

# WEALTH MANAGEMENT JOURNAL

Holiday Edition 2008, Volume 17 Number 52 © 2008 La Jolla Institute for Wealth Management

## MISSION STATEMENT

The mission of the *La Jolla Institute for Wealth Management* is much more than money management! Wealth Management deals with a PHILOSOPHY for investing--developing a process rather than selling a product. Wealth management builds decision-making skills as a foundation for a financial business plan for you and your family. Our client relationship is built on a partnership for success that recognizes the need for a thorough understanding of your situation. Our primary focus is:

- OBJECTIVE & COMPETENT INVESTMENT COUNSEL
- Estate & Income Tax Planning
- Inter-Generational Succession Wealth Management Trust™
- Capital Preservation & Asset Protection
- Retirement Planning & Distribution Analysis

**Our goal is to be the leading provider of wealth management services to families, professionals, small to medium businesses, retirement plans and trusts.**

### In This Issue

Mission Statement.....	1
Bridge Over This Trouble Water?.....	1
Adding Insult to Injury.....	2
Anatomy of a Bear.....	3
The Duke Update.....	4
What If I Run Out of Money?....	5
Season's Greetings.....	8

## Is There a Bridge Over This Troubled Water?

### Do the Right Thing

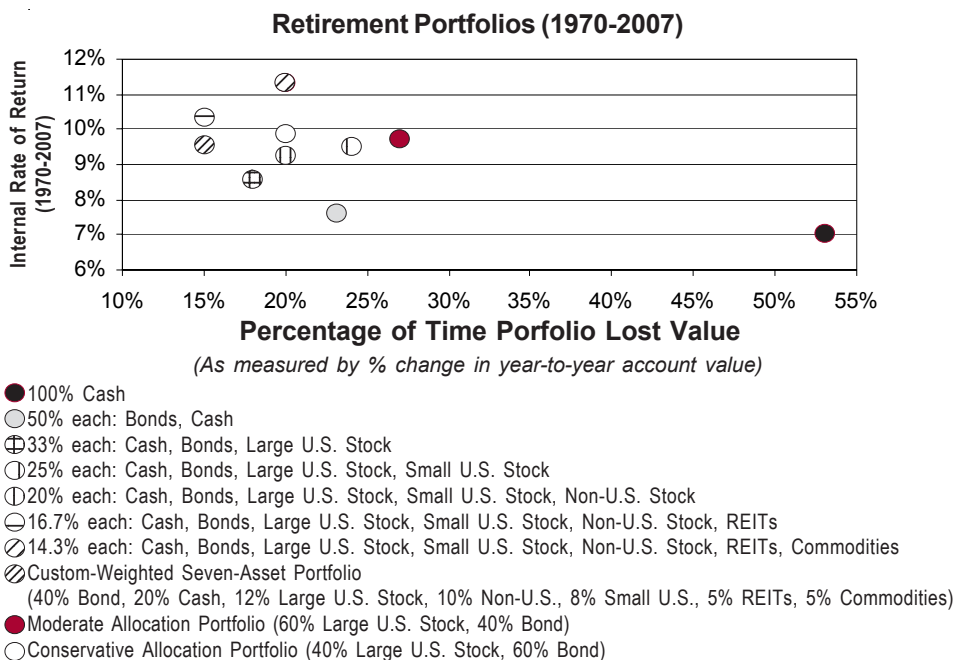
When all around you are worried, or in a frenzy over the collapse of the global capital markets, the right thing to do is reflect on your long-term investment objectives. A diversified portfolio of several asset classes, providing the most stability in market turmoil, involves the greatest diversification. Under current market conditions it is prudent, and the right thing to do, in making a tactical re-

allocation in most investor asset allocation formulas. We propose to make these suggestions during the last three months of this year, along with critical tax harvesting in all affected portfolios. The accompanying exhibit spells out this broad concept of a diverse, well-blended portfolio that we expect to provide consistent, tax-efficient returns over the span of the next 5 to 10 years.

