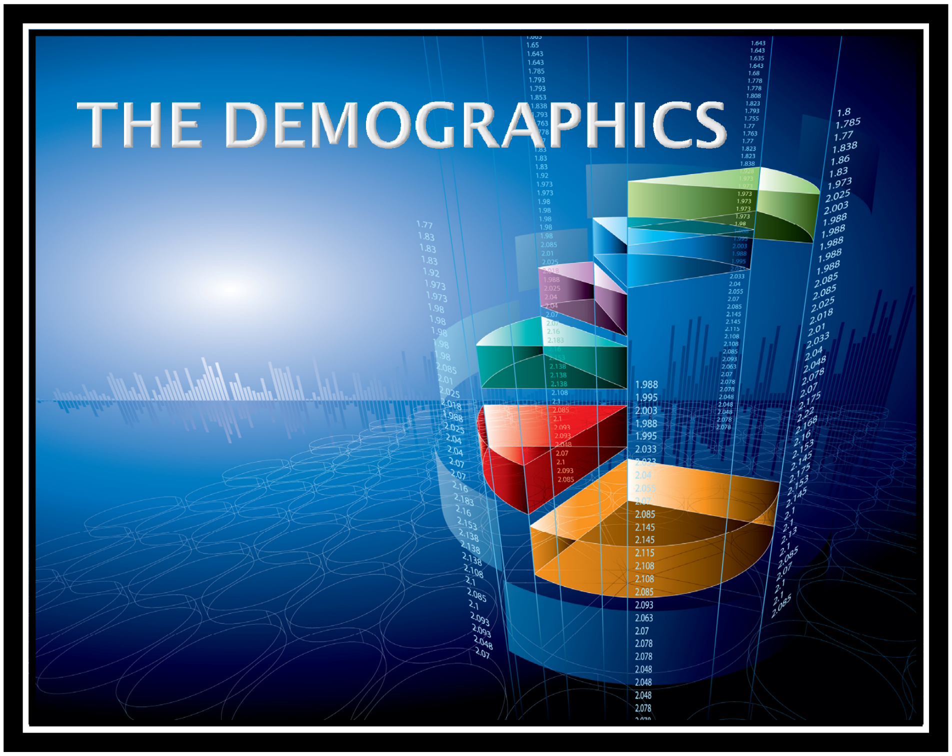
INSTITUTE

ELIMINATING LOSING FINANCIAL STRATEGIES



Demographics
The Changing Financial Landscape

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Intro

Your economic situation is a matter of choice, not a matter of chance. Misguided and self-inflicted, it is centered on the lack of knowledge. Driven by fear, cautious of change and paralyzed by perceptions, financial decisions are made by default, without knowledge, unaware of unintended consequences.

Today, the vast majority of people are troubled and confused about the economy. They have been bombarded by the media, bullied by sales people, and bewildered by the millions of things they feel they need to know. Over the past eight years, they have seen all the financial lessons they learned in the 1980s, 1990s and even recently, fail them. They know they can't live on four and five percent rates of return, yet they are scared and hesitant to make crucial decisions necessary to survive in today's economy. To make matters worse, right now, 90 million Americans are faced with the most critical investment challenges of their lives.[1]

We are going to shed some light on this darkness. We will break this problem down and analyze it carefully. Then, you will have a clear view of choices open to you. You will feel more confident and prepared to make financial decisions.

If something you thought to be true wasn't true, when would you want to know about it? That defining moment in your financial world comes with the understanding of the efficiency of money. It is a simple yet effective method of uncovering and reducing transfers of your wealth that occur everyday, unknowingly and unnecessarily. The financial savings are staggering.

Setting The Stage

Traditionally, we have been taught that there is only one way to make money grow: To get a higher rate of return on the money. But who is the one at risk in this quest? You, or the one making the recommendation? There is another way to make your money grow, but it is often overlooked. It is called the Efficiency of Money. To get a better understanding of this, you must look deeper to get a clearer view of what is happening in your financial world.

