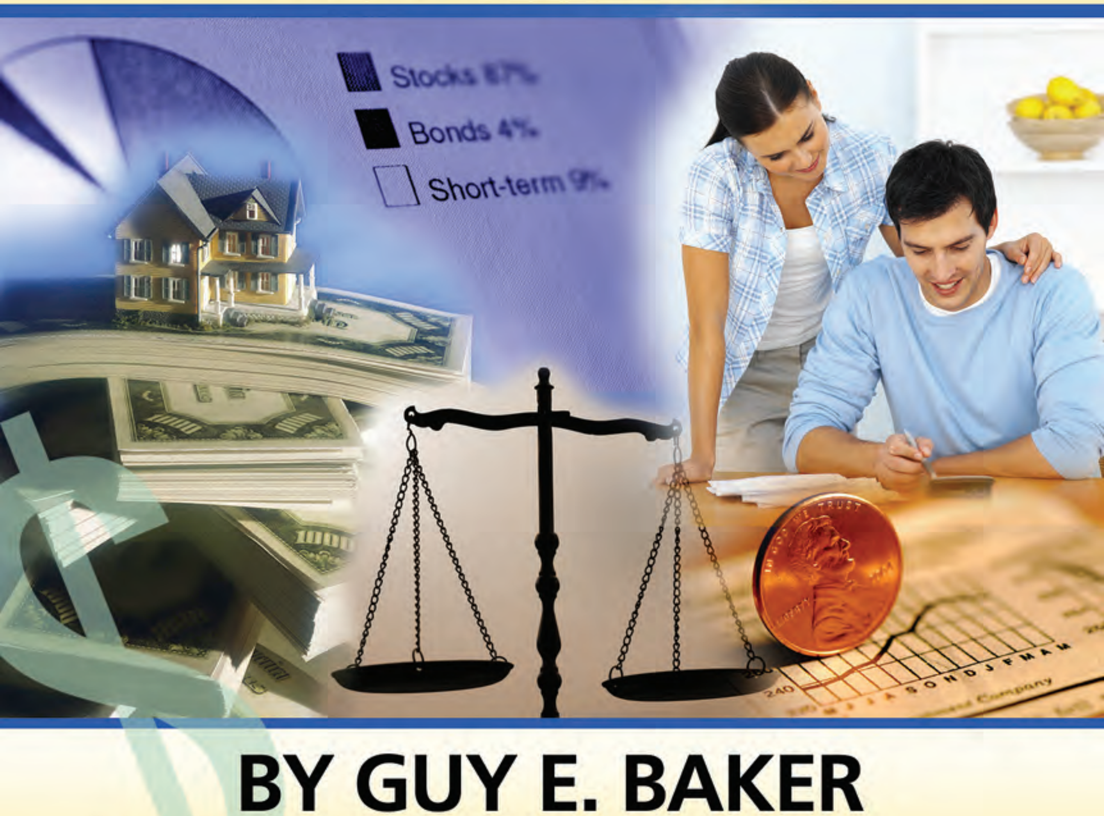
BAKER'S DOZEN

13 Effective Principles for Financial Success



BY GUY E. BAKER

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13 Effective Principles for Financial Success

By Guy E. Baker

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To my wife Colleen,
my partner in life

OUTTAKES

I FIRST WROTE BAKER'S DOZEN in the early 80's, but I didn't actually publish it until 1995. Since then we have sold over 5,000 copies through seminars and industry advertising. Fortunately, I have received incredible feedback from people who have taken the time to actually read this book.

One of my favorite stories occurred when I was meeting a very successful businessowner. We had sent him a copy of the book to demonstrate how we think. When I walked into his home, he bounded energetically out of his office and extended his hand in congratulations. He told me he loved the book and wanted six more copies to give to some of his friends. Heady stuff for a new author.

Writing a book is very rewarding. However, there is a vulnerability too. What if people don't like it? What if there is a glaring error? What if people think you are stupid? Crazy thoughts roll through your mind. In the end, you simply finish and cast it out into the world and hope that it is well received.

I suppose every writer's goal is to get positive feedback. "Oh, it changed my life." "This book is one that everyone should read." Dreams of appreciation and adulation dance in your head. But in the final analysis, all you can do is finish it and try to distribute it.

Talk about a challenge. Once you have completed the book and received positive feedback, how do you get the word out that you have a book worth reading? Besides advertising in trade journals and selling it from the back of the room at seminars, the only alternative is to put it in bookstores and catalogs. There are many book distributors and several direct distribution channels. But getting their attention and having them actually buy volumes of your book to place it in the markets and bookstores is a difficult task.

I am sharing this insight to give you some idea of what happens on the other side of these pages. A writer's most cherished asset is the reader. The fact you have taken the time to buy this book and then invested the hours needed to read it is remarkable. It is the ultimate compliment to have the reader actually like the book.

Outtakes

I have added a few refinements since the original edition, not because my principals or thinking have changed but because I have gained more insight and understanding. One of the most important additions came as the result of the financial dysfunction we experienced in our marriage. Colleen and I had a difficult time managing our spending because we spent money so differently. I would make a decision to make a large purchases and then be done spending, while she would make a series of small purchases that seemed never ending. Her manner of spending was so painful to me—like being stabbed multiple times. In Chapter 2, I share how we solved this problem. The solution made both of us very happy and it turned a difficult point of conflict into a win/win situation for both of us.

Another addition is compound interest. When I wrote *Investment Alchemy,* I spent considerable effort explaining what I have learned about compound interest through the years. By adding this explanation to *Baker's Dozen,* I feel like I have covered the waterfront on this important subject.

Other than those changes, the book is pretty much the same book I wrote on the beach of Maui in 1985. But what took less than a week to write in 1985 has taken nearly 10 months to polish and complete for the 3rd printing. And now we are in the 4th printing of the boo. With rereading, rewriting and editing, it seems the process is harder than the creation.

Having said that, you can well imagine that a lot of work by some very special people must have taken place. And it did. My thanks and sincerest appreciation to both Jill Boocock and Ken Harris. Jill diligently and lovingly read and reread every word (how boring). She carefully edited my thoughts and ideas to keep my tone and structure and to make certain I didn't look like I was ignorant of the rules of grammar and spelling.

Ken patiently prepared the art work and handled the printing and graphic design. Without him and his staff, this book would be nothing but words with no cohesive theme or style. Debbie Brown, spent hours inputting the changes and finalizing the graphics.

All three worked beyond the call of duty to bring this new edition to actualization. I truly appreciate their dedication and desire to see this project completed as much as I did. God Bless you all.

LONG BEFORE GEORGE WASHINGTON ever thought about throwing his silver dollar across the Delaware, America's investors were throwing money around trying to find the key to financial independence. The financial objectives of Washington's forefathers not only led to some pretty crazy scams, but also resulted in significant losses. While most investors have sought their fortunes through conventional methods, such as stocks, bonds, business and real estate, many have been suckered into get rich quick schemes.

A Baker's Dozen: 13 Principles for Financial Success is a book designed to provide financial guidance, not investment advice. By revealing these timeless principles, which are as applicable now as they were before Washington's day, I hope to affect positive change in your financial life. If you will follow every one of these principles, you can attain your financial objectives and build security and independence.

THE BAKER'S DOZEN

1. Establish a Consistent Savings Plan
2. Control What You Spend
3. Only Use Debt for Leverage
4. Set Lifetime Goals and Investment Objectives
5. Make Your House a Profitable Investment
6. Guarantee Your Family's Security
7. Don't Be Greedy
8. Invest Wisely and Don't Spend the Money Money Makes
9. Study How Others Have Made Money
10. Invest in Who You Know and What You Know
11. Invest Regularly and Diversify Your Risk
12. Constantly Review Your Progress and Your Goals
13. Wealth is a State of Mind

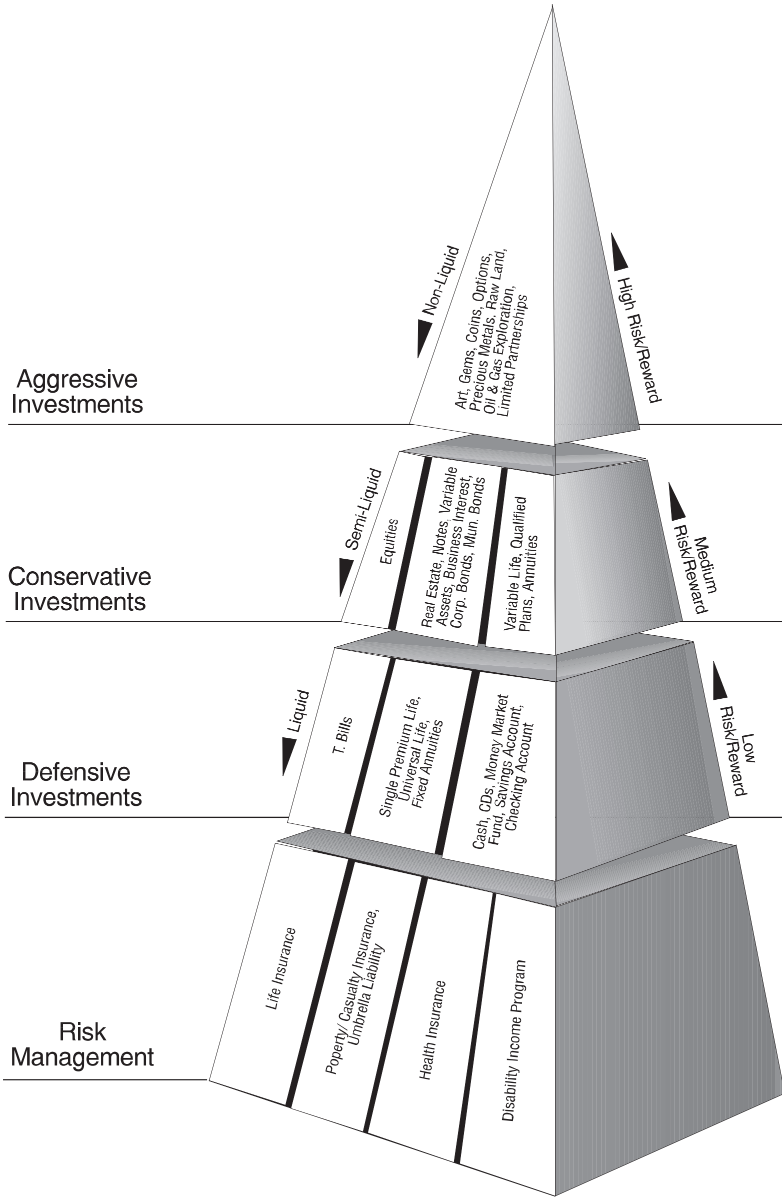
Is it really possible for a book to help anyone build wealth? Certainly, but the first two questions, you, the reader should ask, me, the author are: “What are your credentials to write a book like this?” and “Is your message based on personal experience, knowledge, skill, ability, or just plain arrogance?” My credentials come from knowledge and direct experience. I have personally participated in many different types of investments. And, like most investors, I have made bad decisions and sold some investments prematurely or too late. I have sold high and I have sold low. There have been very few times I haven’t suffered buyer’s remorse. And there have been times when I purchased based totally on emotion.

You’ll be relieved to know that my greed juices flow unabated when I hear about a “good investment” opportunity. I have allowed greed to overcome any good judgment I have and have jumped at a most promising investment only to find disappointment and loss waiting at the other end. I have been cold called and conned by blue sky artists, and approached by people peddling some of the most absurd schemes. My credentials are that, without fail, every time I have not followed the 13 principles detailed in this book, I have met with failure and/or extreme financial stress. While these principles will not guarantee immunity, they will provide a framework for your financial success.

One of the most important lessons I have learned is the TINSTAAFL theory of investments, (There Is No Such Thing As A Free Lunch). It taught me how the world worked. Everything has a pricetag. Once you understand what the pricetag is, then you can evaluate whether or not it is equitable.

The lessons I learned from these investment adventures, only reinforced the wisdom of these 13 principles. I need to assure you that this book is NOT about how to select a good investment. It is NOT about the pros and cons of various alternative investments. It is NOT about winning the tax game. It is about how to prepare mentally to make good investment decisions and achieve financial success, even if you have been a victim of past financial failures or succumbed to pressure tactics in the past. The chart on the next page illustrates the financial pyramid—the hierarchy of investments. Notice that as the rate of return rises so does the risk. Too often,

Financial Success Pyramid



investors ignore risk, seeking instead, to enhance the rate of return. This simple principle will be discussed in detail in principle 7 and 8.

The book also addresses some of the myths of financial success. Many years ago I read in the Wall Street Journal about a young schoolboy in Japan who was praised by his teacher for his excellent school work. However, his classmates sneered and degraded his achievements. They said he was only successful because of the "FOXES." Ashamed and confused by their mysterious accusations, the student finally asked his father what his classmates meant by the foxes. But his father wouldn't tell him. Frustrated, the young boy did receive an explanation one day from the family gardener. He told the boy that for centuries, their family was suspected of harboring witches and sorcerers. It was believed they had kept demon foxes in their palaces and according to local superstition his family sent magical creatures on wicked errands to enhance the family status by stealing and creating hardship and illness among the neighbors.

This boy's family was not the only family to be accused by the villagers of being fox owners. Tens of thousands of fellow Japanese families have been plagued with this same hereditary pox.

Why foxes? Interestingly, these innocent creatures have played a major role in Japanese folklore and religion for centuries and are often viewed as possessing magical power to bewitch people. These fears are steeped in Japanese history. Money was a puzzling nuisance to the 17th century Japanese. As transportation on the island nation improved, outsiders began to move into the traditional rice-growing regions which caused an economic shift from the residents to the newcomers. Unable to understand the economic shift, the elders resorted to explaining the phenomena of making money by attributing these abilities to "extraordinary and mysterious powers." These were the ingredients for legends and tales.

Today, the legend is dying…slowly. But even in modern Japan, the foxes are still blamed for unexplained fate and financial failure or success of many families.

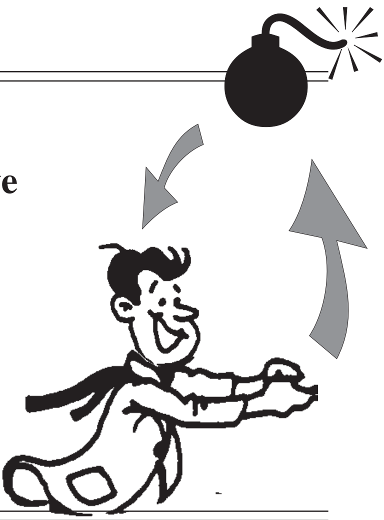
In the USA, the financial success of some, is explained by equally farfetched rationalizations—our equivalent of "demon foxes," if you will: "It takes money to make money." "There is no

Financial Principles ARE NOT:

1. Get rich quick schemes
2. Knowledge of various investments
3. Learning the tax rules

Financial Principles ARE Like The Natural Laws of Science:

There are Irrefutable,
Immutable Laws of Money



Many financial principles have a scientific corollary:

Gravity ➟ What goes up must come down.

Centrifugal Force ➟ What goes around—comes around

Just Remember:

In order to truly prosper you must:
(1) be patient,
(2) respect the rights of others, and
(3) deal with integrity.

wealth like inherited wealth." "Money brings happiness." "Money is the root of all evil."

Despite the voluminous number of American success stories, many people today, especially our youth and even some of our own elders, believe that the streets of America are no longer paved with gold. Instead, they believe that the only way to achieve financial success is to be born into it or steal it. They have adopted the "golden rule." Those who have the gold make the rules.

My message is to ignore the fatalists. Believe you are responsible for your own financial destiny. No matter how much you may wish things to be different, wishing will NOT make it so. There are immutable laws of wealth which have existed since the beginning of the barter system. Just as there are immutable laws of nature, these financial laws protect us from greed and random investment decisions. The TINSTAAFL theory is only one of them. In fact, the wasted efforts of wishing things were different are self-defeating and will only cause you to expend valuable effort needlessly. The way to make a difference is to affect change in your own life.

That's why this book was written! It was written (1) to teach you basic principles of financial management, (2) to help you gain insight into the methods of attaining financial independence, and (3) to create a basic understanding which you then can share with others. It was written to provide protective principles for financial success and attempts to eliminate any fear caused by your own "demon foxes." These principles WILL improve the financial life of anyone who applies them with diligence and persistence.

THE PURPOSE OF THIS BOOK IS TO:

1. Teach basic principles of financial management.
2. Provide insight into the methods of attaining financial independence.
3. Create a basic understanding which can be shared with others.

Outtakes II

Have you ever noticed how most financial books are how-to's: HOW to invest, HOW to buy real estate, HOW to make $2,000 a day in your spare time. Few books present principles that are easy to understand and apply. The forthcoming 13 principles are the result of over 40 years of personal experience and research. They may be initially difficult to apply because each requires determination, commitment and follow through. There is a discipline inherent in them which is counter to most investment teachings. In fact, the underlying theory of each one is so ancient, it can be found in the Bible.

So sit back, relax. Get to know these principles of financial independence. I've included a chapter on…

A Baker's Dozen

13 PRINCIPLES OF FINANCIAL SUCCESS

WHETHER OUR ECONOMIC TIMES are characterized by rising prices or falling prices, by recession, depression or stagflation, or just plain panic, it is clear there are investors who profit by being prepared to take advantage of any or all situations. Many investors make money or successfully preserve their capital, regardless of which way the economy turns. In all types of economies, investors successfully make money in penny stocks, fixed income stocks, and quality common stocks. There are investors who insist the only investment philosophy is diversification through balanced mutual funds. Still others buy only index funds while another might concentrate on small company funds. And of course, there are those who only buy debt instruments.

Besides the stock market, there are many other ways to invest. Real estate developers and investors often try to take advantage of depressed prices and high interest rates to capitalize on the losses suffered by others. Real estate has made paupers of some and geniuses of others. What's the point? There are as many ways to make and preserve a fortune as there are ways to lose it.

A review of economic history has uncovered some of the methods used to attain financial success, but hindsight is virtually blind to the future. Why fortune has smiled on some and destroyed others is anyone's guess. But if you know the basic principles of financial management you will begin to see a pattern. The most important point is for each of us to realize these rules or principles can be applied by anyone, at any age, from any walk of life, to any set of financial objectives. The key word here is APPLICATION. Without dedication, commitment, determination, discipline and sheer courage, financial success will remain elusive. You don't have to be smart to be financially independent, but you do have to be disciplined.

In order to successfully manage the financial growth of your assets, it is important to have a plan. My wealth management model, The BUCKETS, demonstrates steps which I learned and took as a young child. You can take them as well—regardless of your age. But it is only one plan—there are other plans. The important thing is for you to have a plan and then work your plan.

"So where do I start?" The most important first step is to determine your GAP. A GAP exists between what you have and what you need—the two great questions in life. Everyone has a GAP. In order to manage that GAP, you need to first establish a

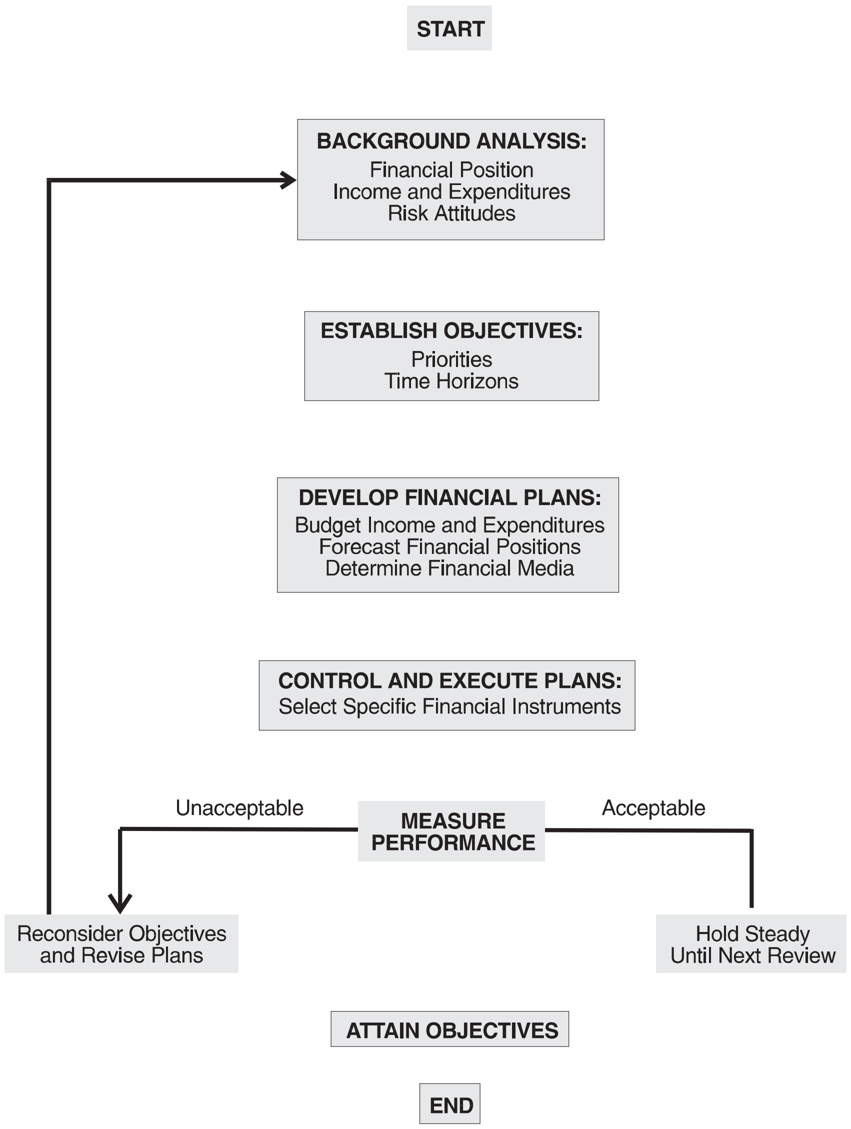
Rules of the Money Game

Rule #1: Never break the chain of compound interest.
Rule #2: Money usually grows faster TAX FREE.
Rule #3: Ultimately, all of what you have is not yours.

Government's Influence

What you may think you have → **minus** → The part you must leave behind → **equals** → What's left for your family

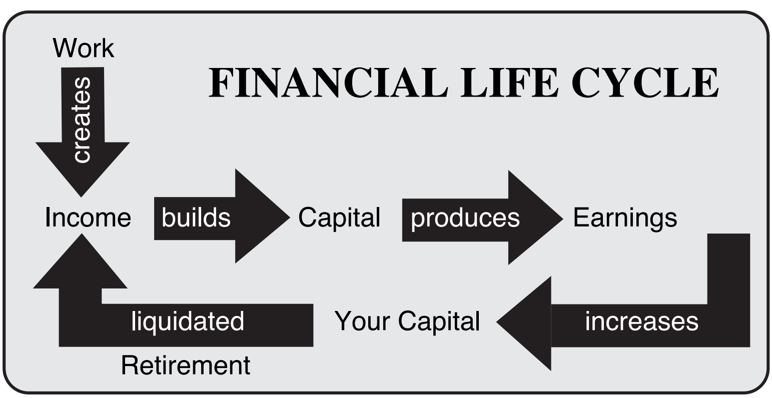
Wealth Management Model



factual picture of your current situation. As you'll discover in Principle 2, understanding your spending behaviors is a very important aspect of this analysis. Judicious management of your cash flows eventually can create investment capital. But what are you going do with this capital? Then you have to set a target. You must realistically establish specific financial goals and objectives for your life. Your financial goals then determine your investment strategy. Every book on financial planning will tell you to set goals. Yet, seldom do people actually do it. Even fewer establish a plan and follow it. Instead they approach their financial wellbeing with less effort than they apply towards planning their next vacation. The result is often chaos.

You might ask why I say this? Let's set a simple benchmark—to have ONE MILLION DOLLARS at age 65. This might amaze you, but if a 21 year old will set aside $2,000 a year (that's just $180 a month) for only 10 years—and earn 8.5% annually, he or she will have $1,000,000 at age 65. What 21 year old couldn't save $180 a month if they were motivated to do so?

Once you define your GAP and set a target, the next step is to create a model which will take you are to your objectives. But before you can blindly begin following a plan and begin investing, it is important to assess the important risks you face. You will learn about five primary risks in Principle 8. In addition, you may want to read my other book, *Investment Alchemy*. This book details principals for creating a successful investment portfolio.



Principles 6, 7 & 8 are all about execution. It is important to thoroughly understand the correlation between risk and reward. Principles 9 & 10 reviews how others have successfully followed these principles. But more important, I will guide you through the alphabet soup of professional designations. In today's world, there are many who would like to help you earn money. So it is important you find someone you can trust, who knows what they are doing and will apply sound principles to your plan.

Once you are your way, you must continually review your progress, (matching the flow chart of your plan to your goals). Principles 11 & 12 reveal important aspects to consider as you move down the road toward your objectives. A 43-year-old dentist once lamented that he didn't understand what right a nineteen year old had to determine what he was going to be doing with the rest of his life. Yet, we often make irrevocable decisions before we know or understand the consequences. It's okay to re-evaluate your course periodically and even change it if you need to.

This book will also show you the Rules of the Money Game. Rule #1 says, "Never break the chain of compound interest." It is better to earn nothing than it is to lose capital. Once you break the chain of compound interest, you go back to the beginning and you have to start over. Rule #2 should be obvious. Taxes take a significant portion of the yield from your earnings. If you can compound your money tax free, then your money will grow that much faster. Our 21 year old must DOUBLE his savings to reach $1,000,000 if he is in a 25% tax bracket. So tax wisdom is crucial. Rule #3 is the most insidious. After you work a lifetime to earn your money, nearly half of everything you have accumulated will have to be liquidated or confiscated by the IRS. If our current estate tax laws aren't changed, 55% of everything you have over $2,000,000 goes to the government in taxes.

Understanding and mastering these rules is the key to successfully winning the Money Game. What most people don't understand is that many taxes are optional. By that, I mean you don't have to pay them to the IRS. Rather, each of us has a choice of paying them to the Government or to a charity which we name. Winning the MONEY game is all about planning.

On the next page are the ten most often expressed financial concerns. Take a pencil and mark each concern based on how important each one is to you. Then add up the points.

If you totaled less than 30 points, you are either in complete denial about your financial life or have your financial world well under control. Between 31 and 50 points you need to establish a plan of action and pay attention to the specific areas where you indicated a high degree of concern. Between 52 and 75, indicates you are a strong candidate for a financial planner. Above 75, you are probably a compulsive spender and need to go to Overspending Anonymous. Just kidding! Actually, there may be elements of this questionnaire which you don't understand. If that's the case, you should probably seek professional financial counseling immediately.

Before we go to the first principle, it is important to look at the law of money—and what I will call the money cycle. Unless you are born wealthy, you likely have to work to earn a living. We do this by getting a job. Along the way we might get married, have kids, etc. Any surplus from our income is then invested to create long term capital. This capital earns income and hopefully is reinvested to build additional capital. But eventually, a time comes when our income stops and the money, money earns must replace our inability to earn an income. In many case the loss of income necessitates a systematic liquidation of capital to maintain our targeted standard of living. Thus there is a race between life expectancy and our capital.

This LAW is immutable. Unless we are able to plan effectively now, each of us will face the pain of managing this problem when we are too old to do much about it. I wrote Baker's Dozen to help you understand this LAW—to start planning now to avoid the consequences of this law—and to close the GAP between what you have and what you need. I hope when you finish reading this book, you will be equipped with financial tools and knowledge that can help you avoid the penalties and consequences of this law.

Now that you understand this immutable LAW and how it applies to the money cycle, let's now look at the first principle…

The Ten Financial Concerns Summary

	Little or No Concern			Moderate Concern				Of the Utmost Concern		
1. Inflation Hedge	1	2	3	4	5	6	7	8	9	10
2. Tax Advantages	1	2	3	4	5	6	7	8	9	10
3. Leverage	1	2	3	4	5	6	7	8	9	10
4. Safety	1	2	3	4	5	6	7	8	9	10
5. Liquidity	1	2	3	4	5	6	7	8	9	10
6. Diversification	1	2	3	4	5	6	7	8	9	10
7. Professional Management	1	2	3	4	5	6	7	8	9	10
8. Income Now or Later	1	2	3	4	5	6	7	8	9	10
9. Financial Independence	1	2	3	4	5	6	7	8	9	10
10. Completion of Financial Plan	1	2	3	4	5	6	7	8	9	10

CIRCLE the degree of your financial concern for each of the 10 items above. This will give you a quick review of your profile of financial concerns; the higher the cumulative total, the sooner you need to start planning; tomorrow, look at the choices again. What would you change? Why? Finally, look at this list from time to time to see if your concern levels have altered at all. If they have, what have you done (or should you do) to adjust?

CHAPTER

1

Establish A Consistent Savings Plan

"AAAAGH," YOU SAY! "NOT SAVINGS! I've been told I have to save money all my life. I just hate it. Why do all financial principles seem to start here?"

Now, you may be one of those rare individuals who is already a successful saver. Whether you are or you are not, I don't think any book on the principles of financial success could start any other place. Financial success starts by understanding the first universal law of wealth—accumulation. It is the foundational principle of financial independence. In order to achieve financial success, you have to develop the proper savings ethic. This is a well-documented economic fact. But before we look at any methods for developing a savings ethic, let's study the sources of income.

THE SOURCES OF MONEY

There are two primary sources of income; man at work and money at work (this is man in the sense of all mankind—man or woman). Obviously, people earn an income by rendering services. The more skills you have, the higher you are paid. All you have to do is look at the list of the highest paid executives in America to see that certain jobs dictate incredible incomes. Whether the employee is the president of a large public company or a popular athlete, the pay is dictated by the value of the individual and the job requirements.

The highly paid are compensated for the skills they bring to the job, as opposed to those who are being paid based on the value of the job irrespective of their skills.

MAN AT WORK

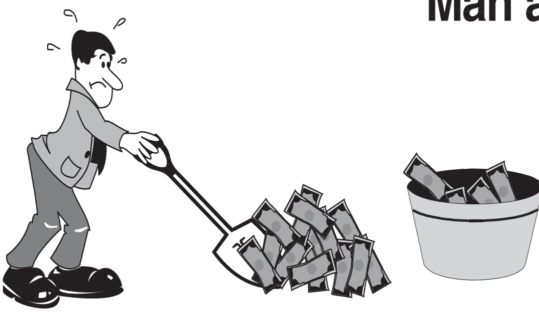
Ever wonder what the motivation is to get up every morning, get in the car and head to work? For most, the goal is to earn enough money to pay bills and have something left over for fun—vacations, toys, clothes, etc. The economics of earned income, derived from man at work, is easy to understand. The more an individual can contribute to his job, the more valuable he becomes. Hence, the more the person can earn, as management recognizes the person's contribution to the success of the organization. In fact, the government even subsidizes additional education, if it is job related, through tax deductions. Obviously, if a job is the sole income source, then you must enhance your value—create your own "dividends" by increasing your value. Deriving surplus from earned income is the beginning of financial independence for most people.

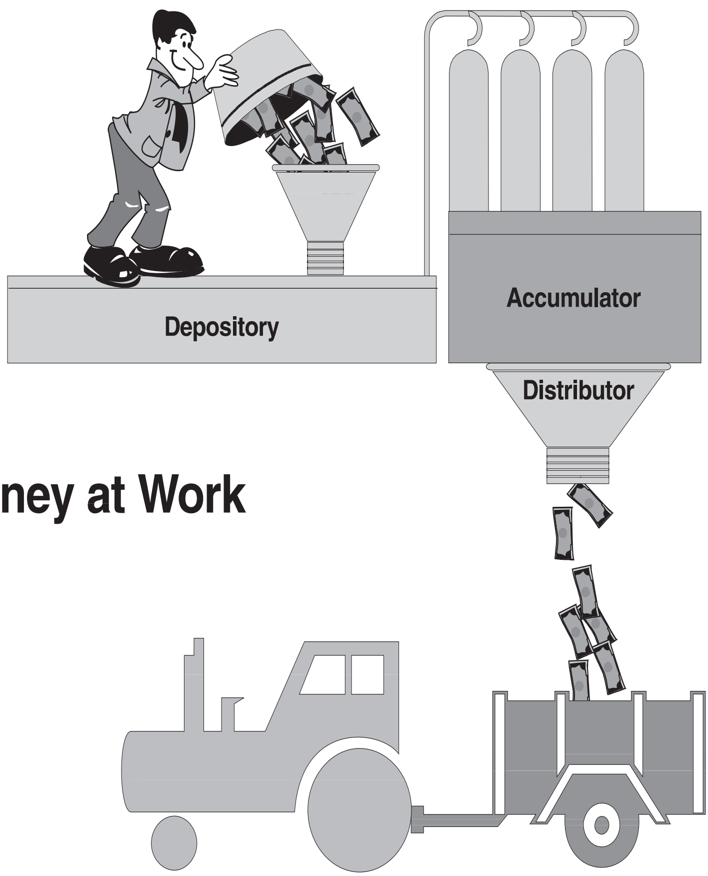
Unfortunately, there is no way most wage earners can become wealthy by just earning a salary. By the time taxes and inflation erode the purchasing power of their surplus (even with raises), most wage earners are left without much to show for their efforts. The age-old battle is to find a way to put some of that surplus income aside so you can create capital. Unless you can overcome the inertia you are doomed to living month to month. The only solution is to convert income into capital.