(See *Troubled Water* Page 3)

### Stemming Losses

The most durable retirement portfolios involve the greatest diversification



*Tax and Law Editor*

Duke Johnson, JD, MBA (Tax), CLU

*Assistant Editor*

Judith Johnson

*Researchers*

Duke Johnson

Judith Johnson

*Layout and Design*

Michelle Shebest

*This newsletter provides general information for educational purposes only. It is not intended as personal investment or legal advice.*

Wealth Management Journal is published twice a year by the La Jolla Institute for Wealth Management at 7946 Ivanhoe Avenue, Suite 216, La Jolla, California 92037. Copyright © 2008 by the La Jolla Institute for Wealth Management.

Annual Subscription: USA \$34.90 Canada \$36.90

## Questions?

Please Contact:

**La Jolla Institute for  
Wealth Management**  
7946 Ivanhoe Avenue  
Suite 216  
La Jolla, CA 92037

[www.lajollawealth.com](http://www.lajollawealth.com)

Tel: (858) 459-8818

Fax: (858) 459-2818

# Adding Insult to Injury

*Phantom Taxable Fund Income and a 30% Loss to Boot!!*

## A Full Court Press

'Tis the season to get prepared for mutual fund capital gains distributions and dividends – a real treat when your fund may be down 15% to 30% this year. These distributions are taxable, and depending on your tax bracket, may be subject to tax at a 0% to 35% rate. It is critical to tax harvest capital losses now to offset taxable distributions we'll almost certainly have this year. You must take action before Thanksgiving to determine if your mutual fund will make distributions and the amount of long/short term distributions per share. Either call your fund company's 800 number or go online to determine when and how much taxable income to expect.

Recent comments and studies indicate that in this frenzied, volatile year, funds are making redemptions and re-positioning sales that will force taxable distributions that cause the Grinch to steal the holiday season!

## To Do List Before Thanksgiving

Making a list (and checking it twice) for stocks and funds to sell should start with buyer's remorse: the selection that was a pure mistake! Another top choice are funds that you want to replace with another fund of the same style with a better manager or wisely selecting an index or Exchange Traded Fund (ETF) with lower expenses.

Next, consider selective shares that generate a loss but holding on to the

remaining shares that may have a gain. Using this method, called "specific share identification" (we use this for many accounts) must be continued on shares sold later on. As a back-up, most fund companies and custodians use as a default, the FIFO method, (First In, First Out); the IRS uses this approach, where you are deemed to sell shares you purchased first.

## CAVEATS

Don't go overboard on offsetting 100% of your capital gains – preserve the last \$3,000 of losses to carryover to offset \$3,000 of ordinary gains, which may be subject to tax at a 35% rate.

Also, a key benefit for early retirees and retired couples with moderate taxable income (pension, social security and munis) may pay little or NO tax on long-term gains in 2008; maybe through 2010 if there is no change by the new administration. An example would be a couple with ordinary income of \$90,000 (\$15,000 tax-free); adjustable gross income of \$75,000 and with standard deductions and personal leaving \$57,000 subject to tax – a 15% tax bracket for 2008.

## Bottom Line

Don't let the tax-tail wag the dog; portfolio strategy and asset allocation are the keys to successful, consistent returns. But, tax harvesting can reduce taxes and keep more value down on the farm.

