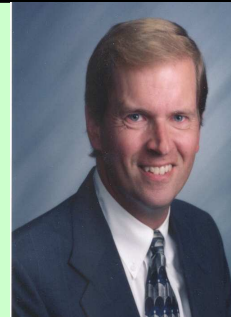


Wealth Maximization Strategies

Empowering People With Sound Financial Strategies



Dan Moericke

“Those who spend too much will eventually be owned by those who are thrifty.”
- Sir John Templeton

W-2, 1099, or Schedule C?

It Doesn't Matter, Because Everyone is Really "Self-Employed"

The Sun Sets on Industrial Age Employment

Some commentary on current events, from a long-term perspective:

On July 17, 2009, US Bureau of Labor Statistics reported the national unemployment rate as 9.7%, the highest since 1983. In several states, unemployment is well over 10%, and is even as high as 20% in some metropolitan regions. This is a major employment upheaval, one that significantly impacts the financial lives of a large segment of the populace.

If the future is consistent with past history, many of those currently unemployed will eventually find their way back into the workplace when the economy rebounds. But those who return to work will find their employment landscape fundamentally and permanently changed, because it is quite likely this “Great Recession” officially marks the end of lifetime employment.

Lifetime employment was one of the crowning distinctions of the modern Industrial Age. Beginning in the post-war 1940s, it was characterized by steady employment, guaranteed pensions, and employer-provided benefits. As a result, millions of blue-collar American households ascended to middle-class affluence; they bought homes in the suburbs, sent their kids to college and after 40 years of service, retired to a life of relative security and ease. At the same time, the white-collar professional and management class grew as well. Every now and then some observer might moan about the dehumanizing aspects of factory work or cubicle life in the corporate maze, but throughout history, there's never been a socio-economic model that delivered so many financial benefits to so many people on such a stable basis.

However, in a world where the only constant is change, Industrial Age lifetime employment could not last forever. The power technologies that fueled the

Industrial Revolution (steam, electricity and the internal combustion engine) laid the foundation for the micro-technologies of the personal computer and the Internet, ushering in the Information Age. And while government policymakers may strain mightily to preserve the “old world” of lifetime corporate employment, every indication is that changes are not only on the horizon, but already here. Even American automobile manufactures finally recognized it. Unless you are working in government (including education) or the military, lifetime financial security, courtesy of your employer, is a thing of the past.

Self-Employed in the Information Age

Going forward (if you haven't experienced it already), these changes will have huge implications for your individual finances. In the emerging Information economy, workers will find it to their advantage to think and act as if they were self-employed. For some, this means adopting some different paradigms and acquiring some different financial habits.



Fluctuating Income, Multiple Sources

First and foremost, **the nature of your work and income may change.** You are less likely to remain in one industry, with one employer, doing one job, receiving one paycheck. Instead, work is more likely to resemble a series of long-term but temporary assignments with several employers (sometimes at the same time), with periods of unemployment and self-employment. This is particularly true for younger workers. As Maureen Sharib, an employment “sourcer” from TechTrak, put in a July 14, 2007 commentary:

“Today, there are 149 million people in our nation's workforce. Every year, approximately 50 million people leave their

jobs. And approximately 50 million find new jobs. That means one-third of our workforce turns over each year because of new opportunities. And the average American has had nine jobs by the time he or she is 34 years old because of new opportunities.”

Not only are tomorrow’s workers more likely to experience regular employment changes, they will also encounter different forms of payment. While government prefers making as many workers as possible W-2 employees because income taxes are withheld by the employer, the just-in-time, low-overhead pressures of the Information economy make it financially desirable for companies to limit their full-time employees and consider out-sourcing or contracting. For many, this could mean the end of regular paychecks.



Combine frequent job changes with non-W-2 compensation and the inevitable result is irregular cash flow, one of the major characteristics of self-employment. Successful self-employment requires strategies to manage these fluctuations and still pay the bills.

Portable, Personal Benefits Packages

As you move, you must either **maintain or perpetually re-establish your benefits package**. When the “company man” was the default career path, the trip included employer-provided benefits. That scenario is no longer on the table for most workers.

Even in holdover Industrial Age jobs, the cost of providing benefits has skyrocketed (particularly for health care), so most employers require employees to share in the costs. Alternately, employers reconfigure their work force so that fewer employees are eligible for any benefits. The structure of Information Age employment puts the responsibility for benefits more directly on the worker.

