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6 UNIVERSALLY ACCEPTED FINANCIAL MYTHS

That Are Inefficient, Ineffective And Are Costing You Dearly

BY JOSEPH BIONDOLILLO

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We are often exposed to a tremendous amount of misinformation. Whether watching television, reading a newspaper, or listening to a podcast, we hear financial strategies that we automatically take as truths. Misguided information, although well intended, fails to mention the disadvantages of financial products. Some common "financial myths" could be stopping you from achieving your most optimal result.

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MYTH #1

"You'll be in a lower income tax bracket in retirement."

Taxes[1] are one of, if not, the most dangerous eroding factor of your wealth. Future tax laws are uncertain, therefore making any planning based on today's tax.

Today we sit in one of the lowest income tax environments our country has ever been in. There is a high possibility that many of the clients we work with will be in in the same, or even higher income tax brackets when they retire.

Rather than the common solutions of tax deferrals and different financial "products" which could lead to more taxes in the future, you should focus on strategies that could allow your financial future to have more certainty.

Aggressive Savings

Save 15-20% of gross income, accounting for short-term liquidity for the unexpected expenses that occur through the wealth accumulation phase of your life.

Debt Configuration

Elimination of inefficient and unsecured debt that reduces cash flow, savings and short term liquidity.

Risk-Reward Optimization

Implement strategies for your money that minimize risk and maximize preservation for future distribution.

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Protect First

Maximize replacement value through protection first planning.

These strategies work because clients will be protected from life's unintended consequences. Clients can maximize their savings and their cash flow will not be eroded by debt. This will allow clients to maximize their wealth while maintaining control over their money today and in retirement, which can place them in the same, if not, higher tax bracket.

MYTH #2

"I love my 401k and you should too."

All financial products have advantages and disadvantages. Often times, when individuals make financial decisions, it is with the benefits of financial products in mind, not the disadvantages.

These are some common myths that people will give as to why they invest in pretax retirement savings:

- I save tax.
- I pay no tax on the growth of the account.
- When I retire, the taxes I pay will be in a lower tax bracket.
- It is a forced savings, it comes right out of my check.
- This will be my biggest asset in retirement.

These plans have some positive features such as: systematic contributions, employer matches, and the tax deferred accumulation of assets over time. While these should have a place in an overall financial strategy, the issue typically lies in this

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being the main retirement strategy, which may not be the best thing for a particular client.

Some of their drawbacks include: taxes are owed on 401k investments when the funds are distributed. Those funds may not be available today (lack liquidity) because of penalties, taxation, and difficult loan repayments. All of the money in a 401k will someday be subjected to ordinary income tax rates, there is no tax planning or arbitrage offset (selling losers to offset winners), and as discussed earlier, we do not know how high or low taxes will be in the future, potentially leading to higher taxes paid. Prior to 591/2 there are major liquidity issues because of the 10% tax penalty.

MYTH #3

"A 15-year mortgage costs less than a 30-year mortgage."

Typically, a home mortgage will be the largest expense a family has over the course of their lifetime. Mortgage loans provide substantial tax benefits. The interest is a federal income tax deduction, limited to a balance of $1.1m.

The common misconception is that a 15-year mortgage costs less than a 30-year mortgage. The thought process is that by pre-paying your mortgage, it costs less because the interest is paid in a shorter period of time. The borrower will have higher home equity value quicker than in a 30-year mortgage. However, when analyzed closely, the costs of both mortgages over time are very similar. Although this thought pattern might be a paradigm shift from the way folks are accustomed to thinking, this myth often allows home buyers to make financial decisions that might not be in their best interest.

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First, home value will increase the same whether you have a 15-year or 30-year mortgage. It is in the CASH FLOW where the differences are being realized. By holding a 30-year mortgage the owner(s) put themselves in a position of having more control of their money (liquidity). Having the longer mortgage term will result in having more cash flow TODAY that can be used for financial opportunities, which can be saved. The added cash flow can also be used to protect the home owner from other external factors. For example, if the client is burdened with a 15% interest rate in credit card debt, potential deficiencies in disability protection, life insurance protection, non-sufficient savings, etc. Alternatively, should the owner lose their job and have a lower income, they would be in a better position with a lower mortgage payment.

