CREATIVE
Wealth Maximization Strategies

Certified Financial Service
600 Parsippany Road Suite 200
Parsippany, NJ 07054

Richard Aronwald
raronwald@cfsllc.com

December 2006

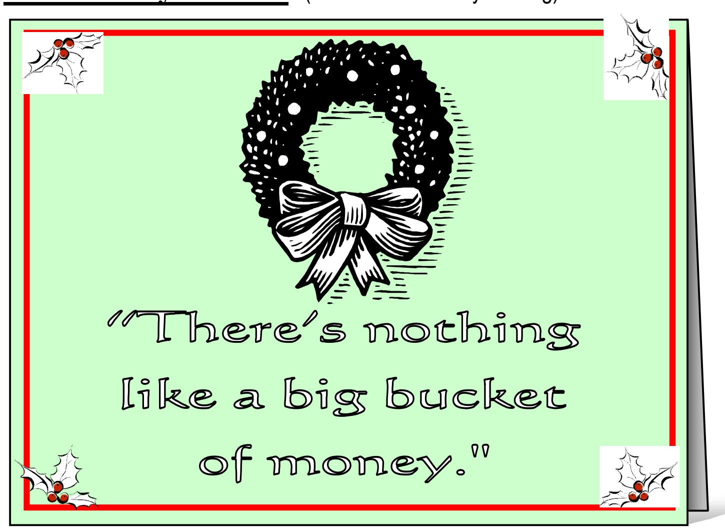
FINANCIAL PHILOSOPHY

ALL YOU NEED IS ONE BIG BUCKET

In keeping with our holiday tradition, the December newsletter issue involves no mental "heavy lifting." This is because we know that between now and New Year's all of the family gatherings, parties and special occasions leave little mental capacity for anything else, especially something that might veer off into a discussion of abstract concepts and numbers. No, this time of year you need a really easy read.

So as you're driving all over town trying to track down that one perfect gift, or sprinting through the grocery aisle desperately searching for the last ingredient for your special meal, here's a simple financial concept, specially packaged just for this time of the year. It's short, it's simple, and yet can be used almost anytime you are faced with a financial decision. What's more, you don't need a degree in finance, a broker's analysis, or background in tax law to apply this concept. Are you ready? Here goes…

The Holiday Version (condensed for easy reading)



Perfect, huh? Well, alright then! That statement should be enough mental stimulation about personal finances to tide you over. We hope this past year was a prosperous one, and that next year will be even better. Happy New Year, and we'll see you in 2007.

CONTENTS:

The Rest of the Story (if you have time for it)

Everyone has money issues. A situation comes up, and the first question is: *"How am I going to pay for it?"*

And a lot of us share many of the same money issues. We wonder "How am I going to pay for…"

- food and clothing?
- a place to live?
- transportation?
- education?
- retirement?
- taking care of my kids or my parents?

In response to these basic money issues, financial institutions offer all sorts of financial "buckets." These buckets are asset containers. There are places where you can either deposit money, or draw money out. For example:

- Need clothing, but don't have the enough cash? Use the credit card bucket.
- Looking for a home? See if you can tap the mortgage bucket. (Best to also fill a savings bucket to qualify for the mortgage.)
- Time for a new car? Check out the lease bucket.
- Anticipating college? Might want to consider a 529 plan.
- Planning for the golden years? Pick a number - 401(k), 403(b) or a letter (IRA, SEP).
- Concerned about your family's future? There's life insurance, disability income and long-term care insurance.

For every financial issue, there's a bucket.

Since many of life's financial issues can be anticipated (the need for housing, transportation and retirement are almost certain), a common financial strategy is to simply buy a number of buckets and start filling them. Each paycheck you drop $100 in the retirement bucket, $75 in the life insurance one, set aside $50 for clothing, another $50 for junior's college fund, etc. By diligently filling the buckets, you hope to always answer the how-am-I-going-to-pay-for-it questions. At least that's the theory.

Flaws in the Multi-Bucket Approach

But there can be several problems with this approach. The biggest practical obstacle to filling multiple buckets is there simply isn't enough money. As Mike Burrill notes on his company web site, mymoneyflow.com:

"What we want competes with what we need. Important needs compete with each other. These competing demands on a limited money supply create tremendous pressure to cut corners and compromise on serious financial issues."

For most of us, putting money in one bucket means not putting it in another. Will it be insurance or retirement or college education or housing? If you can't do it all, it means something's gotta go.