## Troubled Water

(From Page 1)

### Good News, Bad News

When one hears the phrase “I’ve got good news and bad news, which do you want to hear first,” my response is always – “Give me the bad news!” So here goes. Expect a lengthy recession but not a depression, huge government deficit spending on entitlements, rescue and stimulus programs, a la the “New Deal” from FDR’s presidency, or as one pundit said, a “Raw Deal.” This recovery plan will produce much higher taxes, inflation, economic stagnation and 5 to 7% average returns over the next 5 years! But, the good news: The average bear market decline in a recession is 28% over 13 months. To date we have seen a decline of 32% over 12 months. Bear/Recession combos have had average losses of 31%, were longer in duration (more than 15 months); yet on average, the market returned 9.8% annually in the next 5 years, rewarding the buy and hold investor with strong intestinal fortitude. Because you really only have two options: (1) Sell all holdings and sit in cash ‘til you know when to buy

(See *Troubled Water* Page 7)

*"It is not the strongest of the species that survives, nor the most intelligent . . . It is the one that is the most adaptable to change."*

~Charles Darwin

# Anatomy of a Bear

Well-known market sage Bob Farrell, of Merrill Lynch, has stated that there are 10 general market rules to keep in mind at all times:

- 1) Markets tend to return to the mean over time.
- 2) Excesses in one direction will lead to an opposite excess in the other direction.
- 3) There are no new eras – excesses are never permanent.
- 4) Exponential rapidly rising or falling markets go further than you think, but they do not correct themselves by going sideways.
- 5) The public buys the most at the top and the least at the bottom.
- 6) Fear and greed are stronger than long-term resolve.
- 7) Markets are strongest when they are broad and weakest when they narrow to a handful of blue chip names.
- 8) Bear markets have three stages – sharp down, reflexive rebound, and a drawn-out fundamental downtrend.
- 9) When all the experts and forecasts agree – something else is going to happen.
- 10) Bull markets are more fun than bear markets.

When this bear market began on October 11<sup>th</sup>, 2007, the S&P 500 index traded at an intraday high of 1576. By March 17<sup>th</sup> of this year, the market had traded down to 1256 (a loss of 20.3%). From March to May 19<sup>th</sup>, the market moved (intraday) from 1256 to 1440 (up 14.5%). From that date until the close on October 7<sup>th</sup>, the market trended down by 30.8%!

With those movements in mind, we can look to Bob Ferrell’s eighth point (which would appear to be an accurate roadmap for this market so far), and conclude that perhaps we are currently experiencing the third stage of this cycle.

*"My mom was fair. You never knew whether she was going to swing with her right or her left."*

~Herb Caen

*"This nation will remain the land of the free only if it is the home of the brave."*

~Elmer Davis

# the DUKE & DATE

By Duke Johnson, JD, MBA (TAX), CLU

## Do Whatever it Takes, Whomever it Hurts

### The New Greed Creed!

I want to apologize Dear Reader for a glaring omission in the last edition of the WMJ's page 1 headline: "The Gang That Wouldn't Shoot Straight – Bankers, Brokers and Borrowers." We left out – The Honorable Members of Congress who feasted at the Freddie Fannie contributions trough and obtained "Joe's Special" loans from Countrywide's mortgage boiler room. How could I forget the key people who set this sub-prime, derivative madness in motion. Special mention to "Brilliant Bill" Clinton for his kick-off legislation that opened the floodgates for the inalienable right to home ownership – financial suitability was not a factor. This "right" to owning a home goes along with the "right to a college education" for all! Standards, what standards – we go low – to the lowest standard of achievement as the benchmark. Change all right – not for the better when competition, individual achievement and initiative are discouraged by an education system that consistently produces underachievers.

Our next leader and a drooling Congress will pass the hat to us and go on a spending binge the likes of which has never been seen on this planet. Oh, where does the money come from? I'll let you answer that one! The resilience and know-how of Americans have saved our lunch time and time again. I have no doubt we shall fix this mess and be stronger in generations to come if we can keep our heartland values and standards in the forefront and resist the "I want, Greed Creed" values that put us in this fix.

### Aiden's Update

Just a quick update on my 6-year-old grandboy's career progress. You know he works in my office on his half-school days helping with proxy statements. On this last week in the office, he confided in me, that when I retire, he'll take over the office and his younger sister, Madison can do the "files!" I feel a friendly takeover coming on . . .



