NOVIN CANNON
FINANCIAL GROUP

10 RISKS THAT CAN RUIN YOUR WEALTH

#1 TAKING A MIXED-BAG APPROACH

1. TAKING A MIXED-BAG APPROACH

WHAT DOES THIS MEAN?

Everyone wants a personal economy that is tax efficient*, produces long-term wealth and abundant retirement income, minimizes cost, curtails risk, and protects legacy.

However, most people don't achieve that level of optimization in their personal economy. Why not? Because they compartmentalize their financial decisions. They don't consider how one decision affects another. People tend to make separate, independent financial decisions, one at a time, at different times in their lives, and often with different advisors under different circumstances.

WHAT CAN GO WRONG?

When people take this uncoordinated, disorganized approach to decision-making, they end up with a collection of financial products and strategies that do not work together, but instead, resemble a hodgepodge financial plan.

Having a hodgepodge, mixed-bag financial plan can only lead to a fragmented financial life that churns out major inefficiency, waste, lost opportunity, and squandered wealth over time.

LET'S GET CLEAR

We must take a holistic approach to our financial lives. I recommend that you plug your personal economy into a model that illustrates how all of your forms of protection, assets, cash flow, and liabilities interact with each other.

Do you have a model that shows you how each area of your financial life interacts?

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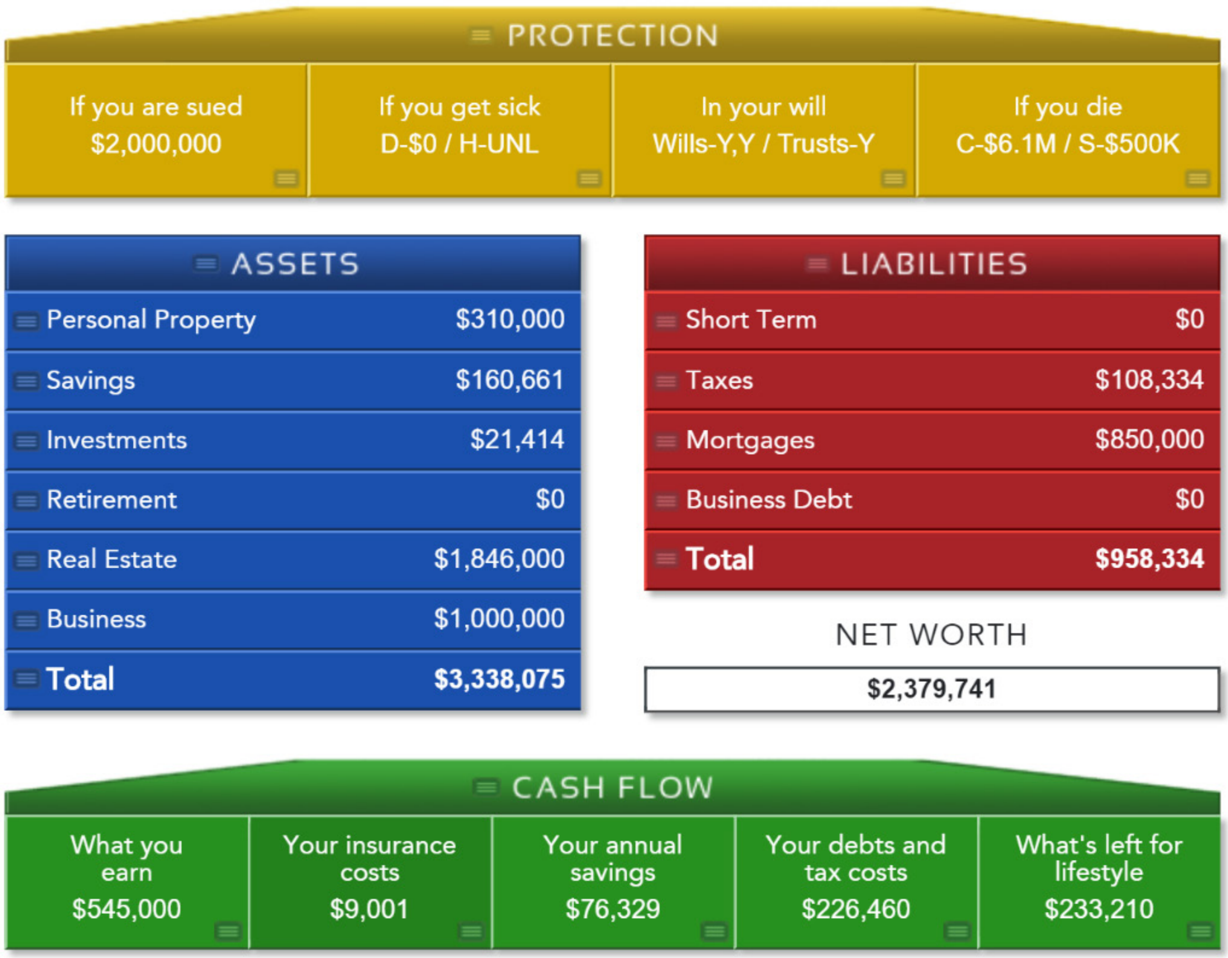
The Living Balance Sheet®