Another problem is that while many financial issues can be anticipated, we cannot control the timing of every issue. In a perfect world, we may buy a new automobile every three years, our children will graduate from college after four years, and retirement will begin at age 60. If we could rely on financial issues occurring according to schedule, our buckets could be filled and emptied in a specific sequence. Thus, the car payment bucket would refill and empty on a three-year cycle, the money saved in the college fund would last exactly four years, and the cumulative deposits and compounding of the 401(k) would result in an adequate stream of income right on time.

But what happens if something goes awry? The market doesn't deliver anticipated rates of return. High gas prices make the car more expensive to drive and harder to sell. A son or daughter is accepted to a prestigious (and much more expensive) university. The job market softens, and salaries stagnate.

Unfortunately, some of the buckets people use to address their money issues may have limited flexibility or utility. They are designed to answer one financial issue, but aren't worth as much if tapped for other purposes. Sometimes the problem is timing ("substantial interest penalty for early withdrawal") or taxes (a penalty imposed on distributions before a certain age) or the way you use the funds (tuition is okay, a vacation home is not) or the capacity (only so much can be added each year). You might put a lot of money in a lot of buckets, only to find you don't have enough money in the right bucket at the right time.

A BIG bucket: The answer for everything.

Instead of a bunch of small buckets, each intended for a special purpose, what might be better is one big bucket that can be tapped for a variety of reasons. That way, there's money available – whatever the issue.

This one-size-fits-all idea may run counter to some current economic thinking. Economists would say that the variety of financial products and programs show a specialization of capital, and that specialization usually results in more efficiency and higher productivity. In other words, the aggregate amount of the small buckets would exceed the amount in the large bucket. Theoretically, this may be true. But the big-bucket-of-money concept has practical support – and some solid historical recommendations.

According to Jewish and Christian tradition, Solomon was the wisest man in the ancient world. More than three thousand years ago, Solomon's words of wisdom were recorded in several books, including Proverbs and Ecclesiastes. While modern scholars are hesitant to definitively attribute the sayings of Ecclesiastes to Solomon, the book contains some timeless observations about the realities of life. For example:

"A feast is made for laughter, and wine makes merry; but money is the answer for everything."
(Ecclesiastes 10:19)

The ancient writer understood that both a feast and wine were valuable things that could be used for specific purposes (laughter and merriment); but money could be used for anything, including producing laughter and merriment. By nature of its versatility, money was the better asset.

This ancient wisdom holds true today. To update the saying, we might put it this way:

"A 401(k) is for retirement, and a 529 plan for college, but money is the answer for everything."

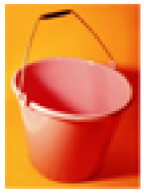
Whether the issue is retirement, or a new car, or a college education, it doesn't really matter which bucket the money comes from; what's really important is that you have the money. And in light of everyone's inability to guarantee the timing and price of their financial issues, the strategy of accumulating a sizable amount in a big, multi-purpose bucket may be more practical than trying to adequately fill a bunch of smaller specialty buckets in a timely manner. Thus, we return to the Holiday version of our discussion:

"There's nothing like a big bucket of money!"

By the way: Having a big bucket of money doesn't rule out the use of smaller buckets as well – especially after the big bucket is full. But in terms of financial priorities, you can make a strong argument for establishing a big bucket and filling it before moving on to other special-use buckets.

STRATEGIES AND APPLICATION

BIG BUCKET CANDIDATES



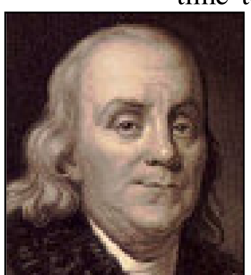
If you already read the previous article, you have an overview of the Big Bucket concept. If you understand the idea, your next question might be

"So what do I use for my big bucket?"

Individual circumstances dictate that the answer will be different for everyone, so this article can't make specific recommendations (see the fine-print disclaimer that accompanies each issue). But we can offer some observation and commentary on what makes for a good big bucket, as well as some of the perceived pros and cons of financial vehicles that might commonly be used as big buckets.

Desirable Features in a Big Bucket

Liquidity. You never know when you may need the money, but you want to know that when you need it, you can get it – as quickly as possible. If it takes longer than a week to move the money from the bucket to your pocket, it's not very liquid.



Ben Franklin would list the "pros" and "cons" to compare choices.

Stability and safety. Since the money accumulating in a Big Bucket may need to be tapped, this isn't a place to speculate. Three months from now, three years from now, three decades from now, you want some guarantees; that the money will be there, that principal is secure, that interest or dividend earnings will be distributed.