~ Check in with Duke ~

duke@lajollawealth.com

Tel: 858.459.8818 • Fax: 858.459.2818 • Web: www.lajollawealth.com

Or, visit our office located in downtown La Jolla:

7946 Ivanhoe Ave, Suite 216 • La Jolla, CA 92037

# What if I Run Out of Money?

## *The Toughest Question of All!!*

### It's All in the Timing

Well, this is serious stuff folks, so bear with me on the technical numbers; and the charts we illustrate may cause some concern to some retirees, because it is clear to many advisors, that the timing of your retirement – “the luck of the draw” so to speak, determines how long your retirement savings will last! If you retire in a bull market – great; your savings may last for 30 years. If you retire in 2008, or at the start of a bear market, you could spend down your savings in 15 to 20 years. **Chart 1** taken from an excellent piece in the July 14-15, 2008 Wall Street Journal, speaks louder than words. Bottom Line: If portfolio returns are weak in the first 5 years of retirement, and you do not cut back withdrawals, the long-term prospect of outliving your money increases substantially.

### We Live Too Long

It is difficult to figure how long our money will last; but, it's a cinch we are living longer and it costs a lot more to stay healthy and be cared for in our last years. A couple aged 65 and about to retire, has a 50% chance one will live to 91, and a 25% chance one will live to 96. That's more than 30 years to spend down retirement savings. Longevity is a huge risk that compounds the market risk of our investments. There is no magic “All Risk Bullet” we can use to protect against every contingency in our retirement years, but we can plan to ease the suffering of

market collapses, health care and guaranteeing a steady stream of income for the long-haul.

### Safeguards and Risk Protection

We'll outline prudent steps you may take in retirement to preserve your nest egg, how to cope with market turmoil, and what is available to guarantee income you can't outlive. Much of what follows can be implemented now; the earlier in the “golden years” the better.

I. Health Care Costs – the fastest cash burn in retirement; Medicare

will pay for a good bit of it, and we know MediCal is not an option, but extended stay in a skilled facility will cost hundreds of thousands of dollars over a couple's lifetime. Add home care, medications, special therapy and equipment and you'll break the bank!

If you are not considering the purchase of long-term care insurance (LTCI) as a key component of retirement planning, then you have a flaw in the risk

(See **Safeguards** Page 6)

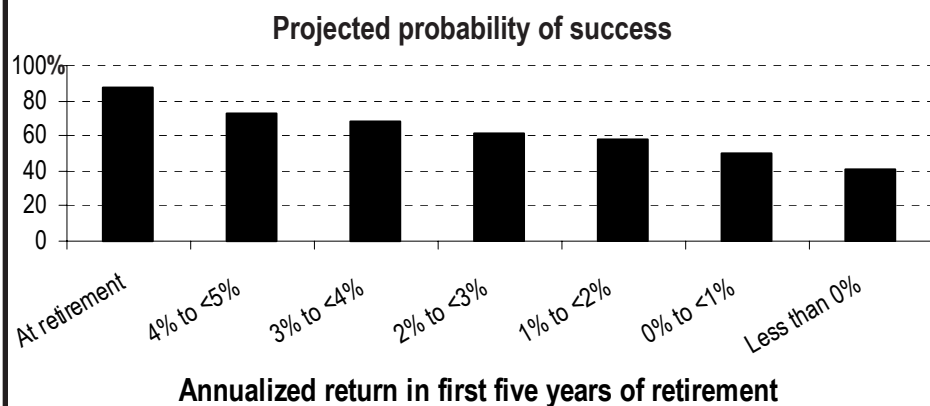
### A Strong Start – or a Weak One?

#### Chart 1

This chart shows the probability of not running out of money over the course of a 30-year retirement, based on a nest egg's performance in the first five years of retirement.