If offered, group disability and life insurance protection may be an inexpensive way to obtain income protection, but these options are usually limited to active employees – if you terminate employment, you can’t take the coverage with you (you may be able to convert life coverage to an individual policy, but the costs are no longer at group rates). This leaves you either hoping your new (and often temporary) employer will offer similar benefits, or hoping you are healthy enough to qualify for similar benefits on an individual basis. The older you get, the more problematic this arrangement becomes.

In the long run, securing a personally-owned package of portable (and permanent) benefits may be a better option, particularly for disability and life insurance, where premiums and coverages for individual policies can be guaranteed to remain the same for specified time periods. In addition, healthy individuals who obtain permanent coverage at a young age may realize some long-term savings because younger, healthy individuals usually subsidize the costs of insuring older, less healthy people in group policies.

Your Own Financial Management Systems

Not only must your benefits package be portable, but so must your **financial management systems**. All employers are subject to regulation regarding taxes and withholding for the employees on their payrolls. This includes the requirements to pay the employer’s portion of FICA and Medicare taxes, plus withholding on income paid to employees. However, when workers are paid by the job or under 1099 conditions, the responsibility for these taxes falls on the worker, not the employer. This increases the possibility that you may have to make quarterly estimated tax payments, at both the state and federal levels. (Even if you receive a W-2, you may be considered a “non-statutory employee,” in which case the employer will not manage your withholding requirements.)

This means your tax return will probably require more than a 1040-EZ form. It also means you’ll want to keep records for deductible expenses, as well as earnings.

Additionally, employers typically handle automatic deductions for qualified retirement plans, like 401(k)s, and often facilitate direct-deposit transactions, making it easy to execute long-term saving objectives. But if you’re not eligible to participate in a company’s plan, where will you put retirement savings – and how will you deposit the money? These issues must be addressed by your financial management system.

You are the Pension Fund Manager

Beyond finding the financial vehicle and making the deposits, you are responsible for **creating your own pension** income from these savings. Unlike the Industrial Era job, there are no formulas based on average salary and years of service to determine your retirement benefit. Instead, it’s up to you to answer questions like: How much funding will be required? When will you be able to receive payments? How big will they be? In addition to figuring out how to best accumulate the funds, you must also become your own actuary and determine how they will be distributed.

If You Can't Handle Self-Employment, Will the Government Bail You Out?

Consider the brief listing above of additional assignments: Insurance, Accounting, Retirement Planning. For the typical employee at the end of the Industrial Age, all these assignments were handled “in-house.” It was group benefits, a W-2, and a pension. Now, the trend is that these are being replaced by the individual. Not surprisingly, it appears many individuals are not up to the challenge of functioning as self-employed independent contractors. Statistical evidence seems to indicate that too many people are under-insured against the difficulties of life, and under-funded for retirement.

This collective poor performance has compelled government officials to seek legislative fixes, using taxation and regulation to guarantee minimum levels of financial well-being. The legislative push for national health care is the most prominent example of current government initiatives, but in the past year, other items have been considered as well, including an idea to establish mandatory all-inclusive Government Retirement Accounts (GRAs) as replacements for company-sponsored 401(k)s.

Some might think that broadly-available government programs for insurance and retirement might serve as suitable replacements for Industrial Age company benefits, sparing individuals the challenges of self-employment. But anytime government enacts policies that seem to restrict or resist market forces (such as outsourcing, globalization and the Internet), there are usually unintended consequences.

For example, economists have regularly documented that minimum-wage laws typically lead to either a decline in employment or inflation. While those who are currently working at low-wage jobs do make more money, employers often consider hiring fewer workers or raise their prices to accommodate their increased labor costs.

What might be the unintended consequences in some of these government proposals? Suppose the law requires companies over a certain size to provide health insurance or be hit with a fine. Depending on the cost, one practical response might be to shrink the company (or perhaps divide it), to fall below the threshold. After careful analysis, another option might be to pay the fine, but not provide insurance. Even if the company conforms to the proposal, the insurance coverage may not be a plan that matches the individual's medical needs.

Because no one knows how the national health care issue will play out, the above comments are pure speculation. Perhaps politicians can actually craft a

utopian solution that delivers far beyond our wildest dreams. But the pragmatic response, considering history, is to assume that government initiatives will not restore Industrial Age benefits to the Information Age economy. Better to think and act as a self-employed individual than hope for nationalized group benefits.