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Without a model, you cannot clearly see how your protection, cash flow, assets and liabilities interact. You will never know if they are positioned for optimum performance and results.

Only with an organized interactive model, like The Living Balance Sheet®, can you test and compare the relationships between your different monetary moves.

#2 OVERLOOKING WEALTH EROSION POSSIBILITIES

2. OVERLOOKING WEALTH EROSION POSSIBILITIES

WHAT DOES THIS MEAN?

When people are preparing for a future financial event, like retirement, traditional planning advises them to plan based upon needs. In other words, you pick a target and you plan for it.

Here is the traditional equation that is used:

Future Need = Amount of Savings x # of Years x Expected ROR % (rate of return)

Thus, if I think I need $3,000,000 for retirement the equation would look like this:

3,000,000	=		x	25	x	8%
Future Need		Annual Savings Needed		Time		Expected Rate of Return

How do we know if our target is right? How do we know what the future will look like? What will taxes be? Will they be higher? What will the stock market look like? What will health care cost? What will technology look like and what will it cost? What will inflation be?

This target, crystal-ball planning fails to consider the multitude of questions posed above as well as the financial forces at play (the so-called financial wind blowing in our faces).

When we're analyzing how much money we need for a future financial event, we need to take outside factors (i.e. wealth erosion factors) into account.

7 COMMON WEALTH EROSION FACTORS:

1. Inflation (not the CPI)
2. Increasing taxes
3. Technological change (which we cannot even fully appreciate until that technology is developed–and let's face it, we have no idea what technology will look like 20 years from now)
4. Planned obsolescence or wear and tear on our assets and belongings
5. The expectation that we will have an improved standard of living
6. Unexpected life events (e.g. illness, job loss)
7. Natural disasters

LET'S GET CLEAR

Since needs-based planning ignores all of these wealth-eroding factors, people are lured into focusing on a "need" and assume they will require less money, not more. While maximizing rates of return is paramount, individuals must use sustainable models that create the maximum amount of wealth—not a random target based on guesses and projections.

> Diversification may preserve wealth but concentration builds wealth
>
> –Warren Buffet

#3 NOT UNDERSTANDING AVERAGE RATE OF RETURN RISK

3. NOT UNDERSTANDING AVERAGE RATE OF RETURN RISK

WHAT DOES THIS MEAN?

Although everyone universally uses average rates of return to judge investments, and it is perhaps the single most incentivizing factor when choosing an investment, many people do not understand how returns actually work. Often, individuals in pursuit of higher returns will chase rates of returns, and abandon investments or leave advisors in search of greener pastures or something better.

However, past returns can be misleading unless you know how to interpret them. When you look at the average return in your portfolio it will not equal the actual results in your portfolio. Why is this?

WATCH THIS...

Take the following fact pattern as an example:

I invested $500,000 in stocks. Over the course of the following year, my stocks decreased by 50%, so exactly one year later, my portfolio is worth half of its original value, or $250,000. The second year, my stocks are up 50% to $375,000. Finally in year three, the stocks are up again, this time by 33% and back to the original starting point of $500,000.

What was my average rate of return?

Year 1	-50%
Year 2	+50%
Year 3	+33.333%
11% Average Return	

What was my actual rate of return?

YEAR 1	$500,000
YEAR 3	$500,000
0% Actual Return	

Now you can see that I am right back where I began, but the average rate of return on my investment report shows 11%.

The disparity between average and actual is due to the losses. When performing a straight line calculation of average returns, we afford gains and losses equal weight. However, if you endure one year of losses, your average return will not equal your actual return. This is because losses have a greater weight and impact on your actual dollars than profitable years do. What is more, is that these losses affect your distribution phase even more dramatically than when your money is in the accumulation phase (see next section on Sequence of Return Risk).

