

WEALTH MANAGEMENT JOURNAL

Swimsuit Edition 2006, Volume 15 Number 46 © 2006 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.

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The Constant Gardener...

What We Do and How We Do It!

What Do You Do?

It's that time of year again--graduation events, beach parties, and steak on the barbie. Meeting new faces always begs the query-- what do you do? Are you retired? At least I'm past the stage when, living back East years ago, the standard was "what does your father do?!"

After my usual flip response about my day job, I'm comfortable with telling folks I'm a "financial gardener." Our job is to give tender care and constant attention to your financial growth and independence. Besides, it sounds sort of classy to drop lines at the next barbecue about the gardener who tends to your estate.

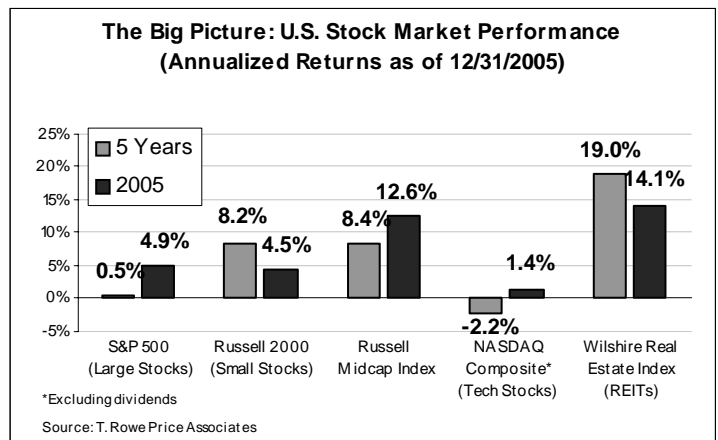
I've been thinking about what you might say to someone asking who handles your investments. Since my recent recognition as the Best Financial Planner in La Jolla, you might say: "you know, Duke, he's a financial planner"; or "Duke, he's my financial/investment adviser"--well every stock-broker in America is a financial adviser, and insurance agents are estate and financial planners, too!! Candace even noticed a banner in Pacific Beach advertising a brand-new firm--"La Jolla Wealth Management"! Imitation is the

highest form of flattery, but on the corner of Cass and Garnet, it doesn't do much for my ego!

So, I'm OK with the constant gardener image. We do the weeding and trimming, and manage the healthy growth of your estate. We have the tools to accomplish a beautiful harvest.

Asset Allocation/Asset Location

As you know, asset allocation is the core of the investment management process.



Spreading a portfolio over various investments helps control investment risk and enhances risk-adjusted returns. The above chart demonstrates the growth rates of the asset classes we employ to build the long-term growth portfolio. Cash and bonds, both taxable and tax-exempt, round out our investment options. A typical mix will include 60% growth investments and 40% fixed income.

(See **CONSTANT GARDENER**, Page 6)

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

Wealth Management Journal is published quarterly by the La Jolla Institute for Wealth Management at 7946 Ivanhoe Avenue, Suite 216, La Jolla, California 92037. Copyright © 2006 by the La Jolla Institute for Wealth Management.

Annual Subscription: USA \$34.90 Canada \$36.90

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Our Clients' Top Ten FAQs-- What's On Your Mind?

In the next few issues of our Journal we'll explore critical planning and investment issues posed by our clients. We invite you to add to our list.

Q: What is a Reverse Mortgage?

A: Must be a great deal-- a mailer I received states in bold print: "There's a government insured program that pays you to live at home."

A reverse mortgage is a government-insured loan secured by the equity in your home. If you are age 62 or older and own your primary residence, a lender will make tax-free payments based on your age, the value of your home, home equity, and location. Reverse mortgages are insured by the Federal Housing Administration (FHA). Loans must be repaid in full, including interest, when the last living borrower dies, sells the home, or permanently moves away.

Reverse mortgages can provide funds for older homeowners to maintain their home, pay for daily living expenses, health care, travel, etc.

Caveat: Reverse mortgages are not for everybody. The thought of easy money brings the wolf to the door. For the most part, reverse mortgage companies are ethical and follow full disclosure rules. However, there are unscrupulous mortgage lenders who prey on older homeowners and try to "help" them with their mortgage proceeds.

Costs are high, too! Appraisal fees, commissions, origination fees, insurance premiums, closing costs, and junk fees can total \$10,000 or more on a loan of just \$200,000. Consider also, you'll only access 80% of your equity (a 20% shortfall) and the interest rate you're paying (on your own money) is typically 2-3% over prime.