Minimal transaction costs. Because money may flow in and out of this bucket on a regular basis, you must be aware of the transaction costs. These can be fees charged by the financial institution (such as fees, commissions, surrender charges, or loan interest), or income taxes assessed by the government when a transaction is completed.

Reasonable rate of return. Based on the previous three features, a shoe box would be a serviceable big bucket, except for one thing: Accumulated money that doesn't generate a return is stagnant. While not being used (or spent) by you, the deposits to the bucket should at least generate some return.

An Evaluation of Several Big Buckets

This isn't a comprehensive list. Quite likely, your financial professional may have some other alternatives for your consideration. And the analyses provided here are only broad descriptions of general characteristics; each of the items mentioned below comes with a variety of "optional equipment." If you really want to find the best big bucket for your situation, a personal discussion with a knowledgeable professional is strongly recommended.

A Bank Savings Account. *Pros:* High in safety (deposits guaranteed by the FDIC). High in liquidity – funds can be liquidated at any time, usually the same day. Dollar-for-dollar deposits – there are no sales charges or fees for establishing the account, and few minimums.

Cons: Low returns (typically the lowest rate of return for fixed accounts – i.e., those that pay regular interest.) Higher returns may require higher minimum balances. Income tax is assessed annually on the interest, even if the account holder compounds the interest rather than receiving it. Some banks may charge a fee for closing the account (they might also waive the fee).

Commentary: The rate of return might not be the greatest, and the tax can be a nuisance, but for simplicity, certainty and immediate accumulation, the bank can deliver big bucket features. A small business owner once told a protégée, "There's nothing better than having $100,000 in the bank. I sleep better at might because I know that whatever could happen tomorrow, $100,000 can probably take care of it. It might not be enough to solve the problem, but it's probably enough to buy me the time to figure out how to solve the problem. And all I have to do is walk up to a teller."

A Money Market. *Pros:* High stability. Although deposits are not guaranteed, most money markets maintain a stable share price of $1.00. Low costs: While they may have minimum deposit requirements (ranging from perhaps $250 to $5,000), most money markets have no sales charge on deposits and no surrender charges on liquidations.

Cons: Although very stable, there are no guarantees of principal or interest. Average returns may exceed those of bank savings accounts, but monthly returns could fluctuate. Like other mutual funds, income tax is due on most dividend distributions (assuming the account is held outside an IRA or similar retirement account). Liquidation may be made from a checking account connected to the money market, or written instruction (a process which may require a signature guarantee or other notarized authorization.)

Commentary: A money market is a mutual fund which holds conservative, short-term investments, some or all of which may be guaranteed. For some, the only perceived difference between a money market and a savings account is the lack of guaranteed interest and is offset by slightly higher returns. Because money market accounts are often connected with mutual fund companies, transfers to and from other mutual funds within the "family of funds" can be executed easily and at low-cost.

Life Insurance Cash Values. *Pros:* High degree of safety, stability and liquidity over the long term. Whole life insurance contracts declare a minimum guaranteed accumulation each year, along with dividends, which are not guaranteed. For long-term policyholders, dividends may deliver returns substantially higher than those from a savings account or money market. Further, there is tax deferral on the build-up of cash value. These values can be accessed at any time as withdrawals or loans. Distributions from the cash value of the life insurance can be structured so that no income tax is incurred.

Cons: Higher start-up costs. In order to have the benefits of the cash value, you must also pay the cost of life insurance. In a typical cash-value contract, the insurance cost is heaviest in the early years, which means cash value grows slowly at the beginning. Insurance contracts also require regular ongoing premium payments. While there may be some ability to "start and stop," most cash value life insurance works best when premiums are paid steadily over a long period of time.

DESIRABLE FEATURES:
- Liquidity
- Stability and Safety
- Minimal Costs
- Rate of Return

Commentary: When it's full, there may not be a better big bucket of money than life insurance cash values. (And what's more, the life insurance bucket is filled as well.) But using a cash value life insurance policy as a big bucket is a long-term commitment. To use a business school phrase, cash value life insurance policies have a "capitalization phase;" it takes time to fill the bucket and recover the start-up costs. Even with the option of paid-up additions (extra premium payments to increase the rate of cash value accumulation), the typical turn-around time on tapping cash values is at least five years, but the optimal accumulation period to maximize growth and benefits is even longer.

Municipal Bond Mutual Funds. *Pros:* High liquidity, minimal tax costs (if at all), moderately high safety and stability. A municipal bond fund is a managed portfolio of municipal bonds, each with a unique rate and maturity. This portfolio may change frequently, as management buys and sells in accordance with their assessment of market conditions. Although the market value of the portfolio will fluctuate daily, the bonds are contracts, and many municipal issues are also insured, so these funds are considered quite stable and conservative.