LET'S GET CLEAR

To combat this average return risk, know how to strategize your assets so that you have certainty and predictability in side model and among your assets. Do you have guarantees backing up some of your equities? What portion? Guarantees set you up so that the "average" cannot wreak havoc inside your economy and life.

#4 TAKING SEQUENCE OF RETURN RISK & SPEND-DOWN RISK FOR GRANTED

4. TAKING SEQUENCE OF RETURN RISK & SPEND-DOWN RISK FOR GRANTED

WHAT DOES THIS MEAN?

In addition to actual versus average, another topic people often overlook is the risk related to how long their money will last once they start taking withdrawals.

When we invest in the market, we tend to pay attention to what our rate of return is each year. However, we are not taught to be aware of the order in which these rates of return occur when we are making withdrawals.

WHAT CAN GO WRONG?

Sequence of returns is arguably the most important factor in determining whether our money will last in retirement, and it is heavily dependent on how our rates of returns are ordered during retirement.

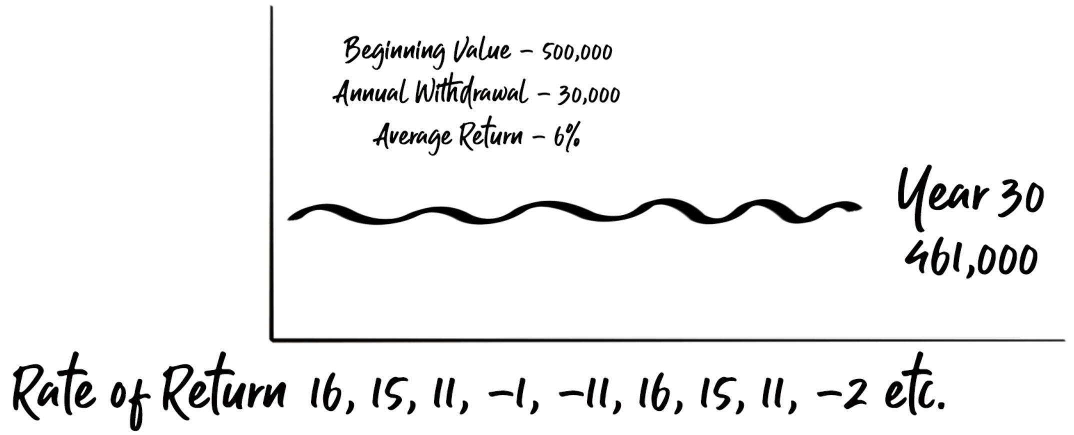
For example, if over a five-year period, our returns look something like this: 18%, 20%, -13%, -2%, 12%, we identify that our average is 7%. However, the order in which we receive these returns gravely affects our money. This is most important when we enter the distribution phase, commonly known as retirement.

Let's take the following assumptions: We reach age 65. We have an account valued at $500,000. It is invested in a moderate growth portfolio consisting of 60% equities and 40% bonds. This portfolio "averages" 6% over time. How does sequence of return impact the account?

We will further assume that we will only withdraw 6% each year (the average earnings), for the next 30 years to protect our principal.

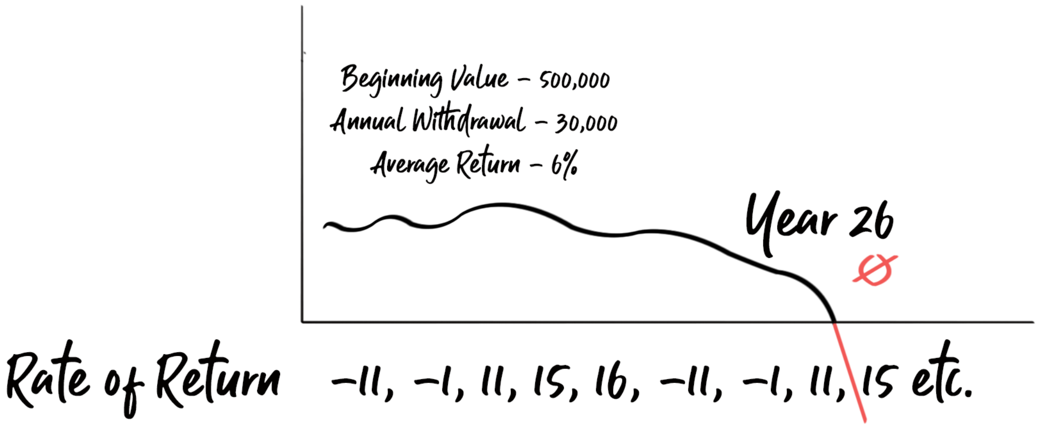
HIGHEST/BEST RATES OF RETURNS COME FIRST

Here, we withdraw $30,000 each year (without any increases for cost of living), in this simulation in year 30 we still have $461,000.