MONEY AT WORK

Money at work results from the income others pay you to use your capital (rent or a risk premium for investing in the growth of the company). Wouldn't it be great to have $200,000 of annual income which was completely risk proof and you knew would be there every year without fail? Capital, if invested successfully, is rewarded by earning a steady income. Another way to say this is that income and growth is generated if the investment's value is desired or required by a willing user. For instance, stocks pay an income (called dividends). If the corporation earns enough money to make a profit, the Board of Directors may vote to give a dividend to

Man at Work





Money at Work

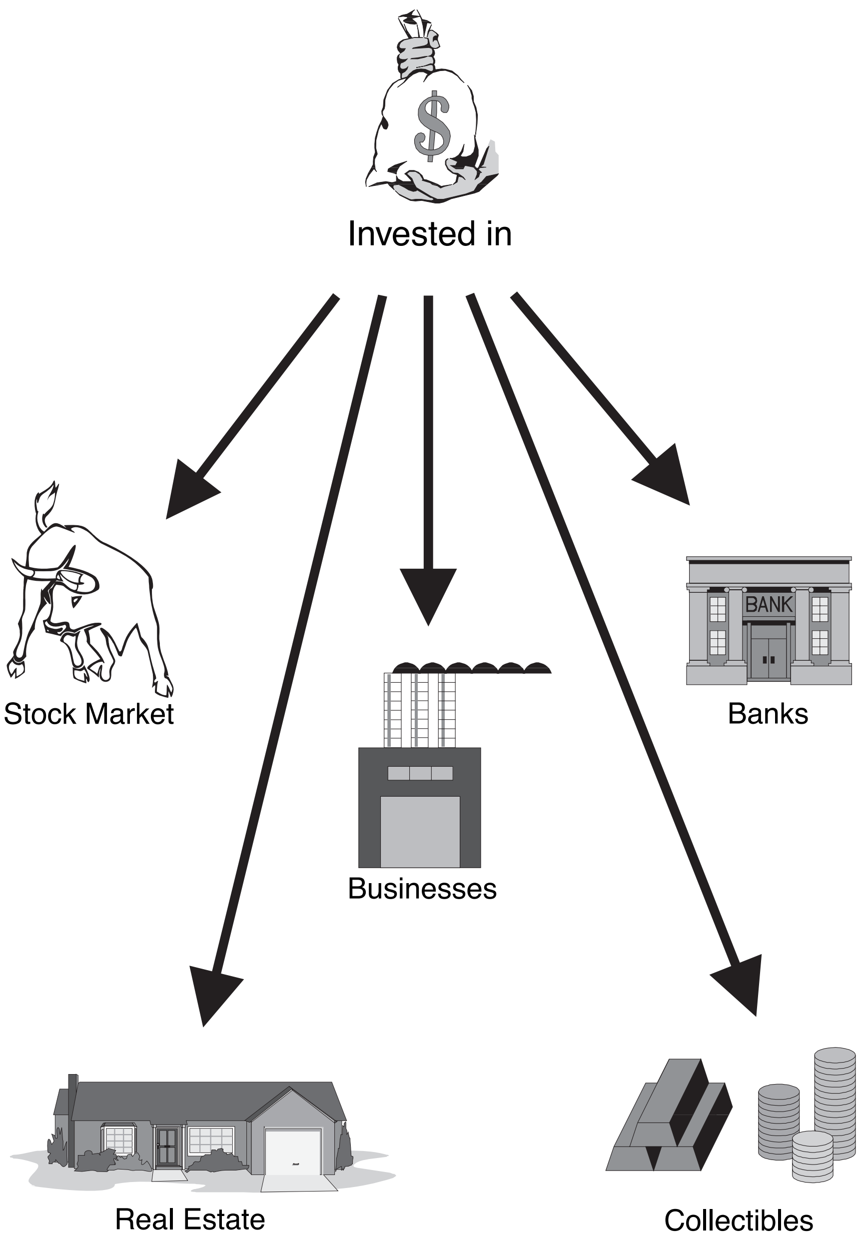
the shareholders as a continuing incentive to remain an investor in the company.

In addition, investors may enjoy an increased value (appreciation) on their stock holdings. If other investors think the market value of the stock is worth more than the market value, they will purchase the stock from those who want to sell it. When this occurs, the price should rise as the bidding continues. But, of course, the opposite can occur. The stock could decline in value, as buyers are willing to sell for a lower price. All the while, the investor may still be receiving a dividend. A dividend, then, is the income earned by having your money at work. Appreciation adds value to your money by having other investors think your investment is more valuable than what you originally paid for it. I call this the risk premium—value added for having been willing to lose some of your money if the market value had declined.

Real estate pays a dividend too, except we call this “positive cash flow.” Gross income is derived from the rent users pay to occupy the facility. As a property owner, you must take care of the property. You incur expenses (such as mortgage payments, taxes, utilities, leasing commissions and maintenance) and pay these from the gross income. If your property doesn’t earn enough rent to cover these expenses, then you have “negative cash flow.” This means you will have to subsidize the payments from your other income. I call the income in excess of expenses the money money makes. Because of various risk factors, the return on your invested capital can be quite high, but it can also be quite low. In fact, it can be negative. This negative cash flow occurs when the income from the rents is not sufficient to pay the fixed and variable expenses attributed to the property. Your economic success all depends on how an investment appreciates.

Of course, no one would ever buy an investment with the idea of losing money. Can you see Bill coming home to his wife and saying, “Ethel honey, I think I’m going to invest in this office building so I can lose $235,000.” Hardly! Everyone invests with the idea they are going to make a lot of money when they sell the investment. But many investors are foiled by the unexpected. The lack of planning or lack of liquidity has defeated many investors. They try to save the investment by pouring good money after bad

Money at Work



(figuratively speaking) in an effort to save a losing venture and their original investment. From my experience, it is very difficult to let go and admit defeat.

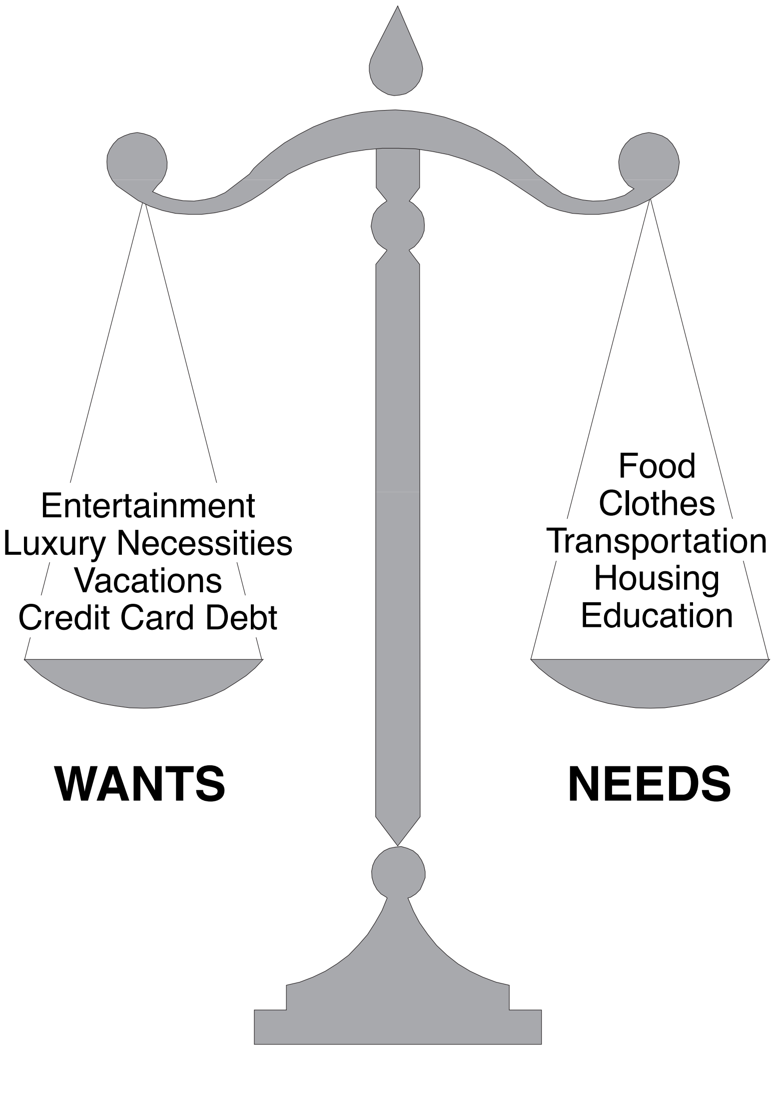
On the more conservative side, you can always put your money under a mattress. But assuming that is not reasonable, you could invest your money in the bank at a fixed interest rate. The bank pays you an income as an incentive for depositing your capital in their institution. The bank takes these deposits and loans it to businesses (called commercial loans) or they may make consumer loans. When businesses borrow money they are assuming the major risk in the event they fail and default on the loan. The saver or depositor is paid a wage (interest) for having provided the capital. Bank failures emphasize the nature of the saver's risk. If the bank fails and can't repay the savings accounts the saver's only recourse is the FDIC insurance limits (currently $100,000). But understand, the saver receives no premium for taking this risk. The same risk also applies to money market accounts where the saver purchases a certificate of deposit or a banker's acceptance note.

SAVINGS ETHIC

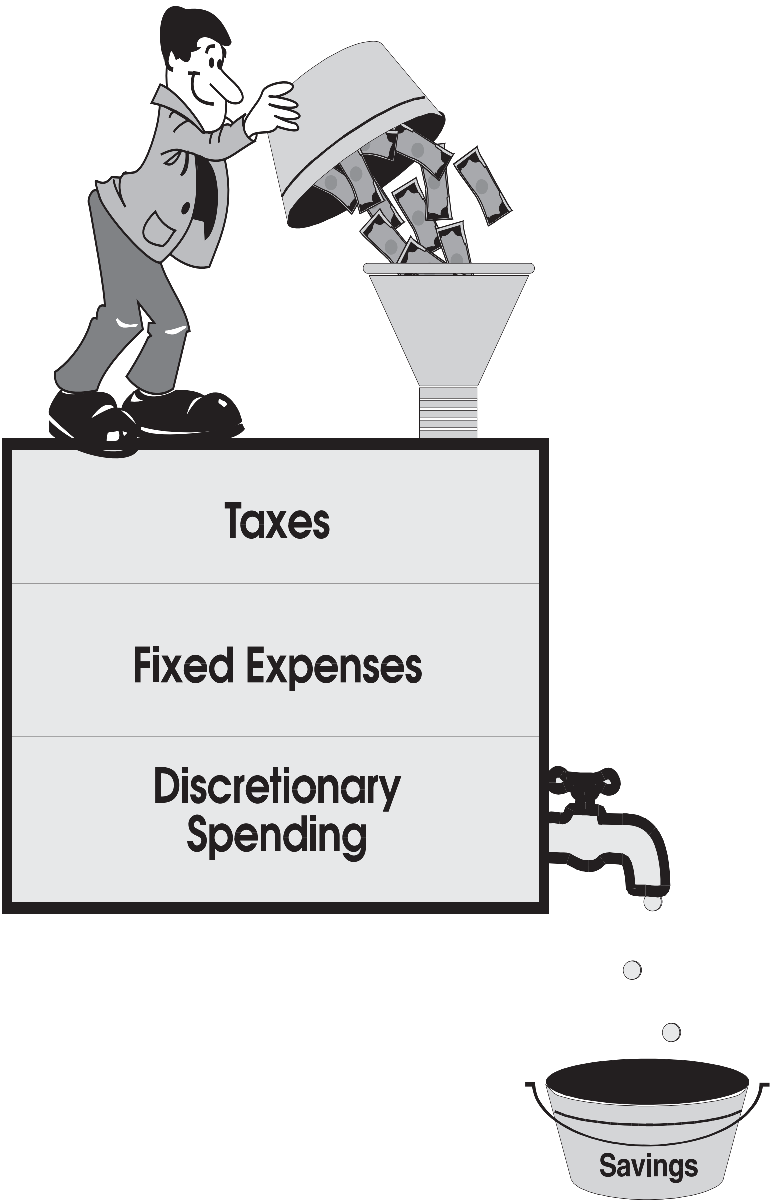
What about developing a savings ethic? Let's look more closely at savings. We know income only comes from man at work and/or money at work. Just as a business strives to create a profit, your profit is measured by the amount you can save. It's the residual after you pay the fixed and variable expenses. Your profit occurs only after everyone else gets paid. This includes the mortgage holder or the landlord, the utility company, the supermarket, your entertainment choices, etc. In addition to these expenses, there are always a myriad of other expenditures which all seem necessary. It is a fundamental fact of life that our savings account is the last "person" to get paid. What are the obstacles to successful savings, which we must all overcome? Here are some I have identified:

TAXES –	Reduce income
INFLATION –	Reduces purchasing power
SPENDING –	Reduces surplus for investment
RISK–	Reduces surplus and capital

The Outgo Exceeds the Income



But Most People Can’ t Save Money



LACK OF KNOWLEDGE CAUSES LOSS OF CAPITAL

Let's be frank, the real reason people are unsuccessful in establishing a savings habit is their spending habits. We can talk about taxes and inflation all day long, but without a major effort to control spending, the "wants" will always exceed the "needs." As a result, there is nothing left to save.

The story is always the same—a new couple starts their life together and ultimately finds out that their "needs" are overwhelming. They buy the things they "need" on credit and spend every thing they make on other necessities. Ultimately, the credit card costs become overwhelming and they are choked financially by the debt. The longer this goes on, the deeper in debt they become. The credit card interest rate absorbs any extra money. The sad thing is, if they would only plan their expenditures better, they could meet their financial objectives while still purchasing those "necessities." We'll look at the budgeting process more closely in the next chapter.Here is the typical wealth accumulation model.

SAVINGS MODEL

If we assume all income is going to be distributed to its highest and most economic use, people would first pay

TAXES

Then, after taxes, most people would pay the expenses they can't avoid i.e. house payments, food, etc., namely the

FIXED EXPENSES

The next expenditures are typically for those things which we call lifestyle choices, i.e. TV, clothes, trips, etc., in other words, the

VARIABLE EXPENSES

If there is a surplus, the remained either goes to other discretionary purchases or to savings. Assuming some will go to savings, let's see why a plan is crucial to financial success.

Risk and lack of knowledge are also factors which affect your financial results. We look at these in a later chapter. But let's spend a little time on the savings model.

TWO TYPES OF SAVINGS

There are only two types of savings plans. First, is what I'll call your "long term" savings account. These are dear dollars that you purpose to keep saved forever. Most of us use a passbook for this account. Let's take a minute and look at this popular method and see why it does not complement the savings ethic.

Most of the savings plans seem to work like this: You get a tax refund and put the money in the bank, thinking you will save it forever. Then oops, something happens and you have to take the money out of the account—new tires, appliance repair, a new roof, etc. A little later you get some additional money, a bonus maybe, and you put that in as well. But then, your car breaks down and you find yourself having to take money out to fix it. Sound familiar? You put it in! Then you take it out! You put it in and you take it out. Appropriately, this is called a PUT 'N' TAKE machine.

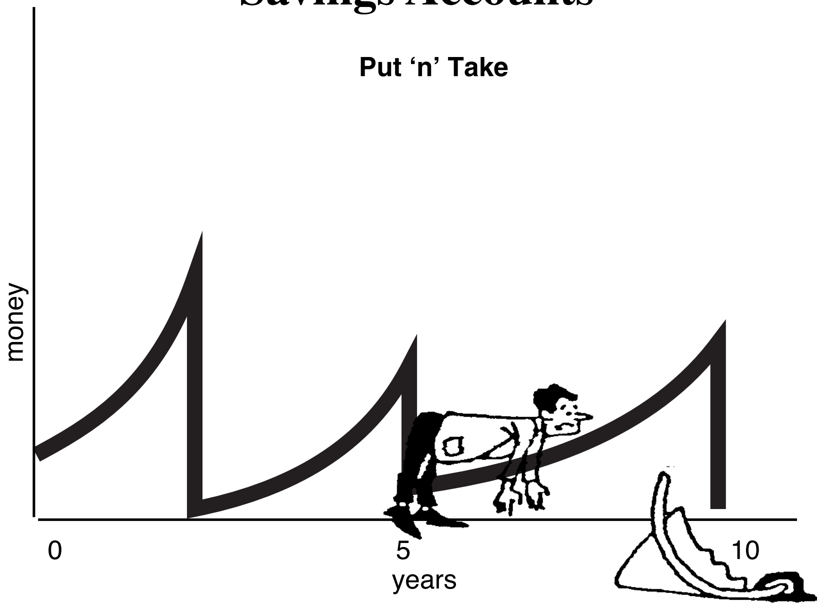
A real "long term" savings plan is an entirely different proposition. This account is designed to keep your surplus money saved regardless of your needs. How do you accomplish this? First you have to set a savings goal by identifying a preliminary goal and then systematically increasing it once you achieve your initial objective. This may sound simple, but I have seen from experience that it is hard to maintain the discipline. Here's the rule: once you put your money in your long-term savings pot, IT CAN'T BE SPENT. That's a commitment!

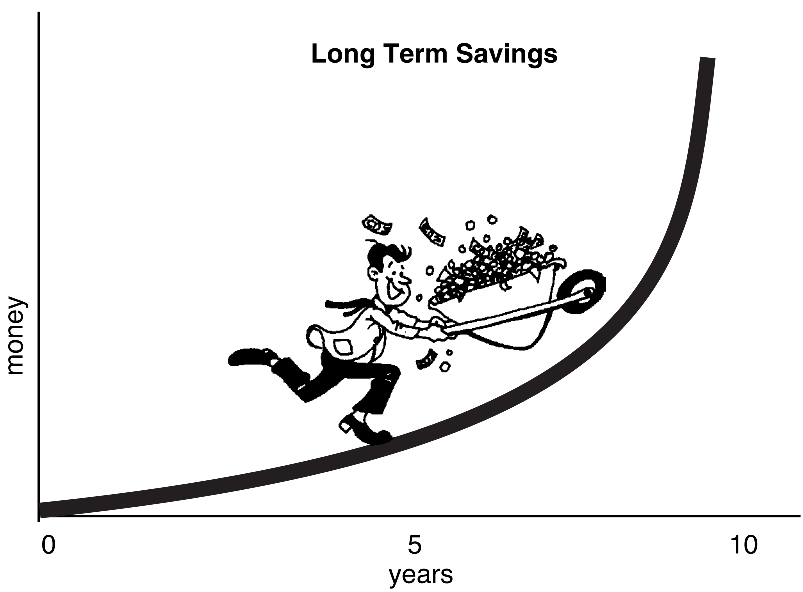
Let's review the secret ingredient to all financial success—the chain of compound interest.

COMPOUND INTEREST

Benjamin Franklin said it best, "Money is of a prolific generating nature. Money can beget money, and its offspring can beget more." Now be honest! How many nights have you spent studying the "prolific generating nature" of money? I mean, if you want to go to sleep quickly, buy a book on compound interest and place it by

Two Common Types of Savings Accounts





your nightstand so you can study it before you go to sleep. Now certainly, a compound interest table is not going to be part of your bedside library. However, once you really appreciate the value of compound interest, you will find it is the most exciting financial concept you will ever learn. It is amazing that more newspapers and magazines don't herald its "prolific generating nature."

Why has compound interest been kept such a secret? Because compound interest is the process not the result. What most people don't realize is that you can't have the end result without going through the process. Financial success, through compound interest can only occur once you have overcome the savings inertia. Let me show you what I mean. Suppose you have $1.00 and you can invest it at 6%. What will it be worth at the end of the year? Answer: $1.06. See how easy this is? At the end of two years you would have $1.12 and the 3rd year you would have $1.19 and so on. The table (*Figure 1*) shows you the progression of growth over the years.Now notice when $1 became $2. It happened in the 12th year. You can short cut this calculation by learning the rule of 72. Essentially, the rule of 72

The Chain of Compound Interest "Rule of 72"

To find the length of time required to double money, divide 72 by the interest rate.

$$10\% \,\overset{\text{7.2 Years}}{\overline{)\,72\,}} \qquad 7.2\% \,\overset{\text{10 Years}}{\overline{)\,72\,}}$$

To find the interest rate when money is doubled, divide 72 by the years involved.

$$\text{8 Years} \,\overset{9\%}{\overline{)\,72\,}} \qquad \text{12 Years} \,\overset{6\%}{\overline{)\,72\,}}$$

If 72 = Years x Interest, your money will DOUBLE.

says if you divide 72 by a specified interest rate, you will determine the number of years it takes money to double.

Likewise, if you divide 72 by the number of years you need for your money to double, it will tell you the interest rate you must earn to achieve your objective. Try it.

Suppose you want your money to double every six years. What interest rate must you earn? What about 10 years? What if you can only earn 9%, how many years will it take for you money to double?

Now check out the Compound Interest Table *(Figure 2)* to see if you were accurate. See how it works? In order to make any progress with compound interest you must understand the rule of 72.

"Rule of 72"
Using 6%

Year	Amount
1	$1.06
2	$1.12
3	$1.19
4	$1.26
5	$1.34
6	$1.42
7	$1.50
8	$1.59
9	$1.69
10	$1.79
11	$1.90
12	$2.01
13	$2.13
14	$2.26
15	$2.40

Figure 1

THE NEXT STEP IN COMPOUND INTEREST

The period of time it takes for money to double is called an interval. If you want to reach your financial objectives by age 65, subtract your age from 65 and divide the result by the number of years it takes for your money to double. Here's an example. Suppose you are 40 years old. If you are earning 6% on your capital, your money will double every 12 years. How many intervals do you have?

Answer: Subtract age 40 from age 65 = 25. Divide 25 by 12 = 2.1 intervals. So if you have $100,000, your money would be worth $200,000 by age 52 and $400,000 by age 64.

Now let's assume you are able to earn 10%. Your money would double every 7.2 years. How many intervals would you have? (25 divided by 7.2 = 3.5). This means your $100,000 would become $1,000,000 by age 65. Unfortunately, higher interest means higher risk and very few people are willing to accept higher risk, unless they understand what risk means and what will happen if they don't take it.

Figure 2

Compound Interest Table

Principal doubles with the rule of 72

Principal doubles the second time with the rule of 144

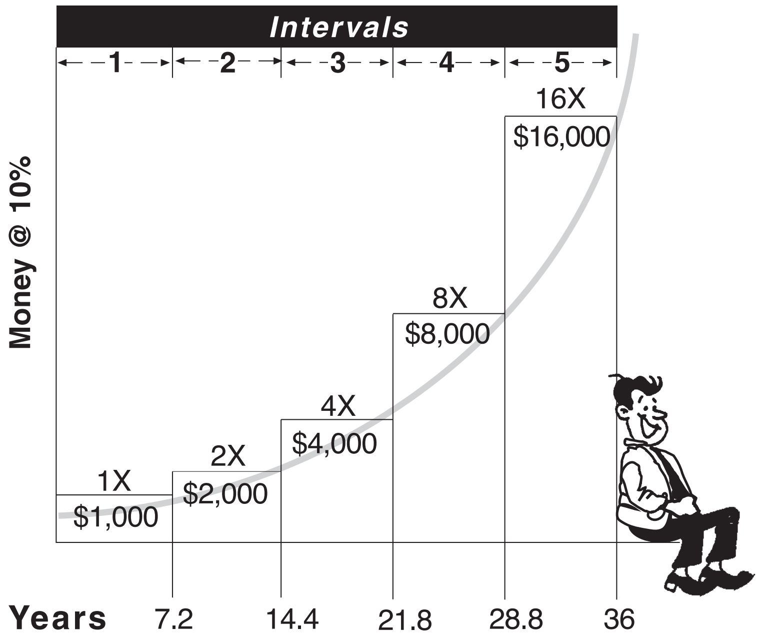
Principal doubles the third time with the rule of 216

	Rate								
Year	5.0%	6.0%	7.0%	8.0%	9.0%	10.0%	11.0%	12.0%	13.0%
1	1.05	1.06	1.07	1.08	1.09	1.10	1.11	1.12	1.13
2	1.10	1.12	1.14	1.17	1.19	1.21	1.23	1.25	1.28
3	1.16	1.19	1.23	1.26	1.30	1.33	1.37	1.40	1.44
4	1.22	1.26	1.31	1.36	1.41	1.46	1.52	1.57	1.63
5	1.28	1.34	1.40	1.47	1.54	1.61	1.69	1.76	1.84
6	1.34	1.42	1.50	1.59	1.68	1.77	1.87	1.97	2.08
7	1.41	1.50	1.61	1.71	1.83	1.95	2.08	2.21	2.35
8	1.48	1.59	1.72	1.85	1.99	2.14	2.30	2.48	2.66
9	1.55	1.69	1.84	2.00	2.17	2.36	2.56	2.77	3.00
10	1.63	1.79	1.97	2.16	2.37	2.59	2.84	3.11	3.39
11	1.71	1.90	2.10	2.33	2.58	2.85	3.15	3.48	3.84
12	1.80	2.01	2.25	2.52	2.81	3.14	3.50	3.90	4.33
13	1.89	2.13	2.41	2.72	3.07	3.45	3.88	4.36	4.90
14	1.98	2.26	2.58	2.94	3.34	3.80	4.31	4.89	5.53
15	2.08	2.40	2.76	3.17	3.64	4.18	4.78	5.47	6.25
16	2.18	2.54	2.95	3.43	3.97	4.59	5.31	6.13	7.07
17	2.29	2.69	3.16	3.70	4.33	5.05	5.90	6.87	7.99
18	2.41	2.85	3.38	4.00	4.72	5.56	6.54	7.69	9.02
19	2.53	3.03	3.62	4.32	5.14	6.12	7.26	8.61	10.20
20	2.65	3.21	3.87	4.66	5.60	6.73	8.06	9.65	11.52

In *Investment Alchemy*, I cover the two risks everybody will face. They either risk losing their capital by having to liquidate in a down market (called volatility) or risk losing their purchasing power through inflation. Most people agree that the inflation risk is guaranteed to happen. Loss of capital, historically, is just a timing issue. Based on historical data, you lose money when you are forced to liquidate your investment at the wrong time.

Understanding Compound Interest

Figure 3



Only 3 Ways to Affect the Curve

1. More Money
2. More Risk
3. More Time

UNDERSTANDING THE POWER OF INTERVALS

We now know $1 doubles to $2 based on the interest rate. How long does it take $2 to become $3? Or $4 to become $5? Let's look at the problem and determine the answer. In Figure 4, it takes a full interval for $1 to become $2.

In the 2nd interval, $2 then becomes $4. This also means $2 reaches $3 at the halfway point. If we use 6%, then $2 becomes $3 in the 6th year. However, at 10%, our $2 becomes $3 during the middle of the 3rd year.

Now, let's look at when $4 becomes $5. This occurs in the 3rd interval. The original $1 becomes $4 dollars at the beginning of the 3rd interval and then grows to $8 by the beginning of the 4th interval. Obviously, $4 becomes $5 sometime during the 2nd and 3rd year and so on.

Compound interest is not a linear relationship. It is a geometric function. A linear progression is 1, 2, 3, 4, etc. But a geometric progression 1, 2, 4, 8, 16, 32. Notice how much faster it grows. Here's where you can use the Rule of 72 to estimate the growth of your investment. It is not perfect, but it will get you close.

The point of this analysis is to show you how powerful compound interest can really be. Think of it—what took nearly 12 years (using 6%) to accomplish in the beginning, took only 6 years in the 2nd interval. And what took 6 years to complete in the first interval, took only 3 years in the 3rd interval. Compound interest becomes more and more valuable the longer you stick with it.

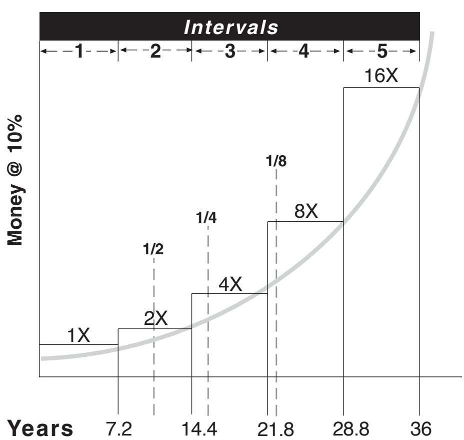


Figure 4

That's why you must never break "the chain of compound interest." What happens if you do? You go back to the beginning of the curve and start over. Most people fail to maintain the chain. They break it for a variety of reasons. But when they start again, they must start at the beginning. It takes so long for the results to show. Let's face it, watching $1 grow to $1.06, then $1.13 is not exciting. Watching $1 grow to $2 over a 12 year period is probably discouraging. Most anyone would become impatient. Let's stop a minute and ask yourself why the majority of savings plans fail.

Look at the flat area on the curve. At 10% interest, the curve is relatively flat for 5 years and only rises in the last three years. In the aggregate, it takes nearly 8 years before the curve starts to accelerate or rise, compared to the entire curve. Even then the rise is gradual. Now, look at the curve in the later years. In the later years, it begins to rise radically. That's the exciting part of the curve, when money is doubling at the same rate but the incremental growth is at a geometric rate. Now that's dynamic.

The discouragement that stops a successful savings plan occurs because you can't see the impact interest is having on your money. What's really happening in the beginning is too small to really measure. But eventually, the compounding growth takes over and the funds multiply at an accelerating rate. What is it about this process that defeats the majority of savers? What prevents them from getting out to the exciting part of the curve?

Before we discuss this barrier, did you know there is an economic term for that flat part of the curve? Economists have terminology for everything. The flat part of the curve is called "BORING." Yes, that's right, boring, and it is aptly named.

It isn't very exciting to struggle and struggle and have no visible progress to show for it in the beginning years. Discouragement is the great inhibitor to wealth accumulation—waiting until the results are both stimulating and encouraging.

So, don't let boredom defeat you! Boredom is the barrier we must all work to overcome. You must work through it! You can not get to the steep part of the curve without going through the flat part. That's simple mathematics.

Remember, there are only two ways to speed up the wealth accumulation process. First, you could dump more money into the investment, or second, you could take more risk and try to achieve a higher rate of return. I suppose there might be a third way—you can try to create more time.

To achieve faster results, you will most often have to take more risk. Unfortunately, risk also entails the potential loss of your capital. If you lose your capital then you have to start over on the flat part of the curve. Now, that really is boring!

Here's a story which illustrates the POWER of compound interest. It concerns a young boy who just turned five years old. His father wanted to teach him a sense of responsibility and decided to offer him a chance to earn a weekly allowance. Already wise to the power of compound interest, this five-year-old offered his Dad a very simple proposition. He offered to forego his allowance for the rest of his life, if his Dad would give him one penny today, and then double it every day for the next 30 days. After that, he would never ask Dad for his allowance again. On the surface, this seemed innocent enough to the father, but if your child ever happens to offer this to you, before you agree, consider how doubling a penny every day for 30 days will affect the outcome.

The chain of compound interest, left unbroken, can be quite dynamic. It starts out innocently enough. At the end of the first week, Dad would only owe him $2.56. At the end of 10 days, the amount has grown to $20.47. Even after 20 days, the outstanding balance is a mere $5,242.82. But with just ten days to go, Dad would be indebted to his five-year-old for eternity. Could your wildest imagination foresee the enormous debt Dad would end up owing his young son $5,368,704? This story is a fantastic and obviously unreal example of how compound interest can impact even the smallest of sums.

Even at 72% per day, it took nearly 20 days for the value to reach $5,000. It wasn't until the last 10 days that the increase was 1000 fold. But if you break the chain by spending the money or losing it, you've lost 20 days and have to go back to zero and start over. Using a PUT 'N' TAKE as a long-term savings plan dooms you to financial failure because you continually break the chain of compound interest.Compound interest is a little like priming a pump. It takes a long time to see any water start to flow, but when it happens, the benefits are wonderful!

HOW MUCH CAPITAL WILL I NEED?

We've seen how long it takes for compound interest to really start to pay off. Let's look at the ramifications of this. Assume you are 45 years old and want $100,000 of retirement income at age 65. How much capital will you need? This is not an easy question to answer. Most people think of their retirement income in terms of today's dollars. But they don't factor into account loss of purchasing power caused by inflation. Look at Fig. #5. To have $100,000 of purchasing power at age 65 (assuming you can earn 6.25% every year), you will need to have $1,600,000 invested by that age. If you retire at age 75 and you expect to have your income keep pace with inflation, you will need $2,150,266 invested to keep up. (This calculation assumes 3% inflation.) If you retire at age 85, you will need $2,889,778 invested in order to maintain your purchasing power.

But what if, you can earn 8%? Obviously, then you will do much better. Fig. #6 shows that you only need $1,250,000 at age 65 to produce the same $100,000 of purchasing power. By age 75, to maintain the same $100,000 of purchasing power you would need $1,679,895 invested and $2,257,639 invested by age 85.

There is only one problem with this logic. Remember, you are age 45 today and you want $100,000 in today's purchasing power. That requires $175,351 in tomorrow's dollars. (Fig. #7). You need to have enough capital at age 65 to produce $175,351 in income. So at 8%, you don't need $1,250,000—you really need nearly $2,200,000 invested at age 65 and if you retire at age 85, $3,900,000. Inflation-proofing today's income really increases the cost.

But, there is another problem. If you don't have sufficient capital today to provide an adequate income tomorrow, it means you must continue to grow your capital after retirement at the same time you are withdrawing your income. Your capital must earn more than the income you are withdrawing.

There is no way you can accomplish this without creating more capital or taking more risk. To sustain a level standard of living, you must either have enough capital when you start taking your income or you will have to earn a sufficiently higher return to compensate for the growth needed to maintain your purchasing power.

Figure 5

No Inflation Vs. 3% Inflation

No Inflation Capital Required (at 6.25%) if You Retire at Age . . .

Desired Purchasing Power	Age 65	Age 75	Age 85
$50,000	$800,000	$800,000	$800,000
$100,000	$1,600,000	$1,600,000	$1,600,000
$150,000	$2,400,000	$2,400,000	$2,400,000
$200,000	$3,200,000	$3,200,000	$3,200,000

3% Inflation Capital Required (at 6.25%) if You Retire at Age . . .

Desired Purchasing Power	Age 65	Age 75	Age 85
$50,000	$800,000	$1,075,133	$1,444,889
$100,000	$1,600,000	$2,150,266	$2,889,778
$150,000	$2,400,000	$3,225,399	$4,334,667
$200,000	$3,200,000	$4,300,532	$5,779,556

Figure 6

No Inflation Vs. 3% Inflation

No Inflation Capital Required (at 8%) if You Retire at Age . . .

Desired Purchasing Power	Age 65	Age 75	Age 85
$50,000	$625,000	$625,000	$625,000
$100,000	$1,250,000	$1,250,000	$1,250,000
$150,000	$1,875,000	$1,875,000	$1,875,000
$ 200,000	$2,500,000	$2,500,000	$2,500,000

3% Inflation Capital Required (at 8%) if You Retire at Age . . .

