3 Ways to Increase Return

without additional investment risk

Avoid Losses

If you want a great return on your money you need to take on more risk. The investment firms on Wall Street have been conditioning the general public to accept this as reality for decades. There is truth to the risk reward relationship. However, there are ways to increase your return without exposing your hard earned assets to additional risk.

We cover three of them here

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Avoid Losses

Preserving Your Future

This seems simple enough. Keep what you earn. Never lose it. Heck, Warren Buffet is famous for his two rules of investing. Rule #1, never lose money. Rule #2, never forget rule number one.

Ok genius, how do I do it? You can't guarantee I will avoid losses when investing, right? Right! I can't guarantee you won't lose money due to investment risk if you invest it. What you can do is prevent loss do to market risk on some of your money.

"But Mark, I won't earn anything if I'm not investing. Interest rates on bank CD's and Savings accounts are paltry." Right again. You are a smart investor!

There are places that bear interest based on an external benchmark. These products are known as indexed products. There are indexed CDs, indexed annuities, and even indexed life insurance contracts. The interest you earn is based on the positive or negative movement of an external benchmark.

For example, many indexed financial products are index linked to the S&P 500 index. Many of them have a floor of 0%. This means that in a year that the S&P 500 declines in value, you earn 0%. Bummer right? On the flip side, you did not lose anything. You preserved your money.

What about when the index is positive? In that case, you earn index linked interest credits. Sounds great, right? Before you get too excited, there are limitations.

You don't earn index interest equal to the entire positive movement of the index. You are limited on how much interest will be credited. That is the trade off for avoiding the potential loss from market risk.

For example, what if your index linked financial product had a 50% participation rate applied to themovement of the index. That means you participate in 50% of the positive movement of the benchmark. What if your product also has a one year crediting period. This means interest is not calculated and credited until the end of a 12 month period. In that case, if the index is positive over the crediting period by 10%, you only get 5%. "That's not fair!," you say. If it were down you would get zero with no loss of your account value or previously credited interest. See the trade offf?

Lets keep this thing rolling. The following year, the index drops by 20%. We've seen this happen in recent history. You get a 0% interest credit that year. You did not lose anything. The next year the index rebounds 20%. What if your participation rate were still 50%? You would get a 10% interest credited to your account. Its credited and cannot be taken away due to market losses.

As you can see, this strategy might be effective for avoiding loss, while still earning a competitive interest rate.

You just have to be OK with not getting all of the upside potential of market-based investments. You don't all of the gain without any of the risk of loss. However, loss avoidance may positively impact your overall rate of return in a volatile economy.

To be fair, you're likely not going to outpace market investments over an extended period of time, say 15 years or more. However, if you have money you cannot afford to lose in the next 10 years because you need it to sustain your retirement lifestyle this is one way to put lower performing assets to work without subjecting them to market risk.

"Rule #1, never lose money."

Minimize Fees & Expenses:

Corrosive On Your Retirement Money

When you invest money, you are going to pay for it. That's a fact. Whether you do it yourself, or whether you hire someone to do it for you, you are going to pay someone.

401(k)s charge fees and have administrative expenses. Commission Broker-managed accounts often contain commission based fees and administrative fees. Even fiduciary investment advisors who are by law required to act in your best interest charge fees for managing your money. The point is that you are going to pay someone for managing your assets.

"Rule #2, never forget rule number one."

-Warren Buffett

Ask yourself questions like, "How much am I paying, and what am I receiving in return?" and "Which of my retirement assets are being charged a fee and which are not?"

Compensating a financial professional, whether it be though commissions earned or fees assessed, for their advice and expertise is perfectly acceptable and reasonable. Paying too much for advice that may not be in your best interest is not.

Every 1% that you pay in fees is one percent less that you keep. If you are paying 2% in fees, and averaging 7.5% in return then you net 5.5%. If you are paying 1.5% in fees and averaging 7.5% you are netting 6%. That may not sound like a big deal. However, compounded over time, the negative impact of fees can really add up!

Ask Yourself:

How much am I paying, and what am I receiving in return?

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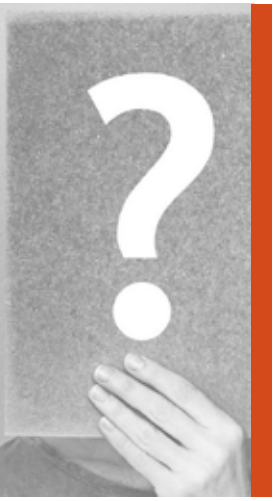

Here's another consideration. Which assets are getting dinged with fees, and which are not? Suppose you have a $250,000 in an old 401(k) at a previous employer. What if the total fees on the account add up to 1.5%. You are paying $3,750 annually on this account. Is anyone from your previous employer advising you on this account? If not, what are you paying for?