LOWEST/WORST RATES OF RETURN COME FIRST

Here, we do the exact same thing as above. The only factor that is different is the order of our rate of return. This simulation shows that we RUN OUT OF MONEY in year 27!



THE SAME EXACT RATES OF RETURN AS THE LAST PAGE, JUST IN A DIFFERENT ORDER.

A cousin of Sequence of return risk is this spend-down risk. It is real and cannot be taken for granted.

Below, is a look at the S&P 500 Index with dividends reinvested from 1990 through 1999. If you began withdrawing 8% from your $1,000,0000 account in 1990 every year until 1999, because of the greater than 8% or positive returns (in nearly all years) even with the $800,000 in withdrawls, you would still have 2,640,516 by 1999.

S & P 500 Index with Dividends Reinvested						
Year	Asset Value Beginning of Year	Annual Distribution	Asset Value after Annual Distribution	Annual Rate of Return %	Actual Average Rate of Return %	Asset Value (End of Year)
1990	1,000,000	80,000	920,000	-3.18	-3.18	890,777
1991	890,777	80,000	810,777	30.41	11.64	1,057,321
1992	1,057,321	80,000	977,321	7.64	10.4	1,051,988
1993	1,051,988	80,000	971,988	10.03	10.32	1,069,495
1994	1,069,495	80,000	989,495	1.24	8.73	1,001,747
1995	1,001,747	80,000	921,747	37.54	12.26	1,267,743
1996	1,267,743	80,000	1,187,743	22.89	13.43	1,459,637
1997	1,459,637	80,000	1,379,637	33.33	15.28	1,839,467
1998	1,839,467	80,000	1,759,467	28.6	16.4	2,262,709
1999	2,262,709	80,000	2,182,709	20.97	16.76	2,640,516

Conversely, if we take the same exact portfolio and assume you make the same 8% withdrawal BUT start in year 2000, by 2009 you would be left with 65,535.

S & P 500 Index with Dividends Reinvested						
Year	Asset Value Beginning of Year	Annual Distribution	Asset Value after Annual Distribution	Annual Rate of Return %	Actual Average Rate of Return %	Asset Value (End of Year)
2000	1,000,000	80,000	920,000	-9.11	-9.11	836,220
2001	836,220	80,000	756,220	-11.92	-10.45	666,098
2002	666,098	80,000	586,098	-22.13	-14.05	456,380
2003	456,380	80,000	376,380	28.61	-6.85	484,065
2004	484,065	80,000	404,065	10.9	-4.41	448,127
2005	448,127	80,000	368,127	4.88	-3.41	386,102
2006	386,102	80,000	306,102	15.74	-1.93	354,275
2007	354,275	80,000	274,275	5.45.	-1.47	289,224
2008	289,224	80,000	209,224	-37.01	-3.21	131,783
2009	131,783	80,000	51,783	26.56	-2.82	65,535

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LET'S GET CLEAR

If the above illustrates anything, it shows that withdrawing money during early negative years can wreak havoc on your nest egg. In addition, how much are you withdrawing? Is your withdrawal rate safe?

How long will your money last? Have you stress tested your plan? What is your back-up plan if the market suffers a tremendous correction around the time you begin taking retirement income?

People's lack of understanding around sequence of returns and spend-down risk has had devastating effects on many financial plans. It is necessary that we take steps inside our plan to place guardrails on our financial plans, create guarantees and balance so that if we're faced with these challenges,our financial futures will not be destroyed.

All investments and investment strategies contain risk and may lose value.

#5 FAILING TO REBALANCE RISK

5. FAILING TO REBALANCE RISK

WHAT DOES THIS MEAN?

All Investment portfolios are designed within specific risk-reward parameters. This is also known as standard deviation. This should include a careful selection of asset classes based upon the individual tolerance for risk.

WHAT CAN GO WRONG?

Because asset class returns vary over time, it is natural for asset allocations to drift slightly from their original set and intended percentages. And accordingly from the original designated risk- reward parameter.

By way of example, if you are investing in a 70/30 allocation and if the domestic large-cap stocks are up and bonds down, the domestic large cap will inevitably make up more of your portfolio than they did of the original allocation. When this happens, the equity-to-bond ratio goes up and, therefore, so does the risk / standard deviation (measure of volatility).