Desired Purchasing Power	Age 65	Age 75	Age 85
$50,000	$625,000	$839,948	$1,128,820
$100,000	$1,250,000	$1,679,895	$2,257,639
$150,000	$1,875,000	$2,519,843	$3,386,459
$200,000	$2,500,000	$3,359,791	$4,515,278

Figure 7

To Earn $100,000 per year

	At this interest rate, You will need this much Capital				
	8%	**9%**	**10%**	**12%**	**15%**
	$1,250,000	1,111,111	1,000,000	833,333	666,667
If you have this much Capital now	*You'll need to save this much annually for 20 years*				
$50,000	22,223	16,241	11,587	4,872	-
$100,000	17,130	10,764	5,714	-	-
$150,000	12,037	5,286	-	-	-
$200,000	6,945	-	-	-	-
$250,000	1,852	-	-	-	-
$300,000	-	-	-	-	-
$350,000	-	-	-	-	-
$400,000	-	-	-	-	-
$450,000	-	-	-	-	-
$500,000	-	-	-	-	-

Figure 8

For $100,000 Annual Purchasing Power, Payable in 20 Years Adjusting for Inflation at 3%, You Actually Will Need an Income of $203,279

	At this interest rate, You will need this much Capital				
	8%	**9%**	**10%**	**12%**	**15%**
	$4,077,547	3,624,486	3,262,038	2,718,365	2,174,692
If you have this much Capital now	*You'll need to save this much annually for 20 years*				
$50,000	84,011	65,369	51,081	31,034	13,240
$100,000	78,918	59,891	45,208	24,340	5,252
$150,000	73,826	54,414	39,335	17,646	-
$200,000	68,733	48,937	33,462	10,952	-
$250,000	63,640	43,459	27,589	4,258	-
$300,000	58,548	37,982	21,716	-	-
$350,000	53,455	32,505	15,843	-	-
$400,000	48,363	27,027	9,970	-	-
$450,000	43,270	21,550	4,097	-	-
$500,000	38,177	16,073	-	-	-

Look at Fig. #7. In order to earn $100,000 at age 65 (in an inflation free world), you would only need $1,250,000 (at 8%). If you could earn 10%, then you would only need $1,000,000. But we know inflation is the nemesis. So we have to factor in growth during your retirement to overcome inflation during that time. Your capital must be much greater than the amount you intend to take as income. To have $175,351 of income ($100,000 of purchasing power @ 3% inflation for 20 years) to keep pace with inflation, you will need $4,077,547. Why so much?

$100,000 at 3% Inflation

Age	Income
45	100,000
50	112,551
55	130,477
60	151,259
65	175,351

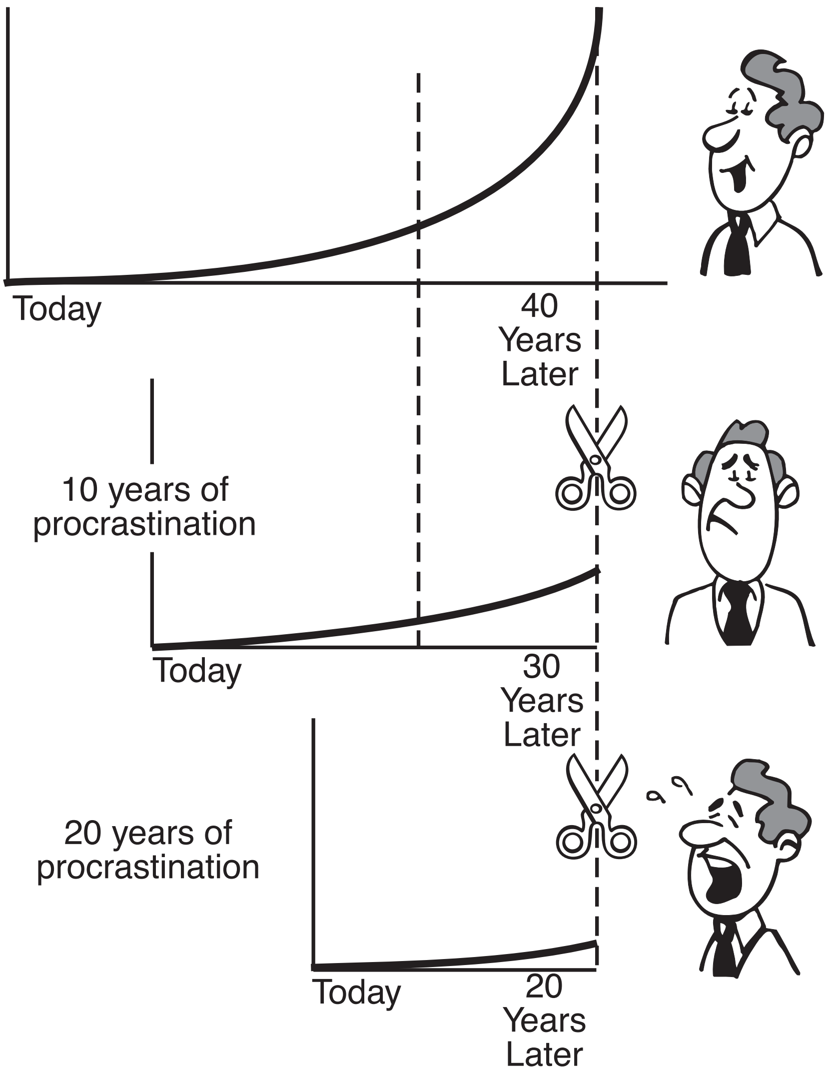
Look at Fig. #8. For your capital to grow today at the same rate you will withdraw an income tomorrow, you need $1,250,000 at 8%. Your capital wouldn't need to grow if there was no inflation. But to keep pace with inflation, you must earn enough to grow your capital tomorrow while taking the income, which is much harder to do. If you are conservative, you will find the extra risk quite uncomfortable.

The invested $4,077,547 provides enough capital to pay $175,351 annually and grow your capital so you will always be able to sustain a level purchasing power. So, how much more do you have to invest along the way to achieve this goal?

If we go back to Fig. #7, the bottom of the chart shows how much you have to save if you are already systematically investing (note this assumes no inflation). If you already have $50,000 working for you, then at 8% you need to invest an additional $22,223 each year until age 65. If you invest this much and earn 8% on your investment, you will have the $1,250,000 that's required at age 65 to give you $100,000 of income annually.

Now let's look at the impact of inflation. In Fig. #8 you now have to invest an additional $84,011 annually to reach your goal. If we look at earning 10% on your investment along the way, the annual amount you must save each year will reduce to $51,081. If you already have some capital working for you, then your job is easier. Look at how much you need to save if you want $200,000 of inflation-proof income. At 8% you have to invest

The Pricetag of Waiting



$68,733 each year, but at 10% you can accomplish the same job by investing $33,462.

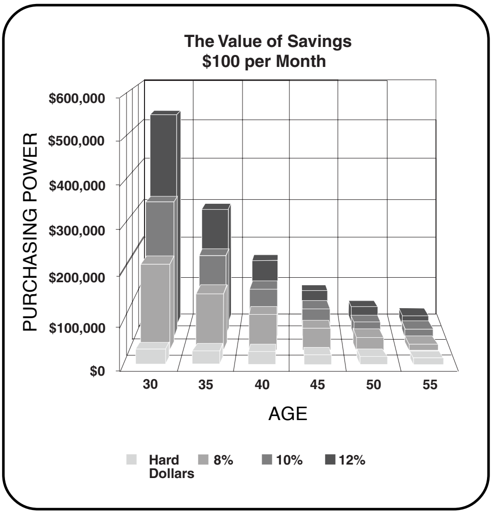
This example just proves the principal of "more time = more money" and "less time = more risk." The more time you have, the more your money will grow. The less time you have, the more risk you must take to reach your goal. There is no easy answer, which brings us to the last lesson in compound interest.

THE PRICETAG OF WAITING

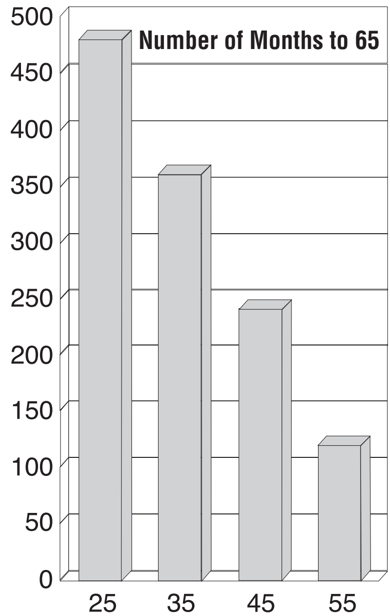
The last lesson in compound interest has to do with procrastination. Look at the chart entitled "The Pricetag of Waiting" on the next page. Let's see what happens if you wait 10 years to start your plan. Notice that pushing the curve to the right (see chart) doesn't shorten the flat part of the curve; what it does is cut off the best part of the curve, the time when compound interest can really make your money grow. These are the last intervals you have before you start to take your income from capital.

Study the following two graphics. The first graphic is the time value of savings. Notice how much interest adds to principal if you start early. But if you wait, there is very little difference between 8% and 12%. Why? Because all interest rates need the same thing to work properly—time.

To really grasp time, look at the second chart entitled, "When is the Best Time to Save?" Quantifying the number of months left until age 65 shows you how little time any of us really have. It's like an hourglass draining away. You can either become the master of time or you can let it master you.



When is the Best Time to Save?
(Time Passes Quietly)



Finally, let's look again at the difference between starting at age 20 and age 30. In our example, a young person at age 20 saves $2,000 a year for 10 years and then stops saving. At age 65 they have $456,000, assuming we earn 6%. Our other person waits to start at age 30. He contributes $2,000 every year until age 65. He only has $350,000 and had to contribute $50,000 more to get there. To catch up, he would have to deposit an additional $50,000. Now, you might be thinking, how do you keep from "taking?" It is important that you don't misunderstand this point. Everyone needs to have a PUT 'N' TAKE account. In fact, it is important to plan for unforeseen expenditures. But don't fool yourself. Call it what it is. Don't try to convince yourself, that your PUT 'N' TAKE is really your "long-term savings plan." It isn't.

Therefore, to implement principle number one—the plan successful money managers use to gain financial independence—you must have two types of savings plans—a PUT 'N' TAKE and a LONG TERM savings plan. Make a commitment to keep your money saved once it is saved! Don't break the chain of compound interest by allowing your long term capital to escape and most important, start now.

SUMMARY

Well, congratulations! You have just completed a Ph.D. in compound interest. Mastering compound interest allows you to understand the importance of investing your money properly. By employing these principles and holding your investments for an extended period of time, you can achieve economic freedom. Only those who want to get rich quick or try to beat the compound interest system risk economic failure.

Judging by the statistics, 92% of the population has opted to take the wrong path on this journey. You can avoid these same pitfalls by “staying the course” and properly using the investment principles outlined in this book.

Let’s now look at why…

CHAPTER

2

Control Expenditures

BY NOW, YOU ARE PROBABLY bored to death with the concept of savings and why compound interest works, why it is so important to have something to compound, and more importantly why breaking the chain dooms you to failure. You now know (if you didn't before) that in order to successfully climb up the financial ladder to the top rung of financial independence, you must create a surplus, a surplus between your income and your expenditures. Now, of course, every financial planning book has made this point in its own way. But how do you actually accomplish it? Let's look at the ingredients needed to successfully create a surplus.

It wasn't until I lost money on some investments that I finally understood the real value of retaining capital. First, I had learned how to save money. But I never realized how hard it is to save money, until I got behind the power curve—debt. Up until then, I considered money a game. It had always come easy and I was no real respecter of debt's power. But once I had a bad game (made a couple of mistakes), I realized how fortunate I was to have learned these principles as a youngster.

The turning point in my life as a child was when I spent all of my earnings at the local county fair. We raised rabbits at home and I was allowed to keep the skins from any who died during the breeding period. I had just received $40 for those skins and took it all to the fair. I had a blast. But when the day was over, I had nothing to show for it and I was devastated. I purposed at that point to NEVER let that happen again, ever. So, I would put half of my earnings in a drawer and the rest I could spend if the need arose. As a teenager there were many temptations which could subvert my savings plan. But by sticking to my one half rule, I avoided the temptation. As a result I saw my money pot grow. After college, Colleen and I got married and I started to earn a real living, as an adult. My goal/habit was so ingrained, we continued to save 50% of my income and I didn't allow my wants to jump so far ahead of our needs that we needed to change our commitment.

Candidly, while writing this part, I was tempted to downplay this personal experience. If you have never really committed yourself to saving, I know it is hard to believe anyone would set their at savings level at 50% and maintain it. In fact, I did reduce ultimately the level to 30%, after we started having children. But we really did save 50% during those early years! During some of our most stressful financial times, we were able to "save" troubled investments by using these "savings" to bail us out of real estate difficulties. Without this savings ethic, we could never have had the cash to hold on until we could preserve our position. A savings ethic is just that—an ethic. An ethic is a philosophy or value. It may be contrary to ordinary behavior. You either have it, or you will need to develop it…especially if you wish to be financially independent and economically free. The question is, "how?"

Let me share another of my kid stories to illustrate what I mean. I was a dedicated baseball fan. It was an addiction. See if this story will help you understand how determination and commitment worked for me. I desperately wanted to be a professional baseball player. Unfortunately, I didn't have the natural ability required. But my desire created a determination to spend countless hours practicing pitching and fielding ground balls. I would throw the ball against a brick wall hour after hour. When I got older, my friends and I would spend our entire day playing baseball—pitching, fielding, hitting. Why? For fun, sure! But also because it was our way of using our skills and hopefully, improving them. Since you've never seen my mug on a baseball card, you know that I was never good enough to play pro ball. In fact, I decided to pursue other activities after two years of baseball in high school. I tried again in college, but thought better of it after one year of playing. I'm certain you have watched kids with real talent practice and practice after school. You may remember how committed they were. The point is, you never see commitment without effort. It doesn't guarantee success, but you are guaranteed failure without effort. The only way you fail is to quit.

Ask yourself, are you committed to anything? Close your eyes for a minute and try to recall those feelings of commitment. Can you remember? Can you recall what it feels like to "pay the price" and know that the effort was worth the price, regardless of the outcome? Sure we all want positive results, but sometimes, they just are not there…at first. But like my baseball, I have never regretted the time, energy or experiences I had playing the game. The chain of compound interest is the same thing. If you go back to square one, you are not going to ever see the compounding growth from your efforts. Commitment is the key to success—any success. A half-hearted effort ends up with halfhearted results.

There are many who pay lip service to their goals. They are only willing to pay the price until the price gets too steep. Unless you really mean it, when you say you want to be financially independent, failure will be the ultimate pricetag. Financial success demands you have the will to succeed. Commitment is critical.

WHY A BUDGET?

Having said the "B" word, a budget is the plan you implement to demonstrate your commitment. It shows you the places where your money is going to go and gives you an objective measurement of your ability to control your expenditures.

> Financial problems occur when you have
> ***too much month*** at the end of your money.

Think a minute! Why do people resist having a budget? There must be some barrier which causes people to fight using a budget, because according to surveys, the vast majority of American homes don't have one. A study done by the Department of Health and Welfare discovered that over half of the non-married males over age 58 had less than $400 in assets. I'm told most nursing homes, house government-subsidized patients. These patients must demonstrate a net worth of less than $700. The average credit card debt in America is over $15,000 per household.

I am a financial advocate. I have found most people shy away from budgets because of the accountability required. Yet, that is its real value—accountability. A budget offers a measurable way to determine and set priorities. It shows you your financial spending habits. Of course, most of us do not like being held accountable.

WHAT IS A BUDGET?

A ***systematic plan*** of accountability.
A ***projection*** of future expenditures. It controls consumption and provides a plan for savings.

It's been said that how you spend your money is a window into your soul. If someone were to look at your checkbook and analyze how you spend your money, they would soon discover your priorities.

The first step towards establishing a budget is to analyze the past six months of expenditures. Go through your checkbook and allocate all of your checks between FIXED and VARIABLE expenses.

A fixed expense is one which requires a periodic set payment, such as a house payment or car payments. Fixed expenses are generally set by contract and carry the threat of forfeiture or legal action, if you fail to pay on time. Variable expenses may be equally as important and just as devastating to your savings plan. But they may not have the same legal consequences for failure to pay. Of course, any delinquency would impact your credit, but failure to pay might not result in the loss of a specific asset, it might just cost you their services. Obviously, utilities, the phone bill, your gasoline or food will all fall into this variable category. The real determinant between fixed and variable expenses is whether or not your payments are predetermined by contract versus a cost which reflects usage. Utility bills vary based on usage, as does food. A newspaper is variable in as much as you have the ability to cancel it with no legal consequences.

The last category is the most vague and the most troublesome. This is what I call the lifestyle. It is often referred to as your standard of living, your way of "keeping up with the Joneses." This category requires a real long, hard look at your commitment to financial independence, because it is the one which offers the most competition for your savings dollar. This is the new TV, video recorder, refrigerator or vacation. It's new furniture and new designer clothes. It's the "I want" and "I really desire it" category. Who hasn't felt that burning desire deep down in your soul which made you a little crazy—until you bought it? You've felt that urge many times but then comes the fear after you've made the purchase. These after thoughts are called buyer's remorse. We'll look at this more later.

After you have defined and categorized all of your expenses, you can then create a personal profit and loss statement—just like any business. It matches your income to your expenses. If you have anything left over in business, we call it profit. Any profit in your personal budget is called savings. How do you establish a budget?

FORMATTING A BUDGET

Since no workbook on financial planning is complete without a proposed budget, let's look at one which covers a multitude of categories. Enter the average of your last six months of expenditures in the various budget categories. If you haven't got a budget format that you like, here are some ideas to consider. Any stationery store has a column rule notebook which you can adopt to meet your needs. Or, if you like, copy this budget and use it. I got it from Crown Ministries headquartered in Florida.

To keep track of total expenditures as well as income by category, you can purchase any number of computer programs or build one yourself using a computer spreadsheet. Whichever format you use, the important thing is to accurately keep track of outlays in a systematic fashion you can review periodically to see how you are doing. It is fun to compare your best guess with your actual results.

Estimated Budget

Gross income wages		______
Federal income tax	______	
State and city income tax	______	
Social Security tax	______	
Other deductions	______	
Total taxes and deductions		______
Net income, wages (Subtract taxes and deductions from gross income)		______

	Monthly Amount	Other Than Monthly	Total Annual Amount
INCOME			
Net income, wages	______	______	______
Interest, dividends	______	______	______
Net rents	______	______	______
Net business income	______	______	______
Retirement income	______	______	______
Other ______	______	______	______
Total Income:			______
Monthly Budget Amount (Total Income / 12):			______

GIVING			
Church	______	______	______
Poor	______	______	______
Other ______	______	______	______
Total Giving:			______
Monthly Budget Amount (Total Giving / 12):			______

SAVINGS			
Permanent Savings	______	______	______
Temporary Savings	______	______	______
Retirement Savings	______	______	______
Total Savings:			______
Monthly Budget Amount (Total Savings / 12):			______

FOOD	**Monthly Amount**	**Other Than Monthly**	**Total Annual Amount**
Groceries	______	______	______
Eating out	______	______	______
School lunches	______	______	______
Other ______	______	______	______
Total Food:			______
Monthly Budget Amount (Total Food / 12):			______

CLOTHING/GROOMING			
Purchases	______	______	______
Cleaning	______	______	______
Hair care	______	______	______
Toiletries/cosmetics	______	______	______
Total Clothing/Grooming:			______
Monthly Budget Amount (Total Clothing / 12):			______

HOUSING			
Rent or mortgage	______	______	______
Property taxes	______	______	______
Property insurance	______	______	______
Electricity	______	______	______
Heating/gas	______	______	______
Water	______	______	______
Garbage service	______	______	______
Cable TV	______	______	______
Telephone	______	______	______
Cleaning	______	______	______
Repairs/maintenance	______	______	______
Supplies	______	______	______
Improvements	______	______	______
Furnishings	______	______	______
Other ______	______	______	______
Total Housing:			______
Monthly Budget (Total Housing / 12):			

______

	Monthly Amount	Other Than Monthly	Total Annual Amount
TRANSPORTATION			
Gas and oil	________	________	________
Automobile insurance	________	________	________
Repair and maintenance	________	________	________
License/registration	________	________	________
Parking and tolls	________	________	________
Total Transportation:			________
Monthly Budget Amount (Total Transportation / 12):			________

MEDICAL			
Doctor	________	________	________
Dentist	________	________	________
Prescriptions	________	________	________
Glasses	________	________	________
Health insurance	________	________	________
Other ________	________	________	________
Total Medical:			________
Monthly Budget Amount (Total Medical / 12):			________

CHILDREN			
School tuition	________	________	________
Allowances	________	________	________
Tutoring	________	________	________
Music/dance lessons	________	________	________
Sports	________	________	________
Baby-sitting	________	________	________
Other ________	________	________	________
Total Children:			________
Monthly Budget Amount (Total Children / 12):			________

INSURANCE			
Life insurance	________	________	________
Disability	________	________	________
Other ________	________	________	________
Total Insurance:			________
Monthly Budget Amount (Total Insurance / 12):			________

	Monthly Amount	Other Than Monthly	Total Annual Amount
DEBT REPAYMENT			
Total from Debt List:	______	______	______
Monthly Budget Amount (Total Transportation / 12):			______

RECREATION			
Adult allowances	______	______	______
Vacations	______	______	______
Magazines/newspapers	______	______	______
Books/tapes/records	______	______	______
Hobbies/pets	______	______	______
Entertainment	______	______	______
Total Recreation:			______
Monthly Budget Amount (Total Recreation / 12):			______

GIFTS			
Christmas	______	______	______
Birthdays/anniversaries	______	______	______
Weddings/showers	______	______	______
Graduations	______	______	______
Office gifts	______	______	______
Total Gifts:			______
Monthly Budget Amount (Total Gifts / 12):			______

PERSONAL/BUSINESS			
Education	______	______	______
Clubs, union, dues	______	______	______
Accounting/legal	______	______	______
Financial services	______	______	______
Other ______	______	______	______
Total Personal/Business:			______
Monthly Budget Amount (Total Personal / 12):			______

Total Income (Total of income category): ______

Total Spending (Add totals of each spending category): ______

Surplus or Deficit
(Subtract total spending from total income): ______

Remember,
Successful Budgeting Requires:

	Estimates
Savings (Put ‘n’ Take and Long Term)	2–10%
Housing	25% Max.
Transportation	7–12%
Clothing	2–4%
Food and Supplies	10–15%
Entertainment/Recreation	2–3%
Education Enrichment	1–3%
Seasonal Expenses	1–2%
Personal Care	2–3%
Contribution	Open
Household	5% Max.
Insurance	5–8%
Miscellaneous	3–5%
Debt Reduction (if necessary)	4–6%
Total	100%

Remember, your expenditures should be categorized by fixed, variable, and discretionary expenditures. Pay special attention to recurring expenses like property taxes, insurance premiums or balloon payments that may not be on a monthly cycle. These are sneaky and are the true enemies of a budget. By anticipating these surprises and planning ahead for them, you are way ahead of the game. If you want to be a winner, create some historical records to test your budget.

Now that you have accounted for all of your checks, go back three or four months and track all of your cash expenditures. Bet you

Expenditures
$50,000 Annual Income

	At Retirement	Current Year	Example
1. **Housing** Rent, mortgage, property taxes, utilities (gas, oil, electricity, water), telephone, home furnishings, household, services, maintenance, improvements			$12,674
2. **Clothing** Purchases and cleaning			2,354
3. **Food** Purchases and cleaning			6,242
4. **Transportation** Car repair and maintenance, installment payments, gas, commuting costs			9,331
5. **Gifts**			N.A.
6. **Contributions**			1,785
7. **Education**			676
8. **Insurance** Life, medical, auto, property, liability			571
9. **Medical and Dental Care** Premiums, deductibles and out-of-pocket costs			1,471
10. **Loan Repayment Costs**			N.A.
11. **Personal Care** Grooming, health club, other			360
12. **Entertainment** Vacations, dining out, movies, plays, concerts, sports events, cable TV, videocassettes, entertaining, sports, hobbies, other			2,282
13. **Pet Expenses**			N.A.
14. **Savings and Retirement** Contribution to company plans, IRAs, Keoghs, SEPs, other savings, investments			5,405
15. **Taxes** Federal, FICA, state, local			6,660
16. **Support of Relatives**			N.A.
Total Expenditures (add lines 1 through 16)			**$ 49,811**
Total Current Expenditures Divided By Current Gross Income			
Total Expenditures at Retirement Divided by Current Gross Income			

can't do it. Cash is slippage. It's another mortal enemy to savings. Give special attention to cash. Cash is an easy way to avoid accountability. If you track your cash expenses, you'll be surprised by how much money will be saved that might otherwise have been wasted. I know this is hard, but if you are committed, it is no worse than anything else you have ever wanted and worked hard to attain.

THE WALLET BUDGET

Eventually, every married couple will ultimately have to deal with how they spend money together. I've talked to so many couples who have had "money shock" when they discovered they had different ways to handle their money. Notice I said "their" money. Sometimes it is a shock to one or both spouses that they have to suddenly share their money and figure out how to spend it "together."

In our marriage, I am a big picture kind of guy (no pun intended). I "macro" budget. I think nothing of buying a car, taking a trip or purchasing a piece of furniture, if we can afford it. Need it? Buy it, within reason! It's a one time purchase. I plan for it, do it and it's finished.

Colleen, on the other hand, deals on the micro level. She likes to spend a dollar here and dollar there. She goes through life finding little bargains. It makes her happy. It also makes me unhappy. Now I know this is irrational, but everytime she comes home with 18 different items, totaling $25 in value, I feel like I have been stabbed in the gut with a knife and then she turned it. There is no explaining it. It has been that way since I was kid. Probably a throw back to that county fair incident.

Income Statement: A report on your <u>past</u>

Balance Sheet: A picture of your <u>present</u>

Budget: A plan for your <u>future</u>

When I went to pay the bills each month, her credit card was "trick or treat." I never knew how much I would owe. I felt out of control and worse, I felt like she was out of control. It would cause me to be afraid and angry. Worse, we could never talk about it. I always sounded more mad than scared. She felt devalued and discounted. The subject always ended up with me having the last word. "Yes dear, you are right."

Eventually, after much trial and error (more trials than necessary) we hit on this simple solution. It has worked for years. On the first of every month, when I am paying the bills, I write her a check. This is her "paycheck" for all the work she does, the kids, the driving, the cooking, cleaning-up, errands, etc. This is her money to do with it whatever she wants. I never questioned her on how she allocates her money. The only rule is that "extra" expenditures have to be discussed and agreed to by both of us, especially if she has no budget for it.

This has worked fabulously for us. She runs the house from this budget. Here's a trick Colleen uses. She bought a small wallet with individual dividers and budgeted out her money into specific categories. Every month, she cashes her check and allocates the money into the wallet. She has a slot for food, clothing, school supplies, Christmas gifts, birthday gifts, entertainment, etc, all of the daily operating items. She knows exactly how much she has and how she wants to spend it. If there is a surplus at the end of the month, it's hers to keep. She might rob "Peter to pay Paul" from time to time, but she knows how much she has allocated to each category and how she is doing week by week. If she runs out, she uses the "no" word.

I pay the major bills. I pay the house, the cars, the insurance and the utilities. The most important thing is that this system eliminated a major source of conflict and irritation from our lives. I don't have to see what she does with her share of the budget. Again, this has worked great for us and solved a major problem.

A benefit of keeping track of all your expenditures is that it helps with that annual rite of spring—income taxes. You might get several envelopes and label each to correspond with the categories in your budget. If you want to be fancy, you might color code those that are tax deductible to speed up your accounting. Place receipts and monthly statements in the appropriate envelope. That way you have it all organized for your accountant (or yourself, if you do your own taxes).

You'll find accurate records will make you feel more in control of your money, give you a sense of pride about your financial acumen, and provide meaningful feedback on your progress. Starting this process takes willpower, but once you have created the system, the habit will follow. You will enjoy and benefit from the information it creates for you.

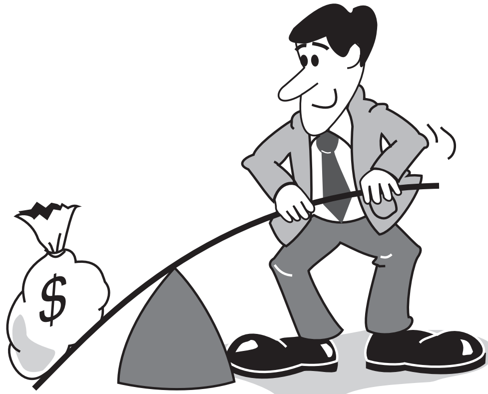
Principle number 2, then, is to control what you spend. How? By establishing a realistic budget and sticking to it. Holding yourself accountable helps you overcome spending problems which may plague your financial progress.

Now let's look at debt. I think you must…

CHAPTER

3

Only use Debt for Leverage



EARLIER IN THE BOOK, I spoke about buyer's remorse. I remember that feeling deep in the pit of my stomach. It occurred after I made a long-term financial commitment and regretted the decision. Buyer's remorse becomes especially strong after the first payment is made and you realize there are so many more to follow. Suddenly that item you wanted so badly and went into debt to buy no longer seems so important.

"Buy now and pay later" is an attitude that has gotten most Americans into real economic trouble. We can't afford to miss a payment because of the dire consequences to our credit rating, the dreaded TRW report. I remember a period in my life when I was literally controlled by the debt I had created and it seemed like there was no way out. I just had to continue to pay the interest until I could sell enough assets or earn enough money to pay off the debt.

Did you hear about the man who refused to report his stolen credit cards? Yeah, the thief was spending less than his wife did so he didn't want to stop him. Then there was the man who went to the financial counselor and announced that he and his wife just had an operation—plastic surgery. They cut up all of their credit cards.

It is important to realize there are two different types of debt: consumer debt and equity debt. Consumer debt comes from using a credit card or a finance contract to purchase items like clothes, furniture, stereos, or televisions. Please understand, I'm not against credit cards if they are used for convenience. That means you must pay them off every month. But for the undisciplined, they can be slow death. The interest on the unpaid balance is astronomical, often as high as 20%, all that in addition to having to pay for the purchases. Where most people get into trouble, is they finance their standard of living with these cards. Then as the payments rise, they have to borrow even more to buy what they "need." The result is maximum limits and high payments, with no end in sight. I have one friend who had over $50,000 in credit card debt and had added $350,000 of debt to mortgage to finance his lifestyle. He refused to reduce his life-style because of what the neighbors might think. The creditors ultimately forced him to do it.

EQUITY DEBT

Equity debt is always attached to a real asset—an asset that hopefully has a liquidation value that can payoff the loan. Examples might include, stock bought on margin, real estate, or some other properties, such as partnership interests, which have an underlying value. There are two types of equity debt—recourse and non-recourse. Recourse debt says if you fail to pay, the lender can cause you to liquidate the collateralized asset and even other assets to repay he loan if your original equit isn't enough to pay off the obligation. In other words, you are on the hook regardless of what happens to the asset you used as collateral.

Non-recourse debt seems immoral by comparison. This debt is tied to the value of the property and the lender contractually must look only to the asset for repayment of the debt if you fail to make your monthly installment. Your house is a good example of non-recourse debt. By law, the lender can only use the equity in your house to fulfill the debt repayment. However, you will have to pay income taxes on the amount of the debt forgiveness over and above the amount you have invested in the house. This can be a very large number.

As a general rule, I am against debt unless you have significant liquid reserves. The only exception is the purchase of a house. Debt for a house is almost mandatory in today's inflationary environment, but consider the entire picture before committing to this debt. Buying a car on time increases the cost of the car 30-50%. In addition, a new car depreciates 15-20% the moment you drive it off the lot - a guaranteed loser. As an investment tool, debt can be used to purchase an asset, but if you abuse your credit, debt can hold you captive for eternity.

WHAT DOES *CREDIT* REALLY COST?

	Furniture	Car	House
Cost of item	$2,500	$25,000	$250,000
Interest Rate	14%	12%	8%
Min. Monthly Payment	$48	$475	$1821
Total Cost	$4,142	$34,200	$655,560
Percentage Increase	66%	37%	262%

CONSUMER DEBT

Consumer debt is available to virtually anyone. In fact, because the interest rates are so high, the profit to the lender more than makes up for any defaults by the consumer. It truly is a rip-off in my opinion. Consumer debt can be through a credit card or a direct loan by a vendor. Let's look at consumer debt and what to do about it.

First, I'd like to share with you how I think you should use consumer debt. Incidentally, some advisors suggest you should finance cars and other types of family appliances. The rationale is you have fewer dollars tied up in non-productive "assets" (luxury items) and inflation will make it a better purchase in time. Other advisors say only pay cash. If you are looking for guidelines, reread chapter 2 on budgets and expenditures. I believe in paying cash for every purchase if possible. The interest becomes your profit and you can invest it in your compound interest machine.

For conservative individuals, debt is the wrong approach. When you have made a real commitment to saving money regularly and have implemented the budgeting process adequately, there will be plenty of cash to purchase the items you desire. Use your Put n take account for these purchases. Hard and fast rules or guidelines are not necessary when you plan correctly. Spending is a function of income and purpose. The idea is not to strap yourself to a budget, but to build principles to help you make buying decisions and use the budget to measure your progress.

TWO FORMS OF DEBT	ACCEPTABLE USES OF DEBT
1. Equity	1. Mortgage
• Recourse	2. Automobile
• Non-Recourse	3. Real Estate Investments
2. Consumer	
• Installment	
• Revolving	

Debt can be an enemy or a friend!

In the beginning of my financial life, my rule of thumb for debt, was to never owe more than one year's income. This usually meant the mortgage on our house plus my cars. (Yes, I wasted money on interest by financing my cars.)

When fixed debt payments, including your house payments, exceed 25% of your NET "take home" pay, you should feel very uncomfortable. Why? It leaves you with no flexibility and more importantly, no savings potential. Alternately, if you have significant cash reserves and adequate investment income from other sources, such as real estate and stocks, debt payments could equal all of your monthly savings. Get the picture? It really depends upon the facts. But as a general rule, if it feels uncomfortable and causes you to worry, then don't do it! Listen to your instincts. Develop your instincts and they will protect you.

What some people forget when they purchase a house is the other hidden expenses that go with the obligation—landscaping, utilities, home owner dues, maintenance, and decorating. A new home can be a science fiction style "black hole." This bottomless money pit can sap your resources for years and leave you with nothing to save. Many couples will justify buying a more expensive home than they can afford, because they will grow into it. Back and review the impact of waiting can do to your investment account if you doubt what I am saying. The point of controlling expenditures is to create savings.

How Higher Payments "Pay Off"

If you increase your monthly payments by as little as $50, you can cut the total interest charges on your loan nearly in half. An extra payment of $200 a month cuts the length of the loan by more than two-thirds.

Increase in $130 Monthly Payment	$16,000 Principal Loan Payments	Total Interest @ 7%	Length of Loan
$ 0	$ 27,820	$ 11,820	17.9 years
$ 50	$ 22,140	$ 6,140	10.2 years
$ 100	$ 20,010	$ 4,010	7.2 years
$ 150	$ 19,040	$ 3,040	5.7 years
$ 200	$ 18,480	$ 2,400	4.9 years

"The Compounding *Debt Reduction* Plan"

Example of Reducing Credit Card Debt

Debt	Balance	Payment
1. Department Store A	$ 1,000	$ 50
2. Department Store B	$ 2,500	$ 125
3. Bank Card 1	$ 2,000	$ 100
4. Bank Card 2	$ 800	$ 90
5. Bank Card 3	$ 400	$ 50

Step 1 Pay off #5 as quickly as possible
Step 2 Take the $50 from #5 and pay off #4
Step 3 Take the $140 from #4 and #5 and pay off #3
Step 4 Continue until entire debt is liquidated

OK, I'm convinced. So how do I get rid of my consumer debt? Simple, PAY IT OFF! Here's how! Take the smallest debt you owe and start pay it off now with any extra money you have. Cut your expenditures somewhere and apply it all towards that debt. Once you have paid that off that debt, then take the payment you were making on that debt plus the money you have from your "lifestyle" reduction and now apply it to the next smallest debt. Repeat this process until you have paid them all off. You will be surprised how fast you can pay off your debts by compounding your debt reduction payments.