As the numbers indicate, those five years are critical. If portfolio returns are weak early in retirement – and if the investor doesn't cut back on the amount withdrawn – the chances of a nest egg surviving begin to fall significantly.

For example, if a portfolio's annualized returns in the first five years are between 4% and 5%, there's a 74% chance that a person's retirement savings will last 30 years, based on 10,000 potential scenarios of market outcomes after the first five years. But if returns in the first five years fall somewhere between 0% and 1%, the chances of a nest egg surviving three decades are only about 50-50.



Source: T. Rowe Price Group Inc.

## Safeguards

(From Page 5)

management of your retirement savings. We continue to offer all you need to know about LTCI in making an informed decision regarding LTCI or self-insuring this financial concern.

II. Establish a Cash Management Fund – we have tried to set up at least 2 years of cash in retirement portfolios to buffer a market downturn. All this is under review, as the 2008 market collapse may require additional cash positions to avoid selling holdings in order to meet monthly distributions in a falling market. My sense is we may suggest incorporating 3 years of cash needs in a short-term muni bond fund to supplement cash distributions.

III. Guaranteed Income for Life – Annuities and so called “payout” mutual funds are offered by Fidelity, Vanguard, Schwab and other financial institutions. These managed payout funds let you draw a fixed amount – up to 7%; their goal is to preserve capital. This has risk too, and is not guaranteed! Guarantees come only in fixed or immediate annuities, issued by major insurance companies. We suggest using annuity payments with Social Security to cover basic living expenses; the retirement portfolios can be invested for long-term growth, and the cash management account to provide supplemental discretionary income.

IV. Reduce Spending and Withdrawals – *Chart 2* illustrates new research that makes a compelling case to cut back on retirement savings withdrawals. T. Rowe Price’s

research suggests you start over with your 2008 “bear market” balance as the benchmark for future withdrawals increased by inflation. So if your \$1 million portfolio is now \$700,000, use the \$700,000 as the base; perhaps skipping inflation increases will help, too. Please see the note in this chart: returns cited are 10% stock which is much too high. But the message is real clear: **WE MUST CUT BACK WITHDRAWALS** and reduce spending until the economy and capital markets return to the post-bear market performance.

We are confident the next 3 to 5 years will be both volatile and profitable. There is no quick fix to this mess we’re in; it will take patience, spending discipline and a positive attitude to weather this storm – but a safe harbor awaits us!

### The New Safe Withdrawal Strategy

Chart 2

New research shows that when retirement savings take a big hit, it's time to trim withdrawals. The best way to restore a 9-in-10 chance of having your money last 30 years is by taking withdrawals as a percentage of your "bear-market" balance, rather than your initial account balance (which is the traditional approach). For example, if your \$1 million nest egg is now worth \$800,000, you would start withdrawing about 4% of that \$800,000, and then increase your income by 3% each year for inflation. If you want to spend slightly more than 4%, you can - but to be safe, skip any inflation adjustments for about five years. Here's what you can withdraw:

Percentage lost on \$1 million	3% annual increase		No inflation increase	
	Withdrawal rate	First year's payment	Withdrawal rate	First year's payment
<b>10% (\$900,000)</b>	<b>3.8%</b>	<b>\$34,000</b>	<b>4.3%</b>	<b>\$39,000</b>
<b>20% (\$800,000)</b>	<b>3.9%</b>	<b>\$31,000</b>	<b>4.4%</b>	<b>\$35,000</b>
<b>30% (\$700,000)</b>	<b>3.9%</b>	<b>\$27,000</b>	<b>4.3%</b>	<b>\$30,000</b>

Note: This example assumes 55% of the portfolio is invested in stocks and 45% in bonds. It also assumes that stocks return 10% overall with a standard deviation of 15% and fees of 1.211%, and that bonds return 6.5% with a standard deviation of 5% and fees of 0.726%. It does not account for taxes or required minimum distributions.