Thus, when the markets rise and fall, asset classes inevitably move away from the intended original allocation and the volatility generally rises inside your portfolio.

Have you looked at your portfolio's increasing volatility if you're not rebalancing on a quarterly basis?
Your portfolio could be well out of range of what you are comfortable with. In other words, the highs and lows could be much more extreme than what you originally signed up for.

LET'S GET CLEAR

Regular rebalancing resets the weighting of each asset back to its intended allocation by selling assets that are priced relatively high (i.e. they have risen) and buying assets that are relatively low (i.e. they have fallen). Rebalancing helps an investor's portfolio more closely resemble the desired risk-reward of that investor and reduces the volatility inside a portfolio in an unsteady market.

#6 CHASING AFTER RATES OF RETURN

6. CHASING AFTER RATES OF RETURN

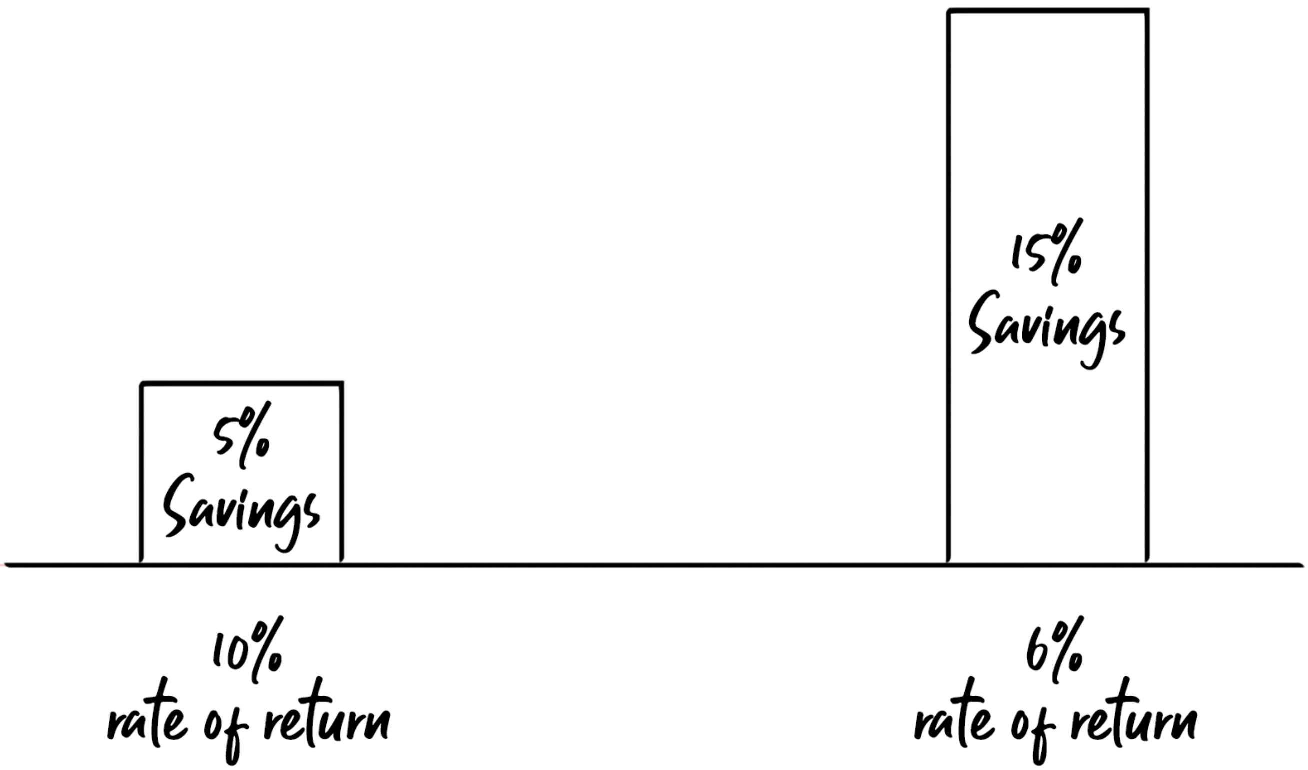
WHAT DOES THIS MEAN?

Wall Street firms have traditionally marketed to consumers in a way that has lured them to open accounts with images of better, fatter, stronger, and higher rates of return.