Many planners suggest a debt consolidation loan. In some cases that will work. But I feel that is an open invitation to disaster. All that happens is the debt gets consolidated. Since the debt payment is now spread out over a longer period of time and each payment is smaller, the temptation is to increase your expenditures. The new cash flow is easily spent and often, more debt is added.

The compounding debt reduction plan works because it teaches you the power of saving to reduce the debt. By avoiding the debt consolidation approach, you have the opportunity to see, firsthand that a quick fix, only postpones the inevitable—financial rehabilitation.

If I had to make a list of what personal items to purchase with time payments, there would be just three: your house, and automobile (possibly) and any fixed home improvements. Don't buy perishables, furniture, clothes, toys (TV's, stereos, radios, etc.) with credit. You are only spending your future income before you have earned it.

Any other expenses should be postponed until you have accumulated the cash in your PUT 'N' TAKE savings short term account. From our previous discussions, you probably can see the need for this kind of discipline. Without it, you may fall victim to the paralysis of debt.

USING DEBT TO CREATE WEALTH

Now let's look at how equity debt can be used to create wealth. Don't get me wrong, the concept of leverage has made vast fortunes, but leverage has also contributed to the loss of many fortunes as well. Debt can easily turn from friend to enemy…often overnight.

Using Leverage to Create Capital

Purchase Price: $50,000
Expected Sale Price: $75,000
Holding Period: One Year
Investor's Tax Bracket: 28%

		No Leverage	80% Financing
(1)	Initial Equity	$50,000	$10,000
(2)	Loan Principal	0	40,000
(3)	Sales Price	75,000	75,000
(4)	Gain on Sale [(3) - (1) - (2)]	25,000	25,000
(5)	Interest Cost [.15 x (2)]	0	6,000
(6)	Tax on Sale [.28 x (4)]	7,000	7,000
(7)	Tax Benefit of Interest [.28 x (5)]	0	1,680
(8)	Net Return [(4) - (5) - (6) - (7)]	18,000	13,680
	Return to Investor's Equity [(8) / (1)]	36.0%	136.8%

The Downside to Leveraging Equity

In evaluating whether leveraging is an appropriate risk, the investor must review not only the potential rewards of leveraging, but also the downside costs if the investment fails. What if he is not able to obtain the expected zoning changes or the market changes and after one year, the investor can only sell the property for $35,000? The investor must still repay the bank the $40,000 borrowed plus the interest of $6,000. The results of this investment would look like this:

Purchase Price: $50,000
Expected Sale Price: $35,000
Holding Period: One Year
Investor's Tax Bracket: 28% (Loss on sale will be a capital loss, offsetting other gains of investor.)

		No Leverage	80% Financing
(1)	Initial Equity	$50,000	$10,000
(2)	Loan Principal	0	40,000
(3)	Sales Price	35,000	35,000
(4)	Gain on Sale [(3) - (1) - (2)]	(15,000)	(15,000)
(5)	Interest Cost [.15 x (2)]	0	6,000
(6)	Tax on Sale [.28 x (4)]	4,200	4,200
(7)	Tax Benefit of Interest [.28 x (5)]	0	1,680
(8)	Net Return [(4) - (5) - (6) - (7)]	(10,800)	(15,120)
	Return to Investor's Equity [(8) / (1)]	-21.6%	-151.2%

My real estate partner and I purchased an office building in one of the prime real estate havens in America: Newport Beach, California. We leveraged ourselves to the max, in order to obtain this little beauty. It was fully rented and these rents were growing each year as demand for office space continued to rise. Another factor which contributed to our enthusiasm for this project was the small office configuration in the building. It was a prime property, in the low-end user market. There would always be a need for small offices, or so we thought!

When the California real estate crash came in 1987, this office building remained rented, but rents dropped and we were unable to make the mortgage payments. We had to feed this little puppy while we tried to restructure the debt so we could afford the building. The bottom line is we sold out for a fraction of our equity and lost significant capital—all with a fully-leased building.

So leverage can be a friend or a foe. Leverage is using someone else's money to create your wealth, yet it still has to be repaid, even if the investment doesn't work out.

For instance, suppose you could buy an investment for $100,000. The anticipated yield from this investment, let's assume, is 10% ($10,000) plus appreciation at 3%. But just before you complete your purchase, a friend comes along and offers to loan you $50,000 so you only have to invest $50,000 of your own capital. He offers to loan you the money for 12% over the life of the investment.

If the property appreciates 3% annually over 5 years, the value will grow to $115,927. The cash on cash return, exclusive of tax benefits, is 10% ($10,000) for 5 years. But remember, you do have to pay your friend $6,000 per year for the 5 years. (I'm assuming no amortization of the debt.) Your net cash flow would be $20,000 (5 x $10,000 less 5 x $6,000). Upon sale, the loan would be repaid and the net proceeds would equal $85,927 on a $50,000 investment. (The $15,927 appreciation plus the $20,000 net cash flow and your original $50,000 investment). The annual yield would be 14.3% ($35,927/$50,000 over 5 years). Contrast this to your yield if you had not borrowed from your friend. The return would be $50,000, (the cash flow) plus the appreciation of $15,927. However, the yield would drop to 13.19% ($65,927/$100,000 over 5 years).

Here is a chart which shows how leverage can increase your rate of return on this building. Your risk is whether you can make the monthly interest payments either from cash flow, any rental income, or from your own surplus income.

USING LEVERAGE TO IMPROVE YIELD

Your Investment	Amount Loaned	Average Yield
$100,000	$0	13.19%
$75,000	$25,000	13.58%
$50,000	$50,000	14.37%
$25,000	$75,000	16.74%
$10,000	**$90,000**	**23.85%**

By studying this chart, two conclusions are apparent. First, the less money you have in the investment, the higher your potential return and the more you can diversify your portfolio. But secondly, the more risk you are taking. In other words, you can own ten $100,000 investments using 90% leverage, assuming you can find them with comparable economics. However, remember, you are responsible for the potential problems created by ten investments and the increased risk if the real estate drops dramatically. When the cash flow stops or declines you could be in big trouble. Do you really want that much risk?

This might be a good time to stop and look at another economic law of investments—O'Toole's Law. Most everyone knows Murphy's Law—it holds that if something can go wrong, it will go wrong. But then O'Toole came along with his sobering corollary. "Murphy was an optimist." So, if you plan your cash needs around O'Toole's Law, you may never have enough in reserve, but at least you won't be taken by surprise.

Let's look at our investment again. The cash return (10%) is being used to pay debt if you elected to borrow $90,000 from your

MURPHY'S LAW
If something can go wrong, it will go wrong.

O'TOOLE'S LAW
Murphy was an optimist.

friend. Analyze the actual transaction, there is an $800 negative cash flow [(12% x $90,000 = $10,800) less (10% yield on $100,000 = $10,000)]. This loss must be covered from personal income or savings until the project is sold or the cash flow increases to cover it. The "hoped for" appreciation makes inflation a required ingredient if this investment scenario is going to be profitable. If the property never appreciates, all you have done is lost money $800.

There are many investors who have guessed wrong about appreciation and inflation. If you study the history of investment returns, you'll find most money instruments (CD's, Banker's Acceptance notes, T-Bills) earn 3% plus inflation. The difference between what money earns and the 15% or 20% return your hear about is your brain power. The real variable is your ability to invest wisely. Money is never worth more than 3%. The individual investor is the one who creates the profit dynamics. You've probably heard of successful friends or relatives who have earned vast sums from a fortuitous investment in a short time frame. They did something special. They often took considerable risk. But rarely, do you hear of people doing this repeatedly, over an extended period of time.

In summary, don't borrow personally more than you can repay in one year. A good rule of thumb is to never owe more than one year's income. Investing is not easy but compounding your risk by improperly using debt only adds to the anxiety and stress.

To avoid this risk, consider my next principle ...

CHAPTER

4

Set Lifetime Goals and Investment Objectives

EVERY MOTIVATIONAL AND FINANCIAL writer will tell you how important it is to set goals. Well, I agree. You must write them down, commit them to memory and review them frequently. Goals turn your dreams into realities. Anyone can dream dreams, but there is something magic about putting them down in writing and then holding yourself accountable (there's that word again).

Even as a teenager I was very goal conscious. For instance, I knew I wanted to go to college when I was in Junior High School. I was focused on doing well in school. I was competitive about practically everything. I was a driven person, focused and serious. Some of that carried through to my college years.

Unfortunately, even though I was unstructured in my approach, I knew that setting goals was important. When I started full time as a life insurance salesman in 1970, I was given a goal setting book by Pacific Mutual to complete. There were questions about materialistic accomplishments: new house, new car, family vacation, furniture, etc. These questions were designed to focus my attention on how much money I needed to earn to acquire these objectives. I'm not criticizing this process, but I can clearly remember my basic attitude toward money. I felt "money was a conduit to measure achievement…it's the scorecard." Money is only a way to determine effectiveness but I let it establish my self-esteem. I'm sure you recognize that the money message sent by our society is:

"If I am a success financially, then I am okay."

I filled out the booklet based on what I wanted to achieve that first year. I was scared and excited. I was asking myself to achieve goals that few had accomplished. I tried to be very detailed in every aspect of my planning. I set my goals and my accountabilities and then proceeded to keep accurate records.

What amazed me was that I had achieved my goals almost to the letter by the year's end. I had attained the sales results I had planned. See the following pages for my results. By keeping accurate track throughout the year, I discovered I had exceeded my goals in some areas and noted where I missed them in others. My natural gyroscope, a checking device first described by Maxwell Maltz in his book, Psychocybernetics, had self-corrected during the year. I had avoided unproductive areas of activity and concentrated on markets where I could attain better than expected results.

The next year I decided to try setting goals again based on improving my self-image and confidence. Again, to my amazement, I attained these new goals almost exactly. All during my life I had been goal directed, but I had never been specific about time horizons or establishing a long term plan. As I thought about past results, it became clear that goal setting was an important life lesson. I started to dream about the future. But instead of allowing myself to be trapped by only my materialistic "I wants," I also tried to concentrate on self-improvement goals as well. I'm not trying to tell you I didn't have financial goals because I most certainly did. I still do. But there was something in me saying there are more important goals to achieve than money. Money is a means to an end. But, I'm okay if I'm not wealthy.

One of the biggest influences in my life was The Million Dollar Round Table. It is a wonderful sales organization made up of the top life insurance agents in the world. It is dedicated to sharing—sharing sales ideas, life ideas and friendships. It is an organization composed of the top 5% of all life insurance agents internationally.

Copy of Goals Record

My Market Plan 1970

Best Present Market Segments to be Emphasized	Estimated % of Time to be Spent	Estimated Production Results	
		Cases	Product Credit
College	20%	48	154,000
Clients	20%	20	200,000
Alumni	10%	10	100,000
Referrals	30%	20	300,000
Contacts	10%	30	400,000
New Markets to be Developed			
Orphans	10%	10	150,000
Totals			
	100%	134	1,304,000

Copy of Goals Record

My Market Plan 1971

Best Present Market Segments to be Emphasized	Estimated % of Time to be Spent	Estimated Production Results Cases	Product Credit
College	10%	6	48,000
Clients	25%	16	217,300
Alumni	0%	0	0
Referrals	20%	22	217,001
Contacts	30%	30	614,000
New Markets to be Developed			
Orphans	15%	10	147,600
Totals	100%	87	1,263,901

Out of the many gifts this organization has given through the years, the whole man concept has been one of the dearest to me and to many of the other members. The need to be well-rounded and balanced in all aspects of one's life is critical to attaining Maslow's self-actualization level. I know it is critical to me. Perhaps like me, you need to be shaken sometimes to have new challenges placed in your path. I have a specific need to be introspective.

Ralph Brown, my professional mentor and close friend since 1966, once told me, that self objectivity is my strongest asset. I have learned that I need to be willing to listen to comments which may hurt, if I can and to always remain open and receptive to new ideas. Being vulnerable is a difficult attitude to maintain. It requires you to let down your defenses and at the same time be receptive to what others think. The potentially ego-threatening observations and criticisms requires each of us to make ourselves vulnerable or else we live in denial.

What's the payback for being vulnerable? First, very few people can do this successfully. So one benefit is that you set yourself apart from the crowd. As a result, this will draw others to you because many are seeking a relationship with honest, direct people. A second benefit is that vulnerability allows you to develop an intimacy with others that cannot be achieved any other way. But the best benefit is that it ultimately creates an inner peace. The Bible says that the "truth shall set you free." This freedom comes from being vulnerable and having no guile. It also comes from being open and receptive to new ideas and perceptions which may at first be threatening and foreign. It doesn't mean you have to buy into them, you just need to listen and evaluate them.

There are many good self help books available which clearly delineate the steps to self understanding and awareness. But the important part is to start the process of breaking down the barriers which have been erected from your youth. Charlie "Tremendous" Jones says that in the next five years you will change based on the books you read and the relationships you develop.

Personally, I believe that it is my duty and obligation to maximize my effort and work as hard as I possibly can when I work. But I know I cannot control the outcome, only the effort. I can only control what I can control. If I do my best, then I have to trust the

Planning Success

Million Dollar Goal Guide

20 Years to reach $1,000,000

I Have Now (000)	I Need (000)	My Money Has to Earn	If the Money I Have Now Earns 5%, It Will Be Worth	Shortfall	Investment Return Needed to Meet Goal if $10,000 Invested Annually OR	How much Do I Need to Invest Each Year @ 5%
$20	$98	21.48%	$53,066	$946,934	13.28%	$27,274
$40	$960	17.46%	$106,132	$893,868	12.82%	$25,746
$60	$940	15.10%	$159,198	$840,802	12.33%	$24,217
$80	$920	13.46%	$212,264	$787,736	11.81%	$22,689
$100	$900	12.20%	$265,330	$734,670	11.25%	$21,160
$120	$880	11.18%	$318,396	$681,604	10.64%	$19,632
$140	$860	10.33%	$371,462	$628,538	9.98%	$18,103
$160	$840	9.60%	$424,528	$575,472	9.26%	$16,575
$180	$820	8.95%	$477,594	$522,406	8.46%	$15,047
$200	$800	8.38%	$530,660	$469,340	7.57%	$13,518
$220	$780	7.86%	$583,725	$416,275	6.56%	$11,990
$240	$760	7.40%	$636,791	$363,209	5.39%	$10,461
$260	$740	6.97%	$689,857	$310,143	4.01%	$ 8,933
$280	$720	6.57%	$742,923	$257,077	2.33%	$ 7,404
$300	$700	6.20%	$795,989	$204,011	.19%	$ 5,876
$320	$680	5.86%	$849,055	$150,945	**	$ 4,348
$340	$660	5.54%	$902,121	$97,879	**	$ 2,819
$360	$640	5.24%	$955,187	$44,813	**	$ 1,291
$380	$620	4.96%	$1,008,253	($8,253)	**	**
$400	$600	4.69%	$1,061,319	($61,319)	**	**
$420	$580	4.43%	$1,114,385	($114,385)	**	**
$440	$560	4.19%	$1,167,451	($167,451)	**	**
$460	$540	3.96%	$1,220,517	($220,517)	**	**
$480	$520	3.74%	$1,273,583	($273,583)	**	**
$500	$500	3.53%	$1,326,649	($326,649)	**	**

outcome will be satisfactory regardless of what actually happens. In other words, I do the work and I trust God for the results. To really accept and be peaceful about my inability to control the result is difficult. But once you attain this level of trust and understanding, a whole new peace prevails and new vistas of opportunity open up.

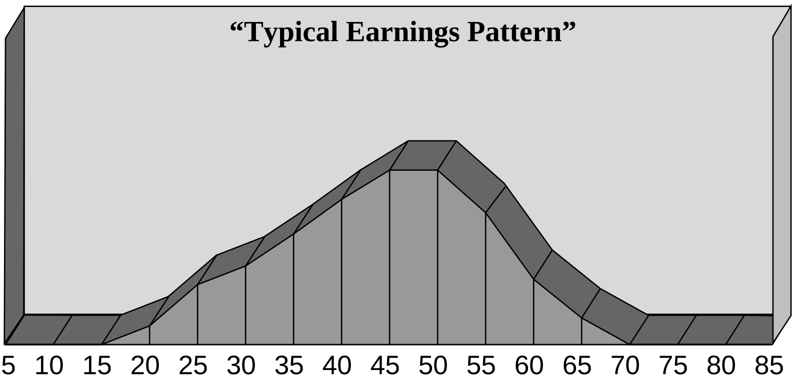
What I have said before bears repeating. Most people fail NOT because of their lack of ability. They fail because of their lack of effort and unwillingness to persist. Failure is really quitting. If you want to overcome your past failures, you must have a plan.

I'm convinced goals are the place to start. Undirected effort is exhausting and futile. Effort directed in a focused planned manner becomes compounding energy. The results literally compound over time. You are supplying the knowledge and effort, but you can't control the rate at which it compounds. Refer back to the discussion on the chain of compound interest and think about the similarity of the two concepts. Can you see that the concept of compounding is not limited to just money? Compounding also applies to effort.

Knowing how much effort to expend is not enough. Being a basically compulsive individual, I could easily devote all of my time to one area of my life. By planning my activities in a sane and objective manner, I am less likely to over commit and make myself lopsided. By defining a direction and a road map for my effort, I provide myself with a way to measure my progress or lack of it. If I am satisfied with the progress, great! But if I'm dissatisfied, I can determine where I am missing the mark. Are my goals too high? This might mean the rate of compounding is not realistic. Am I unqualified to achieve the goals I have set? Then I need to improve my skills. Does this mean schooling? Reading? Talking to others? Determine why you are falling short and then create a plan to fix it. This is much better than quitting and walking away.

I have known people who have refused to write down their goals or even set any at all. Why? Well, I think the biggest reason is their fear of failure. I think fear of failure is prevalent at all levels of society. Fear is the root cause of any dysfunctional behaviors. That may seem like a strong statement. But as I have evaluated my own life, I can clearly see that I am a victim of my own fears. I react when I become afraid I am not going to get my way. I react when

During Your Lifetime You Will Earn a Great Deal of Money!



You will earn a fortune . . . but, how much of it will you keep?

Look at how much money will potentially pass through your wallet during your working years. President Truman had a sign on his desk which read, "The buck stops here." Without a plan, the sign will read, "The buck doesn't even pause here."

Earnings per month	Years 5	10	15	20	30	40
$1,000	$60,000	$120,000	$180,000	$240,000	$360,000	$480,000
2,000	120,000	240,000	360,000	480,000	720,000	960,000
3,000	180,000	360,000	540,000	720,000	1,080,000	1,440,000
4,000	240,000	480,000	720,000	960,000	1,440,000	1,920,000
5,000	300,000	600,000	900,000	1,200,000	1,800,000	2,400,000
10,000	600,000	1,200,000	1,800,000	2,400,000	3,600,000	4,800,000
20,000	1,200,000	2,400,000	3,600,000	4,800,000	7,200,000	9,600,000

I think I am going to fall short of my expectations. I react when I sense I am being threatened by others. Fear masks understanding and prevents open, honest communication.

The unwillingness to commit to a goal demonstrates a fear to commit to anything which might pinpoint or highlight my inadequacy. It is this fear of failure which I believe prevents people from risking and trying new adventures which might open up their life to new experiences and opportunities. Think about this! Did you ever, once, say to your folks, "I don't want to eat spinach, broccoli or a certain meat," only to try it months or years later and find out you liked it? In fact, now it may very well be your favorite food. Or better still, maybe your folks wanted to go on a trip and you didn't want to go. Reluctantly you went along, determined not to have a good time. Afterwards, you discovered it was really fun and you were glad you participated. This happened many times to me. The fear of the unknown inhibits spontaneous activities, it reduces our horizons, it prevents our willingness to try new things.

In other words, if I stay uncommitted, if I refuse to try new things, no one will see my inadequacies or be able to point to my failure and humiliate me. I will be safe, albeit bored, unhappy or wistful. But I will be safe.

WRITE THE GOALS DOWN

Every so often, I am reminded of a study I have heard about. This study, which was supposedly undertaken by Princeton University. It was aimed at finding out why some people are successful and why others are financial failures. The study resulted in dividing the group into four categories: A, B, C and D.

Members of Group A, which accounted for 3% of those who were surveyed, were financially independent. They had no financial worries and were insulated from the economic stresses associated with earning a living or maintaining their standard of living. Group B was well-to-do. In other words, they were able to maintain a comfortable life style and continued to build wealth. About 5% of the individuals surveyed fell into this group.

The people in Group C were described as being able to pay their bills. This is often referred to as having "too much month at the end of their money." These people, who accounted for 13% of those surveyed, were preoccupied with financial survival and are often thwarted by their purchases and life style. Their goal is to make ends meet. But the largest group of people in the sample (79%) were virtually destitute.

The purpose of the study was to determine the socioeconomic differences between the groups. Researchers found that there was one common denominator shared by the people in Group A and B that was not shared by the people in Groups C and D. Can you guess what it was?

In seminars, when I have asked this question, I have gotten a variety of answers such as, inherited wealth, amount of money, rate of savings, education and ambition. The only common denominator was having goals. That's right, goals! The only discernible difference between the two top groups and the others, was that people in the top knew where they were going and when they got there. The other two groups were floundering because the people were not goal centered.

The study went on to analyze the differences between the top two groups. The only real difference again centered on goals. Group A, the financially independent, had written down their goals. They had committed in writing, the strength of their dreams. Group B was less detailed and committed.

I have never been able to determine if this study actually exists. But I do know from personal experience that there is something

PRINCETON STUDY

Group A	3%	Independently Wealthy
Group B	5%	Financially Secure
Group C	13%	Too much month left
Group D	79%	Poverty Level

What was the difference between Groups A & B and C & D?

What was the difference between Group A and Group B?

magical about writing down the dreams of a lifetime (or for a minute). When you see your goals in writing, if they are truly what you want to accomplish, you infuse them with consciousness and awareness. Writing them down also makes you feel more committed and accountable.

That's the magic! The goals become part of your inner consciousness and by continually reviewing them, they are burned into your subconscious and you strive to succeed. Now don't think me crazy, but inner awareness acts as a magnet. As you walk through life, you see things differently. New opportunities and ideas begin to match your objectives and you see things through a different set of eyes. All the components of success are around us, if we only know where to look. I suppose there are those who would take issue with the data or findings of this "study," but I truly believe in the power of written goals. I've experienced it. You can, too!

SETTING GOALS

Priorities and objectives are difficult to define. I spent years trying to accumulate the following questions and understand the thought process involved, so I could help direct friends and clients through this maze. I think the main reason it is so difficult to put our priorities in order is the wide variety of goals and options available. It's like being in a candy store. We are drawn to so many appealing distractions that we may be drawn in an entirely different direction than where we were headed.

When I became a life insurance agent, I knew many before me had failed, but that I would have as many opportunities to succeed as I would to fail. When I started, I vowed to be the best life insurance agent I could be…for ten years. My only focus was on doing the job at hand, finding prospects and serving clients. I wouldn't let myself be distracted into other business investments regardless of how tempting the opportunity might be. It was only while I started working on this book that I realized my ten year commitment tracked with the compound interest curve. Instinctively, I knew I was doomed to failure if I deviated from my specified course. Fortunately, my goals prevailed and my dedication paid off. Here is a list of goals and questions for you to consider.

Standard of Living

This section is designed to help us evaluate your discretionary income for building or preserving purchasing power.

1. What do you estimate your total Annual Income will be for this year? _____ Next Year? _________ Do you foresee any significant changes (raises, promotion, starting own business)? _________ If so, what? ____________
2. Do you use a budget? __________ How much do you allocate to wealth accumulation? __________ Why? _________________________________
3. Quantify your monthly expenditures: Fixed (housing, utilities, etc) $ ______ Variable $__________ Discretionary $__________ Income Taxes $ ____ Total saved or invested last year $__________ This year $ ____________
4. Are you satisfied with your financial progress? __________ If your net worth grows as much in the next five years, will you be satisfied? _____________
5. Do you have any specific financial concerns? ________________________ What are they? ____ What actions have you initiated to resolve them? ______________________
6. What is your most important financial goal? __________________________ Personal goal? ____ Have you written them down? _____________________________________
7. How much income would you need if you were disabled for longer than thirty days? __________ Where would it come from ? ______________________ Have you ever considered the real cost of disability (loss of capital)? _____
8. Do you have a cash reserve for emergencies? ______ How much $ _____ Where is it invested? ____
9. Do you have a specific game plan for increasing your current standard of living (new house, care, education)? _______________________________
10. If you have children, are you planning to pay for their college education? __ What steps have you taken? ______________________________________ Can you use their tax bracket instead of yours? _______________________

Financial Objectives

These questions are used to evaluate your risk propensity and desire to use current tax savings opportunities to increase your net worth.

1. The high cost of income taxes affects people differently. Are you willing to consciously plan to reduce taxes? _________ If so, to what extent? Conservative? _____ Mildly aggressive? _____ Very aggressive? _______

2. How much income tax did you pay last year? _________ How much would you be willing to pay? ____

3. Does your accountant help you reduce taxes? _______________________ In what ways? ____

4. Are you qualified for Social Security Benefits? __________ Have you checked to see if you have been credited for all your contributions? ______

5. Have you started funding your retirement? __________ What method, if any, have you established? _____________________________________ When would you like to retire? _______ How much income will you need? ______

6. Can your investments be easily converted into income? _____ Which ones? ____

7. Is your current investment strategy aimed at appreciation? _____________ or income? ____

8. What do you consider to be a fair rate of return on your capital? _________ What do you think will be the long-term inflation rate? _________________

9. Do you think of yourself as a risk taker? _____ Risk avoider? ___________

10. Do you think "Security Capital" should be invested differently than "Risk Capital"? _____ What do you think is a fair ROR on Security Capital? ____ Equity Capital? ____

11. Have you explored the tax benefits offered through charitable giving (church, college foundations)? _____ Are you interested? _____ Do you give regularly to any charity now? ____ If so, which ones? ____

Family Security Considerations

Two of the major risks to successful wealth accumulation are disability and death. This section is provided to help us measure your capital and income requirements if either should occur.

1. Would your family (spouse) want to remain in your current residence? If there is an existing mortgage, should it be prepaid? _______ Should both of you die in a common accident, do you want your children to live together? _______ Is this currently funded?

2. Could your spouse manage your family assets without professional assistance?

3. Could your family maintain their current standard of living if you lost your job? _______ If death occurred? _______ If your spouse died? _______ How do you feel about your contingency plan?

4. Would your death impair the college education of your children? If so, should any percentage be assured? __________ What about inflation-proofing that percentage?

5. In the event of death, do you feel there is any necessity for an emergency reserve? ________ If so, how much cash should be allocated?

6. Would there be an economic impact on your family should your spouse predecease you? ________ If so, what?

Retirement Objectives

1. How much will come from a formal retirement plan? $_________
2. Do you currently participate in this plan? $_________
3. How much income will come from accumulated capital? $_________
4. How much of this capital is in place? $_________
5. What is a reasonable rate of return for future appreciation? ________%
6. What inflation rate should be assumed? ________%

Estate Transfer Objectives

If death should occur, the government has a lien against all of your assets. In order to release this lien, many considerations must be evaluated.

1. Does your current will (or the state provisions for people with no will) reflect your current desires? ______ If not why? ___________________________

2. Have you ever been an executor or trustee? _____If so, how would you improve the constraints and problems? _____________________________

3. How much do you think your estate would be forced to pay in estate and income taxes if you died today? _____ If you could reduce that cost with no lifetime hardship, would you be willing to take the necessary steps? ______

4. Is it reasonable to expect your net worth to continue to appreciate? ______ At what rate? ____

5. Would "freezing" the estate costs on your assets at today's value make sense? ______ Would you be willing to give up ownership of the future growth to accomplish this? ____

6. Would you be willing to utilize family gifts as a method for "freezing" taxes? ____

7. Do you currently own any life insurance? _______ Why or why not?______ ____

8. Is your attorney qualified to help you plan your estate? _____ Is your insurance agent? ____

9. Should you and your spouse die in a common accident, at what age would you like to see your children obtain "uncontrolled" possession of their inheritance?

   ____ 1/3 at 25, 30, 35
   ____ income to 30, 1/2 at 30, 35
   ____ 1/3 at __, __, __
   ____ 1/2 at __, __, __
   ____ lump sum at ____

10. Do you want professional management until distribution to your children? ____

Setting Priorities and Objectives

Please place a value on each item on the following list. First, rank them according to the importance of that item to your value system. Then assign a priority based on your willingness to implement them. See if you can select your top five priorities from this list, using your comfort level as your guide.

1-10 IMPORTANCE	High -low PRIORITY	
________	________	The assurance that medical bills are paid.
________	________	The replacement of your income if you are disabled.
________	________	The desirability of reducing current income taxes.
________	________	The protection of property values against the hazard of fire and other physical hazards.
________	________	Protection against liability exposure.
________	________	The taking of speculative investment risks with the potential for larger returns.
________	________	The investment in low-marketability properties.
________	________	Protection against the effects of inflation.
________	________	The passage of assets to children.
________	________	Equalizing among children.
________	________	The creation of capital for investments.
________	________	A concern about the amount of assets attributed to your company.

Investment Alternatives

Listed below are a number of savings and investment alternatives. Please indicate your preference with respect to each item by circling a number one (1) through five (5). One indicates a low preference while five indicates a high preference. Additionally, please indicate your degree of familiarity with each investment on the one (1) through five (5) scale. One indicates no familiarity while five indicates a high degree of familiarity.

		Preference Low High	Familiarity Low High
1.	Annuities - Fixed	1 2 3 4 5	1 2 3 4 5
2.	Annuities - Variable	1 2 3 4 5	1 2 3 4 5
3.	Antiques - Furniture	1 2 3 4 5	1 2 3 4 5
4.	Art	1 2 3 4 5	1 2 3 4 5
5.	Asset Management		
6.	Bonds - Convertible	1 2 3 4 5	1 2 3 4 5
6.	Bonds - Corporate	1 2 3 4 5	1 2 3 4 5
7.	Bonds - Government (FNMAs)	1 2 3 4 5	1 2 3 4 5
8.	Bonds - Municipal	1 2 3 4 5	1 2 3 4 5
9.	Cattle	1 2 3 4 5	1 2 3 4 5
10.	Coins - Rare	1 2 3 4 5	1 2 3 4 5
11.	Commodity - Futures/options	1 2 3 4 5	1 2 3 4 5
12.	Convertible Securities	1 2 3 4 5	1 2 3 4 5
13.	Equipment Leasing	1 2 3 4 5	1 2 3 4 5
15.	Foreign Bank Accounts	1 2 3 4 5	1 2 3 4 5
16.	Foreign Currencies	1 2 3 4 5	1 2 3 4 5
17.	Gold Coins	1 2 3 4 5	1 2 3 4 5
19.	Life Insurance		
20.	Managed Tax Trust	1 2 3 4 5	1 2 3 4 5
20.	Mutual Funds - Income	1 2 3 4 5	1 2 3 4 5
21.	Mutual Funds - Balanced	1 2 3 4 5	1 2 3 4 5
22.	Mutual Funds - Growth	1 2 3 4 5	1 2 3 4 5
23.	Mutual Funds - Speculative	1 2 3 4 5	1 2 3 4 5
24.	Mutual Funds - Bond	1 2 3 4 5	1 2 3 4 5
25.	Precious Metals (Gold, Silver, Platinum)	1 2 3 4 5	1 2 3 4 5
27.	Precious Stones (Rubies, Diamonds, Emeralds)	1 2 3 4 5	1 2 3 4 5
28.	Oil / Gas - Income	1 2 3 4 5	1 2 3 4 5
29.	Oil / Gas - Diversified	1 2 3 4 5	1 2 3 4 5
30.	Real Estate - Equity Trusts	1 2 3 4 5	1 2 3 4 5
32.	Real Estate - Ltd. Partnerships	1 2 3 4 5	1 2 3 4 5
33.	Real Estate - Private Purchase	1 2 3 4 5	1 2 3 4 5
34.	Savings - Passbook	1 2 3 4 5	1 2 3 4 5
35.	Stamps	1 2 3 4 5	1 2 3 4 5
37.	Stocks - Common	1 2 3 4 5	1 2 3 4 5
38.	Stocks - Preferred	1 2 3 4 5	1 2 3 4 5
39.	Stocks - Options	1 2 3 4 5	1 2 3 4 5
40.	Treasury Bills, Notes, Bonds	1 2 3 4 5	1 2 3 4 5
42.	Venture Capital	1 2 3 4 5	1 2 3 4 5

Statement of Objectives

Yes	No	
❑	❑	The present estate plan has not been reviewed for several years and revision is required.
❑	❑	An estate plan has not been formally adopted at this time and suggestions would be appreciated in order to achieve stated goals.
❑	❑	There is an interest in comparing the pricetag of the tax law on other estate plan alternatives and how such alternatives might be able to reduce estate costs.
❑	❑	Any long term planning techniques that could be employed to pass ownership and control to the key management team and sustain a fair value to designated heirs.
❑	❑	Understanding any legal methods that could be employed to pass future growth estate tax free to children.
❑	❑	"Flexible" estate planning steps that are not irrevocable in nature.
❑	❑	An interest in any suggestions that would prevent personal and business assets from being liquidated to pay estate costs and taxes.
❑	❑	Desire to see ideas that would minimize income taxes.
❑	❑	Alternatives should be explored that would enhance retirement income and provide tax wise dollars for retirement.
❑	❑	A determination to pass the estate to living issue in an orderly manner that will not inhibit its maturity or personal growth.
❑	❑	Business succession planning should be explored.
❑	❑	Any other requests ____ ____
❑	❑	Regarding estate building and investments, suggestions regarding the following would be appreciated: _________________________ ____

FEAR OF SUCCESS

If fear of failure was the only stressor, life would be much simpler. But there is also a fear of success. Imagine that! Not only do we have to worry about failing, but once we have it all going, we have to worry about being too successful. I would define fear of success as an incongruity between self-image and results. If you have ever played golf, you know the feeling. On the first four holes you go par, par, birdie, par. Then fear starts. Self-doubt and paralysis replace the calm and joy of your early success. "I am not this good," you think to yourself. "When will it all end?" Suddenly the self-fulfilling prophecy comes true and you're back to bogey golf or worse.