Shareholders own a proportionate fraction of the total value of the fund, and are eligible to receive dividends as the portfolio receives interest payments. Most muni-bond funds pay a dividend each month, reflecting the overall interest earnings from the portfolio. These dividends can be reinvested to buy more shares of the fund, which allows for compounding within the account.

Historically, municipal bond fund rates of return will be higher than those offered by savings accounts or money markets, however, past performance is not a guarantee of future results. This dividend/interest is also federal income tax-free, and in many cases, exempt from state and local taxes as well. Account holders can liquidate shares at any time, directly from the fund company, usually receiving a check within five business days.

Cons: Possible sales charges/surrender charges, management fees, fluctuation and possible loss of principal. One way or another, shareholders pay for the administrative, management and distribution costs associated with the operation of the fund. In some cases, this may be in the form of up-front sales charges, i.e., a portion of each deposit goes to the fund and not the shareholder's account. In other arrangements, the fund may charge a fee when shareholders liquidate shares. Annual management and expense charges will also eat into returns.

While muni-bond funds historically show long-term stability and steady dividend payouts, short-term losses are possible. If interest rates rise quickly, bond fund portfolios may decline in value, and as a result, the share price may drop. Thus, it is possible that even with the regular reinvestment of dividends, a shareholder's value could decrease. An example: 100 shares at $10 on January 1st would be worth $1,000. Ten months later, 110 shares at $9 would give an account value of $990. The result: a 10% increase in shares, and a 1% loss in total return. (To be fair, share prices might go up, too. The only downside? If you sell shares for more than their purchase price, the sale will be subject to capital gains tax.)

Commentary: Assuming you have the demeanor to handle share price fluctuations, a muni-bond mutual fund can function ably as your big bucket – especially if you have a lot in it. If the total account value is around $150,000, it's probably not going to make much difference if the daily value goes up or down by $50. As long as the long-term trend is steadily upward, and your financial issues don't require a complete liquidation, you can take advantage of the higher returns and tax-favored status.

As we said at the beginning, the above commentary represents only the briefest of overviews. For a comprehensive explanation of big bucket options, consult with your team of financial professionals.

RISK MANAGEMENT:

"The problem is that no matter what you think of insurance, past problems, future difficulties, etc., it still is a mandatory element of financial planning."
- Errold Moodv

The Risk of Not Consulting an Expert About Insurance *(next page)*

Ever played the game "Would you rather…?" It's where one person asks you to choose between two hypothetical situations. For example:

Would you rather see your dentist or your insurance agent for an annual check-up?"

(Hmmm. Isn't there another option?)

Let's face it. Insurance is the ugly stepchild of financial planning. Unless you're involved in the business, it's not something you want to think about, because the background for insurance is unpleasant events: accidents, property damage, disability, death. And while insurance might be a necessary component of your financial life, nobody gets fired up about paying for something they hope never to use. Furthermore, insurance is complicated – riders, deductibles, definitions of loss, cost-of-living adjustments, exclusions, etc. And for some people, here's what makes the unpleasant nature of insurance even more uncomfortable: most of it is sold by commissioned salespeople. Thus, any information or advice provided by the insurance agent is inevitably biased, and not to be trusted.

When insurance is seen as tragic events, complex products, money out-of-pocket for benefits you hope you never use from suspicious sources, it's no wonder people don't like insurance. So what can you do?

The Choices

1. Do it yourself. Equipped with a credit card, Internet access, a cell phone and a list of toll-free numbers, you can eliminate the insurance agent and "buy direct." Of course, the best consumer is an educated one, so you should also do some research, both on the philosophies and details of insurance. In other words, make insurance your "hobby."

2. Hire a fee-based planner. This approach short-circuits the perceived conflicts of interest inherent in commission-based compensation, and allows you to take up other hobbies that you really enjoy. As the Guinness commercial would say: "Brilliant!"

Except…

It seems many fee-based planners don't know much about insurance. This is the assessment of Errold F. Moody, Jr. who maintains what he claims is "the largest and most comprehensive planning site on the Internet" (www.efmoody.com). Citing a 1999 article, Moody notes that…

"…a recent commentary in the Journal of Financial Planning indicated that many planners were not looking at, or at least not emphasizing enough, the entire area of risk management – not just life insurance, but also disability, health, long-term care and liability coverage."