The ultimate question shouldn't be, "which mortgage is better?" Both mortgages are nearly identical in terms of cost. The ultimate question should be, "Which mortgage gives you more control?" By you being in control of your money, you are a position to be better protected. And should you choose to pay off your entire. mortgage in the future you have the option to pay the balance 15 years from now.

ADDITIONAL BENEFITS A 30-YEAR MORTGAGE MAY OFFER OVER A 15-YEAR ONE

- Your monthly obligation is less
- Liquidity of money accumulating is under your control (available for emergency or unexpected expenses)
- Potential larger tax deductions for paying greater mortgage interest on a 30 year loan

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FOR A $250,000 MORTGAGE AT 4.5% INTEREST:2			
TERM	MONTHLY PAYMENT	TOTAL PAYMENTS	TOTAL INTEREST
15yrs	$1,912.00	$344,248	$92,248
30yrs	$1,267	$456,015	$206,015

30-YEAR MORTGAGE BENEFITS	
30 yr monthly savings	30 yr additional interest deduction
$645.00	$143,593 (53% more)

*Guardian does not issue nor advise on mortgages.

MYTH # 4

"To have more protection, I will have less cash flow today."

Implementing a sound protection based plan is one of the most important pieces of one's financial planning process. There is a systematic approach towards building the proper protection. First, protection strategies should come before all other financial opportunities. Full replacement value coverage is generally the most appropriate to insure assets, income, and life values. Lastly, insurance should be generally owned throughout one's lifetime as opposed to assuming the risk yourself (self-insuring).

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Life is uncertain.

There are numerous perils we face every day. From a home burning to the ground, the loss of valuable jewelry, or an unexpected accident that could result in serious injury or even death. These happen when we least expect them to. In the absence of proper protection through insurance, the financial burden of such circumstances could be crippling to a family and permanently change the way they live.

Although the aforementioned risks are possible, some folks choose to forgo various protection options and instead choose to self-insure. "It won't happen to me", or "I'm in good shape", or "I don't want another bill" are common thoughts in justifying one's position of foregoing important coverage. Consumers often calculate the lost opportunity costs of different types of insurance; adding a time value of money calculation which reminds them of the financial myth surrounding proper insurance decisions.

It is common practice to purchase a sound protection plan that minimizes premium costs while maximizing the protection amounts. One solution for minimizing out-of-pocket premiums is to increase your deductibles or for the consumer to pay more of the "first dollar" costs. Strategies such as increasing deductibles, extending elimination periods, and raising the amount you lay out for "first dollar" costs are ways to minimize the overall cost, carrying an insurance plan while maximizing the total protection.

The higher deductibles can be had once proper budgeting and management of cash flow are arraigned, maximizing short term savings. It is much easier to budget for short term "first dollar" expenses than to not have proper full replacement value.

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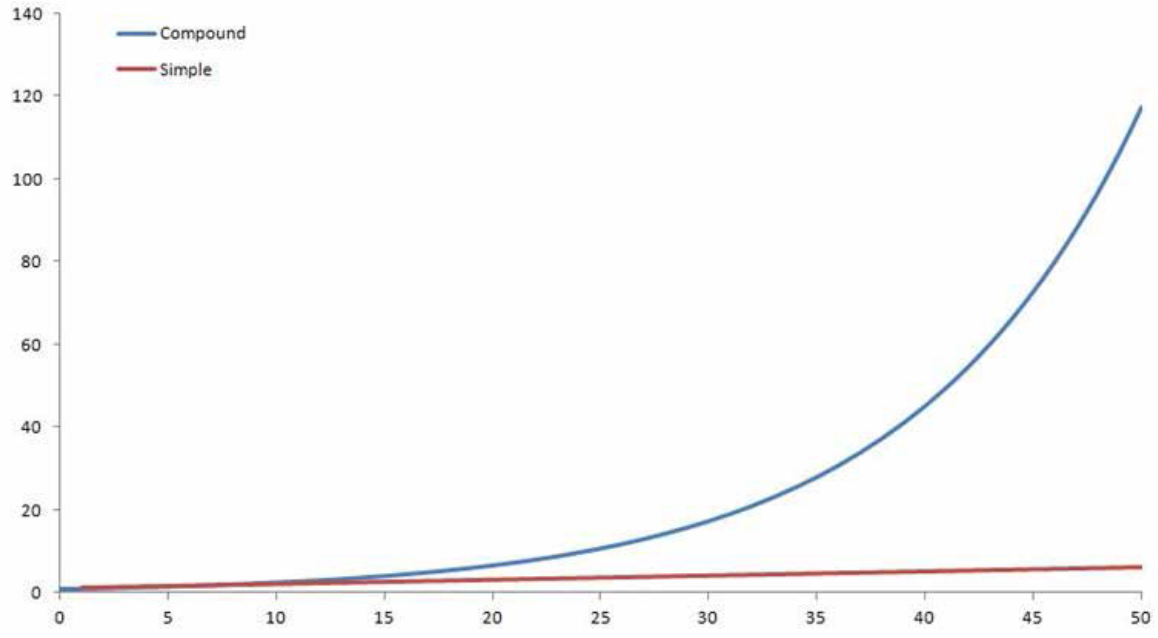
MYTH # 5