In my early years as an agent, my goal was to attain the major sales recognition level within Pacific Mutual called "National Leader." In 1970, it was a rarity for a new agent to qualify for this production club in their first year. But this was my goal. I wanted the recognition and personal satisfaction of making Pacific Mutual's National Leader's Club and I wanted to qualify for the Million Dollar Round Table. Since it was February, I only had ten months to achieve it.

It was an all-consuming goal. I lived and slept this goal. I'm sure I was unbearable. Remember the little boy practicing baseball for hours? Everything I ever wanted to be, everything I ever was going to do, rode on achieving this goal. It was my first step to long term success. In December of that first year, I was real close. I had the goal in sight. In fact, I was a little ahead of schedule. I could see myself attaining this all-consuming goal. And then something happened! I slacked off. Yes, four weeks to go and my concentration and intensity ebbed. I unconsciously relaxed. I could feel it coming, but I couldn't pinpoint what was happening. My goal was attainable and suddenly I was self-destructing, going in the opposite direction.

My life flashed before my eyes and I saw this life pattern emerging. This had happened to me all my life, I thought. Whenever I got close to my goal, I would hesitate and falter. Any financial successes I had achieved were about to be demolished right at the end. But I was not going to allow myself to fail this time. So, I set my jaw and reached down for inner determination. It took nearly a week to refocus but I did it. And to my relief and pleasure and amazement, I finished in a blaze of glory, instead of going down in flames.

There are two observations I'd like to share about this experience. First, I refused to fail by quitting (recognizing I could only control my effort not my results). Yet the fear of success, actually achieving the goal, was my biggest stumbling block. I had to will myself through this plateau of fear and force myself to finish the job. I think we all face these mysterious plateaus. Once we learn to recognize them and overcome them, they disappear. However, they are always lurking in our subconsciousness, waiting for the chance to strike.

The other lesson was even more important. Unfortunately, it took me nearly three more years to really understand its significance. When I got to the other side of my goal, the successful attainment of my year's sales objectives, I felt despair, emptiness. Is this all there is? I had worked my tail off for ten months. I had achieved my all-consuming goal and now I felt emotionally spent, a real letdown. The goal was gone. Where was the ticker tape parade, the television announcers, the headlines, the cheering and shouting, the dancing girls? Who knew and more important, who really cared? Only me and that wasn't enough! Or was it?

The next year I experienced a mental regression for five months. I got lazy and self-satisfied. When I came to my senses, I was now forced to achieve my year's goals in only seven months. I had allowed my emotions and self-satisfaction to destroy my

BARRIERS TO SUCCESS

1. Fear of Failure	2. Fear of Success
Procrastination	Self-Defeating Behavior
Paralysis	Excessive Humility
Excessive Excuses	Low Self-Esteem

consistency. Again I hit the December wall and again, I had paralysis. But a funny thing happened. I had some confidence this time. After all, I had done it before, so I could do it again. Success is cumulative. (Remember compound interest?)

As I look back on those life lessons, I can see how important they were in shaping who I am today. Without those hard times, could I really appreciate the joy which accompanies new successes? Ultimately, I finally concluded I had been working for someone else's goals. And when I started working for my long-range goals, the depression I described earlier was no longer there. Instead, I was able to enjoy life's chain of compound interest. I see this chain working in all areas of my life. My accomplishments were no longer based on what others thought or expected, but instead, on what was important to me!

TEN COMMANDMENTS OF GOAL SETTING

First, we saw from the study, it is important to write down your goals so that you can refer to them regularly. You'll find that the act of writing them down and later reading them, is what makes the goals real.

Second, state your goals in positive terms. Say what you want to happen rather than stating the negative consequences that might happen if you fail.

Third, make sure the goal is honestly attainable. Be realistic. Don't set yourself up for failure. You can always increase your goals if you decide you have set them too low.

Fourth, never make your goal beating someone else. You don't need to have your success measured by someone else's failure. Quantify your goals in a way which allows you dignity and joy for what you have accomplished. If your success means unhappiness or failure for others, where is the victory? Go at your speed for your reasons.

Fifth, keep your goals confidential ... only share them with people who want you to succeed or will and can help you. Many speakers tell us to make our goals public. I would encourage you to share them only with those who you respect and are committed to your success.

10 Commandments of Goal Setting

1. Write them down ✔
2. Be Positive ✔
3. Be honest ✔
4. Be commited ✔
5. Keep them confidential ✔
6. Review them regularly ✔
7. Be creative ✔
8. Set a specific deadline ✔
9. Be specific ✔
10. Visualize your success ✔

Sixth, review them regularly. It helps to update your progress. It also keeps them burned in your subconsciousness. You cannot achieve that which you do not know.

Seventh, be freewheeling and creative. In thinking of goals, start without limitations. You can edit them for reality later. Don't limit yourself by your own fears. What would you like to be when you grow up? Enjoy the thrill of going beyond yourself. If you want it bad enough, you'll find a way.

Eighth, set time limits. All goals should have a deadline: weekly, monthly or at an extreme, annually. There is a difference between a lifetime goal which is not immediately achievable and the little steps you have to accomplish along the way.

Ninth, be specific. State your goal in precise terms. Define the steps you have to take to get to the end result. If you are vague and undefined, you will miss the mark.

Tenth, and last, think of yourself as already having attained them. Look into your mind's eye and see yourself as successful. Our mind acts on what it believes to be true. You'll find role playing changes your attitude into a powerful force which should prevent you from returning to your former aimless self.

Also, never say "can't." Joel Weldon, a motivation trainer in Phoenix, Arizona, once gave me a tin can as a paperweight. The

SIX MAIN REASONS PEOPLE FAIL FINANCIALLY

1. Putting off saving until can afford it.
2. Being undirected.
3. Not appreciating how hard it is to build capital.
4. Not planning to use all of the tax advantages available.
5. Lacking patience and perseverance.
6. No system and relying on emotion.

label read, “Success comes in cans, not cannots.” If you believe you can, you can. If you believe you can’t, you will create a self-fulfilling prophecy. Don’t set yourself up for failure.

So, Principle #4 is to set lifetime goals and objectives. Break them down into small steps. I’ve been told you can only eat an elephant one bite at a time. These goals are the foundation for you to measure your success. If you are true to them and honest in your appraisal, you will always have a benchmark to assess how well you have done.

Now let’s apply these goals to making money…

CHAPTER

5

Make Your House a Profitable Venture

SINCE OUR HOME is often our largest single expenditure, we need to make it profitable. What is really nice about a home is the nature of its tangible value. Obviously, the market determines its value at any point in time. But once you own the house of your dreams, it doesn't matter what others would pay, unless you are going to sell it.

By contrast, most other long-term investments we make are not as liquid as a good home. Notice, I said "a good home." When we wanted to sell our first house, it took one year before I concluded no one was going to buy it. I virtually had to give it away. I sold it to the real estate people for $1,000 less than we paid. Conversely, our second house sold in one day for $35,000 more than we paid for it only two years earlier. Why? Location! Generally speaking, when you are forced to sell off an investment to raise capital, the value may be discounted at the time of sale. Perception and demand dictate value. But with a good house, even if the general market values are down, your house could be worth more. A house can also be a dynamic tool for wealth accumulation. We'll look at how a little later.

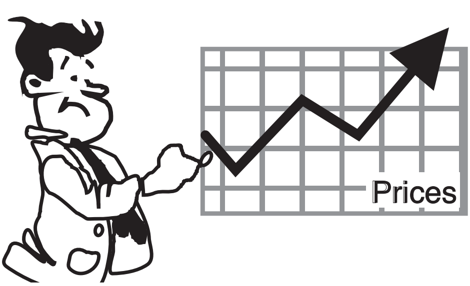
To make purchasing a home as profitable as possible, look first at the desirability of the community, then the general neighborhood and finally the specific tract. Is the community growing or has it

History of Inflation

Consumer Price Index

Source: U.S. Department of Labor, Bureau of Labor Statistics
Figure shown is annual average CPI-W used through 1977 and CPI-U thereafter.

1916	33	1936	42	1956	81	1976	171
1917	38	1937	43	1957	84	1977	182
1918	38	1938	42	1958	87	1978	195
1919	52	1939	42	1959	87	1979	217
1920	60	1940	42	1960	89	1980	247
1921	54	1941	44	1961	90	1981	272
1922	50	1942	49	1962	91	1982	289
1923	51	1943	52	1963	92	1983	298
1924	51	1944	53	1964	93	1984	311
1925	53	1945	54	1965	95	1985	322
1926	53	1946	59	1966	97	1986	328
1927	52	1947	67	1967	100	1987	346
1928	51	1948	72	1968	104	1988	360
1929	51	1949	71	1969	110	1989	377
1930	50	1950	72	1970	116	1990	400
1931	46	1951	78	1971	121	1991	412
1932	41	1952	80	1972	125	1992	424
1933	39	1953	80	1973	133	1993	437
1934	40	1954	81	1974	148	1994	450
1935	41	1955	80	1975	161	1995	466



Average Annual Rate of Inflation
Last 20 Years: 6.1%
Last 10 Years: 4.3%

already had its major boom? Is the neighborhood near a freeway, either existing or proposed? How hard is it to access your development? What are the traffic patterns like in the morning and coming home in the evening? Are you in an airport flight pattern? Is there a long range plan which could negatively affect your house? Are there any political issues which could reduce the value of the area? How about chemical waste or sewage? Go to the city planning commission and look for public notices of meetings or development plans. You won't hear bad things from the seller or the real estate agent. If there is any bad news, you will have to find out for yourself!

BUYING SMART

Logic and "crystal ball" forecasting must go into your neighborhood evaluation. That is to say, do you see well-kept homes? Are the homeowners taking care of their yards? Do the homes need new roofs? Can you determine if there are swimming pools nearby, dogs, or other potential annoyances? Is there a homeowner's association which maintains and regulates home appearance and upkeep? Get copies of the last few year's association minutes. Read the Covenants and Restrictions (C&Rs). Can you predict with some certainty that the value of these houses will steadily increase, or is the neighborhood overbuilt? What about schools, shopping, road access to local areas? Is the home considered rural or urban? Plans for sewers, power, water, future growth should also be considered. Also look for proposed construction which could ruin your view.

Last is the actual tract of streets. When it comes to predicting future value you should look at the lower or mid-priced homes in the same tract because traditionally they will enjoy a better growth rate. For example, a $150,000 house located next to a $200,000 house can enjoy a higher potential value in ten years, than if you purchased the $250,000 house around the corner. That is, if both houses increase $50,000 in value over a decade, the lower priced house has increased by 33% while the larger house has increased by approximately 20%. Ask about the builder and their reputation? Have there been any faulty construction claims? What have been the historical resale values? Is the house overbuilt for the area? Is it on a cul-de-sac or a busy street? Will major repairs be needed soon, such as a

How to Tell Whether Your Area is Getting Soft

1. The average selling time for houses has lengthened by 30% or more.

2. There's a widening gap between asking prices and final selling prices.

3. The number of residential foreclosures is rising.

4. The vacancy rate in office buildings and other commercial real estate is increasing.

5. There's a decline in the number of building permits issued. Such a drop in permits means fewer housing starts—which, in turn, signals that builders believe they won't profit in the market.

6. Note who is selling houses. It's a bad sign if a bank is selling; it probably means the owner or developer lost it.

What to Do

1. If you can, relax and ride out the downturn. If you must sell, get appraisals from three brokers—and don't be too greedy.

2. Try to sell your house quickly. Determine the average selling time in your neighborhood, then add two months for closing time. Estimate your mortgage, taxes and utility costs for that period and then lop that grand total off your asking price.

3. If your income is secure, look to trade up to a fancier house or a more desirable neighborhood.

4. Bid about 10% below what similar houses in the neighborhood have sold for recently—and bargain hard from there.

How to Tell Whether Your Area is Getting Strong

1. Local employment is rising 3% or more annually.
2. A stable or shrinking number of houses are up for sale.
3. The area enjoys significant upgrading or expansion of retail business.
4. There's extensive highway development or a new airport. Improved transportation often brings growth to an area.
5. Major land purchases are being made by expanding or relocating corporations or wealthy investor-developers.
6. Many of the new houses being built are obviously of high quality—not just Tinkertoy tract houses.
7. There's a high percentage of owner-occupied housing in the neighborhood.

What to Do

1. Buy all the land you can, even if it comes with less house than you want. You can always expand the house when you have more cash, but the increasingly more valuable land may eventually move beyond your reach.
2. Get the longest-term mortgage you can if you need to hold down monthly payments in order to buy in the neighborhood.
3. Go shopping in November and December, when there are fewer competing buyers to drive up prices.
4. Settle for a longer commute to get more house for your money.
5. Make a serious offer on an unfinished house—or consider taking on a handyman's special.

new roof? What will general maintenance costs be? Get a copy of any records which show utilities costs, repairs or assessments for property taxes.

Once you make your buying decision, you are in a position to enjoy your house and participate in the fruits of your decision. If your house appreciates, you have created "tax-free" capital for other investments. Frankly, I have vacillated on this issue through the years. There are times when I think having a house with no mortgage is the best idea. Then there are times when using the equity for other investments makes sense. The answer lies in your own personal need for security and ability to accept risk.

If your home appreciates in value, you can refinance and use the equity for investment capital. The key is to make the money grow faster in an outside investment than it costs you to borrow on the equity and continue to keep it in your home. These are questions you may wish to go over with your financial advisor.

California millionaires have a perverted perspective on housing. There have been many fortunes made by trading up and refinancing the equity, but the simple principle is there for everyone. You can't compromise your long-term financial security by over-reaching your income to buy a more expensive house. Owning your own house offers many advantages—tax savings, equity build-up, fixed payments and a credit rating. But too often, people become house-poor, and their entire surplus income must go to support their home. This prevents savings and diversification of assets. There is no guarantee a house will appreciate.

I can remember in 1972, when we wanted to move to Orange County. We could buy the same basic house in Huntington Beach for $42,000, or we could buy in prestigious Newport Beach for $57,000. At the time, an extra $150 monthly house payment was a lot of money. So, we opted for the more conservative mortgage. Both houses appreciated significantly. As I mentioned earlier, our house increased $35,000 in value during those next two years. The Newport Beach house increased by over $60,000. Still, the comfort of knowing our cash outlay was within our means allowed me to invest in other forms of real estate. We could diversify our investment portfolio and maintain our goals and still live in a nice house.

Should Everyone Own a House?

When you contemplate buying a home, remember that the actual cost of a mortgage is higher than the monthly payments. To start with, you forego interest on the money that goes toward the down payment, which is called an opportunity cost. Further, you pay maintenance expenses and property tax. These costs are partially offset, however, by the tax benefit of the interest deduction.

What Does a Mortgage Cost?

	30 Year Mortgage 10% Fixed	15 Year Mortgage 9.5% Fixed	30 Year ARM Now 9%	Rental
Monthly Payment	$1,053	$1,253	$972	$1,100
Opportunity Cost ($30,000 Dwnpymt)	278	278	278	N/A
Tax Benefits	-271	-216	-243	N/A
Maintenance & Property Tax	280	280	280	N/A
MONTHLY TOTAL	$1,340	$1,595	$1,287	$1,100

The table shows how the costs and tax benefits balance out for someone in the 28% tax bracket who buys a $150,000 house with 20% down and closing costs of $5,000. The figures compare three different types of mortgages—each five years old—with the approximate cost of renting a similar property. Current mortgage rates are used, and the opportunity cost is based on an annual compound interest rate of 7%.

Is Renting Right for You?

Are you born to rent, or should you be a homeowner? If you haven't owned a home, this quiz might help you decide.

1. How much has the price of a typical house in your area increased in the past five years? If less than 25%, score five points. ____

2. Plan to move within four years? If so, score five points. ____

3. Do you have ready assets for a down payment and closing expenses worth at least 25% of the price of a typical house in your neighborhood? If not, score three points. ____

4. Are you willing to devote time to repair the plumbing, weed the lawn, grout bathroom tiles and similar homeowner headaches? If not, score two points. ____

5. Will you be in the highest tax bracket this year? If no, score two points. ____

6. Do you contribute at least 6% of your income each year to tax-deferred savings plans such as a 401(k) to compensate for the lack of a mortgage deduction? If yes, score two points. ____

7. Are attractive, inexpensive rentals available in your area? If yes, score two points. ____

8. Is your credit so good that you could borrow $20,000 without using your house as collateral? If yes, score one point. ____

9. Is your annual income less than 32% of the purchase price of the kind of house you want? If yes, score three points. ____

10. Add up all of your scores ____

If you score ten or less, it may be time to buy a home. A score of 11 or more suggests that you should probably be renting.

THE BILL STORY

Bill was an engineer. He was like a lot of people who are trapped by their environment. He was susceptible to what others were doing. He didn't like paying taxes, so he listened to their schemes and unfortunately participated.

Bill bought a house which appreciated with inflation. His equity soon became more than just a nest egg. It was his way to achieve financial independence, or so he thought. Bill refinanced the home like any red-blooded investor would. He invested in tax shelters but spent the tax savings. Time passed and the house appreciated even more. Of course, the only prudent thing to do was to repeat the process. So he put a second trust deed on the house.

Bill invested those dollars as well. For you see, he was trying to build a supplemental income to enhance his lifestyle. This income, he thought, would pay off the debt and eventually be available to spend. A great plan, except the IRS disallowed his tax shelters and the income didn't materialize from his investments. In fact, the investments went south…he lost everything, everything except his mortgage. He had a $4,500 house payment each month out of his $6,000 monthly check. Needless to say, he had to liquidate all of his assets to save his house. But, he couldn't maintain the cash flow drain. So the bank had to foreclose.

There is a classic problem of not having enough "staying power" to sustain a financial plan. The footnote to the story is that his original house payment was only $500 per month. Obviously, Bill goofed. He leveraged his wealth and tried to avoid taxes. He took unnecessary risks and ended up going bankrupt. But, he made a lot of money on his house. So it takes more than just making money to be financially successful.

Let's review why a residence can be the most important real estate investment we'll make in our lifetime. This is true so long as current tax policy favors home ownership. You get tax deductions from your income for the mortgage interest and real estate taxes. If you sell your house, you can role the gain into a new house. If you want to liquidate or down size, there is a tax exemption on the first $500,000 of gain realized from the sale of a personal residence if either seller is over 55 years of age. By properly buying, using prudent leverage and utilizing tax benefits, a “good home” can be a powerful tool for wealth accumulation.

But all of this seems unnecessary if you don’t…

CHAPTER

6

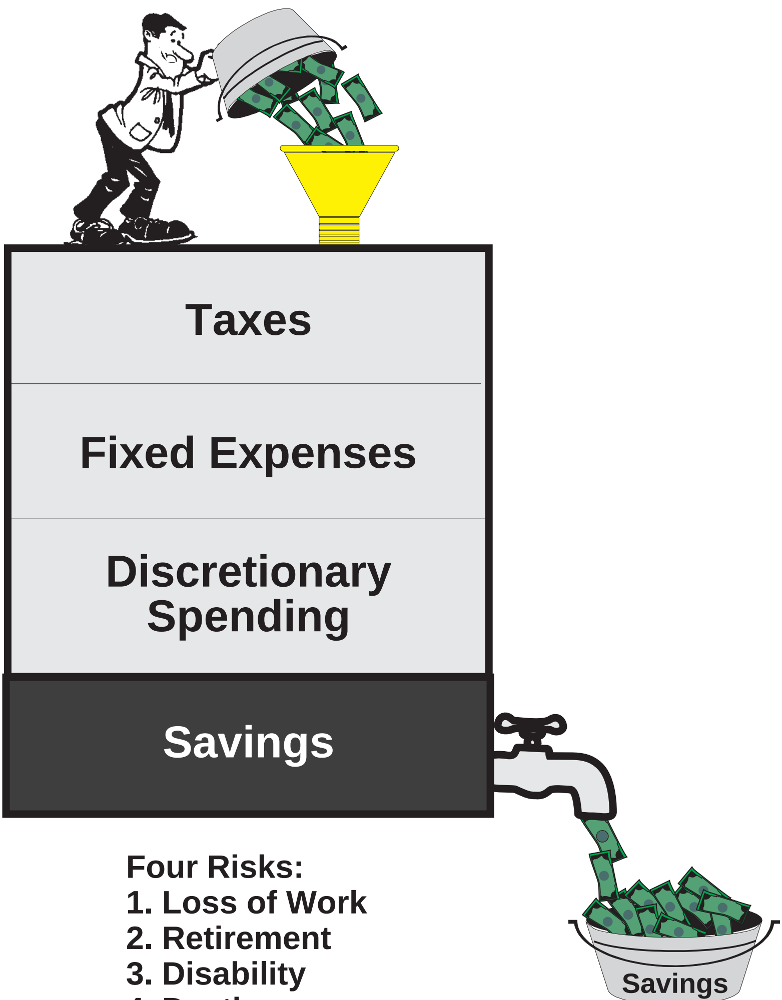
Guarantee Your Family's Security

PEACE OF MIND CREATES FREEDOM. One way to create peace of mind is to know in your heart you have adequately provided for the ones who depend upon you. This may be your immediate or extended family or in some cases it may be your business. The freedom created by doing the "right thing right" has never been truer than when it is applied to this principle. There is no justification in my mind for taking risks which jeopardize the future of those who depend on us.

I think you have to question the judgement and wisdom of anyone who would make risky investments without first assuring his family's safety. Such a "me first" mentality can only mean they are controlled by their wants or greed. To ignore your family responsibilities violates Biblical principles. Besides, it is foolish. And as we all know, "fools and their money are soon parted." Even if they are not parted, there can never be any peace in the marriage for they will always be driven to have more, be more or do more. There is no peace in obsessions.

Assuming the desire to protect your family is a high priority, then let's look at the elements of risk facing the average family. We learned earlier that income is derived from man at work or money at work. Obviously, if money is invested wisely, it will never stop

Financial Security is When... You Stop Working, and Your Income Doesn't.



Four Risks:
1. Loss of Work
2. Retirement
3. Disability
4. Death

working for you. However, economic turmoil can often impact even the most diversified portfolio. Some thought should be given to making certain your family always has money that is securitized.

Man at work faces additional risks. Our lifespan is based on an unknown biological clock whose alarm is set to go off at a certain age, in the future. Obviously, the ability to work and earn a living is not an inherent right guaranteed in this life. But age is not the only risk. You could lose your job, become permanently disabled and unable to produce an adequate income.

Unfortunately, problems beyond our control usually precipitate these events. The only protection for our loved ones is to recognize the possibility ahead of time and protect our family against these risks as much as possible. Contingency plans can cushion the blow. But the results can still be devastating.

Let's look at each of these and review the issues which we need to understand, in order to protect ourselves.

ECONOMIC TURMOIL

Family security is how you diversify your investments. In the Bible, in the book of Genesis, we read about Joseph, the son of Abraham. He was sold into slavery by his brothers. While in prison, he became known for his ability to interpret dreams. He ultimately became friends with the Pharaoh's chief cupbearer and chief baker who were thrown into prison by the Pharaoh. While in prison they both had dreams which Joseph was able to interpret.

Two years later, the Pharaoh had similar nightmares which he couldn't understand. He called his magicians and wise men to help him interpret the dream. They couldn't. But the Chief cupbearer, who was no longer in prison, remembered Joseph and told the Pharaoh about a man he knew who could tell him what the dreams meant.

The Pharaoh sent for Joseph and he was removed from the dungeon. The Pharaoh asked Joseph to interpret the dreams. Joseph told the Pharaoh that only God could tell him what they meant. The Pharaoh told Joseph his dreams. "There were seven fat cows by the stream and seven ugly, starving cows came up and ate them." In another dream, "Seven heads of grain, healthy and good were eaten by seven thin, scorched stalks of grain." God told Joseph that Egypt

Growth in Income Required to Keep Pace with Inflation

(Per $100 of Income)

	Rate of Inflation				
Year	**6%**	**7%**	**8%**	**9%**	**10%**
1982	$100	$100	$100	$100	$100
1983	$106	$107	$108	$109	$110
1984	$112	$114	$117	$119	$121
1985	$119	$123	$126	$130	$133
1986	$126	$131	$136	$141	$146
1987	$134	$140	$147	$154	$161
1988	$142	$150	$159	$168	$177
1989	$150	$161	$171	$183	$195
1990	$159	$172	$185	$199	$214
1991	$169	$184	$200	$217	$236
1992	$179	$197	$216	$237	$259
1993	$190	$210	$233	$258	$285
1994	$201	$225	$252	$281	$314
1995	$213	$241	$272	$307	$345
1996	$226	$258	$294	$334	$380
1997	$240	$276	$317	$364	$418

would have 7 years of great harvest followed by seven years of famine. God was warning them that this was coming soon. God said that the Pharaoh should appoint a caretaker to manage the harvest. This caretaker should take one fifth (20%) of the harvest each year and put it aside to prepare for the famine. The Pharaoh believed Joseph and said "Since God has made this known to me through you, I will put you in charge of the plan."

Clearly, God protected the Israelites through this principal. By allocating 20% of the harvest, Egypt had enough grain to last during the seven years of famine. In addition, there was enough for Israel to come and find protection in the land of Egypt as well. It was there that they grew to be a great nation. Should you protect your wealth against a coming famine? This principal was established by God for all to read and understand. It is not limited to just the Pharaoh and Egypt. The question is, do we have ears to hear? Will we heed the message? And how?

JOB TERMINATION

Many people build financial plans with an expectation their income will always stay the same or grow. Then, suddenly, they make a decision to relocate, change jobs or they get the pink slip. I've seen many investment plans fall apart this way. No matter how it happens, it is tragic to be financially over-committed when the "money machine" stops. Again, Joseph's 20% rule can come to the rescue. I know I have been tempted to jump into long term payments but shied away because my income can fluctuate. Being on straight commission, I have never been lulled by the false security of a "guaranteed income." But salaried workers don't necessarily have this same foreboding and therefore fail to build discipline.

Some never consider the possibility that an economic depression, technological breakthrough or an downsizing can eliminate their paycheck. They continually fail to assess the real degree of insecurity in their job. Cutbacks, economic cycles and poor management can affect the innocent. But planning for the worst can prepare you to handle any consequences. The government recognizes this possibility and requires employers to fund unemployment insurance. While the amount is minimal and can keep you in

ISSUES TO CONSIDER

1. EMPLOYMENT
   - Continuing Education
   - Consulting
   - Start Own Business
   - Sinking Fund 6 Months
2. RETIREMENT
   (How Much Capital is needed to Create Income?)
   - Taxes
   - Inflation
   - Annuities

necessities until another job is available, it won't protect your wealth accumulation.

The only solution is a sinking fund, held for this purpose. Noted economist, Elliot Janeway says a person should have six to eight months income in cash reserve. That's right, six to eight months in the bank. I recommend a minimum of $20,000 to $25,000 in cash at all times. You just never know when you may need it. Do this before you invest in any type of long term or short term investment! Nothing should come before this emergency fund has been established—not a new home, an extra car, or any type of investment.

RETIREMENT

Another form of famine is inflation. Inflation causes economic disruption during retirement. More than one retiree has had to return to work, to protect his purchasing power. But the time to plan isn't when you are too old to do anything about it. Start planning now while you still have a few years between you and age 65. Remember, compound interest is your friend.

If there is one basic law to retirement security it's—START NOW! It's never too late. In the chart "Building Capital for Retirement," there are some examples of tax brackets, inflation and the effect it has on purchasing power. In Chapter 1, I showed you some ways to determine the impact of inflation.

As you can see, it is no easy task to build an income by age 65 that is equal to $50,000 of today's purchasing power. Putting it off

Building Capital for Retirement

What does inflation do to your income?

Widow Age 50, 5% CD rate, 3% inflation, $400,000 investment capital

Year	Capital Purchasing Power	Projected CD Rate	Real Yield
1	$400,000	5%	$20,000
10	$294,970	5%	$14,748
20	$217,518	5%	$10,876
30	$160,403	5%	$8,020

How much capital is needed to maintain $50,000 constant income?

Male Age 65, $50,000 constant income for 30 years, 5% CD rate

Year	Capital Required	Projected CD Rate	Real Yield	Present Value of Real Yield
1	$1,000,000	5%	$50,000	$50,000
10 (Age 75)	$1,343,916	5%	$67,196	$50,000
20 (Age 85)	$2,427,262	5%	$121,363	$50,000
30 (Age 95)	$5,891,603	5%	$294,580	$50,000

How much should I invest to maintain $50,000 of purchasing power during retirement?

Male Age 45 wants $50,000 of today's purchasing power when he's 65, 5% CD rate, 3% inflation

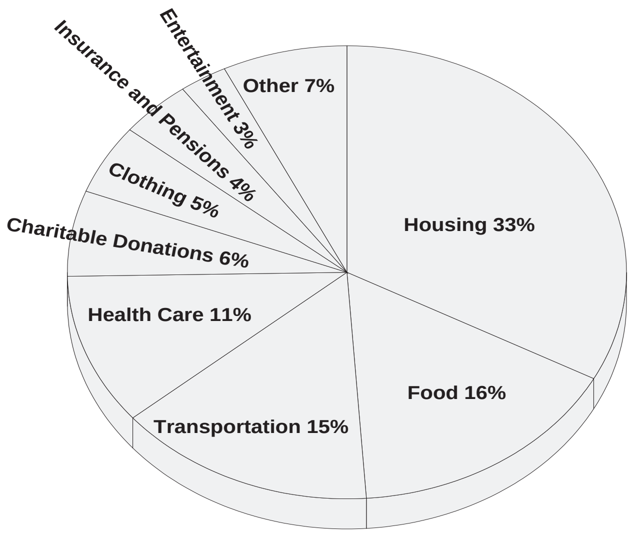
The amount necessary from the above table is $2,427,262 at age 85.

Year	Years Remaining to Invest	Projected CD Rate	Real Yield	Annual Investment to Reach Goal
Starting Now	20	5%	$50,000	$73,407
Wait 5 Years	15	5%	$57,964	$112,485
Wait 5 Years	10	5%	$77,898	$192,978
Wait 15 Years	5	5%	$121,363	$439,273

until you can afford it, may doom your entire financial future. My advice is to start small and let compound interest work for you. If you employ the basic principles of this book, you will automatically fulfill the yearnings of your golden years. My goal in this book is to help you understand the proven principles of financial success so your life-style during your earning years can be maintained or improved during your retirement years. It is important to know that the SECOND ten years of retirement is when the inflation crisis will become apparent.

Where It All Goes

How the Typical Retiree Spends Annual Income



Source: Orange County Register, May 24, 1993

DISABILITY INSURANCE

Most Americans ignore the possibility of becoming disabled. Less than 25% of working Americans have purchased disability insurance. But if the heart attack comes up short or cancer strikes or whatever, a crippling illness can be as more devastating and more costly than death. This has been true for many with serious illnesses.

Your Income

Your income is your most important asset. It provides for your future and immediate needs. If you become disabled and can't work, will you have enough money to pay the mortgage/rent, other bills and buy food? You can and should insure your income.

Fact: The chance of you becoming disabled before you retire is greater than your chances of death or of your home burning down. Consider these odds. In one year:

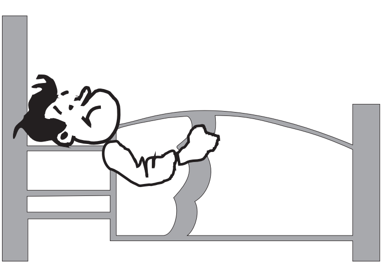
- 1 in 106 people will die
- 1 in 88 homes catch fire
- 1 in 170 cars is involved in a serious accident

BUT

☆ **1 in 8 people suffer a serious disability each year**

Fact: Disability is the highest risk of all, yet only 25% of Americans have individual disability insurance

At Age	Within the next		
22	year, the chances	7.5	... times
32	that you will	6.5	greater than
42	suffer a disability	4.0	the chances
52	of 3 months or	2.5	of your
62	longer are ...	2.0	death.



If you are disabled more than 90 days... The average disability lasts 5 years.

I am speaking of costs in excess of any medical bills. Consider how the loss of income during disability can break the chain of compound interest on your regular savings program. It's never a dollar for dollar loss, but one that is geometric because liquidation of capital causes the loss of earnings on your capital as well. Remember it takes approximately $1.00 plus the taxes you have to pay to replace the capital. Then you have to replace all of the compound interest you lost when you liquidated the capital.

It requires a quick, agile mind to prosper and survive in business. If you are disabled, you may not have the strength or quickness you once had. I remember seeing the video story about a disabled dentist and his wife. It was about their life after his disability, caused when he dove into a pond and broke his neck. The most important point he made was how his disability was impacting his family. If he died, they would lose that income. He purposed to live despite the pain and the guilt he felt, as long as he was alive, he was able to provide financially for his family. It was him living that caused the disability check to arrive every month. That was a powerful message I had never considered before.

The best formula I know for determining how much disability usually issue 60% of your current earned income, less social security. Once you know your liability, you can then purchase whatever amount you can afford. Even if you have substantial

ISSUES TO CONSIDER

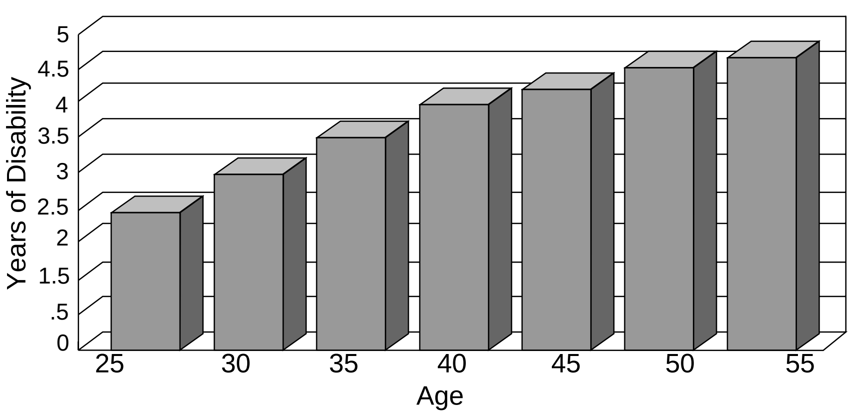
3. DISABILITY
    - Sinking Fund
    - Insurance
        - Return of Premium
        - Graded Premium
        - Step Rate
        - Traditional
4. DEATH
    - Liquidation
    - Borrowing
    - Estate & Income Taxes
    - Sinking Fund

Probability of at Least One Long-Term Disability Out of a Group of Men

Calculated from the 1985 Society of Actuaries' DTS Experience Table (Male—Class I Experience)

Age	Years to 65	Number of Men in the Group 1	2	3	4	5	6
25	40	20.3%	36.5%	49.4%	59.7%	67.8%	74.4%
30	35	19.6%	35.4%	48.0%	58.2%	66.4%	73.0%
35	30	18.9%	34.2%	46.7%	56.7%	64.9%	71.5%
40	25	18.1%	32.9%	45.1%	55.0%	63.2%	69.8%
45	20	17.0%	31.1%	42.8%	52.5%	60.6%	67.3%
50	15	15.3%	28.3%	39.2%	48.5%	56.4%	63.1%
55	10	12.5%	23.4%	33.0%	41.4%	48.7%	55.1%
60	5	7.8%	15.0%	21.6%	27.7%	33.4%	38.6%

How long is your disability likely to last?



assets, if you do not have disability coverage and you become disabled, it may require you to liquidate assets to retain your financial holdings in bad economic times. So, even though it is expensive, don't overlook this critical protection.