Alternatives: For our clients whose parents or older friends need additional income, we suggest looking at other options. Reverse mortgages work best for individuals who have few assets other than their homes.

One practical approach is to look at the conventional home equity loan. This works best for those who are not sure how long they will stay in their home, or who don't want to spend down their personal savings. This option gives more control and timing over the use of the home equity line of credit. From a pure financial number crunch, the best approach is to sell your home, move into a rental or less expensive home, and put the proceeds in CDs or US Treasurys.

In all cases, exercise caution and get another opinion from your CPA or financial adviser. Ask hard questions up front, get a detailed fee schedule, check the lender's reputation, and ask for individual referrals to existing clients and professionals.

(See **FAQ** Next Page)

FAQ: **What's On Your Mind?**

(From Page 2)

Q: Should I treat my children equally with gifts and inheritance?

A: Oh, brother, here we go into no-win territory! So, Duke's general rule for gifting--dead or alive--treat 'em equally!

The concept of family equality doesn't come easy; there are always circumstances where one sibling or grandchild is the exception. But generally, my advice is to go to extra effort to equalize gifts and inheritances. It starts with gifts for holidays, birthdays, and selling up college education accounts for the next generation. It just drives me crazy at Christmas time--my sweetheart still counts the number and cost of gifts for our adult sons, so as not to favor one over the other. Grand-boy and girl too! But that's OK. We'll do the same at the end of our rainbow.

Traps to avoid: We all have good intent, but inadvertently slip on the best-laid plans. Giving large gifts or bequests to grandchildren where one child has a single child and another has three offspring. Does family planning deserve to be penalized? Or, the classic, single daughter school teacher and the surgeon or dot-com brother--sorry, gender neutral--where we equalize the situation when the will "matures" by leaving the majority of our assets to the teacher. Bet it's fun to see how the doc

feels at the family reunion! Maybe it won't impact the children at all, but why risk it?

Another innocent predicament is naming one child to be a fiduciary (e.g. executrix or trustee). I've been very aware of this standard selection process, usually based on who is geographically closest and has more financial savvy. Think about it though--this is a difficult job at best, but by design it excludes her siblings from details and

"So, Duke's general rule for gifting --dead or alive-- treat 'em equally!"

information they may or may not be entitled to. If the fiduciary receives compensation for her role, you are taking money from her siblings. Seems best to consider co-fiduciaries if possible and get these issues on the table before the will reading!

Q: What To Do With Mom's House?

A: Great Question! I've so many good ideas. My top 5:

1. A hostel for the grandkids.
2. A timeshare for the siblings (Bob and Sally get two weeks during high season).
3. QPRT it now!

A Qualified Personal Residence Trust has mom deeding her house into a QPRT; she names herself as trustee, and reserves the right to live in the home for a period of ten to twenty years, at which time it passes to her children (or a trust for their benefit). The home is valued at a gift tax discount, subject to her \$1 million lifetime exemption. Saves gift taxes and estate taxes, too!

4. Gift to Mom's charitable remainder trust (CRT).

...Another of my do-good, feel-good, save-taxes strategies! Mom can transfer the family castle or the condo in the desert (everybody wants it but doesn't

"...The tax-exempt trust [QPRT] sells the real estate, invests the proceeds, and sends Mom a check!"

use it) to her CRT. That way, she'll avoid capital gains tax and receive a nice income tax deduction for a portion of the gift, PLUS lifetime income. The tax-exempt trust sells the real estate, invests the proceeds, and sends Mom a check!

5. Sell & downsize or hold for step-up! (Or, just keep it and take good care of Mom.)

Current law provides that all assets passing through an estate receive a date-of-death increase called a "stepped-up basis." After December 31, 2009, the step-up will not apply. The new rule will probably provide for a carry-over basis or a fair-market-valuation at death, whichever is less. The whole estate and gift tax issue is up in the air at this point--Buffet and Gates want estate tax, and the farmers in Des Moines say no way!

Selling the family home is a traumatic event, but for Mom, it may be the best solution. Paying 15 cents on each dollar of gain might be a bargain if it provides funds for a smaller or more senior-friendly environment and cash to boot for home care, travel, etc.

the DUKE & DATE

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

Why I Show Up!