First, you must understand that there are only three types of money in your life . . . lifestyle, accumulated, and transferred money. Your lifestyle money is the money you spend to maintain your standard of living. Accumulated money is the money you try to save, and transferred money is the money that you spend and give away, sometimes unknowingly and unnecessarily. It is in transferred money where you lose most of your wealth. This is where your perceptions become greater than your knowledge.

There are many forms of transfers, but the largest by far is taxes. The average household hands out about 50% of its earned wealth for direct and indirect taxes. For whose benefit do we labor, ours, the banks', or the government's? Financial advice given by the government and the banks has created record profits for banks and record tax

[1] Maselli, Frank. Seminars The Emotional Dynamic. PowerSpeak, Inc., Franklin, Massachusetts, 1996.

revenues collected by the government. It is no longer enough to simply invest money without understanding the unintended consequences that will confront you financially in the future. Understanding the changes that are going to occur in the near future could dramatically affect any financial planning that you may have considered. If several years ago someone would have given us warning signs that the market would be depressed, that we would be involved in a war, that the Twin Towers in New York would be attacked and destroyed, that thousands of people would die, that we would have terror alerts every day, that entire industries would be near financial collapse, that scandals would rock Enron, Kmart, Arthur Andersen, WorldCom and the airline industry, would we have made some changes? Having that information in advance could have eliminated huge personal financial losses.

Today we have uncovered some of the problems that we will have to confront in the near future. They could affect your personal finances tremendously. Given this information now could help you eliminate or reduce future financial trauma. This is not about the financial products you own, rather what you know about controlling your money. Without this knowledge, you may simply become the perfect taxpayer.

One of the problems we have is that we confuse assumed rates of return with facts. A fact is something we know is going to happen. In preparing your financial future you need more facts than estimated guesses. Wouldn't you agree that having the facts would be a good place to start planning your financial future?

Demographics

In 3000 days, about two-thirds of the now-working population will be 60 years old or older. This is a certainty! Unfortunately, this leaves one-third of the now-working population to pay for all the government social programs for a majority of retired citizens. To compound the problem, the costs of social programs such as Medicaid, Medicare, and Social Security increase every year. This leaves little doubt that increased taxation will be needed to maintain these programs.

Increased life expectancy of retirees also adds to the cost of these programs. According to the 2000 U.S. Census, there was a 12% increase in people 65 years of age or older during that decade from 1990 to 2000. It is estimated that by 2040, the elderly population will represent 20.7% of the total population. The largest segment of the population that grew the fastest was people between the ages of 90 and 94, which increased 44.6% since 1990.[2] Overall, the number of people between the ages of 80 and 94 increased 25.7% since 1990. A 65-year-old woman in the U.S. as of the year 2000 could expect to live another 19.2 years and a 65-year-old man could expect to live another 16.3 years. In 1900, the average life expectancy was 47.3 years.[3]

This shift in the demographics creates other problems we must face. As elderly people retire, they have a tendency to shift their investments from stocks to more secure

[2] http://www.census.gov.
[3] http://www.cdc.gov/nchs/fastats

positions. Alan Greenspan addressed this issue in February 2002.[1] Greenspan stated that because of the demographics of the country, it will be a real challenge to maintain the value of these retirement assets. He states, "This ever larger retired population will have to be fed, clothed, housed, and serviced by a workforce growing far less rapidly. The retirees may have accumulated a large stock of retirement savings, but the goods and services needed to redeem those savings must be produced by an active workforce assisted by a stock of plant and equipment sufficiently productive to meet the needs both of retirees and a workforce expecting an ever increasing standard of living."[2] He goes on to say that ". . . the focus of the economy as a whole, of necessity, must be on producing the real resources needed to redeem the financial assets."[3]

In that same speech, Greenspan goes on to state that "[i]f the Social Security Trust Fund is depleted, the law requires that benefits are paid only to the extent that they can be financed out of current payroll tax receipts."[4] Do you really think a politician will allow this to happen? No, but it will take increased taxation and less benefits to keep them in existence. If retirees move to more secure investments, it leaves only one-third of the now-working population to buy the stocks being sold off. The problem is, when there are more stocks to sell than buyers to buy them, prices fall. Future retirement accounts could plummet again. Compounding this problem is the fact that companies rely on stock revenues for future research and development. This loss of revenue could stifle future economic growth and profits. Relying only on stocks for retirement could result in unintended consequences, caused by taxation, unstable market conditions, and the inability to maintain the value in stocks as we now know them.