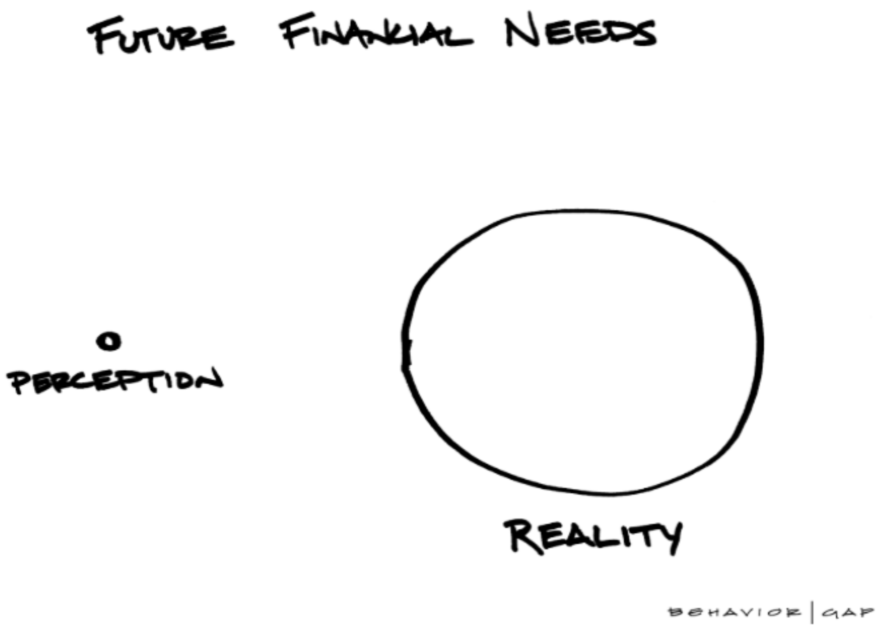
In fact, consumers believe that in order to achieve a high reward on their money they must accept the highest levels of risk. Quite often this has led people to chase rates of return. While rates of return are critically important, savings is a more crucial factor that must be addressed FIRST.

WHAT CAN GO WRONG?

When individuals count on higher returns, they are less inclined to save as much. Do you want to be the individual consistently saving 5% of income and averaging a 10% rate of return? Or do you want to be the individual who saves 15% of income and earns a 6% rate of return?

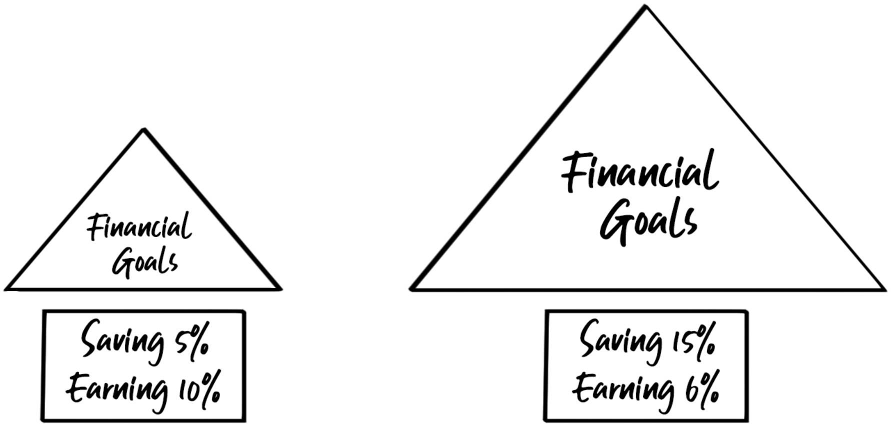


(Of course, most people will pick the 5% savings that generates 10% rate of return. Not only is 10% return more appealing, if you are only saving 5% of your money, you have that much money left over to spend on "life")



LET'S GET CLEAR

Average returns might not pan out. Rising taxes in the future could take a larger piece of your nest egg than you planned, double-digit inflation could affect your nest egg; and unexpected life events are a part of everyone's lives. We must prioritize our savings rate BEFORE we chase rates of return if we want to succeed financially.



#7 FORGETTING TO PLAN FOR TODAY

7. FORGETTING TO PLAN FOR TODAY

WHAT DOES THIS MEAN?

When planning, Americans are often laser focused on their tomorrows: a future financial goal or a financial event that will take place years from now. It could be a goal like purchasing a first home or investment property, wiping out college loans, sending kids to college, or achieving specific retirement dreams.

WHAT CAN GO WRONG?

When we are focused on our tomorrows, how can we be assured that our tomorrows will even happen if we do not protect our todays? If something occurs today that knocks our plan off track, planning for tomorrow seems senseless. We must protect today and fortify our economies before we begin to plan for our tomorrow.