(Even with mandated nationalized programs, you still end up functioning as an individual. Think of Social Security. When it comes time to apply for benefits, you aren't part of a union, or some other select pool of beneficiaries. You don't have a Human Resources advocate to guide you through your options – you'll go through the bureaucratic maze on your own, or hire expert assistance – just like a self-employed person would.)

You Might Be Self-Employed, But You Don't Have to Do Everything Yourself



30 years ago, a successful self-employed individual understood the necessity of a team of financial advisors. Finding someone to keep books, secure insurance, oversee investments, prepare returns, was part of the cost of doing business. This hasn't changed. If you're self-employed, you will almost certainly benefit from expert assistance.

One of the fortunate side effects of the Information Age is the expanded access to expert services and technologies. When computers occupied entire floors in corporate offices, only big businesses could deliver the benefits of advanced technologies. Now, a personal computer and an Internet connection can bring all sorts of expertise right to your doorstep. And the technology far surpasses anything that was produced by a 1970s main-frame program.

It is understandable that some people choose to hold onto the past as long as possible; they will do everything possible to preserve the status quo. But contrary to efforts by politicians to “preserve” or “create” more Industrial Age jobs, the free-market trend is toward a new era, and a different paradigm. Specialized self-employment comes with a new set of challenges, but also better ways to overcome them.

Here's simple checklist. As a self-employed individual, how well have you...

- **Made allowances for fluctuations in cash flow?**
- **Established good management systems?**
- **Secured your insurance benefits?**
- **Prepared a spending plan for retirement?**

YOU ARE SELF-EMPLOYED. BE YOUR OWN BOSS.

Using a Lottery as an Incentive to Save

According to Wikipedia, **behavioral finance** is a “*separate branch of economic and financial analysis which applies scientific research on human and social, cognitive and emotional factors to better understand economic decisions by consumers, borrowers, investors, and how they affect market prices, returns, and the allocation of resources.*” Among the things behavioral finance studies are the factors that influence people to make bad or short-sighted economic decisions. For example, why do many people opt for the unlikely chance of a big payout from gambling, and avoid the sure-fire success of regular saving?

As Jason Zweig notes in his July 18-19, 2009 “Intelligent Investor” column in the *Wall Street Journal*, “in 2007, the latest year numbers are available, Americans spent \$92.3 billion on legalized gambling, according to Christiansen Capital Advisors; that same year, says the U.S. Bureau of Economic Analysis, Americans saved only \$57.4 billion.”

Why do Americans put more dollars toward gambling than saving? Someone in the field of behavioral finance would theorize that people tend to over-estimate the odds of rare occurrences, like winning the lottery, or breaking the bank at Vegas, in part because the magnitude of reward is so enticing – “I know the odds are 10 million-to-one, but can you imagine what we could do with a million dollars!” Saving, on the other hand, provides minimal thrills, and no chance of outrageous gain. For many, potential thrills trump low-level guarantees. This is especially true with smaller amounts of money. Given the choice between saving \$25 or buying 5 lottery tickets, the tendency to gamble is strong, because \$25 saved doesn’t add up to much, but a single winning ticket could mean millions.

But what if there was a way to tie the thrill of gambling to the boring activity of saving? This was the idea behind the “Save to Win” program developed by Peter Tufano, a professor at the Harvard Business School.

In a campaign launched in February 2009, eight credit unions in Michigan offered one-year Certificates of Deposit, with a minimum deposit of only \$25. These low-minimum, short-term CDs actually pay interest below those of conventional CDs, but come with a unique kicker: With each new CD, the depositor is entered in a monthly and annual drawing. The monthly winner receives \$400, the annual winner \$100,000. In essence, depositors get to play the lottery when they save money.

Zweig’s article noted the campaign has been quite successful: In 25 weeks, the credit unions attracted over \$3 million in new deposits. But some of the best

comments come from participants in the program, reporting their experience on the Internet. Here’s one, from “Dean L.” posted in a forum on www.savingadvice.com :

I had less than \$5 in my bank account a couple of months ago. This had been a typical savings amount for me for as long as I can remember.

I have read about saving money and have known for a long time that it’s something that intellectually I know I should be doing, but there had never been the incentive for me to do so. The paltry interest rates that banks pay made me feel like it was a waste of time to put aside money, so I took my chances each month and played the lottery instead. It was always \$2 here, \$5 there, but it added up to close to \$100 over the entire month.

That all changed two months ago when I walked into my local credit union and learned about a new savings promotion they were offering called “Save to Win” where if I placed \$25 or more into a 1 year CD, I had a chance to win up to \$400 on a monthly basis plus a chance at \$100,000 at the end of the year. Although the payout isn’t as high as the lottery, it gives me a chance to win something which makes the low interest rates more palatable.