Along with shifting age demographics, the government itself plays a role in diminishing our future wealth. Over the last 30 years, the only thing the government has done consistently is overspend the amount of money it has taken in. The government's central focus has become collecting revenues, a/k/a taxes. The government is very good at it, but the financial burdens are passed on to us. We are expected to follow the 47,000 pages of tax law under the threat of penalty or imprisonment. Another problem is that, in 3,000 days, there will be fewer workers to pay for the government's increases in spending, along with the cost of social programs. This will leave an enormous cost burden for the workers to pay, along with the challenge of trying to improve their own standard of living. Diminishing benefits and increasing costs will leave no one satisfied. To survive, the government will have to raise taxes. Let's take a look at what the government has said they have done to help us. Recently they raised the amount of money you can put into the government qualified retirement plans. Why? Why? Why? To secure your financial future, or theirs? It sounds like you will save on taxes but you

[1] Remarks by Alan Greenspan, *Saving for Retirement*, at the 2002 National Summit of Retirement Savings, Department of Labor, Washington, D.C., February 28, 2002.

[2]Speech on *Retirement Savings*, Alan Greenspan, February 28, 2002.

[3]*Id*.

[4]*Id*.

most likely won't. We have left it to them to decide at what rate they will tax this money in the future when we retire. Will it be lower, likely not! Just look at the dilemma they have created for themselves. This is imperative: DO NOT BECOME THE PERFECT TAXPAYER.

If We Know Something For Certain

Once again, why did the government recently increase the levels that an individual can contribute to 401(k) plans and IRAs? Was this change initiated because they were concerned about your financial future OR THEIRS? They already know they are going to need larger pools of money to tax at whatever rate they can justify to finance the government's future liabilities. Read that again. They will tax retirement incomes at the highest rates achievable without jeopardizing their chances to get re-elected. A 401(k) or IRA simply defers taxation to a later date. It would be a different story if the government would guarantee that you would be taxed at the same tax level you were at when you put the money into these plans. Will they ever do that? No! They need and want as much of that money as they can get.

I can still hear the words echoing in the halls of financial wisdom "You will probably retire to two-thirds of your income, and thus be in a lower tax bracket." Don't count on it! First of all, if you're working with a planner whose goal (because it's easy to achieve) is to retire you to two-thirds of your current income, do yourself a favor and fire him. They are telling you to retire with less money so you pay fewer taxes. Not a great solution. When you add the changing demographics, do you really think that, at any level, taxation is going to be lower in the future?

Now let's look at government spending. To get current levels of the public debt, go to: http://www.publicdebt.treas.gov/opd/opdpenny.htm. There, the current public debt of the government is listed daily. Look for the years in which large government surpluses were proclaimed and look for payments against this debt. Can you find any?

2009	$12,011,838,881,463.68
2008	$10,699,804,864,612.13
2007	$9,229,172,659,218.31
2006	$8,635,596,937,286.06
2005	$7,932,709,661,723.50
2004	$7,379,052,696,330.32
2003	$6,783,231,062,743.62
2002	$6,228,235,965,597.16
2001	$5,807,463,412,200.06
2000	$5,674,178,209,886.86
1999	$5,656,270,901,615.43
1998	$5,526,193,008,897.62
1997	$5,413,146,011,397.34
1996	$5,224,810,939,135.73

[1]http://www.publicdebt.treas.gov

Now do you think that with this increasing debt to be paid, and the changing demographics of the country, that future taxation will be lower?

People should be hesitant to put money into government-sponsored retirement plans (401(k)s and IRAs) at a 28% tax bracket, knowing that upon retirement the tax levels could be, at that time, 35% or higher. Is that a 7% increase in taxes? No, that's almost a 30% increase in tax levels. Planners often recommend maximizing these plans without telling you about future demographic complications. The unintended consequences are lurking in the shadows. Why? Because some planner has determined that this information wasn't important for you to know. One thing you do need to know for certain, taxes will be waiting for you in the future. There will be fewer workers and more retirees and continued increases in government social programs and spending. That's for certain!