ASK YOURSELF THESE QUESTIONS ABOUT YOUR PROTECTION:

- "What excess liability protection did my property and casualty professional recommend to shield my family and me from a lawsuit?" *
- "What would happen to my assets if I were sued?"
- "Does my auto insurance policy cover replacement value? Is there limitation on lawsuit? Are my deductibles appropriate?" *
- "What amount of income protection do I have in place to protect my most valuable asset if I cannot work due to a sickness or disability?"
- "When was the last time I had my legal documents reviewed and updated? Are there mandatory distributions or lifetime trusts?"
- "The last time I met with my insurance advisor, did they discuss my life insurance protection and human life value?"

**Guardian does not issue nor advise for Property and Casualty nor Auto Insurance*

LET'S GET CLEAR

All of the above questions are essential to making sure your plan is self- completing. We cannot plan for tomorrow if today is left wide open, vulnerable, and unprotected. Protection must be the first discussion with your advisors and it is one that should be revisited and re-evaluated each year.

#8 PAYING OFF YOUR DEBT TOO SOON

8. PAYING OFF YOUR DEBT TOO SOON

WHAT DOES THIS MEAN?

Often, I sit with people and they tell me that they are paying off their mortgage early. If paying off a mortgage is a priority for my clients, I will work it into their planning. However, I will always discuss good debt vs. bad debt as well as the concept that paying off your debt too soon is not always the best thing.

Let's take the following example with a conventional mortgage of $350,000:

PERSON A
15-year mortgage
180 payments, 4% interest
Monthly payment: $2,588
Interest payments: $116,003

PERSON B
30-year mortgage
360 payments, 4% interest
Monthly Payment: $1,670
Interest Payments: $251,543

WHAT CAN GO WRONG?

Right away, you can see that with the 30-year mortgage, interest payments are $135,000 more. That is 116% more in interest! Thus, the banker tells us to take the 15-year mortgage over the 30 (or pay extra principal over time) and you will save, save, save!

However, did you notice that the monthly payment on the 15-year mortgage is $918 more per month? That is a 54% higher payment. Let's assume for sake of comparison, Person B with the 30-year mortgage deposits $918 (due to the lower 30-year payment) into a wealth-accumulation account every month. This translates to $11,016 over the course of a year. Now, let's assume Person B does this every year, for the next 15 years. This translates to $249,595 in 15 years at an assumed rate of return of 5%.

Surprisingly, at the end of year 15 (of Person B's 30-year mortgage), the principal balance owed is $225,900. Therefore, Person B could arguably use the accumulated money to pay off his principal in full.

LET'S GET CLEAR

This example illustrates that we can engineer the same outcome (i.e. pay off our home in 15 years) but have the use of the money over the next 15 years.

Why is this important? Well, if other financial investment opportunities arise that may grow at a faster pace than your home, wouldn't it be nice to take advantage of them?

If you have a 30-year mortgage with the side wealth-accumulation account, you are in control of your money. But with the 15-year mortgage, all of your money is tied up in the house (and is your house guaranteed to appreciate?).

Other issues impacting the above is the amount of interest deductible to Person B. If Person B is able to itemize deductions, she obtains 52% more in deductible interest on her returns over time.

In addition, if there is a life event, such as job loss or sickness, there is a lower risk of default with the 30-year mortgage.

While some may object to the reasoning above, stating that a 15-year mortgage is often 5 points lower than a 30-year, the logic still holds.

If the $350,000, 15-year mortgage was 3.5% and the $350,000, 30-year mortgage is 4.0%, in order to pay off the principal balance in year 15, you would need to earn an average of 3.57% in your wealth accumulation account.

#9 PUTTING YOURSELF AT LIQUIDITY RISK

9. PUTTING YOURSELF AT LIQUIDITY RISK

WHAT DOES THIS MEAN?

You have probably heard of liquidity, but do you know how much cash-like assets you should have? If there is a life event and an emergency, will you have enough?

Most people I meet are well versed in the ins and outs of maxing out their 401(k) and profit sharing plans. This is good. There are many benefits to retirement plan ownership. It is systematic. It is tax deferred. There is growth potential. However, if you are over relying on your 401(k), you are depriving your economy of the necessary liquidity it needs to grow and take advantage of opportunities.

WHAT CAN GO WRONG?