Reflections

I have been thinking a lot about the nearly 40 years I've spent in the financial services industry. This adventure started in law school--I was a full time student with a newborn and a toddler at home. Judith was at home, too, working part-time with autistic and speech therapy patients, along with the Hartford School for the Deaf. Between classes I drove a school bus (a patience builder) and worked for Investor's Diversified Services (IDS, later acquired by American Express) as a Registered Rep. Yes, I must confess, many of my clients were at the medical school--I invested their money in savings plans, CDs, and mutual funds--imagine that! Proves my oft repeated phrase: "there is nothing new in this business!"

Brings Tears

All this history helps me understand why I love what I do. I always had the vision of a small town practice--offering a mix of estate planning and investment advice to clients. Well, my vision looked more like a New England town, but La Jolla is a village, too!

Recent events have reinforced my purpose and passion! We lost a wonderful client after a long illness. He

always fretted about having enough to sustain his health care expenses, and marveled at how we seemed to keep his savings intact. His daughter sent us his letter of direction: "Send Duke \$\$ over and above his fee after my departure." In her cover note, she wrote, "...There is nothing he or I could pass on to you which would adequately express his (and my) gratitude."

That same week I had a phone call from a long-time friend and client. I am his respite caregiver as his sweet lady has dementia. He just called to say thank you! Thank you for keeping his savings intact and providing income to deal with recurring expenses.

Million Dollar Baby

This is a kick! My mantra has been and is--"we manage expectations, not money." I opened a note to me last week-- attached to it a floral arrangement and chocolate pieces--it was short and sweet. "Dear Duke--many thanks from your Million Dollar Baby!" Super! Our affair is glorious: building her personal portfolio to the magic number. It is chock-full of tax-free income and no worries. We did it!

The New House

Another reason why it's always "the journey." Our client's ten-year plan was to build his savings, including the profit sharing plan at his company and his personal investment account with us. His goals were to buy their "dream house", have their daughters finish college, and if he chose to, semi-retire at 55. Yep, on May 3rd we closed out the first ten-year plan. New home in Westwood (from the "valley"); girls all set, business booming, and ready to start another ten-year savings plan!

Regardless of how much money you have, or where you came from, it's really all about your hopes and dreams! A new home, higher education, keeping a healthy and active lifestyle, having enough saved to be and feel independent--whatever the expectation, we'll adopt it as our own and help you get there.

That's why I love going to my office!!



Trading: Hazardous to Your Wealth?

Candace Jackman

May Market Slump? Let's Trade!

Higher borrowing costs, geopolitical uncertainty, and inflation fears sent jitters through US and foreign markets in the month of May. Like many investors and many of our clients, I was considering a few changes to my portfolio in response. International markets seemed to be bottoming out--I saw equally compelling reasons to add to my international holdings and to reduce international holdings. Many clients called with similar concerns: Do we get out of equities? Do we buy international while it's low? Should we move more of the account into cash? What to do?

Though the temptation may be great, in reality much of the time the answer is "do nothing." The reason we implement Investment Policy Statements and asset allocation plans is that we need an established framework for making investment decisions--a "trading guide" which ensures that trades are disciplined and strategic, not reactive. Investing is long-term. If we reacted to every ten-day market slump or rally by making what we thought were strategic portfolio moves, the only likely winners would be the brokers who collect our transaction fees and the market makers who get rich on the bid/ask spread.

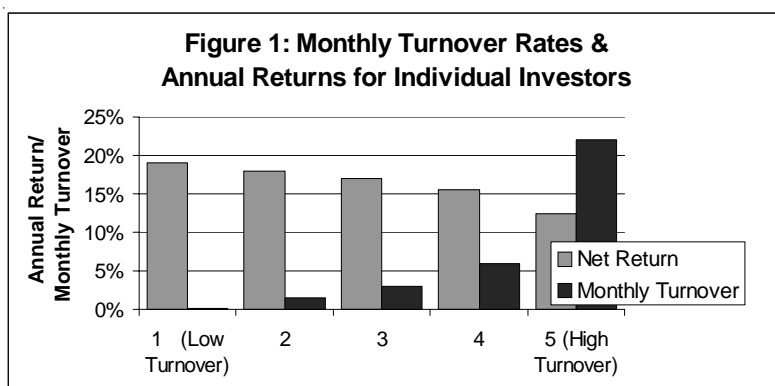
Hedge funds and advertising have popularized the notion that active trading is easy, profitable, and exciting. Internet investing, discount brokerage firms, and the ubiquity of financial "information" lead individuals to believe that they can beat the market if they are alert, informed, and intelligent. Unfortunately, the record shows otherwise.