LIFE INSURANCE

Life insurance, unlike disability insurance, can be purchased to provide large lump sum amounts to replace earning power or pay taxes. But many people overlook how it can serve as double duty dollars. If you select permanent insurance, the annual premiums will accumulate in a cash value account which can be used to meet emergency needs or to ultimately fund a long term retirement plan. Term insurance is very inexpensive, but it provides no long term cash reserves.

Again, Elliot Janeway has a rule of thumb for life insurance too. He thinks you should have four to five times your annual income in life insurance. There is not an exact rule of thumb to determine the best amount. Tom Wolf, one of the nation's legendary life insurance agents, developed a system called "Capital Needs Analysis."

This method looks first at all of your liabilities and expenses (mortgage, debt, education obligations, cost of dying) and the amount of income your family would require if you were no longer alive. Suppose you determine your family needs approximately $50,000 annually and they can earn a safe 6% after taxes on their capital. Ask yourself, how much capital would be required at 6%, after taxes to meet this objective? It would require $850,000 ($850,000 x 6% = $51,000). Next, add up all of your income producing assets, including insurance. The difference is your shortage. Do the analysis for yourself and see how you stand.

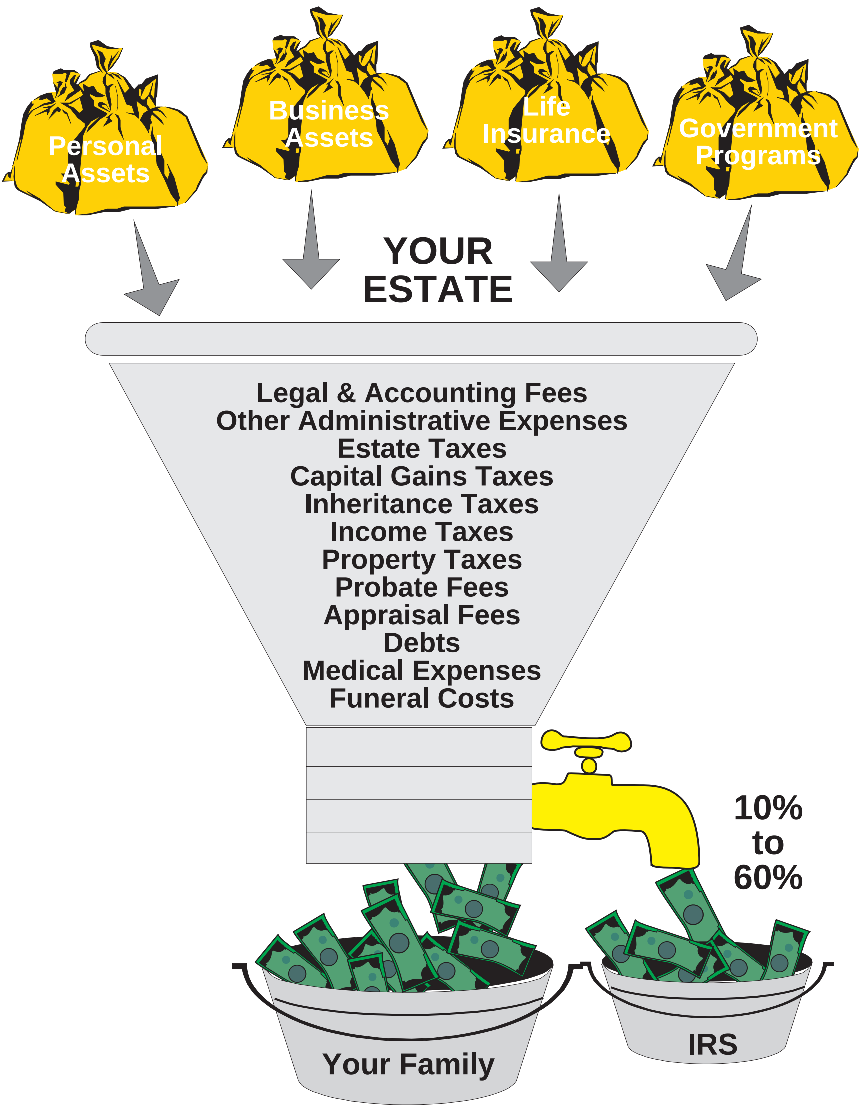
There are more sophisticated methods to determine insurance needs. Consider discussing your situation with a qualified life insurance agent or financial planner who understands how insurance can be used effectively. (We'll discuss credentials in Chapter 9.)

BASICS OF LIFE INSURANCE

How does life insurance really work? Most people don't feel comfortable with the entire subject of life insurance. However, it is

How Much Life Insurance is Enough?

Capital Need Analysis



important to understand the basics. Financial writers and commentators have made their living trying to explain life insurance and the mathematical principles of how it works. Unfortunately, the jargon and vocabulary often stops people cold. The purpose of this section is to help you develop a working knowledge of insurance which can be used to understand the types of insurance and the premium alternatives offered by a salesperson.

There are many misconceptions about life insurance and the best type to buy. It is important to remember that life insurance products are designed to meet specific problems. Some products are short term in nature and other products are designed to be retained until age 100 or older. Let's look at the reasons people purchase insurance.

WHY PEOPLE BUY LIFE INSURANCE

Life insurance is purchased because someone loves someone or something. Here are some common reasons people buy life insurance:

Joseph's 20% Rule—Life insurance is an incredible place to put safe capital. Not only does it grow tax deferred, but you can access it tax deferred through policy loans. The assets are guaranteed by the insurance company and can be invested safely through different economic conditions. In addition, the insurance provides an income tax free death benefit to provide capital for your family in the event of death.

Pay a debt—My philosophy is that a debt should die when you die. Every debt will have to paid by someone. The question is who? If you have borrowed money for your business, to purchase equipment or property or just owe money to the bank, you should plan for that debt to paid if you die. This is usually a short term obligation. But I find most people always owe money to someone.

Finance a tax—Taxes are like debts. They are unrecorded liens against your property. Before your family can own everything you have earned, they must repossess it from the government. The taxes and expenses due at death range from 35% to 60%. You need to analyze these taxes and determine the best method of paying them.

Purchase your partner's interest—Many business owners have partners. If one of them "walks out" because of death or disability, it leaves behind several problems. The most significant is to figure out how to purchase the company stock or their partnership interest from the heirs. Most partners are not interested in doing 100% of the work for only half of the pay. Heirs often do not understand how they can own an interest in a thriving business and not receive any money. Either way, there is a need for cash to solve the problem.

Provide for your family's security—When the breadwinner dies, the family must find a way to replace that income. Unfortunately, that isn't easy. House payments continue, educations must be considered, roofs leak, cars need repair and retirement is still a real problem for the surviving spouse. The uniqueness of life insurance is its ability to create capital when it is most needed. The very problem of life and death solves the problem of too little money.

HOW MUCH IS ENOUGH?

One of the most often asked questions is "How much insurance should I own?" The next page is a worksheet to help you determine the right amount of insurance for your situation. Life insurance is often the ONLY solution.

RISK SHARING

Life insurance is based on the principle of risk sharing. By providing coverage to thousands of people, insurance allows each person to pay a small amount of money annually to have a large lump sum payable to their family or business. It is available to everyone who can qualify. Once you decide you want to own life insurance, then you need to determine the best way to pay for it. There are several ways you can deposit money into your life insurance account.

HOW TO PAY PREMIUMS

Earnings • Gifts
Loans • As a fringe benefit

A Life Insurance Worksheet

Completing this worksheet, based on one by Boston financial and insurance advisor Virginia Applegarth, can help in estimating how much life insurance in needed. Use current dollar amounts.

Funds to Cover				Example*
1.	Funeral and other final expenses		____________	$10,000
2.	Estate taxes	+	____________	
3.	Paying off mortgage (optional)	+	____________	150,000
4.	Paying off other family debts (optional)	+	____________	10,000
5.	College fund	+	____________	120,000
6.	Special needs	+	____________	
7.	SUBTOTAL	=	____________	290,000
Funds for Survivor's Living Expenses				
8.	Current household expenses		____________	$51,500
9.	Target percentage	x	____________	67%
10.	Survivor's annual expenses	=	____________	34,505
11.	Social Security benefits	–	____________	
12.	Spouse's take-home pay	–	____________	20,000
13.	Annual need	=	____________	14,505
14.	After-tax interest rate	x	____________	.07
15.	SUBTOTAL	=	____________	207,100
16.	Total amount needed (7 + 15)		____________	497,100
17.	Existing insurance	–	____________	150,000
18.	Income-producing assets	–	____________	65,000
19.	ADDITIONAL INSURANCE NEEDED	=	____________	$282,000

**Example is for a 45-year-old man who earns $75,000 a year. His wife, age 42, earns $25,000 working part-time. Their two children are 15 and 12.*

Regardless of how the money is placed into your account, knowledge that the ultimate benefit will be paid provides security and peace of mind for the survivors. First and foremost, life insurance is protection against a premature death. Without insurance, survivors are faced with finding ways to meet their financial needs. Usually they have very few alternatives. Let's now look more specifically at how life insurance works.

WHAT IS LIFE INSURANCE?

It is a legal contract (called a policy), that pays a certain sum of money (death proceeds) to a specified person (the beneficiary) when the insured dies, as long as the cost for it (premium) is paid when due. You can own the policy or someone else may own it, instead. The owner has the legal right to name the beneficiary and may change the beneficiary any time he wants.

How is the price determined? People die according to a predictable pattern (called a mortality table) based on accumulated historical data. They don't know who, just how many. This predictable pattern and the amount of coverage is mathematically converted into a lump sum which the company needs to have in order to make the contractual payment at death. The lump sum is usually financed with annual payments based on a specified rate of interest.

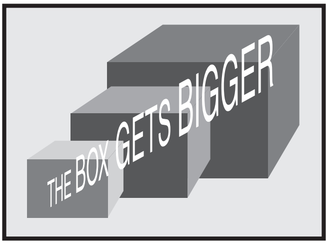
What factors impact the price? The amount of each payment (premium) has four determining factors: first, the predictable pattern of death (mortality costs); second, the cost of doing business (expenses); third, the amount of interest earned each year (sometimes called dividends); and finally, the number of people who actually keep their insurance policies (called persistency).

Where do you put the premiums? Your money is placed into what I refer to as THE BOX.

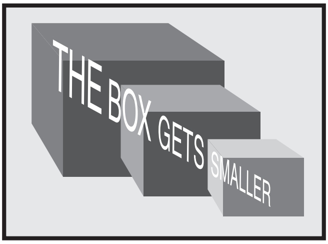
What is THE BOX? THE BOX is an individual account within your policy which holds all the premium payments you make to the insurance carrier. This account was designed by the insurance company to help you accumulate the lump sum premium needed to cover the factors that affect the price of the coverage. From THE BOX you must pay the annual cost of insurance (mortality costs) and the policy expenses. THE BOX also receives the interest credited each year by the insurance company. So long as all of the original assumptions are achieved, THE BOX will grow to meet the projected lump sum. If you want to cancel your insurance early, THE BOX must be assessed a surrender charge if the insurance company has not recovered all of their start-up expenses. It takes ten to fifteen years for a company to start making a profit.

What happens if you don't use THE BOX? The cost of the death benefit at life expectancy (that's when 50% of your age group is still alive) is 74% of the contractual death benefit. This is the same cost for virtually every life insurance company. However, if you live longer, to when only one-third of your age group is still alive, the cost increases to 119%. No one could afford to pay the premiums as these insurance costs continue to increase. THE BOX provides the only guaranteed a way to pre-fund the cost of insurance, so that compound interest can actually pay the insurance costs at the older ages.

What happens to THE BOX, if the assumptions are incorrect? Since the insurance company projections are based on assumptions, the illustrated results will vary based on those four factors. THE BOX will either get larger or smaller, depending upon what happens to these factors.



If interest rates fall, expenses rise or people die faster than expected, THE BOX will need more money than originally illustrated. I say, "In order to meet your promised, contractual obligations, THE BOX must be made larger to hold enough money." If this happens, you will either have to pay premiums for a longer period of time or you must increase your annual payments to achieve the targeted contractual results you are expecting.



Likewise, if interest rates rise, expenses fall or people live longer, THE BOX will not need as much money from you as originally illustrated. THE BOX can become smaller, to reflect the improved performance. This means you could pay premiums for fewer years or you could reduce your annual payments to reflect the improved performance.

In the final analysis, THE BOX must have enough money to equal the mathematical lump sum targeted by the insurance company for your age. Otherwise, the company will be unable to stay in business because they will have underfunded all of their contracts and they won't have enough assets to meet their obligations.

DOES INSURANCE REALLY WORK?

Absolutely! Many of the major insurance companies have been in business for more than 150 years. This seems to me to be obvious testimony as to the accuracy and stability of their methodology.

SUMMARY

Life insurance is a BOX. It is the foundation for a contractual promise to deliver dollars at some future date when you die. To accomplish this, the insurance company calculates the number of dollars you will need to put in THE BOX. The premium is based on the number of expected deaths in each year for this group of insureds. Premium dollars contributed to THE BOX are based on the actuary's estimate of how much money you need to pay, if their assumptions about interest credits, expenses and mortality costs are accurate.

YOUR FAMILY'S SECURITY

Once you have taken care of your family's security, you can proceed toward your ultimate goal, financial independence. I'd like to repeat here the additional benefit to applying this principle of securing your family's financial security. Once they are protected against these common risks, ***then*** you can be more aggressive with your surplus cash without guilt or worry. I believe there is a natural law of investing. Wealth begets wealth. When you are relaxed and secure, it seems you attract financial success. When you are anxious and uptight, failure seems to stalk your every move. It's almost like money knows who can handle it.

So, relax and ...

CHAPTER

7

Don't be Greedy

HAVE YOU EVER EXPERIENCED GREED? True greed? If you have, then you know how foolish greed can make you feel. What exactly is greed? I think it is the feelings we have when we want more and are not satisfied with what we already have. For years I felt greed was amoral. That is, it didn't really reflect negatively on one's character or values. Greed just is. I know now that greed is a reflection of fear. Greed results from feeling deprived. It is often accompanied by a lack of direction, a lack of goals and a lack of trust. By clearly knowing what you want to accomplish and clearly setting out your plan, your can over come the emotions of greed.

Let me share some of my own personal examples of greed. In the late 1960's I had a chance to purchase stock in a new public company. This company was going public at $10/share and I could get in on the ground floor—the blue sky offering. What made this exceptionally appealing was the broker was also underwriting the entire offering. He knew the company and had a real feel for its potential. This was my big chance to make some BIG money!

I was still in graduate school at the time and newly married. But we were free of a mortgage and other encumbrances. It seemed like a good time to roll the dice so we invested heavily. I bought 100 shares. Now $1,000 may not seem like much today, but in 1968, for me, a mere graduate student it was a fortune. The stock did exactly what the broker predicted. It jumped immediately to $14. I asked him if we should sell or hang in for a larger gain. He told me this was just the beginning. Stocks like this have been known to go as high as $35 or $40. I was convinced he knew what he was doing and decided to ride it longer.

As I mulled this information over in my mind, I began dreaming the dreams of fantastic wealth. I decided to buy another 100 shares. My reward was almost immediate, the stock rose to $20. Now I was no stranger to the stock market. In fact, I had followed the stock market since I was a young kid and was fascinated by its dynamics. I had taken a class in college where they gave us $100,000 of seed money to invest (hypothetically that is). My fictitious portfolio had grown to more than $500,000 during the class term. But this was reality! This was my money. This was a real test under real conditions. A week elapsed. I called the broker again inquiring about whether I should sell. Once again he convinced me the stock would go higher. He suggested I buy some more. So I bought more. With the stock now at $24 per share, I was confident I could retire soon and just manage my holdings. This was real excitement. No longer did I want to sell. If I had had more to invest I would have done so.

Now, before I reveal the results of this magnificent adventure, I should remind you that when I initially purchased this stock, I would have been delighted to ever see $20 a share. In the beginning, just doubling was a pure fantasy. To see it valued at $25, $30, or even $40 was way beyond my dreams. But my goal was $20. Anything else was pure greed. Yes, greed! Here I was pouring more money into an opportunity of a lifetime; at $24 a share when $20 was my goal. I was chasing wealth instead of letting it chase me.

I don't suppose the result will surprise you. The stock rose to $28 and then fell like a rock to $2 where it remained for almost four years. When I finally sold my last shares, I ultimately took a $1,500 bath, a fitting end, considering the exhilaration I felt on the way up. In retrospect, even as I tell you this story, I can feel the greed, the thrill of the market. It was exciting—something that is impossible to experience unless you have been there.

The Love of Money is the Root of All Evil

What is Money?

- Medium of Exchange
- Method of Valuation
- Measure of Success

Conclusion

Money is an intangible method of barter which is neither good nor evil.

Why does loving money impact our lives?

- Greed
- Poor Judgement
- Power
- Fear

The lesson I learned was this: it's okay to ride an opportunity to its conclusion, but play on their capital, not yours. In other words, had I sold out my original investment at $20, and let the stock ride on their money, I would not have lost any of my money. I lost some of my CAPITAL and all of the appreciation. It was expensive tuition but I tend to remember the hard lessons especially when I pay dearly for them.

It was only a couple of years later when I was tested again. We were given a chance to put this lesson into action. I was asked to purchase coffee options by a cold-canvas salesman who promised a "once in a lifetime" opportunity. Who knows how he got my name? I have discovered, they are always a "once in lifetime" opportunity. Once again the chance for real wealth germinated deep in my soul. Greed started to boil. I could feel the excitement and the chance to make my fortune.

A severe cold spell in Brazil had destroyed a large percentage of the coffee bean crop but the shortage had not hit the market yet (Sure!). This is a common characteristic of most greed investments—you must move quickly. There was no time to think or investigate. Invest now or you will lose the opportunity of a lifetime. Well, I met with the salesman and he showed me all of the research his company had accumulated. Now this looked good, so I bought it!

Wow! It worked. The shortage did materialize and coffee was in short supply, so the price soared. You may not remember, but coffee rose to 75 cents a cup. The options we purchased quadrupled but then fell back eventually so we only doubled our money when I liquidated. We had $22,000 in the bank from my initial $11,000 investment. The salesman gave me our check and then tried his luck again. "Let's buy more," he said.

But I was ready for him. "No thanks, I'm not interested," I told him. But he persisted and told me all the reasons why I could quadruple my money this time around. I talked it over with Colleen. She said, "Don't do it. Coffee is too high now. Housewives will boycott coffee." Well, I may not know much about coffee, but I do know economics, after all I was an economics major. "Inelastic Supply," I countered. "People will never give up their coffee." But she persisted in her arguments, so we compromised. I held back our initial investment of $11,000. Now, I will tell you, I thought my wife to be foolish in her analysis, but I remembered the lesson of playing with only their money. Sure enough, she was right. Consumers did boycott coffee and we lost all of our option profit. But fortunately, we didn't lose our capital.

Greed can strike in many ways. We may not recognize it at first, but it's usually the same—it comes as a quick move. A "once only" opportunity. The salesman gives you "inside" information and you feel trusting of the salesman. You don't have long to make the decision. So, bottom line, always check it out with people you really can trust. Make certain it passes the "smell test." Bad deals always stink. There is a saying, "If it walks like a duck, sounds like a duck and looks like a duck, it's probably a duck."

So how do we avoid the mistakes I have made? I only know one way—you must have a specific plan in mind before you are faced with tough decisions. Use the financial goals you set in Chapter 4. Have a solid criteria in mind before you are asked to evaluate any investment. If you invest regularly and often, using a set game plan, greed opportunities won't be so appealing. It's impossible for a salesperson to overcome your objections if you are truly committed to your plan. You can simply say, "That sounds like a great investment, but it doesn't fit my plan." Remember, there is a simple saying—bulls make money and bears make money, but pigs get slaughtered. Don't be a pig.

When an opportunity comes along and you match the investment with your plan, you'll know if you should consider it. You will feel comfortable and have no anxiety. You should be able to afford it. Hopefully, the investment won't be so speculative that you will fear losing the entire investment. But, be prepared. You will have these opportunities, so plan in advance what you will do.

So, it wouldn't come as a surprise if I told you to…

CHAPTER

8

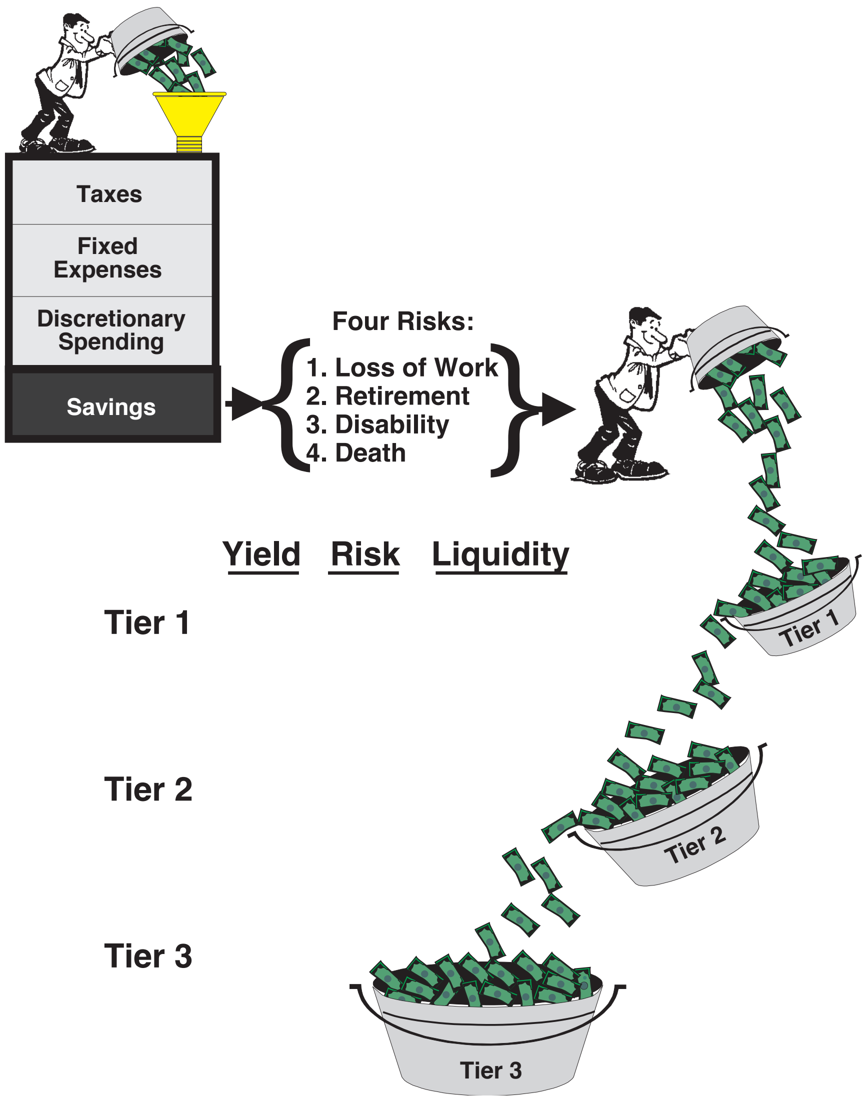
Invest Wisely, and Don't Spend the Money Money Makes

THIS PRINCIPLE IS REALLY THE WAY to financial success. Although the other chapters play an important part in the financial planning process, you must have a system for investing. It is critical to your success. This chapter will explain my investment system.

There are really only three distinct categories or tiers of investments or put another way, three different categories of investment risk—conservative, growth and speculative. The conservative category is your core dollars. Those dollars you do not want to lose under any circumstances. The growth dollars refer to capital you are willing to allocate to long term growth investments. The speculative dollars are for high risk investments. Here is where you can really score, but you must also assess the chance of losing it all. By understanding the risk element associated with each level, you can formulate a game plan, an investment strategy. Let me illustrate how simple the administration of this simple idea can be with a metaphor—a bucket of sand.

Assume you are at the beach and have a large bucket of sand. As you pour sand into your bucket slowly, it will ultimately overflow and begin pour over the side back onto the beach. If you place another bucket below it, the sand will begin to fill the second bucket. I like to think of how an hour glass transfers sand through

The Tier System of Investing



the little hole. The sand on one side of the glass transfers from one side to the other when you tip the bottle. The sand builds up in a perfect cone until there is too much sand and then it flattens out as the final grains of sand fill the other side.

In a similar way, the sand in our second bucket pours into yet a third bucket. This systematic transfer of from the initial container into the second bucket and then in the third bucket is a great example of how a systematic investment program should work. This is how I see my three tier system of investing.

The first tier is comprised of your very safe dollars. You only use investment vehicles which are safe and secure. Let's use three categories to measure the general investment characteristics of tier. The first one we'll just call risk. In reality, there are at least five faces of risk and I describe these on the following page in more specific detail. But for purposes of this analysis, let's just think of risk as the possible loss of capital. Another investment characteristic is rate of return and the final element we'll call liquidity—your ability to get at your money. We can distinguish between Tier I, II and III capital by understanding the differences in these characteristics in each tier.

Investments in Tier I have rates of returns which approximate 3% plus inflation. I wrote earlier that money is only worth 3%. The excess value comes from your added value. So if inflation is 3%, then you would expect your investment return to be 6%. If inflation were 8%, then you would expect it to be 11%. These Tier I investments are typically comprised of your long-term, guaranteed investments. Bank savings account, certificates of deposit, fully insured demand funds and annuities. Other Tier I investments include savings accounts, T-bills and other savings vehicles like Banker's Acceptance notes, money market accounts and other short term, highly liquid money instruments. An IRA wouldn't qualify because of the tax penalty for liquidation.

Tier I investments have little or no investment risk because they are short term instruments. Their value is not determined by market forces only the price of money. You can still lose capital in this tier, but only if you are forced to liquidate before the investment matures. Most advisors will say there is generally no risk associated with these investments. They are liquid and short term in nature.

The Five Faces of Risk

Most people realize that investing is a risky business, but they often fail to recognize the diversity of risks that a portfolio faces. As a result, even cautious investors overlook serious threats to their financial security. When you invest, be alert to the five major risks described below. With proper diversification, you can guard against each while maintaining the likely long-term return on your overall portfolio.

Economic Risk The risk that slower economic growth will cause investments to fall in price. Shares of emerging growth companies may shrink because they require a booming economy to sustain their robust earnings gains. Cyclical companies, such as automakers and chemical producers, cannot easily cut costs during a recession, so their shares may nose-dive, too. Economic downturns can also undercut junk bonds issued by financially weak firms that might default.

Inflation Risk The danger that rising prices will reduce the purchasing power of an investment. An annual inflation rate of only 5% over 15 years will cut the value of $1,000 to $481. Overcautious investors who hoard all of their assets in low-yielding investments such as savings accounts and money funds may not earn enough to outpace rising prices. In addition, rising inflation erodes the value of future income on investments with fixed payments, most notably long-term bonds.

Market Risk A catchall term for factors such as political developments and Wall Street fads that can batter investment markets. Tax law changes, trade agreements, program trading and the quirks of investor psychology all contribute to market risk, which has accounted for much of the stock market's day-to-day volatility. Gold also carries considerable market risk because its price moves sharply when political or military upheavals in other countries encourage the flight of capital.

Interest-rate Risk The chance that rising interest rates will cause investments to drop in price. For example, higher rates make yields on existing bonds less attractive, so their market values decline. Rising rates also hurt stocks by making their dividend yields look less appealing. Individuals who invest borrowed money through margin accounts or who have other floating-rate debt increase their interest-rate risk because higher borrowing costs cut into their net profits.

Specific Risk Any occurrences that may affect only a particular industry. For example, the death of a young company's founder could send the business into a tailspin. Individuals often take on a high degree of specific risk when they invest in a real estate partnership run by inexperienced general partners, or buy stock in a firm with a heavy debt burden. Specific risk also includes the chance that government regulation will harm a particular group of companies, such as banks.

WHAT ARE THE THREE BASIC INVESTMENT CHARACTERISTICS?

1. Rate of Return
2. Liquidity
3. The Overall Risk Quotient

WAYS TO AVOID RISK?

- ✔ Don't Invest
- ✔ Diversify
- ✔ Be Very Conservative

Conclusion: *Pretty Difficult*
Avoid risk if you want your money to beat inflation.
Invest in who you know or what you know.

The next level (Tier II) ups the investment ante significantly. Here you are choosing to expose your capital to market risk. These investments have some liquidity risk because the investment vehicles are subject to market fluctuations. There are two basic investment classes—bonds and stocks. For a full discussion on these classes you should read my other book Investment Alchemy. I discuss more fully how to manage the risks in these markets.

If the general level of inflation rises, it takes less money to provide the same return. As a result, investors are willing to buy these investments from you, but at a lower value than your original investment. However, the converse is true. If inflation and interest rates decline, then investors will pay more because the yield is higher than they can get in new issues. This is why bond prices move inversely to interest rates.

Buying stocks is another example of investments which have market risk. Here willing buyers and willing sellers compete for ownership by trying to determine the real value of a company. The bidding for these stocks causes the market to rise and fall. When you invest, you have the opportunity to participate in this process.

The expected rate of return is 5% to 7% plus inflation. The general level of risk is heightened because there are no guarantees. Value or worth depends upon market performance. Thus if you're into stocks or conservative real estate, you are totally dependent upon market forces. An historical analysis has shown that these markets deliver a 10%–12% return. But you may discover the markets have fallen when you want to your money back. (This is called the liquidity risk). Bonds, tax free municipal bonds, REITS and stock mutual funds are typical Tier II investment vehicles.

I refer to Tier III investments as frozen assets. It could take ten to twelve years or longer for you to retrieve your capital. Once you invest, your money becomes literally locked up until someone wants to purchase the same investment. There is only one reason why anyone would want your frozen asset. They must think it is under valued and will significantly increase in value once they buy it. This may mean you should continue to hold it. Remember too, there may not be any profit or cash flow during your holding period.

Even though you have a great opportunity to achieve significant appreciation, you must remember you also have tremendous risk of losing everything. Again, nobody invests with the intention of losing capital. Losing money just happens. Laws change, markets dry up, supply and demand takes over. Regardless the potential for appreciation, the more risk you take, the more liquidity you give up.

As a general rule, most investors are totally naive. If they have an investment IQ, chances are it has not been adequately tested. As a result, they tend to invest strictly on emotion. There is only ONE way to be successful financially. You must have a systematic approach and then stick with it. When investors see the stock market go up for a long period of time, they tend to jump in too late—near

Characteristics of Each Tier

	Risk	Rate of Return	Liquidity
Tier I	None	3% + inflation	High
Tier II	Interest Market	5%-7% + inflation	High
Tier III	Very High	Unpredictable	Low, If Any

the end of the market climb. When the market values starts to decline, they get out when it is too late and often lose a significant part of their investment capital.

Wannabes are looking for a quick hit. They are not patient and they don't want to wait and work a system. So they jump into Tier III before they can afford to cover the risks. The key to entering this level is you must be able to afford to stay, regardless of economic circumstances. You only lose capital if you are forced to withdraw from the game. If you've secured your future against financial calamity by successfully protecting yourself in Tier I and Tier II, you can now go for the golden ring, i.e. financial success in Tier III.

The universal rule for successfully investing in Tier III is to have plenty of STAYING POWER. Staying power comes from having enough capital in the top two tiers to help you hold on when the going gets tough (and it always does). Investors lose money, not because they chose the bad investments but because they can't wait to see the economic potential mature. It's like the baseball manager who would never admit defeat after losing a ball game. His attitude was his team didn't get beat, it just ran out of innings. If you run out of money, you can lose a lot more than your investment. It could cost you all of your capital.

Remember Murphy and O'Toole? Staying power can be illustrated by revisiting those laws. Murphy believed if it could go wrong, it would go wrong. But O'Toole said Murphy was an optimist. If you've applied the financial principles discussed up to now (saving money, covering your risks, building up Tier I and Tier II), then you will have staying power. Tier I and II investments guarantee you a base of capital to weather any storm. You will make your house payment if you have sufficient cash reserves to protect you from job loss, illness, vacancy, soft markets, etc.

What type of investments do the "get rich quick" want to make? A steady 7-10% or a glitzy 25-30%? Well, of course, 25-35%. But remember what it takes to play? Staying power! The greedy go for broke. Remember Principle 7.

Tier III offers you glamorous investments, cocktail party talk. You always hear about the winners. Don't these people ever lose? Be concerned about yourself! Recognize the risks and the staying power required by these "high return" instruments. Avoid them until Tiers I and II are full of cash, cash equivalents and other growth assets which can be easily liquidated. Do I sound convicted, or what?

I learned the wisdom of this principle in 1979-1982. My partner and I had an office building which stood vacant for 2 1/2 years. We were forced to make all the payments on this "see through" for those 30 months. Only our staying power, investments in Tiers I and II, made it possible. Yes, I had to liquidate all of our assets, but both Steve and I believed in the building and ultimately our faith was justified. If all of the factors were analyzed properly, there is no such thing as a bad investment—only bad timing. We were right, but it took two more years than we thought to make the building work and ten more before we sold it. Inflation and high interest rates caught us at the wrong time, but we made it and so can you, if you have staying power.

Here is an example of how you might allocate your investment capital in the three tiers. Remember, the idea is to let the money in Tier I cascade into Tier II.

Now let's go back and see how much sand it takes to fill the bucket of Tier I. Let's assume you earn $50,000 per year in a relatively stable job, but have no net worth. I think you should build up Tier I to at least $30,000. Then let Tier II build to an additional $50,000 to $75,000 before you even think about investing in Tier III.

But suppose you already have a net worth of $500,000 but you only make $50,000 in a stable job. Then as much as $150,000 could

Tier Distribution

	I	II	III
$50,000 Income $0 Net Worth	$30,000	$50,000	$0
$50,000 Income $500,000 NW	$50,000	$300,000	$150,000
$100,000 Income $2,000,000 NW	$200,000	$500,000	$1,300,000

be invested in Tier III but only after you solidify $50,000 in Tier I and $300,000 in Tier II.