Moody follows with some commentary of his own. (As you read this, keep in mind that for the past 22 years, Moody's "major focus has been in individual fee financial planning." As a professor at the University of California at Berkley and Irvine, he taught classes for Professional Designation in Financial Planning. And from 1995-2004, he was an Insurance instructor for various licenses and continuing education programs.)

"Insurance is, in my mind, one of the most difficult of all planning areas. While it is easy to get information about mutual funds and other investments from the likes of Morningstar or Value Line, it is almost nigh on to impossible to obtain [an] objective and intensive analysis of a life insurance product. Therefore, since the analysis is hard, and since very few planners had the capability to do such analysis, they simply have decided to effectively eliminate planning for that area in total….Therefore, while somebody may have limited the conflict of interest in regards to commission, they simply have paid an hourly or flat fee for an incompetent, unknowledgeable adviser who [has] effectively breached its fiduciary obligation to a client."

Conclusion: A fee-based planner who doesn't know insurance probably isn't going to help you.

3. Find a knowledgeable, trusted agent – even if they receive commissions. Moody acknowledges that "while it is unquestionably true that commissions can taint the planning process, it is not a universal fact." The real issue is the financial professional's knowledge of insurance, their ability to accurately transmit that information to the consumer, and then deliver the appropriate products. Because of the variety and complexity of insurance contracts, you need to work with someone who is immersed in the business, the most likely "expert" is an insurance agent, commissioned or not.

Bottom line: If you want to take care of your insurance issues, find a good agent. One of the biggest mistakes in risk management is trying to do the job without expert assistance.

DETAILS:

Who Are Your Beneficiaries?

When you submit an insurance application, IRA account, or a 401(k) enrollment form, one of the required sections is the beneficiary designation. In the moment, many people may not give the process much thought, simply naming a spouse and/or children and then putting the whole thing out of mind. But the correct designation of beneficiaries is an important detail, and little mistakes can have big consequences.

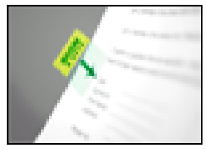
Precise wording is important. Beneficiaries can be specific (a person identified by name and relationship), or designated by class (a group of individuals such as the "children of the insured"). While the naming of specific beneficiaries is usually clear-cut, unintended complications can arise when designating classes of beneficiaries. Improperly named beneficiaries can impact how proceeds are distributed. For example:

- If your IRA beneficiary reads simply "my wife" (instead of "Jane Doe, wife") it could result in an ex-wife (remember Janice Doe?) receiving proceeds intended for others.
- Saying "Children of the insured, John Smith" could mean that your wife's child from a previous marriage, whom you meant to include, is in fact excluded.
- Saying "Children born of the marriage of John and Susan Smith" may exclude adopted children.

Per stirpes or per capita? Even if you properly identify the beneficiaries, there may still be issues at distribution, especially when the beneficiaries are identified as a group. The terms "per stirpes" and "per capita" are often used to define the terms of distribution to family members and heirs. Per stirpes means "branches of the family," and per capita means "by heads." If an insurance contract designated two sons as equal beneficiaries, what would happen if one of them died? In a per stirpes distribution, the deceased son's surviving children would receive one-half of the proceeds. Under a per capita distribution, the one living son would receive the entire amount.

Name contingent beneficiaries. Most documents with beneficiary designations require only a primary beneficiary. But in case the primary beneficiary dies first, you may also name secondary or contingent beneficiaries. Two comments on contingent beneficiaries:

- Life insurance proceeds payable to a named beneficiary pass outside of probate. If the primary beneficiary is not alive, and a contingent beneficiary has not been named, the proceeds may be assigned to your estate. This subjects the money to the probate process, which can be both lengthy and costly.
- A common beneficiary arrangement is spouse as the primary beneficiary, and children as contingent beneficiaries. However, if your children are minors, most insurers insist on paying proceeds to a legal guardian rather than to a minor. This means you should also have a guardian designated as well.



Update and review. As time passes, you may need to amend your beneficiary designations. Changing beneficiary designations is easy, but you have to remember to do it. Ideally, beneficiaries should be reviewed annually. At the very least, review the designations after "big events" – such as births and deaths, marriages and divorces.

Seek expert assistance. As to the correct wording of beneficiary designations, don't hesitate to seek expert assistance, particularly if a beneficiary distribution is part of a larger estate or inheritance plan. Even with simpler arrangements, it's wise to make full use of the expertise that your attorney, accountant, insurance representative, or other financial professional can provide.

Certified Financial Service

Richard Aronwald

raronwald@cfsllc.com

600 Parsippany Road Suite 200

Parsippany, NJ 07054

richardaronwald.com