Investors Who "Trade Too Much"

Brad M. Barber, a Professor at UC Davis, and Terrance Odean of UC Berkeley have dedicated years of research to tackling the question, "Why Do Investors Trade Too Much?" I had the pleasure of listening to a teleconference given by Brad Barber, and was impressed by the duo's methodical approach and logical conclusions. After studying trading patterns of thousands of individual investors in the US and Taiwan, these university professors reached a conclusion: "Individual traders trade too often and to their detriment."

"Individual investors trade too often, and to their detriment."

In their US study, Odean and Barber obtained portfolio trading data on 66,465 households from a sample of brokerages small and large, discount and retail. They divided investors into five groups based on the turnover rates of their stock portfolios and compared annualized rates of return net of trading costs.



Astounding is not the result of their finding, but its magnitude. Odean and Barber found that the 20 percent of investors who traded the most earned an average annualized return 7.2% less than the least active traders in the sample. Figure 1, which charts monthly turnover rates versus average annualized returns for the five groups, demonstrates a clearly negative relationship between frequency of trading and portfolio returns.

Overconfidence: Why This is So

Psychologists have long held that people are generally overconfident, and that men tend to be more so than women. Odean and Barber introduce this idea with the classic example of a self-reported survey in which a group of drivers is asked to rate their own driving abilities. Almost without fail, a majority of individuals will report their driving skills to be above average. Thus when the average individual, already overconfident, is bombarded with ads suggesting that ordinary individuals routinely beat the market, he tends to believe it. "The overconfident investor is so sure that he is right," postulate Odean and Barber, "that he is more likely to act on his beliefs. The result: he trades too much."

(See **TRADE TOO MUCH** Page 7)

The Constant Gardener

(From Page 1)

Location-Location-Location!

Location! As in the old real estate adage, the key to our investment process is to efficiently apportion assets among tax-deferred (IRA, 401(k)) and taxable accounts. We generally will design a taxable account to hold 40 percent in a mix of tax-exempt cash and bonds. Our 60 percent allocation to equity makes use of passive, tax-efficient, index or exchange-traded funds (ETFs) clustered around a core managed mutual fund or individual securities. The investment policy statement of an IRA, or other tax-deferred account, will call for taxable bonds or bond funds. Equity in the account is typically concentrated in actively managed mutual funds complemented by sector-specific ETFs for domestic and international equity diversification.

No Consensus

This process seems easy enough--square blocks in square holes, right? Well there is no absolute, and two recent academic studies provide well-researched data, but even the academics disagree.

One study, funded by TIAA-CREF, recommends holding individual stocks in taxable (trust, individual) accounts because of the lower capital gains rate and the ability to time sales. Tax harvesting, or offsetting gains with losses, is another plus, along with the potential for a step-up in basis at death. Good stuff! The university professors also concluded

that retirement-type accounts should be overloaded with taxable bonds. Income for income!

A contrasting study was published in the January 2005 issue of the Journal of Financial Planning. This author lobbied for inefficient, high-return assets in IRAs, including REITs, commodities, and managed large cap funds notorious for throwing off significant capital gains distributions. This study did agree with the TIAA-CREF analysis on one point--tax-efficient assets (ETFs, index funds) fit best in taxable accounts. This Journal study pushed for taxable bonds in either type of account. Other assets neutral in placement included international large cap funds, emerging market stock funds, and actively managed small cap funds.

Ecumenical Positioning

Our study, if published, would propose holding a mix of stocks and bonds in both types of accounts. We also consider tax brackets, investment time-lines, and tax efficiencies of various assets and investments. We like municipal bonds for individual taxable accounts; we don't like high turnover, high-expense-ratio funds. We jump for joy to invest in ETFs, index funds, and value-oriented mutual funds.

It certainly bears repeating by this constant gardener: when we ship to you the fruit of your estate, we want plump, after-tax, after-CPI returns.

May your garden grow with a bountiful harvest for you and your family.

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"Former president Jimmy Carter, in his 70's, once told me the main change in how he viewed the meaning of life. 'When I was in my 50's,' he said, 'I thought the things that mattered most were the things you could see: an expensive car, a beautiful home, status, and wealth. Now I see that it's none of that. What truly matters in life are things that you cannot see: the deep love you share with your family and close friends, your spiritual faith, the contributions you make to other people's lives, and your wealth of lifetime experiences are what really matter.'"