Another example to consider is someone who makes more income, say $100,000 and has a total net worth of $2 million. They might have $200,000 in Tier 1, $500,000 in Tier 2 and then put $1.3 million into Tier III—especially if you have strong banking relations and a stable income.

There are no exact answers. This is an art, not a science. It takes common sense to determine what's right for you. But if you put your money into Tier III before you have successfully built up the other two tiers, you will ultimately feel uncomfortable. Heed your instincts. It's better to be conservative than aggressive, especially when you're just starting out.

WHAT DO I DO NOW?

Now what happens if you've already invested in Tier III without a sufficient base? Stop adding to your problem, now! Go back and build Tier I and Tier II. Start developing your staying power. Remember, greed can take many shapes and forms. So just look at your current mix and even if you are comfortable and happy with your current portfolio, just think about how you would feel if suddenly your economic position shifted and you were required to put additional money into your investments to keep from losing everything. Decide whether you are happy with it.

A FOOTNOTE

The difference between a successful investor and an unsuccessful investor, is that the successful investors always have money to take advantage of a good opportunity when it comes along. They have built a solid base of capital under them and they can afford to take advantage of an opportunity if it suddenly presents itself. It may be the greatest opportunity in the world, but if you don't have the cash, regardless of how good it is, you may have to pass and wait for another deal.

Investing wisely is only part of the equation. In order to preserve the chain of compound interest, you need to be patient and disciplined. Taking the dividends from stocks or the interest from

General Philosophy or Theory
"Nobody deliberately loses money."

The Major Reason People Lose Capital is:
NO STAYING POWER!!

a maturing CD, and purchasing a new big screen TV is wrong. But so is pouring everything you have into real estate or any other frozen asset. The money money makes is the compounding growth of your portfolio. It is critical to not take the profit as your reward and spend it. The systematic reinvestment of yield back into your three tiers guarantees your success.

To understand these principles all we have to do is look at history and how others have parlayed small results into big fortunes.

If we look at economic history, we can…

CHAPTER

9

Study How Others Have Made Money

THERE ARE MANY BIOGRAPHIES and autobiographies which tell fascinating stories about the rich and famous as well as the rich and anonymous. Napoleon Hill's *Think and Grow Rich* and Og Mandino's *University of Success* profile successful individuals in various walks of life. These and many others have attained success their own way, yet they have developed a methodology based on principles anyone can follow. You may not agree with the beliefs and values of each individual who has succeeded financially, but you can learn from the common denominators. Solomon, in the book of Ecclesiastes said, "There is nothing new under the sun." As you study others and their fascinating stories, you may find philosophies and concepts which even parallel your own thoughts or particular circumstances. You can benefit from their experience.

As you can imagine, a salesman meets thousands of business people through the years. What I recognized years ago and would like to share with you is just a couple of the commonalties from some of these success stories.

FROM HUMBLE BEGINNINGS

There are many who have money today who were not born rich. They started in their proverbial garage. These people were focused, had a basic "bread and butter" product and they knew their market. For the most part, all of them were frugal. They controlled their expenditures and saved a set percentage by investing back into their business. It wasn't until years later, when they had achieved financial freedom, that they allowed themselves any luxuries. Unfortunately, even then, they were often psychologically unable to enjoy the spoils of their victory.

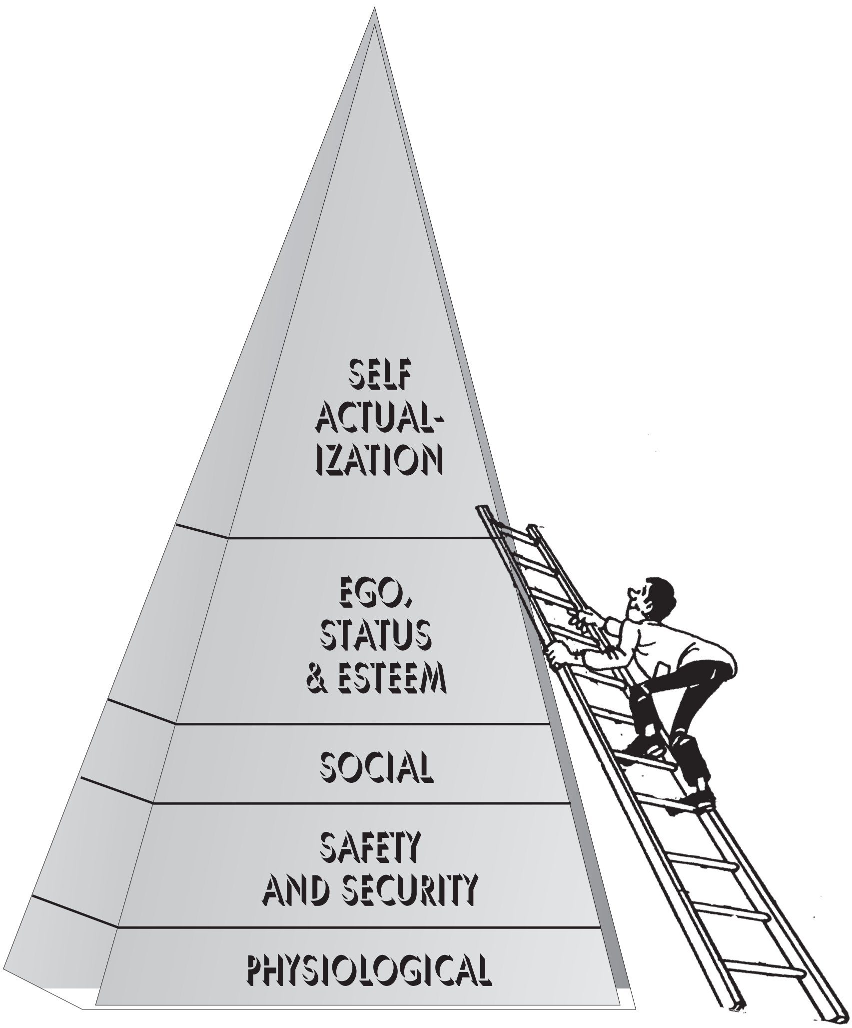
Most often they didn't spend or waste their capital. Using their excess capital, they diversified their holdings beyond their business. Because they understood risk, they didn't rush frivolously to invest in "sure things." Instead, they had a clear understanding of their goals and objectives and stayed the course. These goals were defined, set and then attained systematically. The financial giants know what they want and then set about getting it. Usually slow, sure, boring progress is all that you can expect. Sound familiar? Sounds a little like the chain compound interest.

I remember reading an article in a business magazine about Tishman and how he sold his company for $17,000,000. The story described how he invested his limited assets in property until eventually he sold out to Equitable Life Insurance Company. What's important is that he did the same thing we've talked about here. There's just more zeroes involved.

The principles are exactly the same. The main difference between somebody who has $17,000,000 and somebody who has $17,000 to invest is that the one with millions can manufacture some of their own opportunities whereas the person with $17,000 has less margin for error and may be totally dependent on someone else's advice. But you don't have to take my word for it. Expand your library to include "the other masters." Many biographies and autobiographies have been written about the financially successful. These stories are interesting and informative and will reinforce in your mind that it is possible to attain financial independence even when you may not have thought it was possible.

Be sure to select people from different historical eras. The captains of industry from the nineteenth century had different obstacles from those of the twentieth century. So be aware of both and look for their common denominators.

Maslow's Hierarchy of Needs



As a student of those who succeeded, you'll note successful people make it with what's given to them; whether they are blessed with good or poor economic times, war or peace, an active or reactive U.S. Congress, they still succeed. They overcome all obstacles by persevering. Usually it's just a combination of ambition and timing. But then to sustain the financial momentum, the principles we've learned must be applied.

ANOTHER GARAGE STORY

I remember one of my first real clients. He was the proverbial garage story. He started with nothing and was very conservative. He offered good benefits to his employees and paid better wages than his competition. More importantly, he used his good sense to make money out of other people's junk. He had patience and he persevered during all sorts of economic cycles. He had all of the values needed to be successful. He had them in spades. Years later, he successfully transferred his company to his son using the best tax strategies possible. Now his son is continuing to prosper in the same business.

I watched two brothers became one of the largest in their industry. They started small, in their garage and they watched their pennies as they built their business. They were focused, persevering and used the compounding interest of labor to become one of America's richest families. They started from scratch and built their business slowly into hundreds of millions.

The lessons I have personally witnessed are consistently there. These people use systematic growth, patience, endurance, smarts and opportunity to grow. There are consistent values in most every case. These values and attributes are common among the truly successful people I've ever studied. They had a work ethic and applied it repeatedly. They were frugal, they loved their families and they were patient while they grew.

But it's not enough to know how to be successful. Application of these principles must be the starting point.

Once you have surplus…

CHAPTER

10

Invest in Who You Know and What You Know

BE CAREFUL. EVERYBODY, INCLUDING YOUR financial planner, has a bias, but that's not bad! A bias, is only bad if they try to hide it from you. You must not let it affect your good judgment. If you stop and think about it, all financial planners had to start somewhere. They were either stockbrokers, tax shelter specialists, real estate agents, life insurance agents, CPA's, attorneys or they come from some other financial services profession. Everyone did something BEFORE they became a financial planner. Each of these disciplines has a natural bias. A bias that comes from being successful in their chosen field. Let's look at some of the more obvious ones.

I find that stockbrokers are typically transaction-oriented salespeople. They specialize in debt and equity, not real estate and not guaranteed investments like insurance or annuities. They make their living selling stocks and bonds and are trained to reposition low yield, low risk assets into dynamic (hopefully) growth-oriented, inflation proof(?) investments. A good stockbroker is attuned to the nuances of the stock market. They are traders and market timers. They may study the trends of industries, general economic cycles and conditions, supply and demand implications, P/E ratios, even future federal and state legislative thinking. Their bias and expertise plays an important role in selecting investment for the second and third tier of the Baker's Dozen planning model (Principle 8).

Mutual fund specialists (asset managers) are biased against debt instruments. They tend to believe you should be 100% invested in the stock market and hold on for eternity. Using their systematic approach they believe you will never lose. They base their belief on the long term investment performance of stocks vs. bonds.

Tax shelter experts bring an entirely different orientation to the table. Their bias stems from an acute awareness of the tax implications from sophisticated investments aimed at tax reduction. They know, for instance, the rules relative to leasing and expense allocations, the impact of straight line depreciation vs. accelerated depreciation, and the recapture rules in the event of sale. Their main objective is to market tax saving investments, and they presume that everyone they talk to must want the same thing. To become a full-service planner, however, they can no longer be concerned with just saving taxes—they must also focus on the whole person aspect of wealth accumulation and preservation which may not include tax savings as a primary objective.

Real estate agents have a narrower focus. They make their money, listing, selling and/or leasing real estate. Few of them have any awareness of the tax implications and fewer still really understand how to integrate passive income rules with ordinary income to minimize income taxes. A good realtor, who understands charitable giving, estate planning and income taxes can be worth his weight in gold, especially if he understands the principles of real estate, and that location and timing are the secrets to success.

Life insurance agents are probably the most maligned group of advisors in the financial planning profession. Their bias is security. They are often accused of lacking objectivity because all they want to do is sell you life insurance. Those who make this criticism misunderstand the planning process.

If you recall, greed motivates most of us into taking unnecessary risks. It is the investor's desire to hit "the home run" that gets them to deviate from their original plan. The life insurance agent inhibits this home run philosophy by diverting capital from the growth investments to security assets. The perception is, life insurance is not only a necessary evil but a bad investment as well. But insurance is not an investment. First and foremost it is protection against premature death. The life insurance agent is biased towards protecting families against the three risks, living too long, dying too soon or becoming disabled. As we have seen, security is the foundation, the first rung on any financial planning ladder. Remember Joseph's 20% rule.

The Certified Public Accountant (CPA) and attorney-based financial planner bring a special combination of analytical skills and biases to the table. The CPA, by nature, is historical and compliance oriented. These professionals are deluged with tax forms and must be adept at record keeping. As historians, they tell what happened and try to figure out why and if it is good.

As planners, they escape the monotony of the compliance world and are able to utilize their vast experience with the numbers to project tax impacts and plan prospectively. The bias of the accountant is often conservatism. But certainly there is nothing wrong with this.

Conversely, the attorneys are firefighters, who are rarely able to devote time to implementation and who have been trained to find the problem in every solution. They often concentrate mostly on documentation. Most attorneys are necessarily mired in complex legal issues and are usually unable to take the time to stand back and look at the big picture—although they will tell you they do. As a planner, the attorney brings a wealth of technical and legal strategies to the party. The bias is often complication and confusion—too many choices. It is not unusual to find lawyers acting as planners who make simple issues overly complex.

I am not trying to criticize or suggest that any of these biases are bad. They just are. At least in my experience. The point is, every planner brings a different orientation to solving the equation based on their education, experience and their own set of fears. You, as the consumer, need to recognize each individual's bias before you are trapped into it.

The key to working successfully with a planner is to understand the impact those biases will have on the recommendations they make to you. Those biases are especially critical when you start to invest in tier three. When you enter this level, you are starting to assume additional risk and hopefully you will reap the financial rewards. But you can only afford to play once you've secured your future against calamity through successfully building up investments in the first two tiers. The planner's biases will strongly impact not only your selections but your analysis.

It is critical to understand that financial planners don't just happen, they evolve! They don't just, one day, hang out a shingle and say, "Oops, I am a financial planner." It is a long trail of education and experience. Most of their experience is the best kind, OJT—on the job training. The more experience and education your planner has, the better he can review and evaluate the alternatives.

I am reminded of a metaphor created by Dan Corrigan in Oregon. He asks what would happen if you allowed financial builders with various biases to build your yacht? If you allowed the stock broker to design the ship, you would end up with a small rudder, a small keel and a big sail to catch the wind. If you used a banker, you would have a small sail and keel, but you might have a big rudder to steer through stormy seas. Likewise, if you used an insurance agent, you would end up with small rudder, a small sail and huge keel for stability. In all three instances, the ship would hardly be sea worthy. What you need is a ship designed by a ship planner. Someone who knows ships. Do you think it would have a huge sail that would tip over in the heavy winds? Would it have a keel so big and a sail so small, that the ship would hardly move. Do you think the rudder would be so big as to dwarf the rest of the boat? I don't think so.

If you understand their bias, then you can predict and evaluate their advice in the context of their recommendations. That's why I say the bias is okay, so long as you recognize it for what it is and the planner is honest and open enough to share his bias with you.

This brings us to a major myth associated with planners—their OBJECTIVITY. Many financial writers who have definite opinions and access to the public would have consumers believe they will get better, more objective advice if they work with a fee-only planner. The argument goes like this, "Planners who are paid by commissions have an ax to grind and cannot be objective." Just so you know, planners usually get paid one of three ways: by fees, by commissions, or by a combination of both. The question that always comes up is, "How can you be objective if the only way you can get paid is if I buy something?"

First, the consumer has to be realistic. If you are planning to build a long-term, professional relationship, do you want your planner to be unsuccessful financially? The planner has to be in business to make a profit or else they will be unable to sustain their service over the long haul. I've also heard people ask the question, "If he's so successful financially, why is he working?" That's a good question and it deserves a good answer. In fact, any time you question the integrity or the motivation of the planner, you need to ask the hard questions and you deserve a truthful and detailed answer that satisfies you. A good, professional planner will have an acceptable answer.

So what is a good answer? Let's first remember that financial planners, like you, require capital to invest. If they don't inherit their capital, then they must work for someone or themselves to generate their investment capital. It is unrealistic to expect every financial counselor to be independently wealthy enough to pursue his own investments exclusively. In fact, if their independence were to be the deciding factor, there would be a remarkable vacuum of qualified professionals in this key industry. Don't you figure an entrepreneur of some ability would fill the void and, I suspect would profit handsomely in the process?

Being suspicious of the planner may be beneficial if there is reason to believe the planner is not telling you everything. The consumer must hold the planner to the highest standard of excellence and integrity. To further answer this question we need to look more closely at the three ways a planner gets paid.

Fees—Presuming for a moment we acknowledge that the financial planner, like anyone else in the service industry, requires a profit to operate, what does it take to run a successful business? Overhead is the killer. To be profitable, the planner's fees must cover the actual time invested in the project, the fixed overhead allocated to each hour of work, and include enough extra to make a profit. The normal formula for pricing a service is 2 1/2 or 3 times the actual hourly cost paid to the planner. So, if my time is worth $100 an hour, then I have to charge, say $300 an hour to cover staff time and fixed overhead just to produce a plan. The problem is, most people are unwilling to pay more than $75–$100 an hour for planning.

A fee-only planner must generate a lot of hourly revenue to sustain an organization which can provide the services required to adequately serve you. One major cost is continuing education. To remain current, the planner needs to attend continuing education seminars, buy tapes and devote several hours to finding out what is best for their client. This could require 3–4 weeks of time each year or more. They don't get paid to do this. In addition, there are costs associated with upgrading computer, software updates, building a library of financial planning information, attending study group meetings and obtaining other resources which will directly improve the quality of the service and advice. This must also add to overhead.

Assume the planner can do a plan and conduct client meetings in a 10-hour period and schedule enough meetings to stay fully employed. That would amount to 2,000 hours per year. They might expect to earn $150,000 (200 plans times $750). Not bad with no actual overhead. But studies show overhead actually runs between 40 and 60% of total revenue for most service organizations. If this is the case, then our hero can only net $90,000. What happens if he doesn't maximize his time and can't keep totally busy?

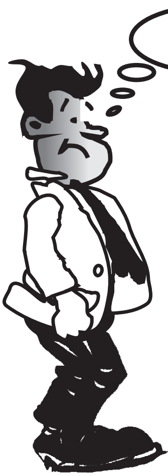
Now, just suppose you want a plan AND you want to purchase product afterwards. You end up having to pay your planner $750, which includes his profit on the plan and then you must go out and purchase product from an implementer. Here you pay a commission on the product. In essence, you could end up paying the profit twice. In some cases, the fee planner will direct you to no-load products, where no commission is paid, but they receive an annual fee from the fund of 0.50%–1.00%. Their bias may prevent you from evaluating a group of commissionable products which are equally worthwhile. Some planners charge an overhead fee to set up files and establish goals. Once the actual planning is completed, the annual updating and analysis, except for special projects and services, is routine. Thus, you should avoid paying one organization a fee for analysis and another commissions just to obtain this mythical objectivity.

Some fee planners offer wrap fee arrangements. This allows you to purchase products with no commissions but you pay a single fee based upon the amount of assets you have under management. I like this arrangement so long as the total cost—the planner's share plus the asset management charges are reasonable. The range should be no more than 2% (including professional asset management fees) with reductions for larger amounts under management.

Commissions—Direct compensation paid by the product vendors has been a source of constant criticism and confusion for many consumers. They often ask, "If this planner is paid by the vendor, isn't he going to be influenced by the commissions earned from his recommendations." This may be true! However, I can point to many cases where a fee-based planner or other professional (CPA, attorney, M.D., dentist, etc.) has recommended marginal solutions or "hung on" to the client relationship just to collect more fees. There has been more than one court case where a plaintiff was inappropriately advised by a fee professional. Fees do not guarantee objectivity!

In fact, we saw earlier that fee consultants have unique problems of their own. Fee based consultants can only work so many hours in a day, so how do they increase their income—except by leveraging their time? They have to hire staff, who are usually less qualified, or they must resort to computerized reports to increase efficiency. This also costs money and usually means higher fees not to mention lower-grade work product. So the work product may suffer as a result of their attempts to create more time. Obviously, there are some very good fee-only planners. The point is, you need to be careful when making your selection.

I submit to you that how a planner gets paid—fees vs. commissions—IS NOT the sole criteria for objectivity. A better measure is the degree of success the planner has produced! If the planner you select is successful, he has more to lose by allowing his greed to overcome his good judgment. A truly successful professional does not require professional standards of ethics to guide their judgment. His internal sense of values will protect him from poor decisions and hence protect you. A successful professional will not need to



DON'T BE...

- Embarrassed to Ask
- Ashamed to be Specific

ALWAYS...

- Ask for Several References
- Find Out How Well They Have Done Financially

Do You Know These Common Designations?

• CLU	• ChFC	• CFP	• MSFS
• RHU	• CPA	• CFA	• LLB

milk every dollar out of every deal. He can give you ample opportunity to make the right decision for you.

Here is one "caveat" to consider. Many investors are natural procrastinators. This is the bane of any financial service business. Recommendations heard but not implemented are a waste of time for the planner and investor alike. A professional with a sense of urgency should not be accused of "lacking objectivity." Sometimes a planner is considered "high pressure." But often his success is dependent upon whether his recommendations are implemented. No decision at all is worse than a yes or no. Good planners want a conclusion to their work.

WHY PROCRASTINATION

Since procrastination is commonplace, and potentially costly, let's look at its cause. Experience has shown me that investors procrastinate because they are afraid of making a mistake. This fear of failure paralyzes most of us until eventually the decision is made for us. When faced with a particularly tough decision, it is easier to allow time to decide than force an intellectual action or confrontation that one can second guess later. There is nothing inherently wrong with waiting. If it's a good decision today, it will be a good decision tomorrow. The indecisive merely want more facts so they can feel more comfortable with their decision. A good planner will give you alternatives, not a single choice. If you are given only one choice, then you should balk! Get all the facts first, compare your understanding of the facts with your goals. Then a clear course of action should be apparent.

Most people do what they want to do when they want to do it. What they are looking for is someone they can trust and have confidence will do what is in their best interest. A planner who is unwilling to work with you and help you understand is not doing their job very well. They are looking for a quick buck and are not really planners as much transaction specialists.

Deceit and misinformation can hide in darkness. Truth and knowledge seek the light. Remember, the Bible says, "The truth will set you free." A good planner will bring out the truth and let you choose the best course of action. Obscuring the facts and alternatives forces investors to go elsewhere for their information. So who loses? The advisor and the investor. If the advisor won't deal in "light," giving you alternatives, then get a new advisor who will.

CHOOSING AN ADVISOR

There are many elements to consider when selecting an advisor. The most important is charisma and trust. Do you like the advisor? How does he think? Is it a thorough process you understand and does he make you feel comfortable? Also, before selecting an advisor check on their: (1) references, (2) track record, (3) credentials, and (4) experience.

***References*—**Don't be afraid to ask for three or four client names. Look for ones in the same general income or net worth bracket as yourself or at worst, someone who started where you are and has grown financially over a measurable period of time because of the wisdom and talent of the advisor. You want to make sure the planner is experienced enough to handle your account. Even more important is that he wants to! Too often, out of courtesy or some inherent sense of guilt, the planner will accept a client and not be prepared to devote the time, energy or attention required to do a good job. You need assurance the planner is qualified to handle your individual needs.

The biggest hurdle for most consumers is actually calling the references. Most rationalize that the planner wouldn't provide references who were unhappy. This may be true. But you can glean pertinent information by asking some simple questions. Are you pleased with the relationship? Does he contact you frequently? Does he provide options for you to consider? What happens if you don't accept his advice and want to do something else? Ask questions which will provide feedback on the style and leadership offered by the planner.

Begin with the length of their relationship. If your advisor has been in business five years, look for clients who have been with the planner from the beginning. Anyone who has been a client less than two years won't tell you very much. The honeymoon is not over yet. Investments have a way of not really maturing for several years. Anything less than two years does not demonstrate staying power or reflect the planner's sense of responsibility. You want to know your planner lives and dies with his recommendations. It is unrealistic to expect every investment to be a winner, but a record of success is to be expected.

Next, ask if they are satisfied with his service? Again, you are looking for staying power. Has your prospective planner followed up and completed all that he or she promised? I'm a 90% guy. I do a dynamite job on 90% of the project. But I hate the last 10%. I have hired staff to finish each job for me. They know I will only do the first 90% and are willing to pick up the pieces. If your planner is a professional, he knows his strengths and weaknesses. You should ask his references how he handles details like reviews, data gathering, analysis, enrollment and reporting. Beware of the planner who has not completed the job. You don't want a salesman who gets his commission and then disappears.

The real service is the follow up. If you are really interested in a long term plan, then find a planner who will help you assess your goals and values, help you implement and most importantly, keep you accountable to them over time.

Third, are you happy with your experience? Probably your interviewee will yield positive comments. But you need to ask the questions. Don't be lazy! If you are, you may get clobbered. It only takes a few minutes to make the phone call. Invest in your future. You deserve to know the truth. Don't be embarrassed by inquiring. The planner has probably told the clients to expect the call. He expects it, so do it!

Track Record—Any advisor should be able to demonstrate a track record that shows his own performance with investments choices or how his recommendations have done for others. If the advisor stresses mutual funds instead of selected stocks, then you need to evaluate his method of selecting funds. In fact, don't hesitate to ask for his financial statement and two or three years tax returns. Has he done well with his own money? What kind of investments does he use to create his own wealth? Has he demonstrated a savings ethic? What planning has he done? Does he write down his goals? What about taxes? Does he follow the advice he gives? If not, why not?

Choosing a Financial Planner

1) Examine Work Product

- Individualized
- Computerized
- Competence
- Identifies Issues

2) Nature of Clientele

- Who They Know
- Age, Income, Net Worth
- Business Experience
- Their Banker/CPA/Attorney

3) Measure of Planner's Success

- Ask to See Tax Returns
- Financial Statement
- Assess Business Stature

4) Credentials

- Education
- Professional Association
- Staff

It may make you feel uneasy to ask for such personal data, but don't apologize. You are making an important financial decision. Stand up for your rights and do your due diligence. He will respect you and needs to know you respect him. If he hasn't done a very good job, then you need to know that up front. It doesn't mean you reject him, but you need to know the depth of his commitment and review the record of his own activity. Don't be fooled by a story which cannot be substantiated.

Credentials—Even though I have invested significant time earning diplomas and designations, they don't reflect counseling talent—they just show where I paid my tuition. Degrees do however show commitment. Anyone willing to pay the price to complete a professional training course, established by his profession, has shown at least some evidence of success. You wouldn't go to a tax advisor who had not studied the law. The CPA, LLB, and Masters in Taxation, are all indicative of the professional's ability to learn and stay current. The professional planner has an assortment of credentials to call upon. ChFC, CFP™, CLU, MSFS are just a few. Most are self-study but they indicate a willingness to go beyond the gut level education learned through experience. So look for these designations but don't allow a degree to overly influence your personal judgment. After all, you are the best judge of whether you feel comfortable or not.

Experience—There is no true way to really determine experience, but you can tell some things by the caliber of clients the planner uses as references. Another indicator is the type of investments they say they have in their own portfolio. I have invested in every major financial vehicle possible. I haven't profited from most of them, but I have learned through trial and error, in the process. Your advisor should be able to go outside his bias or at least have a network of advisors to refer you to so they can avoid the pitfalls of his own inexperience. To rely only on the due diligence department of a broker dealer is absurd and has proven to be unwise. When you purchase a partnership or other investment, you are buying more than the facts in the prospectus. You are buying the expertise offered by the broker and your planner.

DEFINITIONS OF DESIGNATIONS AND DEGREES

CFP™—Certified Financial Planner—a designation earned by taking a national test on financial principles through the College of Financial Planning in Denver, Colorado. Has a code of ethics. Clients can be charged fees only, commissions on products or both.

ChFC—Chartered Financial Consultant—a designation earned by taking several tests on financial principles through the American College in Bryn Mawr, Pennsylvania. Has a code of ethics. Clients can be charged fees only, commissions on products or both.

CLU—Chartered Life Underwriter—a designation earned by life insurance agents on the principles of insurance and taxation. Offered through the American College in Bryn Mawr, Pennsylvania. Has a code of ethics. Agents are compensated through commissions paid by life insurance companies.

MSFS–Master's of Science in Financial Services—a master's degree earned by taking a series of courses on the basic principles of financial planning. A three- to four-year program offered by the American College in Bryn Mawr, Pennsylvania. The college of Financial Planning also offers a Master's degree.

A FOOTNOTE

Obviously, choosing an advisor requires some expertise and hard work on your part. Where do you start if you don't have a referral? I wouldn't advise the yellow pages unless you like blind dates. A more preferable place to start is with your banker, CPA, or attorney. They are deluged with planners looking for referrals. But beware. Just because you are referred by someone you trust, is no assurance the reference is trustworthy. Why? You don't know the games people play to get leads. Maybe the individual is very creditable, but on the outside chance he isn't, CHECK HIM OUT with client referrals. Again, don't be lazy.

Loyalty is a virtue to be admired and cherished. Growth is often painful and today's business cannot survive with poor leadership. The margins in most businesses are too thin to make many errors. These businesses rely on loyal relationships to grow. Individuals are faced with the same dilemma. Remember, it is possible to outgrow your trusted advisor. You need to recognize this possibility exists. They are expected to grow, too. I am not advocating you immediately fire all of your advisors who are old personal friends. If you have outgrown one, move on. Loyalty is a two way street. An advisor needs to be honest enough to recognize when a client has outgrown him. It is rare for an advisor to be that objective. You need to consider the possibility, however. By outgrowing your advisors, you are not in unique company. There are very few professionals who can keep up with the massive number of changes caused by federal and state lawmakers. But unless you are privy to the best advice you can find, you run the risk of making errors you could have possibly avoided. Most good firms have specialists who advise in the main service areas, tax, investments, strategies and tactics.

Don't fall into the trap of obsolescence. Knowledge becomes obsolete through benign neglect. You are not responsible for keeping current on financial legislation, but your advisors are. When you choose an advisor, you have delegated the responsibility to him to keep you up to date. Don't allow yourself to outgrow his knowledge and capabilities.

INVEST IN WHO YOU KNOW

We've seen how difficult it is to find someone you can trust as an advisor. But many investors get "sucked in" to a deal because they know the key investor or principal of the firm. He's a neighbor, a friend at church, an advisor, etc. "It sounds good. I trust the person. Why not, I have a few extra bucks?" The problem is, most of these deals go south.

Personally, I first started investing in real estate after we bought our second house. I met a young aggressive real estate agent named Rick. His name and company's signs were plastered everywhere in our neighborhood. He could list a list. When we decided to sell our house, I sought him out because his success was so apparent. He sold our house in one day.

We became friends with another investor, Malcolm—we purchased houses together in a "loose" joint venture. Rick would find them. Malcolm and I would put up the cash. We hired another friend to fix them up and Rick rented them. This was a great adventure and we did well. At one point, we owned five houses. Then we started to diversify to other types of investments. The most important lesson I learned from this experience was to stay with a successful program. It is another example of how the chain of compound interest works. If you can develop a system—or a pattern—which works, don't stop once you have it down. Continue until things change so drastically (new laws or new technology), that you can no longer use that method. Losers quit because they get bored and change for change sake or abandon faith in their concept, usually just before success was about to occur. Winners stick it out and see their problems turn into opportunities.

It is important not to allow your emotions to rule the investment pocketbook. I have learned this the hard way through the years. The only way to protect yourself, as I've said before, is to have a clear set of goals in mind and apply your criteria to these objectives. If you can establish investment boundaries, then you can say no and not feel bad about yourself or like you are letting your friend down.

Most of the wealth in America has been made through the efforts associated with hands-on work, such as through manufacturing, programming, building or selling. The best investments are those very things you know, understand and can control. Too often, successful business are lured into believing that their success can be duplicated in a different adventure. Investors become patsies for a scheme because they are disenchanted with their own business. They see an opportunity to diversify and get into an investment which will create income and appreciation. Unfortunately, these assets usually have the opposite effect. They end up costing cash flow instead of providing it.

Most losses occur from a single error. But that error compounds into additional problems. The investor feels obligated to continue to try and save what they have already put into the deal. The result may be throwing good money after bad. The safest investments are those which you understand and appreciate; the ones where you know the risks, where you can instinctively tell whether to go forward or wait and watch. There is no shame in holding fast to a course of action. There is nothing wrong with sitting on the sidelines until naive investors have lost their new money. Sometimes the smartest move of all is to just wait.

1. Smart $$$$ Makes Money

- Accept a Lower Yield
- Cut Your Losses Early
- Fully Investigate—Due Diligence
- Check <u>ALL</u> References Carefully

2. Common Reasons People Use Bad Judgement

- Too Busy
- Unable to Say NO
- Trusting Others Judgement

INVEST IN WHAT YOU KNOW

Knowing the people with whom you are investing and/or knowing the specific industry so well that you almost feel it is boring, is in reality smart. Rarely will smart money seek "get rich" quick schemes. It is usually new or naive money which is lost through ineffective research or misplaced trust. Smart money invests in smart investments. The focus is not a fast return on the investment as much as a fair return. Opportunity knocks, but only for the prepared.

We have reviewed the basics of finding out who you know. But to be truly safe, it is smart to invest in what you know. Unfortunately, most people don't have a wide knowledge base in investments.

I mentioned earlier I had lost money every way possible. I'm sure there are many additional ways to lose money that I haven't thought of yet. But let me give you an example. When I started seriously investing in real estate, I joined forces with someone I could trust and had many years of experience.

One would think that this was a formula for success. However, our track record was abysmal. The first building we bought, lost money for us because the developer was a crook. He used inferior materials, lied about price and in general took us to the cleaners. The second building lost money because the loan was a bad loan. No one would invest in the building with that loan on it. We had to ante up hundreds of thousands of dollars just to get out of the loan. We lost another time when the money partner went bankrupt and took the project with them. Another time we lost because the bank was able to enforce a contractual provision that no one caught in the documents.

Now you might say, "Gee, you were sure stupid." Well, maybe we were. But I am convinced there are many more ways to lose money than there are to make it. Again, know the people with whom you are investing and/or know the specific industry thoroughly. But there is no guarantee you will not get caught by the sophisticated nuances of the game. This is why Tier III is so dangerous. Before you start trying to make money quick, make sure you know, and I really mean know, the game.

Invest in Who You Know and What You Know

As an investor, it is important to be positioned with other successful, experienced investors. But even with professional counsel and knowledge, there is only one sure way to proceed.

You must...

CHAPTER

11

Invest Regularly

ALTHOUGH THIS IS A SHORT CHAPTER, it offers the most sound, practical investment advice I have ever learned. This principle is based on the fundamental rules of investing. First, you can not be right (or wrong) all the time, and second, life is subject to change. Emotions govern the first rule, while economic cycles govern the second.

Most investors have had a variety of experiences. Let's assume for the sake of argument, you have lost money investing in the stock market, more specifically, you have made one or more investments which resulted in you losing some of your capital. Investing money and losing it often creates a predictable response. You might say, "Oh, I'm not going to do that again." Right?

Wrong! Losing money drives most investors to conservative cover. From my point of view, temporary loss only proves the basic rule of investment: you need to invest regularly, according to a specific plan. For most, the fear of loss causes concentric circles of fear to develop. If you understand the principles of long term investing, there is nothing to fear.

