MIKE CHADWICK'S

MONEY MATTERS

ADVISING, EDUCATING & INSPIRING YOU TO A BETTER LIFE

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Certain Opportunity

In every field specialists make profits by using their expert knowledge position in the market to take advantage of values against people who have less knowledge. Antique dealers, coin dealers, car dealers, jewelers – in virtually any profession experts are using their industry specific knowledge to outwit the general public. If the general public knew what the experts know they'd be in the field – they're not! It's like playing chess with Bobbie Fisher on your side of the game table and the opponent is your in laws. (stop smiling! ☺) It's not even fair and should be illegal, but isn't. Today's world of extreme uncertainty is creating opportunities like I haven't seen in 14 years of following investments. Every headline will lead you to believe that things are awful and Armageddon is around the corner. The media thinks the real estate dilemma we're facing today is news – we've been telling people about this for three years now. What's newsworthy is how things fundamentally aren't bad if you're not involved with real estate or bad loans. The rest of the economy is cooking along quite well – as I write this 20 out of 24 technology firms exceeded expectations in recent earnings announcements. Everything is getting punished right now because of what former Fed chairman Alan Greenspan once coined "irrational exuberance." This current irrational trend is on the downside but that one was on the upside of the technology swing in the late 1990's. I've decided we need

Continued on page 2, Opportunity

INSIDE THIS ISSUE

Annuities Defined

This is likely the most confusing term in the financial business. The word has so many different uses and meanings it's difficult to understand many financial issues because of it. An annuity can be a noun and it can be a verb, and it has almost as many uses as duct tape. Let's first define the various definitions of the term.

An annuity as defined by Webster is "a specified income payable at stated intervals for a fixed or a contingent period, often for the recipient's life, in consideration of a stipulated premium paid either in prior installment payments or in a single payment." What this means in plain English is a fixed income stream for a certain amount of time – 10 years, your whole life, the life of you and your spouse, etc. Annuity payments are often had when a person retires and accepts a pension, when a lawsuit is settled or when a lottery is won. That is arguably the most common definition of the word annuity and it refers only to the stream of payments derived from a certain financial vehicle.

An annuity is also an insurance company investment product that you can put your money into. Annuities are okay vehicles in specific applications but grossly overused in today's world by unconscionable sales people. The insurance industry is never short on complicated ideas to separate you from your money and here is how the various types of annuities work…

All annuity contracts offer certain provisions, which include: tax deferral of your money – you pay no tax as the money accumulates; no deposit limits – you can put in as much as you have; age restrictions – you cannot take your money out prior to age 59 ½ without a 10% IRS tax penalty (certain exceptions apply such as rule 72q which allows you to take money out anytime as long as you take an income stream and not a lump sum for at least 5 years or until you reach at least age 59 ½, whichever is longer); when the money comes out of the annuity you pay income tax at

Continued on page 3, Annuities Defined

Opportunity *Continued from page 1,*

to coin a term for the recent housing upswing and subsequent meltdown – as I think about this it's a difficult mission. Housing isn't an investment to begin with, it's a lifestyle decision that people don't make any money on over a lifetime. It's very clear now but people couldn't see it clearly when homes were tripling in value in 10 years. Now once they deflate, over the years the average homeowner will have earned +/-1% on the equity in their homes over a lifetime including maintenance, repairs, taxes and inflation.

I'm not advocating renting, just know your house isn't an investment. In good markets there can be great gains and in down markets there will be terrible losses, but over a lifetime the houses we live in are zero sum games. Think about it, a house is a liability in the balance sheet of life and many people were trying to profit by buying liabilities! The term I'm coining for those who try to profit from the homes we live in, flip houses, or "get ahead" with housing schemes are the ***liability lottery*** players. They've got about the same chances of hitting Powerball – when all of the stars line up just right they may win, in all other circumstances they lose. They have a better chance of drowning in a teaspoonful of water, but they play anyway. In the history of humanity this is the first time we've experienced people using their homes as investment chips to be traded as if they were shares of stock. Many have learned the hard way stocks are far more liquid than houses. It'll be just a blip on the screen of history as time unfolds alongside such winning strategies as prospecting for gold and day trading.