"The miracle of interest compounding."

Compound interest is perhaps the most well-known piece of conventional wisdom when it comes to financial strategies. At face value it seems to make a lot of sense. There are advantages. You earn more money the longer it compounds (presuming you're making money of course). Interest compounds interest in an exponential manner.

The advantages are often shown through a "mountain chart" or "yield curve". The chart typically shows an amount of money, a hypothetical rate of return, and a fixed period of time (5yrs, 10, 20, etc.) – see Figure 1. Although this chart is impressive and assumes you make money, it does not show you the pressure against that yield curve – its ability to produce compound interest.

FIGURE 1[2]



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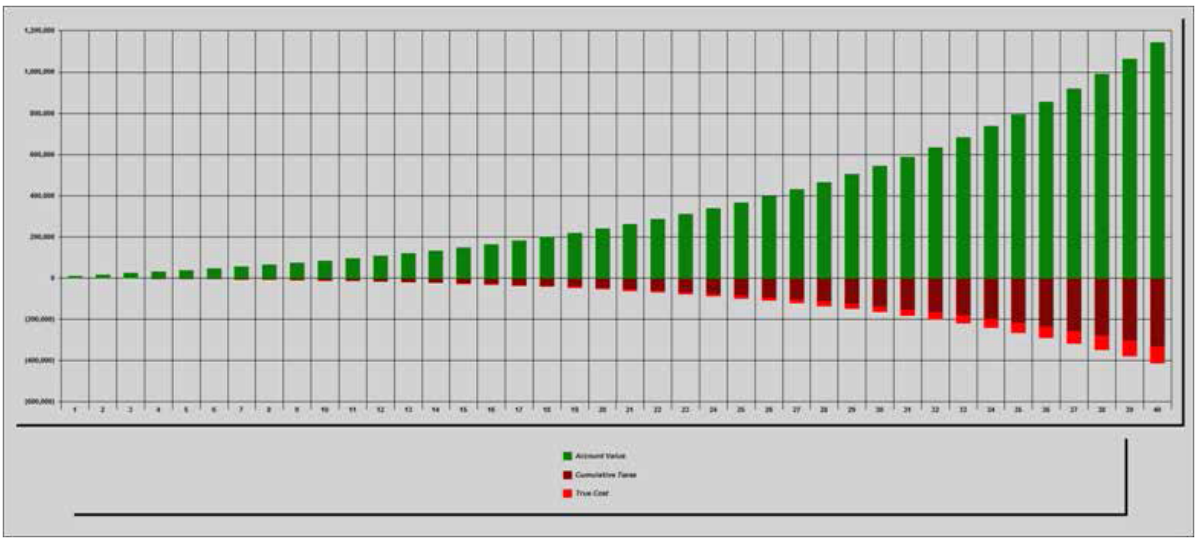
In the mountain chart below, it shows some of the actual costs and expenses that can minimize your wealth over time. Figure 2 shows the impact of taxes (and lost opportunity of those taxes) on compound interest. Imagine if we add market volatility, expenses, inflation, and the lost opportunity cost of each of these. All of the sudden compound interest isn't what you were sold.