Doctor, It Hurts When I Do This

If it hurts you, don't do it. The government's doctor says don't worry about the pain (paying unnecessary taxes) keep doing it until you die. Even then, taxes will be due but at least you won't feel the pain. Today, you need more knowledge so you are capable of making better financial decisions. The more you know the less pain you will suffer financially. The solutions to a rewarding financial future are not found just in the stock market. But that's what most people believe. Why? Because that's all they know. IT IS DIFFICULT TO GET THE RIGHT SOLUTION WHEN YOU START OUT WITH THE WRONG PREMISE. Unless you work with someone who understands demographics and other wealth transfers and helps you eliminate or avoid them, your financial problems will continue and will compound and that is truly unfortunate.

Remember Who You Are

Not only must you invest wisely but you must learn about the *Efficiency of Money* and wealth transfers. Your investments must be intertwined with these lessons to maximize your wealth no matter what level of wealth you are at. REMEMBER: The government sees you as a taxpayer. The bank sees you as a borrower. Investment companies see you as a fee payer. If you don't utilize the lessons of efficiency, these organizations, the government, the banks, and investment companies, will be first and foremost in your entire financial life. There will be no financial freedom until you can loosen the burdens in dealing with them.

The Last Picture Show

Imagine taking your spouse and kids to see a movie. You go into the theater, buy some popcorn and snacks. You find seats with no tall people in front of you and you start to relax. Looking around you notice an IRS agent that you're acquainted with. His family is with him. You continue looking around the theater and you notice your banker and his family are also there. A few rows behind them are your investment broker and her family. What a small world! The lights dim and the movie begins. About five minutes into the movie an usher comes down the main aisle and the lights come up. "Ladies and gentlemen we have a problem. There is a small fire in the lobby and we want everyone to leave calmly using the emergency exits." You're stunned. You look at your spouse and kids and say, "Don't worry, everything will be okay. Wait right here for one minute." You run over to the IRS agent and his family and help them out of the theater. Running back to your family you say "just one more minute," and you run back to help your banker and his family to the exits. This time on your way back you don't even stop at your family but simply give them that gesture with your index finger meaning you'll be right back. You continue running to assist your investment broker and her kids out of harms way. Finally, you get back to your family to secure their safety. They have that dumbfounded look on their faces and you realize you may have lost a few votes for the Parent of the Year Award.

First, Not Last

This story may be irrational from a humane, loving standpoint. But from a financial standpoint, it is very true more times than not. The government, the banks, and investment companies have remedies to make sure that, in the event of something happening to you, they will still get paid...FIRST. Your family's outcome is of little consequence to them. Sustaining their financial future is more important to them than yours is. You must learn financial concepts and ideas that will put you and your family and your financial goals first. You must develop liquidity, use, and control of your money. You must also learn about lost opportunity cost. These concepts will increase your wisdom in making financial decisions. Knowing this, the next time your family is faced with a crisis or even new opportunities they will be first, not last.

You're Hooked

Nevertheless, we continue to load up 401(k)s and IRAs without any clue what future tax rates on these programs will be. The government is like a casino owner, they know they are going to win. You must learn the difference between government debt and government deficit. You must also learn and know how to plan for retirement besides using government-sponsored programs.

Handwriting On The Wall

The government knows it is between a rock and a hard place on the issue of Social Security. Greenspan's comments are an "I told you so" type of statement. "In addressing the impending retirement of those born just after WWII, we will need to consider whether Social Security should better align itself with the funding provisions of our private pension and annuity system. Policy makers need to consider these issues now if we are to ensure a comfortable retirement for the post-war generation, while at the same time according due consideration to the needs of the later generations that now make up our work force."[1]

The problem is the politicians spend our Social Security revenues faster than they are collected. If they would create a Social Security system with a public investment option, the government would lose control of that money. Remember, they consider it *their* money, not yours.