In my new coined term "liability lottery" the liability refers to the house, which it is all day long. I use the term lottery because all well-adjusted adults know you don't win at lotteries. The Indians wouldn't be building multibillion dollar resort casinos if you won more than they did. Lottery wouldn't have a category of voluntary income tax on any state's income statement if it was an expense – it's an income and they make money on it. We now have a whole new category of people who can help the world go round and not profit themselves while they enrich those who can see above it all – the banks.

It's sad to see how this new category developed. Some people succeeded in a silly temporary frenzied market so many innocent people followed suit, they made a few TV shows about it and it created a vacuum of sorts that attracted a few million suckers. Now reason has come back to people and we currently sit in a world where there is a lot of uncertainty – which is creating opportunities galore! Financial education in our schools from elementary to high school would help avoid such issues in the future. ☺

Manias & Mantra's

In the past decade we've lived through two manias – the internet bubble and the real estate bubble. This is a very interesting experience lived very early in life for generation's X & Y. There is a similar experience for those who were young when the Great Depression hit our country. That changed behaviors of millions of people for the next 80 years. Will the next decades witness very different behavior from the generation X & Y crowds? I already see them treating technology and internet companies very differently after the dot com meltdown.

Now what should the associated mantras be when it comes to the downside of a mania? The mantra is that all significant periods of stock market history, especially times of extreme volatility, have also come along with significant opportunities to make money. Fear and greed take over during the times when a mania is running wild and millions of people show a disregard for risk on a mass scale, then they pay for it dearly. I can't tell you how many physicians I've seen over the years who told me their retirement dreams were derailed by ten years because they were chasing performance in technology stocks in the late 1990's and early 2000's and lost half of their retirement savings. I'm sure in the coming decade the most prolific story will be very similar but based on over-investing in an inflated real estate market.

Successful investing starts with being a realist, basing views on facts, data and research. When looking at the big picture you cannot ignorantly take a slanted stance such as blind optimism or stubborn pessimism, you must judge things from a neutral point of balance. For those acting with those tenants, it's pretty obvious how ridiculous things get when we have a mania environment. Immediately following such a mania collapse, the opportunities are extreme and plentiful, but the associated rewards come years later. It takes the ability to see what can be, not what is in today's media-overloaded society. Look at the savings and loan crisis of the 1980's – over a thousand banks went belly up under the weight of bad loans. But many were able to keep strong balance sheets and gain market share in the coming decades. What do you think is happening right now? It's a very similar story. Some firms such as Countrywide, Citibank, Washington Mutual will have big problems and others will enjoy the fruits of healthy competition. The banking industry isn't going away, the positions of the players are simply changing. I don't think the banking mess has fully unfolded yet, but it will and there is money to be made there.

You make most of your money in a bear market, you just don't realize it at the time! ☺

Noteworthy News! ! !

- Congratulations to Jim Russo on his recent promotion to Director! ☺
- Congratulations to Rich & Renee Gallagher on the purchase of their new home! ☺
- Congratulations to Tom & Irma Maddalena on the purchase of their new home! ☺
- Congratulations to John Gordon on his recent retirement! ☺

The Big 5

I'm not talking about some combination of athletes that make a winning team here, I'm talking about the five behaviors that cause people to be bad investors. The best investors in our world have the ability to think rationally and not be distracted by big ego's, random experiences or incomplete memories. Some people we joke 'live in a vacuum" and that hinders their ability to make good decisions about the big picture. The big bad five behaviors are here:

- The Recency effect – this is when people tend to give recent events a greater level of importance than longer history that includes the ebbs and flows of the markets. This would support the notion that subprime mortgages account for most of the loans in America. ☺
- Endowment behavior is the inclination to hold onto what you have, even when its usefulness has past. Do you have an 8 track player anymore? Do you know what an Ipod is and does? How about an MP3 player?
- Neophobia – the fear of the new, signified by the investor who stays with his old portfolio, investments or investment style because he is afraid. If Enron is the last stock you've owned or purchased you're likely a neophyte.
- Heuristics – the formulation of beliefs based on irrational rules of thumb or on assuming a cause and effect result from incomplete anecdotal data. Are *you* getting out of the market because your friend/relative lost money on Countrywide?
- Framing – a mode of thinking filtered through your own emotionally biased history, experiences and knowledge. If you or your folks lived through the Great Depression and you have all of your money in a bank you're framing.

Annuities Defined Continued from page 1

regular income tax rates, not capital gains rates on the gains above your original investment. If you invested $100,000 in the annuity and it's worth $250,000 when you cash it in, then the tax burden is based on the $150,000 gain. If you take an income stream from that point instead of a lump sum we must calculate the annuity factor, or 'exclusion ratio'. In this example $100,000/$250,000 = 40%, so 40% of the income is tax-free because it is a recapture of your original investment. The other 60% of income is taxable as ordinary income.

Deferred sales charge: almost all annuities have some type of deferred sales charge, which means if you want to cash in your annuity prior to the specified period, you'll be charged a fee. The period ranges from 0 – 46 years (yes 46 years isn't a misprint but should be illegal) and typically declines over the years. The most popular is the 7 year surrender and if you cash out in the first year there is a 7% fee, the second year a 6% fee, the third year a 5% fee and so on.

The first type of annuity is the fixed annuity. This operates just like a CD at a bank – it pays a fixed interest rate for a specified period – 1 year, 3 years, 5 years, 10 years, etc.

The next type of annuity is the Immediate Annuity – this is where you give the insurance company a lump sum and they give you a guaranteed income stream for a specified duration – just like the original definition. These contracts are nice if you like guarantees, but you lose control of your money once you sign.

Next is the variable annuity – this is a vehicle where you can invest your money within "subaccounts" inside the annuity which operate and feel like retail mutual funds. You can also choose a "fixed" rate fund or money market fund inside these contracts. These contracts offer riders that can guarantee your principal even though you're in subaccounts. They also charge M&E (mortality & expense) fees, which is simply life insurance, typically 1 – 1.5% of the account balance.

Next is index annuities – these are contracts that offer you either a fixed rate of return (typically 2-3%) or whatever the stock market index they track earns (S&P 500, NASDAQ, EAFI, Russell 2000, etc.) <u>limited by a cap, spread or limit</u>. These contracts seem to offer guarantees while providing stock market like returns but don't be fooled, they're very limited in actual real world returns. They're better than a bank account and have guarantees, but they aren't equities.

Now the term annuitization – this is where you turn a pile of money into an income stream – this pile of money can be any money you have, money in the bank, an IRA, a 401(k) – anything – in return for a guaranteed income stream. This is the same as immediate annuity or the original annuity definition. I hope this demystifies annuities. ☺ ☺ ☺

Money Quiz

Last month's quiz was won by Mario Genoa! ☺ there were 24 years in the past 50 years (1958-2007) when the S&P 500 produced a return of least a 15%. He and Lisa are enjoying dinner at Chili's on us. ☺☺ ☺

This month's challenge is to tell me what percentage of admissions applications are rejected by the "Ivy League" schools? The winner will enjoy dinner on us at Chili's. BTN 111207

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Healthcare Pain

As if there weren't enough pain in this area already! This past holiday season between Christmas and new year the federal Equal Employment Opportunity Commission (EEOC) gave our country a gift we might or might not want. The gift they gave was the ability for employers to reduce or eliminate health care benefits for those over age 65. The premise is that people over age 65 qualify for Medicare so let's remove some of the burden business must carry and allow them to offer younger folks better insurance. In theory it works great, but not in reality and enough stop gap measures are not in place to protect some people who are falling through the cracks. This removes age discrimination protection for over ten million American's that are age 65 and older.