FIGURE 2[2]



In my preparation of this myth paper, I searched the web for "compound interest charts" and could never find any that showed the forces at play against compounding. It's as if one wants to talk about its limitations given the eroding factors.

Forces That Erode Power of Compounding

What are some of the forces your money will face which may not make this yield curve end as hoped?

Inflation, fees, lost opportunity costs on taxes paid, volatility, or a potential emergency that would force you to touch the investment while it was compounding.

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Taxes

Often times, they are not withdrawn and taken from an account therefore are paid out of earned income or by liquidating another asset. In tax deferred accounts, you are potentially deferring a tax and compounding the tax you will pay. Compounding would be best if no tax was due on the account at all.

Inflation

Over time, the purchasing power of your money decreases. There is an increase of the cost of goods you will purchase over time, essentially making the value of your dollar weaker.

How does this impact you?

If inflation is said to be 1-2% at a particular point in time, that means your money would need to earn 1-2% per annum just to be as valuable in the future as it is today.

Investment Fees:

There are charges when holding your money in financial institutions or to have someone manage your money. Although there is nothing wrong with reasonable fees, the question is, when you are projecting a rate of return on your mountain chart? Is that rate of return before, or after fees?

Lost Opportunity Costs:

This is one of the most overlooked wealth eroding factors. This is the actual money you lose as a result of making any particular financial decision as compared to another financial decision. It must be a calculated expense such as a taxes, fees, interest cost, etc.

If most people spent more time holding on to their money rather than focusing on the rate of return of an investment, they would be better off.

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Volatility:

Markets do not go straight up as a chart might indicate. The bigger problem lies in the fact that we do not know when declines will occur. Is it the year you decide to retire? The year your children begin college? How will withdrawing funds during a decline impact the future?

If your portfolio declines 50% in 1 year, it requires more than 7 years of 10 percent gains to recover.

When considering a compounding strategy, have you considered the pressure against your "yield curve"?

Be mindful volatility can often minimize your projected returns and even eliminate them all together. Rather than just compounding, ask yourself if the redeployment of your interest can provide better financial outcomes. There are a limitless number of strategies that can help you increase savings, pay down high cost unsecured debt, improve levels of protection, etc. Evaluating volatility might result in improved wealth building and protection.

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MYTH # 6

"You don't need life Insurance in retirement."

Conventional wisdom tells us that life insurance's main purpose is to replace one's income should they die prematurely. When retirement arrives, it is assumed that the children are out of the house and the mortgage is paid. The main reason for the purchasing life insurance is behind you. At this point, conventional financial thinking would have you cancel your life insurance. It is also assumed that life insurance is needed for folks who aren't as financially stable and that it's not needed by wealthier people who can simply "self-insure".

Increased Cash Flow

While life insurance protects against the financial impact of "premature death" with certainty, there are certain types of life insurance such as permanent life insurance which can serve as an effective financial component in one's retirement due to its ability to provide a "future value certainty". When a retiree is guaranteed a sum of money in the future, payable at a defined time, it may increase their cash flow and the ability for them to spend other assets.

The Advantage of Knowing

Having the financial certainty of a death benefit (permanent insurance)[3] may give a retiree the confidence to take advantage of alternative distribution strategies knowing that the cash flow or income spent will ultimately be replaced. This may occur through various strategies, including cash spend-downs, reverse mortgages, pension maximization strategies, etc. The increased income may even provide the retiree with the ability to take less risk in their portfolio.

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Recent studies show that 93.6% of life insurance cash values are held by the top 49% of individuals by wealth. 55% of life insurance cash values are held by the top 10% of wealthy individuals. (Source: Creative Wealth Maximization Newsletter, 2017) This shows that contrary to popular belief; the wealthiest people hold more life insurance than most.

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[1] Guardian, its subsidiaries, agents, and employees do not provide tax, legal, or accounting advice. Consult your tax, legal, or accounting professional regarding your individual situation.

[2] Hypothetical examples are not intended to suggest a particular course of action or represent the performance of any particular financial product or security. The Living Balance Sheet® (LBS) and the LBS logo are service marks of The Guardian Life Insurance Company of America (Guardian), New York, NY.

[3] All life insurance policy guarantees are subject to the timely payment of all required premiums and the claims paying ability of the issuing insurance company.

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