They Do It Well

In recent years, the government has become obsessed with imposing and collecting taxes. The collection of taxes has become job one and they do their job well. We are now being taxed at the highest levels in our history. Yet, even after collecting historical amounts of revenue in the form of taxes, the government continues to outspend these revenues and posts record amounts of debt. Even with all the proclaimed surpluses of the 90's, neither did taxes go down nor did government debt. In recent years, taxation has grown 42% faster than incomes.

One could argue that we have experienced tremendous growth in our standard of living. However, those increased standards have been fueled by a record amount of personal debt. Personal bankruptcies are at all time highs along with credit card debt. For the last several years, the average household has saved at a negative rate. Any sustained economic downturns or lethargic stock market results, or both, will do serious damage to future savings. Even though market losses can occur at any time, taxes will continue to increase. Why? Because they have to. The demographics of this country demand it.

Demograph X

Without understanding the demographics of our society, any attempt to financially plan our future will be doomed and filled with unintended consequences. My spelling of *demographX* with an "X" represents a missing factor. The "X" represents all the necessary changes that will have to be made by the government in order for it to survive. This will dramatically affect our personal retirement wealth. Demographics

[1] *Id*.

have been basically ignored in most financial planning. This will create major flaws in any future financial projections, and could leave us exposed to many financial hazards. Not only will it be difficult to achieve the goal of preserving our own financial future, we must also provide for the government's ever increasing financial future. Even with very clear warning signs, the government continues in its record levels of spending. The debt of the nation continues to spiral upward, out of control, for future generations to figure out. Let's face it, the only power our Federal Representatives have is their ability to spend our money and we have given them a blank check to do it. If I could tell you the exact day that your retirement account will suffer its greatest losses, would you want to know that day? Then, in having that information, if you could do something now to prevent those losses, would you do it? You see, the day you retire and start receiving income from these accounts is the day your retirement accounts will suffer their greatest losses due to taxes.

Another victim of the changing demographics could be the housing industry. The idea that the value of homes will always increase is wrong. People today often miscalculate the increased values of their homes. They don't take into consideration the cost of maintenance, improvements, insurance, and taxes that are paid while they live there. The average homeowner may experience only a 2% or 3% growth rate of return, even though the value of their home may have increased by 40% in a ten year period. The numbers can be deceiving. As an example let's take a couple who purchased a small starter home ten years ago. The purchase price of this home was $110,000. Today, ten years later, the home is valued at $150,000. Overall the couple believes that the value of their home increased over 30%. They would also agree that while they lived there they also spent another $5,000 on the home for improvements and maintenance. In reality the annual rate of retire in the growth of the value of their home for those ten years was 2.69%. Remember this doesn't include the cost of the property taxes and insurance. The inflation rate alone generally averages between 2.5 – 3.0%. Yet this couple had been led to believe, by everyone, that buying their home would be one of their greatest investments.

Getting Older

After all, a 6,000 square foot home requires a lot of maintenance and upkeep, not to mention the increasing cost and upward-spiraling property taxes. If the aging population sells their larger homes and builders continue to build larger homes at a record pace . . . who will buy them? The younger generation?

In 3,000 days, with two-thirds of the now working population being 60 years old or older, we will be dealing with a smaller number of new buyers. This young group of buyers will also want to build new homes for themselves. This will create an overabundance of larger homes in the marketplace. The rules of supply and demand may take over. Too much product and not enough buyers equal lower prices. The government and the banks will have to get more creative when it comes to buying a home. After all, this is a source of revenue for both of them. Having this information, it may not be in your best interest to pay your house off as fast as you can. This could cause major unintended consequences in the future. The key is to maintain liquidity, use and control of your money. Owning a home is the most misunderstood American dream. You should look at home ownership very carefully, and understand your options. If the experts giving you advice could be proven wrong, would you want to know about it? Your dream home could be a financial nightmare.

These are a few of the many demographic changes that could affect your finances in the near future. Following a natural and logical course of events, these things we discussed will most likely happen. Their effect on your current financial planning could leave you exposed to financial loss. Your exposure to these losses is a matter of choice, not a matter of chance.

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