This reminds me of the tuna fish story. Let's say for a minute that you really like tuna fish. You stock up on tuna fish to make certain you always have enough. You are a tuna fish expert. So

Six Mistakes Investors Make

1 **Having too much in your company's stock.** Investors who concentrate a sizable share of their assets in any single stock are courting trouble. Many people make that mistake - often without even knowing it - because they invest heavily in the shares of the corporation they work for through vehicles such as 401(k), profit-sharing and other deferred-compensation plans.

2 **Leaving too much money in cash.** Some investors escape the defaults and real estate slumps by keeping the bulk of their assets in cash. But they often overlook an even more relentless threat—inflation. Cash equivalents such as Treasury bills and money market accounts offer no chance for capital gains that can outpace rising prices.

3 **Assembling a portfolio piecemeal.** You may be a genius at spotting undervalued stocks or choosing top-performing mutual funds. But a collection of great individual investments does not always provide the balance your portfolio needs. A systematic method of asset allocation and rebalancing will beat the piecemeal method.

4 **Buying more investments than you can monitor.** To diversify fully, you may be tempted to own so many issues that you do not have time to follow them all carefully. Or you may buy investments for which accurate information is difficult to obtain. Remember that less can be more. Choose a mutual fund or two instead of a host of individual issues to fill out the gaps in your diversification plan.

5 **Acting on yesterday's news.** After the stock market crash in 1987, many investors were reluctant to own stocks and missed out on the ensuing recovery. When interest rates drop, investors usually avoid bonds. Yet, that's precisely when bonds make sense.

6 **Overlooking important assets.** Many investors focus their diversification efforts narrowly, excluding assets such as their earning power, their home and their tax-deferred accounts. But such assets may be the most valuable. If your IRA is invested in long-term bonds and cash, consider diversifying your remaining assets toward growth-oriented investments.

much so, that you regularly read the tuna fish ads to make certain you are buying tuna fish at the right price. One day, you notice you are almost out of tuna fish. You look in the paper and discover tuna fish on sale for $.75 a can. This is a great price! So you race out and do what? You buy all the tuna fish you possible can, all you can afford. But if tuna fish were selling for $2.00 a can, what would you do? You'd probably only buy one or two and wait for the price to drop, right?

Now think of stocks and how most people react. If a stock is going up in price and we know it will go higher still, we buy as much as we can afford, expecting to make a profit as it increases in value. If the price is dropping, logic tells us not to buy, something is wrong, we need to sell, get out, the sky is falling. As consumers we only want to buy at low prices. As investors, we only want to buy when prices are rising. What's wrong with this picture?

If you could purchase a brand new Lexus for half the market price, would you do it? Of course, yet when the Japanese economy is in the tank and everyone is afraid the Nikkei will fall into the ocean, what will the average investor do? Wait until the market turns around and looks like it is going to recover. The emotions of investing cause most investors to make the wrong decisions.

A study done by Morningstar, Fidelity and Ibbotson reported the stock market grew at a compounded rate of 12.3% from 1989 to 1999. The average investor only earned 2.3% during this time. Why? They bailed out during the down times and bought in during the up times. In other words, they didn't treat the stock market like tuna fish.

How many times can you stand to lose before you learn? The more experience you have, the less likely you are to make the same mistakes again. For instance, I mentioned that in real estate I have found every conceivable way to lose money. We've lost because the financing package was not marketable, the location was bad, market timing was lousy, interest rates were high, interest rates were low, a bad leasing market, a good leasing market—you name it and it has cost us. But once you learn, often by making a mistake, you are not likely to do it again. The question is, can you afford the learning curve?

Here is the emotion cycle. It goes like this. You invest and for some reason you lose money. So you decide to be brave and you try

DOLLAR COST AVERAGING

Month	Fund Value	No. of Shares
1	10	100
2	9	115
3	8	125
4	7	143
5	6	167
6	5	200
7	6	167
8	7	143
9	8	125
10	9	115
11	10	100
	7.8 Avg.	1500

Annualized Return of 13.6%

again. Maybe, it is a different form of investment this time. What happens? You end up losing once more. So you bravely invest again, but perhaps a little less and you are more tentative. Ultimately you fall deeper into the concentric circles of fear to the point where you become financially paralyzed. Unfortunately, I've seen many people lock themselves into these concentric circles. Not only in business matters, but in their marriages, their job and their social activities. They simply can't adapt to the dynamics of experience and hence they do not grow or learn, rather they confine their vision to what they know and become less venturesome. They allow fear and bad experiences to dictate their future.

This negative mentality leads most to limit their investment portfolio to the safe and guaranteed passbook interest rate. It is as if to say, "I don't care if I lose 3% per year to inflation, so long as my principal is safe and secure." But there are two risks, loss of capital and inflation. Only one is guaranteed to happen. Inflation has been a permanent part of our economy for hundreds of years. There has never been a mutual fund yet that has gone bankrupt.

This is the difference between using emotion and a systematic process. If your emotions govern your decisions, you are certain to

Dollar Cost Average: Five Ways to Cut Your Risk

Dollar cost averaging and similar strategies can help you avoid investing too much money when prices are near a peak. The table below compares five hypothetical portfolios to illustrate how such strategies work. In each case, the manager invested $28,000 over nearly 12 years, following a formula that split a $200 monthly contribution between the S&P 500 index and a top money fund. Calculations begin with September 1976 and end March 1988.

Constant Share Purchase

- Each month, buy the same number of shares in the stock fund (for comparison with the strategies below, 5.4 shares) and invest the remainder in the money fund.

Average Cost per Share: $19.82	Portfolio Value: $57,874

Dollar Cost Averaging

- Each month, invest $100 in the stock fund and $100 in the money fund.

Average Cost per Share: $19.12	Portfolio Value: $59,838

Constant Ratio

- Each month, invest $100 in the stock fund and $100 in the money fund.
- Whenever the value of your stock fund shares reaches 55% of the total portfolio, shift assets to the money fund to reduce the percentage to 50%.
- Do the opposite if the value of the stock fund shares falls to 45% of the portfolio.

Average Cost per Share: $19.23	Portfolio Value: $60,264

Variable Installments

- Start out by investing $200, divided equally between the two funds.
- Thereafter, when the stock fund's share price is below your average cost, allocate more of your monthly $200 to stocks.
- When the price moves above your average cost, put more in the money fund.

Average Cost per Share: $18.75	Portfolio Value: $59,344

Leveraged Variable Installments

- Begin by investing $200, divided equally between the two funds.
- Thereafter, use a formula which sharply varies the amount going to the stock fund as its share price rises and falls.

Average Cost per Share: $18.66	Portfolio Value: $59,902

make bad decisions, virtually every time. The best method to beat this problem is to use dollar cost averaging (DCA). DCA is usually associated with the stock market, but it could be applied to other investments as well. When you invest an incremental amount of your capital on a regular basis without concern for the specific value of the market or the investment vehicle, you stand a better chance of riding the waves of the market. If you invest regularly, and "dollar cost average," you will pick up the highs and lows in the marketplace. The chart on the following page shows what happens if you were to invest $1,000 every month for 11 months into a stock fund.

If the fund value started at $10 and then fell in value $1 each month for 5 consecutive months and then rose back to its original value during the next 5 months, the rate of return would be 13.6%. The important thing to realize is the starting value and ending value of the investment was exactly the same—11 months later. There was no gain in the portfolio, yet the investor made a 13.6% return. The key is not the value of the investment, but the number of shares you own times the value per share.

The theory of buy high/sell low always results when you try to time the market. Most investors and advisors will guess wrong. It is human nature. The only way to protect your capital is to invest on a systematic basis, not on an emotional basis. Obviously, if you can avoid the impact of bad news and wait a few days to invest (i.e. major tax reform or a catastrophic world situation) then do so. But most markets discount the impact of news long before an individual investor ever hears about it and can act. It is foolish to try and

HISTORIC ASSET RETURN

Asset Classifications	Annualized Rate of Return
Common Stocks	12.1
Long Term Corporate Bonds	5.3
CDs	4.7
Inflation	3.2
Gold	1.8
Treasuries	3.6
Real Estate	4.1

outguess short term trends. The current price is the market. That is the definition of market. It already reflects the value other investors place on it.

That's why most financial investors recommend investing on a regular basis. Just plan your goals and objectives around constantly putting money into your chosen portfolio so you can participate in the growth of the market. Set your level of risk and accept the growth rate that commensurate with your portfolio. Then be patient and work your plan. Generally speaking, patience always shows an acceptable profit.

Studies of consistent investment results have determined that asset class allocation is the most important factor in determining the success of a portfolio. Asset classes are based on the characteristics of various types of tangible assets. Again, my book *Investment Alchemy* explains this thoroughly. The following table lists the primary asset categories and the historic rates of return going back several decades.

After you determine your relative risk tolerance, you can then choose a mix of asset classes which is most likely to achieve your long term objectives.

An important consideration to remember about risk is that over a long period of time the various asset categories should repeat their historic average yield. For instance, stocks have averaged over 12% during the last 60 years. The probability of duplicating a similar return is very high over a long period of time in the future. But what is the probability of achieving a 12% return during a given 12-month period or a 24-month period? Look at the historic returns of the Standard and Poor's since 1972.

S & P HISTORIC RETURNS

1972	19.0%	1979	18.4%	1986	18.5%
1973	-14.7%	1980	32.4%	1987	5.2%
1974	-26.5%	1981	-4.9%	1988	16.8%
1975	37.2%	1982	21.4%	1989	31.5%
1976	23.9%	1983	22.5%	1990	-3.2%
1977	-7.2%	1984	6.3%	1991	30.4%
1978	6.6%	1985	32.2%	1992	7.7%

Adding Up the Risks in Your Portfolio

Most people shield some of their investments against different types of risk, but few balance all of their important assets so that they are well protected. This quiz can help you identify your points of vulnerability. With each question, you will accumulate points for one or more of the five major investment risks. Write the points in the answer sheet on the next page.

1. Are your assets diversified among fewer than four of these five major categories: stocks, real estate, gold, bonds and cash? If yes, score one point for each risk category.
2. Are more than 35% of your assets invested in any one of the five categories? If yes, score one point for each risk.
3. Is at least 10% of your portfolio in assets such as gold, natural-resource stocks or high-grade collectibles such as rare stamps? If no, score one point for inflation risk.
4. Is at least 30% of your portfolio in investments such as growth stocks and real estate, which are likely to produce long-term capital gains that can out pace inflation? If no, score two points for inflation risk.
5. Are your real estate and gold investments held primarily in assets such as gold-mining shares, REITs or real estate mutual funds which fluctuate with the stock market? If yes, score one point for market risk.
6. Do you generally keep at least 15% of your portfolio in cash equivalents such as Treasury bills or money-market funds? If no, score two points for interest-rate risk.
7. Is more than 30% of your portfolio composed of long-term bonds, certificates of deposit or annuities that provide fixed payments over a period of many years? If yes, score three points each for inflation and interest-rate risk.
8. Do highly volatile zero-coupon bonds account for more than 30% of you fixed-income assets? If yes, score two points each for inflation and interest-rate risk.
9. Do emerging growth stocks or junk bonds, which may fall sharply in a recession, account for more than 25% of your portfolio? If yes, score three points for economic risk.
10. Do you switch money among different assets to try and catch the highs and lows of different investment markets? If yes, score two points for market risk.
11. Do you use dollar-cost averaging or a similar plan that involves adding money to your investment portfolio at regular intervals? If no, score two points for market risk.
12. Is more than 20% of your portfolio concentrated in a single industry? If yes, score three points each for economic risk, market risk and specific risk.
13. Do stocks or bonds issued by one company-including the one you work for-or shares in a single limited partnership account for more than 15% or your assets? If yes, score three points each for economic risk and four points for specific risk.
14. Does rental property account for more than 30% of your portfolio? If yes, score one point for economic risk and three points for specific risk.
15. Do foreign stocks and shares of domestic companies with significant overseas sales account for less than 10% of your portfolio? If yes, score one point each for inflation and economic risk.

16. Will you need access in the next three to five years to principal in volatile assets such a stocks or long-term bonds? If yes, score one point each for inflation, interest-rate, economic and market risk.
17. Do you own your own home? If no, score three points for inflation risk.
18. Do you have variable-rate loans such as mortgages or credit-card debt amounting to 30% or more of the value of your portfolio? If yes, score four points for interest-rate risk.
19. Is 20% or more of your portfolio financed by loans or invested in highly leverages assets such as options? If yes, score one point each for interest-rate and market risk.

Inflation	Interest Rate	Economic	Market	Specific
1.				
2.				
3.				
4.				
5.				
6.				
7.				
8.				
9.				
10.				
11.				
12.				
13.				
14.				
15.				
16.				
17.				
18.				
19.				
Total				

Total the points for each risk and interpret your scores as follows: Fewer than five points is low; five to 10 points is moderate; above 10 is high. While you may want to vary your exposure to different risks somewhat, depending on your personal circumstances and the outlook for the economy, any score above 10 would set off alarm bells.

Once you have identified vulnerabilities, you can take steps to shore up your defenses. For example, say that you score high for inflation risk and low for market risk. You might balance your portfolio better by switching some money from money funds to real estate, stocks or gold. While your risk of a temporary decline in the value of your portfolio will increase, you will have a better chance of outpacing inflation.

In answering the questions, don't forget about IRAs, 401(k) plans, or any other savings or deferred-compensation plans. It may be difficult to pin down the value of some assets. For instance, you may have a universal life policy with an important investment component. Just make the best estimates that you can. It isn't necessary to be exact, but it is important that your inventory be complete.

The historic returns are all over the place. But the average has been 12%. I would think this is a strong demonstration of what I have been saying: a systematic investment over a long period of time is likely to achieve similar results for the asset allocation mix you have chosen.

Before we move on to Principle 12, let's look at the most common reason people lose their capital. I talked about greed earlier, but you must remember we can control our greed. What we can't control is the integrity of others.

By applying Principles 10 and 11 to any investment, you can achieve your long term goals. Remember Principle 10 says to invest in who you know and what you know. If you can eliminate the integrity risk, you have eliminated 90% of the potential problems that cause loss. By minimizing the integrity risk you significantly increase the chances you will preserve your capital and achieve an acceptable rate of return. Nobody can guarantee the economics of an investment. The factors affecting risk change regularly. But there will be "windows of opportunity" where an investment will have a high probability of being worth more. Experience, knowledge and personal contacts are often the key to achieving investment success. Principle 11 says to invest often and regularly to create more opportunity for that success.

Do you see what I am saying? If you can trust the people you are investing with—and they truly are honest—then the universal laws of growth will bring ultimate success. In other words, staying power creates wealth. But if you don't invest regularly and you compound your fear by changing investment strategies often, you will significantly increase the chance of losing your capital.

Don't lose heart or nerve if a project or investment goes badly. I've been on the brink of loss many times and have been forced to "hang in there" and "feed the deal." My instincts told me to quit and take my loss. But because the investments were sound, and I was working with honest people, the projects eventually became successful. If I'd have quit, I would have lost my capital. That's why staying power is so important. The sin of investing is losing your capital. So don't quit if you believe in the people and the basic economic factors which caused you to invest continue to be strong.

SIX QUESTIONS TO ASK TO AVOID BECOMING A DISILLUSIONED INVESTOR

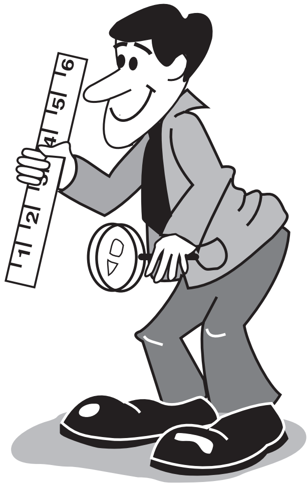
1. SAFETY: How much, if any, of the principal and/or interest is guaranteed? Who provides this guarantee? Can any entity liquidate my principal without my permission?
2. LIQUIDITY: How soon and at what cost can I get my money back? At what cost? Is there a surrender charge or a back-end fee?
3. CASH FLOW: How much cash, when, and under what circumstances must I or might I expect to receive a pay out? What could reduce this payout? How reliable will the cash flow be?
4. GROWTH POTENTIAL: How much growth/appreciation is reasonable to expect, over what period of time? What is the basis for this estimate? What factors could cause this investment to decline in value? What outside factors impact this investment?
5. TAXATION: What will my taxable income be? Will there be any tax deductions? Will I ever have to worry about paying tax on income I never receive? Will there be a deferred tax liability?
6. MATURITY: When, if ever, can I expect to get my principal back and from whom? Who controls whether we sell this investment? What do they get paid for handling the transaction?

It will take courage to “hang in there.” Yet from time to time it will require you to…

C H A P T E R

12

Constantly Review Your Progress and Goals



IT'S GOOD TO REVIEW your progress. I already mentioned, Maxwell Maltz's *Psycho Cybernetics.* This is a terrific book on how we can check our life gyroscope. The book says essentially, most people start on course, but from time to time may wander off unknowingly in the wrong direction. If you are just one degree off now, you may be way off target before you realize it. Do you remember the law of compound interest? It prescribed the value of constant growth but you want to make certain you are growing in the right direction. Once you are off track, it is going to take time and energy to re-establish your course and resume compounding. Breaking the chain of compound interest can be very expensive. It's important to know when you have varied from your original path. But how are you to know unless you have something to measure your progress against? I call this benchmarking.

Knowing where you are and where you're going is an important part of measuring your progress. It's those two great questions in life—what do you have and what do you need? Many times our initial goals prove too modest or inappropriate.

When I first started selling in the life insurance business, I set numerous goals. I established goals which were long term in nature; many were what I thought were career goals. My financial goals related to wealth, income, status—a house, automobile, all of the entrapments of youth—the dreams of a lifetime. My short term goals were results-oriented, related to activity and sales accomplishments. They were all of the normal, appropriate types of success objectives. My biggest rule was I would keep my head down and not "look up" until I had completed ten years in my career.

Well, I did just that. I kept my nose to the proverbial grindstone and concentrated on results. I kept track of my results and gauged them by my timetable. I was delighted by the progress I made during the early years. In fact, if you recall in chapter 4, I detailed how accurate my projections were. I only had one problem. I forgot to review my progress. I had blown by my original goals, but more important, I had no new ones to take their place.

SEVEN WAYS TO MAKE GOALS WORK FOR YOU

1. Decide on a goal. Then start.
2. Never consider failure. You can never go back.
3. Do it one level at a time. The only time you have is now.
4. Avoid naysayers. Fly with eagles.
5. Welcome difficulties. They are there to instruct you, not obstruct you.
6. Be clear on your goal, but flexible on your method.
7. No one does it alone. Be generous.

When I looked up after 10 years, I had outstripped my wildest imagination. Compound interest indeed had multiplied my input. What I hadn't counted on was inflation. I had not only met my expectations, I had exceeded them. What was once a lifetime goal ten years earlier, was now accomplished…done…finalized. The dreams of my youth had become a reality. Suddenly I found myself without goals. I was lost with no clear direction or path.

This was new territory for me. I was in a new world, looking at the future with a new perspective. I had to re-determine what was going to be important to me and how it would impact my family. Ultimately, new goals came into focus and I discovered new challenges and goals which transcended my original expectations. However, it was a painful journey. One I could have avoided, if I had been tuned to the problem. I think there is object lesson here for anyone who hears what I am saying. It took me over two years to gain my equilibrium and re-establish my priorities. During this time, I lost valuable compounding on my efforts and my resources. It took nearly five years to go through the boring part of the curve…again. Finally, after much distress, the compounding returned bigger dividends than I had anticipated. But, the point should not be lost. I basically had to start over.

If I had to do it again, I would have continued to study my goals regularly, adjusting them to reflect the new realities. As I saw myself completing the list of objectives and goals, I would have replaced them with new, higher thresholds of accomplishment. But maybe they would have been less materialistic and more servant directed. For those who are not driven to go higher and higher, accomplishments can be replaced by new incentives and challenges in other areas of your life. You can easily move the focus from doing to being. Ask yourself, are you a human doing or a human being? Regardless, the point is to not come to a complete standstill like I did.

That's why we need to be prepared for success, too. Part of goal setting is to be realistic in both directions. Most investors are willing

SEVEN WAYS FOR MAKING AN IMPACT WITH YOUR LIFE

1. Education never stops.
2. Set your mind on your objectives.
3. Know yourself.
4. Focus on what you do best.
5. Forget the past.
6. Re-evaluate every so often.
7. Have a meaning beyond the goal.

to pull back, especially when they are ahead. Consider, however, re-evaluating your goals and setting your sights higher with a more aggressive financial plan, but only when you have surpassed your previous expectations. This is not greed. Greed results from no planning. It embodies a desire to have more when more is too much. A systematic, well-constructed plan, with specific measures of accomplishment turns unfocused greed into a beneficial and profitable plan with specific objectives. Greed is knee-jerk reaction to unanticipated success. When you get to excited about your results, you can be assured greed is operating.

Let me assure you, I have never found anything wrong with change. Change occurs when technology creates a new environment. You can anticipate these changes and use them to your advantage or you can become a victim, waiting until change offers no alternatives. There is nothing which says you can't alter your direction or path, especially when your pace is greater than your original predictions. In fact, change can be a sign of maturity.

Make the most of your money and skills. It is very gratifying, especially if it is coupled with a motivation which brings peace of mind and inner satisfaction.

In fact, wealth and success is all in our mind, which brings us to the last principle…

CHAPTER

13

Wealth is a State of Mind

DESPITE SOME CRITICISM that the book *Megatrends* lacked statistical accuracy, author John Naisbitt did identify one unassailable piece of knowledge. He said, "Tell me what people are thinking today and I'll tell you what will happen tomorrow."

People thinking—attitudes—that's what investing is all about. That's what life is about—people thinking. Anticipating trends and investing in these trends before they get popular. A key to personal success is how we approach a problem. We either do it with enthusiasm and optimism or we face it with fear and trepidation. The glass is either half-full or half-empty. It's always your choice! How one handles a problem is a function of the "altitude of your attitude." In other words, right thinking brings right results. But you also have to sow the right things—right? This approach may not bring about the results you desire as quickly as you would like, but a winner often wins by being a survivor.

What is the right attitude towards wealth? And if you do have the right attitude toward wealth, what do you plan to do with it? Does wealth seem finite?…yet somehow unlimited?…yet inaccessible? Paul Pilzer, in his book *Unlimited Wealth,* says that true wealth is a function of how you *use* your resources. In some cases your ability to create wealth may seem unlimited. But when you really are desperate, wealth will elude you until you can relax and let it happen. Another hard principle to accept is that true wealth is really out of our control.

We have seen earlier growth compounds our original capital. But if you can't harness the growth and utilize it for worthy purposes, wealth will only bring stress, turmoil and dissatisfaction. I once read that H. Ross Perot pointed out that "the problem with things is they begin to own you." If you could control wealth's destructiveness, wealth would bring peace and satisfaction. If you can control wealth's power, it can bring about harmony and good. When a person is in awe of wealth and fights the natural laws of wealth (which seem to surround it), then true wealth—the kind which produces peace of mind and ultimate satisfaction—can NEVER occur.

Unfortunately, wealth, by itself, is never going to bring "peace of mind." There will always exist the possibility of losing it. True peace comes from an inner trust of self, not wealth. The question is what do you trust—yourself, your money or a supreme power that really owns and controls all wealth? Some people refer to this power as God.

To believe that we in anyway control or possess wealth is to ignore historical evidence. Wealth is not power. It is merely the instrument of power. Wealth is a friend of the greedy and the selfish until it crosses over a threshold. It almost seems like there is a point of no return—that wealth tolerates dysfunctional behavior to a point and then turns on the steward of that wealth and administers discipline and often punishment. To these people, wealth is an invisible enemy who ultimately conquers them. They live in fear, yet they deny its existence. Wealth also creates a lack of joy and peace. It can produce a constant need to strive and acquire more, to be more successful, to gain more riches. Yet, to those who are mindful of the rules of wealth, and do not succumb to its tantalizing allure, wealth can be a friend.

By containing greed, employing prudence, patience and personal discipline, the rules of proper money management makes wealth a friend, a natural part of our existence. But remember, wealth is fickle, a woman scorned and will turn against you if you abuse it.

Why People Have Trouble Saving Money

1. Saving reduces their spendable income.

2. They find it difficult to envision the end result.

Benefits of Financial Planning

1. Creates an awareness of the problems they face.

2. Develops a plan to accomplish objectives.

3. Provides an accountability, a comparative base.

IS WEALTH ONLY MONEY?

Why is wealth so mystical? Is wealth only money? Nothing says you have to be rich or have money to be wealthy. There are some wonderful people who are financially destitute, totally humble, unassuming and unpretentious, yet rich in many ways other than fancy cars, large homes, expensive jewelry. Mother Theresa comes to mind. I believe wealth has more to do with inner contentment and how you think, than how much money you have or how you got your money.

Have you ever noticed how financial success changes people? Financial wealth creates power. Power can cause people to be overbearing, demanding and possessive, abusive, especially of others. Wealth can bring other equally endearing qualities. There is a feeling of omnipotence, a feeling of supremacy which accompanies the freedom created by money. Wealth also ruins relationships, builds barriers, feeds fears and justifies abhorrent behaviors. It causes boredom which can lead to other forms of excitement—drugs, alcohol, permissive sex and as well as a means to various physical and mental stimulations. New wealth often leads to divorce—of one's lifelong mate and of one's friends. It often creates a network of dependents who actively seek access to this power and the wealth. Let's look at two of the most common characteristics of wealth.

OMNIPOTENCE

I mentioned that financial wealth can cause feelings of omnipotence. The very nature of money is power. The world admires power and all it controls. With power, people respond quickly to the leader's vision and direction. The wealthholder's decisions are always right no matter the ethics. The power wielder is bestowed with a godlike aura which can transcend reason and righteousness. It is not unusual for the fear this power creates to cause hatred, promote illegal activities and other overt coping mechanisms to avoid loss—loss of job, loss of proximity to the power or direct access to the power.

If the person wielding the power feels unconquerable, the omnipotence can create feelings of super human strength and invincibility. There is nothing they can't buy, conquer or rule. The only question is "Where do they start?" This invincible attitude often leads to massive risks, unbelievable debt and setting unachievable expectations, not to mention the mental and perhaps physical abuse of others. From time to time, philanthropy may assuage some feelings of guilt. An anonymous gift would most likely be out of the question. For some of the rich and famous, jealousy, envy, boredom and feelings of inadequacy become controlling behaviors. The ability to rise above it all may be only a thin veneer of doubt about whether they will ever have enough or be enough. In short, the Forbes 400 can be a gentle prod for those not on it…to do more, risk more, have more, make more…just to be seen at the top. It's like the major league baseball standings. It's not how you played the game, it's whether you won or lost. Who remembers second place?

Five Worlds of Success

JUST WIN, BABY!

A second element is competition—win at any cost. In our competitive society, where success often is measured by who has the most toys, money, power and other accoutrements of wealth, the rich and/or famous seem driven by motives other than security. You must remember, there is nothing wrong with money. Money is neutral. Money is dumb. The Bible says it is the *love* of money that is evil, not the money itself. Money is neither evil nor good. It has no qualities other than value for barter, no value other than what it can purchase. But when the ego needs transcend security needs, it is important to think about priorities. To win, can mean at any cost or it can be the result of hard work and effort which culminated in a victory. Is it possible to win even though you aren't in first place? If there can only be one winner, then what value is second place? In life, not everyone can win. It is important to be satisfied with doing your best, then everyone wins.

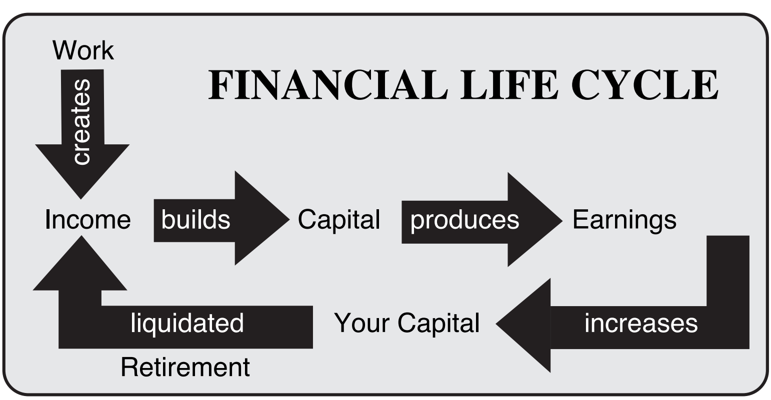
Ask yourself this question. Which needs are the driving forces in your life? Material wealth or relationships? Dignity or winning through intimidation? Ethics or win at any cost? While there are not always direct trade-offs, the impact of money often interferes with the humane aspects of life and relationship factors are sacrificed for profit.

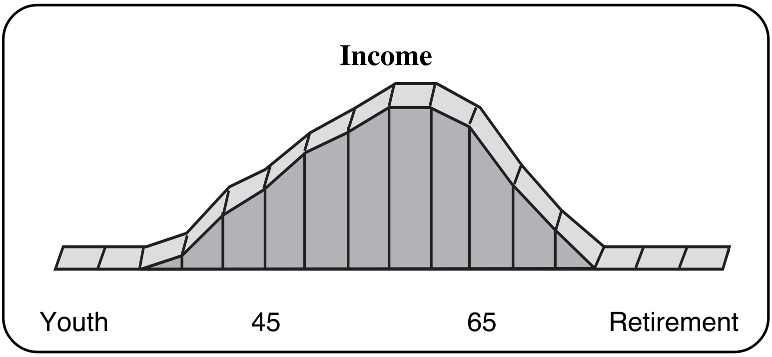
HIERARCHY OF NEEDS

Maslow demonstrated in his hierarchy of needs that there are needs beyond obtaining financial security. Self-actualization, the last of his five levels, must be more than using power and money. Self-actualization, in my opinion, is the involvement and participation in the growth of others. It is the highest level of giving—because you are giving of yourself. It happens when the person gets outside himself and wants to help others become successful—to become part of the success others feel. A mentor relationship gives more than advice, it gives wisdom and intimacy. True success is the attainment of self-proclaimed goals which are inspired by an internal spirit of sharing. The motivation to succeed must be greater than the accumulation of riches, otherwise the history books would have less bloodshed and anarchy through the ages. Power is about control. Money is only one element of power.

The Bible talks about the rich young ruler who was told by Jesus to give away all of his possessions. The rich man refused and walked away. Why did Jesus request the rich ruler to give away his material possessions? Was it because the rich man's focus was on the security created by his money? Money does not and cannot create security. Security is illusory. In fact, it is just the opposite. Riches create insecurity. Jesus went on to say "it is easier for a camel to go through the eye of a needle than for a rich man to get into heaven." Forgetting about the theological aspects of heaven, why would Jesus say that money is a barrier to entry? The answer may be obvious to you. Money and what you can do with it can so dominate the lives of people that money prevents them from focusing their eyes outside themselves. This spiritual truth, focusing outside your own needs and centering on the feelings of others is central to the basic tenant of the Bible—love one another. Wealth causes people to focus on keeping it, protecting it, growing it. Seeking wealth and protecting wealth prevents most of us from enjoying the journey. Acquiring wealth becomes the journey.

Again, the Bible never said that money is the root of all evil. What it said was the "love of money" is the root of all evil. Putting maximum effort into earning money, spending money and protecting money expends a lot of effort. Where is that youth of years past, those childlike feelings of yesteryear? What happened to intimate relationships? When the cash register rings up its final sale, who will really care?





It's very important to build a strong foundation under your life so that wealth is merely a part of your pleasure—not the pleasure. The motivation to achieve financial independence must withstand the scrutiny of the soul. If your motivation fails this test, the ability to sustain long periods of financial security cannot exist. It is the peace which comes from "not loving money" which brings true peace. When security is dependent upon wealth itself, the very first financial conflict will discourage the weak and uncommitted. They will lose their wealth and all of the time it represents.

CONCLUSION

So, remember to start at the BEGINNING, analyze the basics of your heart's desires. Establish personal and financial goals (Principle 4) before you do anything else. Know why you are striving. Write them down. Make sure your reasons can and will withstand the scrutiny of your soul. Review them every week, month or year to determine if they are still viable. As your financial situation changes, your needs, and consequently your goals may change too. Young investors are primarily interested in wealth accumulation for purchasing possessions. To be successful though, there must be balance between acquisition and accumulation. Middle-aged investors are more concerned with balanced growth and preservation of capital. This is the time when compounding must work for them. Don't break the chain of compound interest. Older investors don't want all the headaches of managing finances.

They need dependable, uncomplicated, guaranteed income from sound investments—investments which will protect them from inflation. Obviously, needs change with age.

People earn income so they can build capital so they can create income. Another way of looking at it is that they earn and create to accumulate and build so they can convert wealth to income.

Here's how it works! The wealth accumulation graph shows a slow start. When I was a child, I was caught up in the desire to spend money. I had to force myself to save. I have noticed that each of my children have different attitudes toward money. These attitudes are shaped during their early years. Most people, upon reaching their teens and twenties and thirties, use much of their surplus income to acquire, which develops their standard of living. But once Tier 1 is filled, then compound interest can accelerate. Middle age (35-60) is the time to build Tier 2 and 3 investments, but in a safe, secure fashion. The major deterrent to accumulation is education for children. By the time an investor reaches 55 or 60, thoughts turn to conversion of assets to income. Isn't this the cycle?

So, if you want to guarantee financial security, work as hard at investing your money as you've done earning it. It has been said that people spend more time planning their vacation then they do their retirement. Develop the same success financially, you have attained in your chosen field of work.

Sometimes the old cliches in Principle 8 makes the perfect point—DON'T PUT ALL YOUR EGGS IN ONE BASKET! Diversify your investments, but you can overdo that as well. Remember Principle 10, the more you know about a particular type of business or company, the better qualified you are to determine how much money to invest in that particular venture. We say in Principle 11 that it's important to stay with the plan. You need to be wary of all investments. However, don't become so afraid of taking your first step so that you miss the trip altogether.

You also want to assume the least financial exposure possible, as explained in Principles 5 and 7. This means, avoid having your spouse sign on any dotted lines unless you have had good legal advice, and NEVER, NEVER sign for recourse debt, as I explained in our discussion of Principle 3. It seems of all the different kinds of problems we face in this world, financial matters are at the root. Fear of loss can cause severe depression and discouragement.

I've known too many situations where the person thought they could stand the heat in the financial kitchen, but then had to get out when the going got tough. They left a big mess for others and worse, had to waste precious energy and money to straighten it up. That dissipation robs you and your family of the real value of compound interest in Principle 1.

So now what? Well, my mother, Kathleen taught me early in life, "Actions speak louder than words." She was right! You can dream the dreams of the rich. You can plan and plot your schemes and strategize, but nothing happens until you do something. You have to take the initiative and start the process.

So as that famous commercial says, "Just Do It!" That's right, so start now!