Besides the fact you are paying fees on the entire account, what if you wanted some of it to be in a place where you were not subject to market risk. What if you want to earn some interest, like we discussed earlier, based on positive movement of an external benchmark? Remember, that is called index linked interest. Why would you do this? Off course it is to avoid the potential for market-based loss on some of your money.

How would you be impacted working with an advisor who charges a 1.5% fee for advising your on money managed in an investment account, and no fee on money that you place in a loss avoidance strategy? What if decide on splitting $200,000 to a loss avoidance strategy, and $150,000 to a managed account. You pay a 1.5% fee on $150,000, and no fee on the other money. Your fee is $2,250 for the year, and expecting to receive professional advise on what to do with your money. Your fee as a whole on your total retirement assets went down. You keep more of your money.

Mitigate Tax Impact

Preserving Your Future

We've been conditioned to defer taxes. Certified Public Accountants, retirement plan sponsors and their third party administrators, as well as Wall Street firms have been preaching the power of deferring taxes in retirement plans for decades. Even the government encourages tax deferral though their policies and public announcements. It would seem like tax deferred retirement plans are the way to go.

Why are all of these groupings of people championing tax deferral? Think about it. The government permits you to delay paying taxes on some of your retirement assets. Where do you save them? Often they are saved in employer sponsored qualified plans managed by the third party administrator. The money you save goes directly to Wall Street firms to buy their investments. The accountant saves you money during taxes season on last year's taxes. You get a refund, and he looks like a hero. This goes on and on for decades.

Then one day you retire. You stop working and earning a paycheck. You stop contributing to your tax deferred retirement plans. You begin to withdraw money from your tax deferred retirement plan to replace your paycheck.

Think about what happens next. If your investments have done well and you retire with more money than you contributed the government wins. Their share of your deferred taxes also grew. Their share of you retirement account is larger. You took all of the risk.

The third party administrator got paid too. They earned a fee for managing your money, and for providing you advice on how to invest your contributions. They did provide you advise, didn't they?

Wall Street firms received their cut too. The third party administrator invested your money in their mutual funds, stocks, and bonds. The Wall Street firms had the use of your money, and they received a fee for that as well.

It would seem like everyone wins until you make your first distribution from your tax qualified retirement plan. How much will you owe in taxes? I don't know. Neither do you. Your distribution is subject to income tax. No one knows what the taxes rate will be when you need the money.

What if you thought you needed $60,000 per year to maintain your lifestyle? That's what you determined you'd need to spend in order to maintain your lifestyle. Will you have enough money for the year if you withdrawal $60,000 from your tax deferred retirement plan? Not likely. Not after you pay your taxes! You'll need to withdrawal much more.

Taxes are another cancer that will erode your return over time. Different investments are taxed differently. Dividend yield on bonds or preferred stock for example is taxed as regular income.

Taxes are another cancer that will erode your return over time!

Appreciation of securities or real-estate are taxes as capital gains when sold.

The type of account you own may also determine how it is taxed!

To complicate matters, the type of account you own may also determine how it is taxed. For example, an IRA or 401(k) is tax deferred. However, it is also an IOU to the IRS. Taxes will be paid on distributions. They will be paid as regular income. In other words, distributions are taxed as if you had earned a paycheck at yet to be determined tax rates.

Taxes will also impact how much of your social security check you get to keep. If youave too much income generated from tax qualified retirement plans your social security check may get taxed too. Up to 85% of your social security check could be subject to income tax. There's another bite out of your retirement income apple.

Up to 85% of your Social Security check could be subject to income tax.

What if you determine that you don't want to take distributions from your tax deferred retirement plan to avoid social security benefits from taxation. That may not be an option. On your 70 ½ birthday the IRS requires you to begin taking distributions whether you need them or not. RMDs as they are called, must be taken. What if you don't want to? You will be penalized at the rate of 50% of the required distribution for not complying.

Oh no! I almost forgot about how your accountant benefits from all of this. If you think about it, your accountant has job security for years to come. Taxes may be very complicated. You're likely going to need him to assist with juggling all of these distributions from various taxable sources.

Summary

Many Ways To Increase Return

There are many ways to increase the rate of return on your investments. Not all of them require you to take more risk. Prudent planning may result in less risk overall by putting your poorest performing assets to work in a strategy designed to avoid loss while creating the potential to earn index-linked interest. You may also keep more of your money, and give less of it away, when you are sensitive to the impact of high fees on your entire retirement portfolio. Finally planning ahead to mitigate the impact of future taxes in retiring may allow you to keep more of your retirement income and prevent you from writing big checks to the government. These are just some of how you may increase the overall rate of return on your retirement assets without exposing them to additional investment risk.

It's your future. Be involved. Work with professionals acting in your best interest. If you chose to do otherwise, it's no ones fault but your own.

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