Since that time I have put aside the money that I would have put toward the lottery and instead have placed it into CDs. I’ve opened 5 CDs over the last 2 months which has my savings at more than \$125 — an amount that I haven’t had saved in years. I plan to continue to place the money I would have spent on the lottery into CDs for the rest of the year and should have close to \$1,000 in savings by then. And if I’m lucky, I may win some cash prizes along the way or \$100,000 at the end of the year.

One of the popular books relating to behavioral finance is *Nudge* (Penguin, 2008) by Richard Thaler and Cass Sunstein. The subtitle of the book is “Improving Decisions About Health, Wealth and Happiness,” and extensive sections of the book are devoted to methods used by individuals and institutions to provide strong incentives for a desired financial outcome, whether it is cutting expenses, saving for retirement, or even spending money on luxuries.

In the paradigm of the book, the “Save to Win” program is an example of what the authors call “Libertarian Paternalism,” which means people are free



to choose, but choices are structured to encourage the “better” choice. No one is forced to put money in a one-year CD, but as Dean L. writes, the “chance to win something...makes the low interest rates palatable.”

The next time you have a discussion about your long-term financial objectives (with your spouse or one of your advisors) you might want to consider “nudges” you could include in your financial strategies. You might not be entered into a \$100,000 drawing, but any strategy that can help you “save to win” is probably a good one.

“Down Goes Math! Down Goes Math! Down Goes Math!” (Again)



Joe Frazier was a feared boxer, a heavy-weight champion who, between 1971 and 1975 fought three momentous bouts with Muhammad Ali, winning once. In 1973, he fought a relatively inexperienced

George Foreman in Kingston, Jamaica. Foreman had been a 1968 Olympic champion, but the veteran Frazier was a prohibitive favorite. The fight was no contest. Foreman knocked Frazier to the canvas six times, and ended the fight with a 2nd-round knockout. The legendary sports commentator Howard Cosell was at ringside calling the fight. As Foreman pummeled Frazier, a stunned Cosell, uttered this famous refrain (that is so legendary you can even buy as a ringtone for your cellphone):

**“Down goes Frazier!
Down goes Frazier!
DOWN GOES FRAZIER!”**

In the world of financial mathematics, a “veteran” financial formula has taken a similar beating as a result of the recent stock-market decline. Asset Allocation is a historical, mathematically-driven approach to investing that attempts to select investments from different asset classes to form a diversified portfolio, with the idea that the mix of investments will limit losses and smooth out returns.

At the mathematical heart of the Asset Allocation strategy is the matching of disparate asset classes – ones that move up when others move down, and vice versa. This disparity is quantified by using a correlation ratio; if two investment classes perform exactly alike, their correlation is 1, while asset classes that perform quite

differently might have a correlation of 0.2. For most asset mixes in the United States, the benchmark asset class against is the S&P 500 stock index, against which all others are compared.

Asset Allocation has a long history. It first appeared in the 1950s, and Harry Markowitz, a pioneer of Modern Portfolio theory, was awarded the Nobel Prize for his work. As *Wall Street Journal* reporter Tom Lauricella writes in a July 10, 2009 *Wall Street Journal* article (“Failure of a Fail-Safe Strategy Sends Investors Scrambling”), “asset allocation became ingrained in nearly every corner of Wall Street.” For over four decades, asset allocation was used in all sorts of financial products and delivered consistent, almost predictable returns.

But the last two years have not been kind to Asset Allocation. Lauricella notes that **when the S&P 500 dropped 47% from March 2008 to 2009, many asset allocation funds performed even worse; their diversification didn’t work as a buffer against losses.**

What happened?

The analysts interviewed by Lauricella noted two significant changes. First, globalization of the economy means greater correlation and less opportunity for diversification. The economy in China is connected to the economy in Europe, is connected to the economy in America – when they all act the same, you can’t diversify by investing in different regions.

Second, the popularity of diversification may actually make it a less useful strategy. As analyst Vineer Bhansali said, “when (lots of) people start buying an asset, the act of them diversifying actually makes the asset less of a diversifier.”

Money managers are divided about whether Asset Allocation is finished as a viable model. The value of diversification still seems logical and useful, so some adherents believe the process simply needs tweaking. But others see it as a relic of a past economic era – the “new” economy will require a different method of diversification.

