



Napa Wealth Management's The Sensible Investor

November 2010

Next Newsletter: January 2011

Imagine if...

By George P. McCuen, CFP®, President



What a difference a decade makes! The negative real rates of return over the last ten years are bringing financial planning back in vogue. Consider this fact; On May 3, 1999 the Dow Jones hit 11,000. On October 8, 2010 the Dow Jones closed at 11,006. It looks like we simply went sideways for 11 years, right?

Let's take a closer look; in May 1999 gas was \$1.11/gallon and gold was \$287/ounce. Currently gas is over \$3.00/gallon and gold is approximately \$1,350/ounce (almost 5 times higher). Food and energy costs followed suit. We didn't move sideways, we moved backward!

Add to this data historically low interest rates (e.g., 10 year Treasury yielding 2.5% as of October 25). This is not the time to coast along. Columnist Lee Eisenberg writes, *"The dawn of a brighter day still seems a long way off. But when it comes, will we step into it older and wiser or just older and poorer? There are signs that a more sober mind-set is emerging. We're placing a greater value on value (instead of glitz) when we go shopping, opting for the functional over flashy, the rational over the reckless."*

In the 80's, financial planning became the mantra of the financial services industry. The brokerage firms wholeheartedly embraced the notion that financial planning helped investors focus on the long-term aspect of investing and furthermore, it helped investors visualize their goals as opposed to the scattershot method of constantly looking for the next hot stock. Planning created a sense of security for those who were retired as they could see how their plan gave clarity for life-long income they would not outlive and the vision of a financial legacy.

What happened? The roaring 90's hit and the conservative rates of returns underlying financial plans were overshadowed by the technology boom and the seem-

ingly unstoppable stock market. Investors began to count on double digit returns on their investments. The financial plan with its modest projections seemed out of touch. Why bother planning when everyone's getting rich?

When it comes to their wealth, investors are coming back to basics - setting realistic objectives and designing a plan to reach them. In a recent Merrill Lynch survey, more than 50% of the retired respondents said that if they could do it all over again, they would focus more on "life goals" and less on "the numbers". Financial planner/author, George Kinder asks each of his new clients to respond to three hypothetical scenarios:

"Imagine you have more money than you ever dreamed of. What would you buy? Where would you travel?" At this point, Kinder says, most people go crazy; Golf memberships! A condo in Vail! A 45-foot cabin cruiser!

"Now imagine that your doctor diagnoses a rare disease; you will die within 10 years." Suddenly, we're thinking harder about what's really important. Plenty of material goodies still wind up on the list, but it's clear that with a tighter time horizon, we're far more discerning about what really counts.

"Now the doctor says that you have only 24 hours to live." The question isn't "what would you like to do or buy between now and tomorrow?" It's this: *"what did you not get to do in life - who did you not get to be?"*

Each one of us would answer those questions differently, of course. But Kinder says that most people answer in one of only a few ways. We wish we'd exercised our creativity more, given back to the community, our church, or fixed a broken relationship. The telling thing; none of it costs a huge amount of money. But it does require thinking about the meaning of money - and that we open ourselves up, that we share our hopes, our dreams, our goals with others ... and that, in the end, we focus less on net worth and more on self-worth.

Nobody would deny that financial planning, at any age, is a valuable component of building and preserving wealth. Let's not forget that when we get to the end of our lives, we won't be calculating how much wealth we amassed or the things we have accumulated, rather we will most likely look at the lives we have touched and the people we were while we were here. Planning simply relieves investors from the day-to-day market minutiae that encumbers their minds when they're forced to rely on the tide of the market. A plan, properly designed with sensible objectives provides peace of mind. Then you're ready to make a difference.

Imagine if...

George



Use Leverage to Keep Estate Taxes in Check

By Jim Riley, CFP, EA

Last month we discussed term life insurance. Term insurance insures a person's life for a set period of time such as 20 years. Another type of life insurance is whole life insurance which, obviously, would cover the insured for the remainder of their life. If a 40 year old man buys a whole life policy with a face value of \$100,000 and dies in 2 years time then his beneficiaries receive \$100,000. If our 40 year old man dies at 95 then his beneficiaries will receive \$100,000.

Like term insurance, there are a number of different uses for whole life but in this issue I want to address what is probably the most significant planning benefit to whole life - that being how insurance can create leverage especially in the payment of estate taxes.

Ending in 2009, a single individual could leave his or her beneficiaries up to \$3.5 million without paying federal estate tax. A married couple could thus shelter \$7 million in assets from the tax man. According to statistics compiled by the Congressional Budget Office only 0.3% of estates paid estate tax in 2009. Thus, 99.7% of Americans were not subject to the tax.

Then in 2010, the estate tax was abolished soooo...

oooo... what's the problem? 2011 is the problem. In 2011, provided legislators don't effect some changes, the estate tax exemption amount will revert to the 2001 level of \$1,000,000 and a married couple will only be able to shelter a total of \$2 million from the estate tax bite. Still a pretty high number but in real estate rich Northern California \$2 million estates are very common.

So here's an idea. Todd and Tanya, both 70, have net estate of \$3 million consisting of a home valued at \$500,000 and \$2.5 million in stocks and bonds. They establish a trust with their 40 year old daughter Lu-luBelle (known as 'L.B.' for obvious reasons) as the beneficiary. With funds that they have 'gifted' to the trust, the trust purchases a second-to-die life insurance policy on the lives of Todd and Tanya. Second-to-die means that the policy will only pay when both Todd and Tanya have died. This type of whole life policy is considerably cheaper than a policy insuring only one life. The annual premium of \$20,000 purchases a policy that will eventually pay out \$1 million. If Todd dies in 2020 and Tanya in 2022 they will have expended \$240,000 in annual premiums (12 years X \$20,000 per year) in exchange for \$1,000,000. Remember, however, that we established a trust that holds the policy. Carefully planned, the trust can pay the \$1,000,000 to L.B. estate tax free. We've removed \$240,000 from their estate that would have been subject to estate tax and in return L.B. receives \$1 million estate tax free with which the estate tax can be paid. Quite a difference.

You can't hold me to the exact numbers as this is just an example. However, the leverage generated by whole life insurance is something many should be investigating. This use of whole life insurance won't work for everybody but in the right situation the savings can be enormous.

Frankly speaking, Jim

Annual Holiday Party

Friday, December 10th

You and yours are invited to join us for a festive night of fellowship, food, and fun. Friday December 10th, from 5:00 p.m. – 8:00 p.m., at our offices, 1836 Second Street, Napa.

Save the date!