~Ken Dychtwald, Ph.D., Reinventing Retirement 3/23/2006

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.

TRADE TOO MUCH

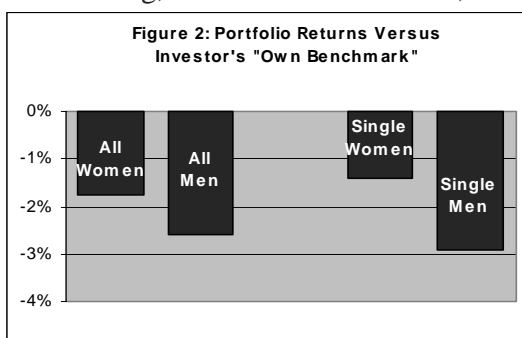
(From Page 5)

Psychology has long theorized that men are more overconfident than women, particularly in "masculine tasks" like investing, Odean and Barber assert.

Indeed, the duo found that men not only trade more often than women, but that through excess trading, experience a greater reduction in their returns. Figure 2 separates the performance of women and men against their own benchmarks: the portfolios they owned at the beginning of a given year. This illustrates the difference between the returns investors would have realized had they not traded at all versus the returns they achieved by active management. "Both men and women are lousy traders," conclude Barber and Odean. "Men merely trade more frequently."

Why Diversify?

A frequent result of overconfident investing, Barber and Odean assert, is



underdiversification. "If you know you are right, what's the point of hedging your bets?" In the typical month, Barber noted, the median investor in the study held only three stocks, far too few to achieve any level of diversification. The authors concede, however, that investors in the study may have achieved diversification through mutual funds.

What to Do?

Trick question! Do nothing! Establish a long-term asset allocation plan, and rebalance once a year. Trade if it makes sense in terms of your long-term goals, long-term risk tolerance, and long-term view of the long-term market. See a trend here? Sell stocks and funds for tax harvesting; buy inexpensive, passively managed, low-turnover ETFs or mutual funds. If

active mutual fund managers armed with teams of analysts and CFAs can't beat the market through research and timing, do you think you can do it part-time using Yahoo! Finance and Google searches?

Well, honestly, me too. But we're overconfident, remember?

Reaching Retirement: Setting & Staying The Course

The disappearance of traditional pensions, rising health care costs, and longer life expectancies have, more than ever, shifted the burden of retirement to the individual. Providing adequate income for retirement is now the single largest expense most investors will face--a daunting task even for the financially savvy. The following tips are pearls of wisdom from the Vanguard Group. These timeless principles can guide you through your years of retirement saving and investing.

1. Take advantage of "automatic" investment opportunities. Put retirement planning on autopilot by joining an employer-sponsored retirement plan and by taking advantage of automatic investment plans for IRAs, savings accounts, and taxable accounts.

2. Consider your retirement money untouchable. Except in a dire emergency, do not withdraw or borrow money from your retirement accounts. Taxes and penalties are usually imposed on early withdrawals, and worse, your greatest losses will come

"Youth is the time of getting, middle age of improving, and old age of spending."

~Anne Bradstreet

in the form of foregone investment earnings.

3. Don't change your plan because of short-term market moves. While

rebalancing once a year is a good idea, frequent trading can boost your costs. Chasing returns in hot stocks, sectors, and funds is bound to hurt performance in the long run.

4. Expect years with losses. A portfolio with a mix of 80% stocks and 20% bonds scored a negative annual return 21 times between 1926 and 2004. Still, the average annual return was 10%. If you have trouble accepting volatility, consider holding more assets in stable investment options such as bonds and money market funds. Know, however, that lower risk most likely means lower long-term returns.

5. Look for opportunities to increase retirement contributions.

As your income increases and you pay off debt, increase salary deferrals and IRA contributions. Begin to build an

after-tax portfolio, too. Compounding interest means that even incremental increases in savings can have a big impact in the long run.

6. Think in terms of your entire portfolio. Though it is important to periodically review the performance of each fund you hold, your individual investments should not be scrutinized in isolation. Instead, you should consider the distinct role each fund plays within your entire portfolio. Diversification is the name of the game: different securities may outperform and underperform at different times, making it easier to weather fluctuations in the market.

"Don't change your plan because of short-term market moves."

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