Retirement strategies such as the 401(k) or 403(b) have limited liquidity features. If you are in need of liquid cash and withdraw money from your qualified retirement plan, you will be penalized (before age 59 ½ you pay a 10% penalty). Having a disproportionate amount of money in your qualified bucket might adversely impact you if you were faced with a major life event–and what is more, is that it does not help your financial statement when you're trying to secure a loan.

Liquidity is a must when we are talking about life events such as college planning, loss of a job, sickness or injury, and divorce.

LET'S GET CLEAR

Financial Balance® is everything. Many people believe that participating in a 401(k) plan is an immediate tax savings and improves cash flow. In reality, it is really just a tax deferral. It is a timing move. We are putting off paying tax on that portion of our income that we defer. Once stashed away, we are very limited in our access to it to utilize or leverage it.

We WILL pay ordinary income tax on 401(k) contributions when we take our withdrawals at some point in the distant future.

The one looming question is–what will tax rates be when we are ready to make withdrawals? Will they be lower? Unfortunately, no one has a crystal ball. Building a sound 401(k) strategy is essential, and doing so in a way that you are not sacrificing liquidity is of utmost importance. Each person has a distinct economy, and harmony occurs when everything is in balance.

#10 LETTING EMOTIONS GUIDE YOU

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WHAT DOES THIS MEAN?

People tend to get emotional about their money. And with the volatile nature of the market, people are especially prone to making financial decisions based on their emotions, rather than on sound financial advice.

For example, when the market is overly volatile or goes down, the investor's natural tendency is to feel negative and want to flee the market.

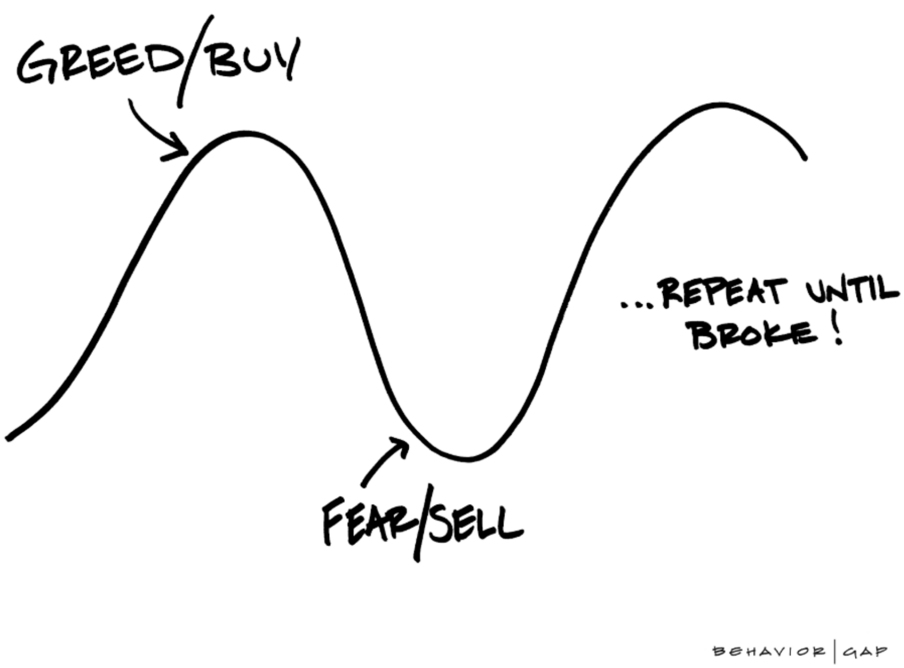
Conversely, when the market is rising, the investor's natural tendency is to feel positive and want to jump in. If the market continues to rise, the investor feels elated and quite possibly in control. In some bull markets, investors begin to feel confident about their stock picking ability...until the next bear market.

WHAT CAN GO WRONG?

These emotions, which continue with the rise and fall of the market, usually lead investors to make decisions that are based on market performance, not on accepted principles of investing. Thus, investors' propensity to buy high and sell low causes investors to underperform the market over time.

DALBAR, a leading Boston-based financial services market research company studies just this phenomenon. Each year, they publish the **Quantitative Analysis of Investor Behavior**. And each year, this study shows the gap between investor performance vs. investments' actual market performance.

We saw an example of this gap in 2016, when the average 20-year annualized S&P 500 Index return was 7.68%, while the 20-year annualized return for the average equity fund investor was only 4.79%.



LET'S GET CLEAR

Seek out a financial advisor. Work with them and develop a strategy that makes sense for you. Revisit it, revise it, but most importantly, STICK TO IT. Feelings cannot guide you to success–principles and strategy will.

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