Source: T. Rowe Price

# THE BACK PAGE

## The La Jolla Institute for Wealth Management

*The La Jolla Institute for Wealth Management is an independent advisory firm that secures investment, legal and insurance services from leading third-party providers. We offer objective advice to clients on a fee-based retainer. The Institute provides the following wealth management services:*

### Life Insurance

The Institute reviews and analyzes insurance needs, including existing and proposed life and disability contracts. Clients receive substantial savings plus objectivity in placing the proper amount and type of insurance.

### Estate Planning

The Institute performs tax and distribution analyses, develops and assists in implementing wills, trusts, intra-family and elder care planning, and family business succession.

### Severance Benefit Planning

The Institute develops and installs severance benefit plans for corporate sponsors. We also represent severed employees in negotiations with employers to assure an equitable settlement. Our team of legal, actuarial and tax professionals provide knowledge and experience.

### Investment Management

The Institute develops and implements your written investment plan, using no-load funds, institutional-priced stocks, bonds and money managers. The Institute closely monitors the investment portfolio and provides you with scheduled status reports.

### Retirement Planning

The Institute performs plan design, investment funding and distribution analysis of individual and corporate plans.

### 401(k) Investment Advisory Services

The Institute selects investment options, tracks and reports investment performance, and presents employee education workshops on the basics of investments and retirement planning. We assist in audits of 401(k) plans and offer both bundled and unbundled plans.

**Tel: 858.459.8818**

**Fax: 858.459.2818**

**Web: [www.lajollawealth.com](http://www.lajollawealth.com)**

### Troubled Water

*(From Page 3)*

back in!! Research shows investors buy high and sell low; and market timers seldom prevail in a fear driven market as we are experiencing now. (2) Buckle up and hold on and take the hit to your net worth. This volatility (chaos) will continue and could get worse before things get better. Sticking with your long-term plan requires patience, discipline and the ability to shut out all the “noise” and negative news. Sticking with the plan is what I’m doing – we have substantial capital at risk along with you, and I feel it is okay to consider adding money to our plan if extra cash is

available. We expect to raise cash in certain portfolios by year-end through tax harvesting and retirement contributions. Re-investing is the right thing to do for our long-term game plan. History doesn’t give us all the answers, and this time I feel “it is different” and we were on the edge of the abyss, but it brings home the fact that market collapses bring fear and frenzy; it is part of the market cycle, and they all end. We hope this disastrous market meltdown will set us up for periods of strong returns years ahead.

My son, early 30s, entertainment exec, called me about his 401(k) plan. I had

to remind him that the 401(k) plan has a 50 year horizon. Keep the game plan in place and don’t look in the rear-view mirror!! Gee, Father always knows best – doesn’t he?

Be well and do good works!

*“We may pretend that we’re basically moral people who make mistakes, but the whole of history proves otherwise..”*

~Terry Hands

# 2008 Seasons Greetings

by Judith Johnson

Hello friends! Well what a year!!  
Would anyone have thought we'd end up here??  
A market disaster, and financial downer,  
and yet we hope for a good high rebounder!

So what do we do, where do we go from here?  
Duke has the answers, so never fear.  
A thoughtful approach - no hysterics, folks.  
We look for the best - common sense - no joke!

Its times like this we must stick together  
looking for good things to give to each other.  
Love, future planning and savings so true-  
What could be better from us to you!!

Ready or not the Holidays are a com'n  
So prepare your traditions and start a hum'n.  
We know Family is the dearest of all -  
Enjoy what you have, and have a ball!

So here it is, our wish for everyone-  
Holidays with love, good cheer and fun.  
Happy New Year we sing - hear us chime-  
May 2009 bring a life that's just fine!!!

Duke  
Judith  
Michelle



7946 Ivanhoe Avenue, Suite 216  
La Jolla, CA 92037

Return Service Requested

PRSR STD  
U.S. POSTAGE  
PAID  
SAN DIEGO, CA  
PERMIT NO. 960