People may have to rethink their financial plans based on either reduced or vanishing health insurance. If you're "completely insured" for social security purposes you can certainly enroll in Medicare and buy a supplement, but not everyone is. If you are eligible for Medicare but your spouse is younger and isn't eligible then you're in a bad position. This is a big deal and we suggest you call your Human Relations department to see if your employer or ex employer is planning on changing the benefits at all.

If you need to, as always, call the office anytime to discuss this in more detail. ☺☺☺

Scoop it up

Dog owners know that some towns have 'scoop it up' laws, but out in the sticks where we live, there are no such challenges. As states are faced with budget issues, they are looking at odd places to find new revenue sources. Many states are now focusing on unclaimed property as a new source of revenue and scooping up unclaimed assets. Every state has an unclaimed property division and each are run differently. The original idea was to protect consumers who lost track of what they owned through death, divorce, moving, etc. Some states have become essentially thieves, scooping up millions of dollars without even notifying true owners. California and Delaware are the worst states and Iowa and Kansas are the best when it comes to returning unclaimed property to its rightful owners. California actually "found" 52,224 shares of Intel and sold them, without even trying to contact the rightful owner. He eventually figured it out and sued and won – the state paid him $3.8 million. We're not talking chump change here, this is real loot.

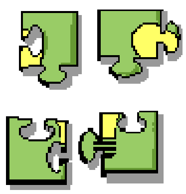
In the past as we've researched issued for clients we've uncovered unclaimed property for them. It makes sense for you to look at each state's website where you or your loved ones have ever lived, worked or transacted business to see if some state is out there trying to scoop up your assets. Also check states where companies you've worked for were incorporated. I'd rather see you get them back or get them back in the hands of their rightful owners.

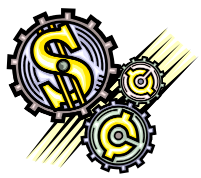
Here's a quick look at what states hold, what they return to owners and what they collected in 2006 ($ millions).

State	'06 collections	Returned to Owners	Total held by state
CA	656	292	5,100
CT	71.1	26	675
MA	121.6	46.9	1,459.3
NY	509	151	7,000
DE	325	0	2,400
KY	45	8.7	2.0
WYO	4.5	1.4	22.3
RI	26.7	10.9	168
NH	10	4.4	80
VT	7.0	4.5	39
ME	25.1	10.4	122.4
NJ	227	82	2,000

Inspirational Quotes

- Write to be understood, speak to be heard, read to grow, *Lawrence Clark Powell*
- To hell with circumstances, I create opportunities, *Bruce Lee*
- If you always put limits on everything you do, physical or anything else, it will spread into your work and into your life. There are no limits. There are only plateaus, and you must not stay there, you must go beyond them, *Bruce Lee*
- The finest steel has to go through the hottest fire, *John Mitchell*
- Success is a journey, not a destination, *Ben Sweetland*
- Wisdom is knowing when you can't be wise, *Paul Engle*





We can piece the puzzle together and make your money work for you. ☺

Kids Korner

Allowing Lessons

Most kids get an allowance but few learn money lessons until after college. We're trying a new system with the rugrats and this is how it works. We're going to estimate how much money we spend on them each week for extra's, lunch, entertainment, etc. and give them that amount of money so they have something to work with. We're going to make them write down their income and expenditure decisions – good and bad. I'd much rather they screw up with $8.00 now rather than $250,000 when they're 25. We'll give them total control over that money and will not bail them out when they inadvertently spend it on something silly. If the kids don't have to make decisions, how will they learn? They won't. Don't tie allowances to chores – the kids should be expected to contribute and if cleaning the bathroom isn't worth the two bucks that won't help in money management. ☺

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