But either way, there is a financial lesson that bears repeating: While events in life can be cataloged and categorized, **life cannot be reduced to a mathematical calculation.** This is especially true about the use of formulas to predict the future. There are too many variables that can change, and too many ways for the changes to be unforeseen. And just because something is improbable does not mean it is impossible. A primary objective of a good financial program is to adequately address all possibilities, not just those considered most likely.

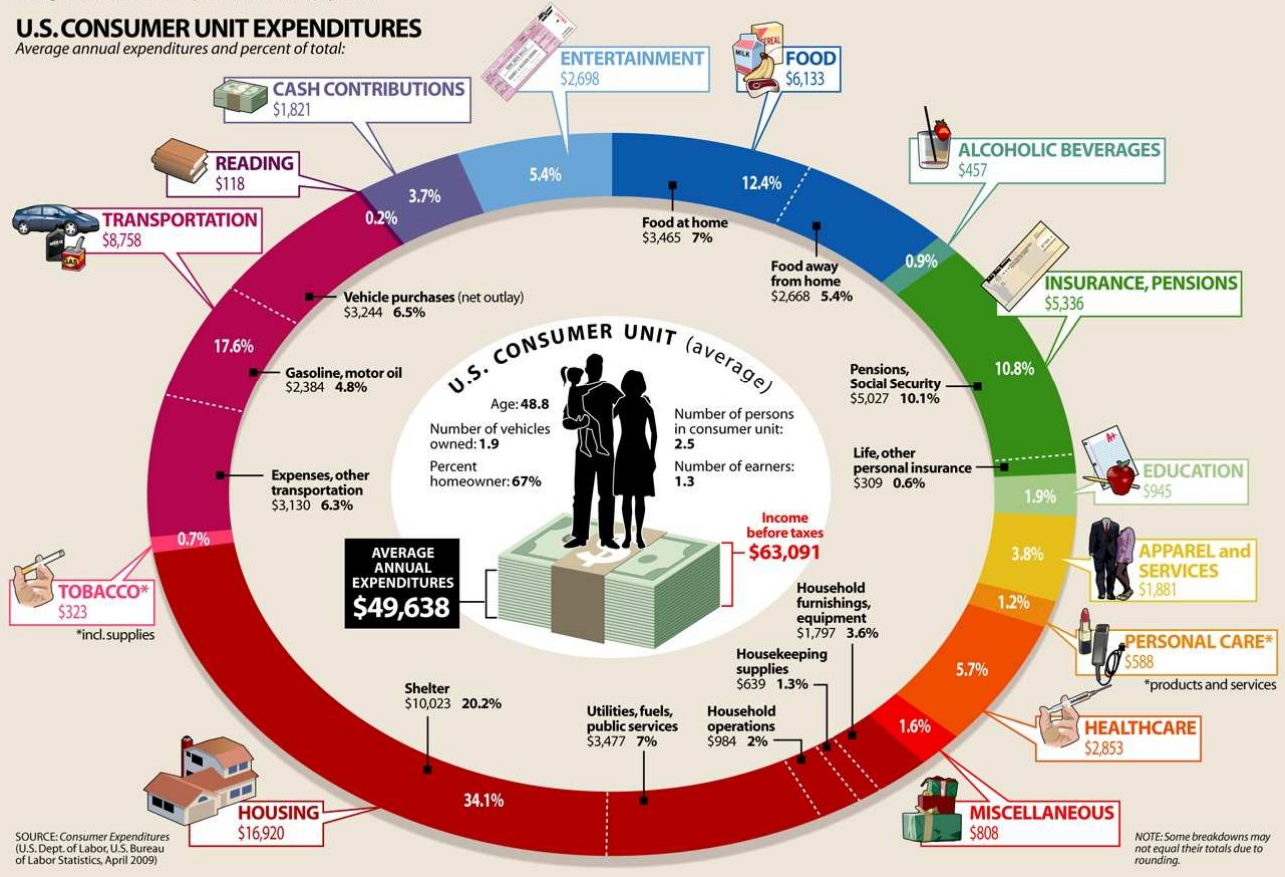
**Life cannot be reduced to a
mathematical calculation.**

Where Does the Money Go?

The Department of Labor's latest survey provides a detailed look into how the average U.S. consumer unit spends their annual paycheck.

U.S. CONSUMER UNIT EXPENDITURES

Average annual expenditures and percent of total:



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Dan Moericke

Financial Design Group
 4006 Hummingbird Rd.
 Wausau, WI 54401
 (715) 359- 2300
 (715) 359- 2228 fax

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