

# THE H GROUP, INC.

*The Independent Wealth Management Firm™*

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## THE KELEMEN-WAY FINANCIAL PERSPECTIVE

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## What Do You Want Your Legacy To Be?

As financial planners, we help people with their wealth—accumulating it, growing it, preserving it, and passing it on. As our clients age, they become more concerned with leaving a legacy. All too often, the focus is just upon transferring financial wealth.

But when you stop to think about it, your wealth is much more than just money. It's about who you are, how you got to where you are in life, your values, and your concerns.

As we see it, there are three building blocks of your legacy: 1) Financial wealth, 2) Social wealth—the things you care about, and 3) Personal wealth—your personal values.

When you are gone, what will be your legacy? How will you be remembered? How do you want to be remembered? What continuing impact on others will you make?

### Creating your vision.

Visioning your legacy is not easy. We often find that the legacy our clients would like to leave conflicts with their desire to give everything they own to their children. To guide you in this process, here are some things to think about.

1. Consider each child separately. What are your hopes and fears for that child? What are that child's abilities, dangers and opportunities? If you carefully think this through for each child, it may mean that one child may receive more than a sibling. But remember, equal is not always fair, and fair is not always equal.
2. What is an appropriate inheritance? Ask your children a hypothetical question about what they would do if they received a large sum of money. Try to visualize what you

think they should spend their inheritance on. We have found that quite often, the size of the intended inheritance is far greater than what that child could responsibly spend. As Warren Buffet says, "I want to give my children enough to do anything they want, but no so much that they do nothing." Or as oil baron T. Boone Pickens said, "Never deprive your heirs the satisfaction of earning a paycheck."

3. What do you want your wealth to do for them and others? Provide security? Provide opportunities? Toys? Luxuries? Become sources of discord? The sad fact is that, according to the American Bankers Assn., the average inheritance is spent within 19 months. Do they need it? Could some of your wealth be put to better use helping non-family members through charitable organizations?
4. What organizations have helped you along the way and contributed to your success? To what organizations have you volunteered your time and money? Would a bequest to them make a statement to your heirs about your values and how you lived your life?
5. How can the wealth you leave them be a source for family unity when you are gone? We often recommend a charitable donor advised fund, in which the family members have a reason to get together at least annually to decide grants from the fund to other charities. We would be happy to provide you with more information about donor advised funds.
6. Talk about these issues with your heirs. Let them know your thoughts in these important matters. More importantly, write them down and integrate them into your estate planning documents.

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# Cutting Through the Confusion on Annuities

## Part I—Tax-Deferred Annuities

Annuities have certainly received their fair share of bad publicity in recent years, some of it well deserved. They have been heavily promoted by the financial services representatives in banks, insurance agents, and brokerage firms for a variety of reasons, including commissions, guarantees, and tax benefits. But like any good idea, those that manufacture them, sell them, or buy them can get carried away.

There are two kinds of annuities: tax-deferred and immediate. We'll cover immediate annuities in Part II. At its most basic level, a tax-deferred annuity is an account in which the growth of a lump sum or regular payments into it is tax deferred until withdrawn. The reason the growth is tax deferred is because an annuity is an insurance contract in which there is a small element of life insurance, and thus, the annuities enjoy the same tax-free build up as life insurance policies. The gain over contributions is taxed at ordinary income rates.

### Fixed Annuities

In a fixed annuity, the account is part of the general assets of the insurance company. The company guarantees the principal and pays an interest rate based on its overall investment portfolio. Insurance companies are regulated by the states and are required to invest a substantial majority of their assets into bonds and mortgages. Thus, as a very broad generalization, the interest rates on annuity contracts generally resemble the current interest rates on 30-year mortgages. Because the annuity is part of the insurance company's assets, the guarantee is only good if the company remains solvent. Thus, think twice when tempted by a higher than average rate from "Slippery Rock Insurance Company."

So what is the insurance element? You have the right to convert your contract into an immediate annuity to receive an income stream over your lifetime, regardless of how long you live. We'll discuss this more in Part II.

### Variable Annuities

In a variable annuity, your account is not co-mingled with the assets of the insurance company. You have a variety of portfolios, called sub-accounts, in which to invest the assets of your account. Some companies offer more than 30 sub-account choices, and some of them may include management firms that are not even related to the insurance company, and may even be competitors of the company.

These sub-accounts offer the professional management, diversification, and built-in portfolio management fees similar to mutual funds. Unlike mutual funds, there are no taxable capital gains or dividend distributions because they are not distributed to the account owner. Rather, all investment results increase or decrease the unit value (shares) of the sub-account. This leaves the managers free to make investment decisions without regard to tax consequences, since there are none inside the contract. This also makes automatic portfolio rebalancing a popular feature.

### Fees

Variable annuities are criticized for their higher fees, ranging from 0.4% to 2.25% more than for comparable mutual funds. This can certainly be an investment drag on performance, but they need to be taken into the context of pre-tax and after-tax returns. They were better deals when tax brackets were higher, and before the Federal tax rate on dividends and long-term capital gains were lowered to 15%.

But taxes and fees aren't the only litmus test in evaluating annuities. The extra fees go to pay for certain life insurance benefits in addition to those for fixed annuities. In the past three years, insurance companies have been very creative in adding so-called "living benefits" and more generous death benefits to their contracts, which we will address in the future. However, the main life insurance benefit offered by variable annuities over the years has been to guarantee that upon your death, your designated

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MEET

*Alex Sheppard, MBA*

After nearly a four year search, we are pleased to announce our newest associate, Alex Sheppard. He brings a lot of technical skills to compliment our team approach and gives us the capacity to provide more client service.

Alex grew up in Eugene and spent his junior year in high school as a Rotary exchange student in Brazil. He went on to receive his BA in mathematical economics from Pomona College and later an MBA in Finance from the University of Texas at Austin.

Before joining us, Alex worked four years as an analyst for the Franklin Templeton group of funds, plus briefly with an institutional brokerage firm in Texas and as an intern on the floor of the American Stock Exchange. He also had summer internships with Volvo in Brazil and Percon in France.

A fast learner, he recently passed his Oregon Insurance license exam, is a candidate for the Chartered Financial Analyst Level II exam, and is studying for his CFP® certificate through Boston University's

online program. Like us, he is Series 7 registered with Financial Network and an advisory associate of The H Group, Inc. Unlike us, he is fluent in Portuguese and proficient in French and Spanish.

Alex enjoys reading, playing rugby, tennis, ultimate Frisbee, skiing and golf. We've kept him too busy to enjoy much of those, but he has been learning to find his way around Salem and traveling over recent weekends to weddings and his grad school class reunion.

Alex already does a lot behind the scenes to back us up, and we hope that in the near future he can assist you, too. His main job right now is to get to know each and every one of you, so please feel free to ask for him the next time you call or stop by. What can Alex do for you? He is now responsible for any client-initiated transactions to buy, sell, or exchange stocks, bonds, and mutual funds. He is also responsible for rebalancing portfolios, researching client questions, helping to prepare projections, and—like anyone else of his generation—helping us with our computers.

# ... Annuities

## Part II—Immediate Annuities

This part focuses upon another way to take money out of an annuity contract, through annuitization.

Technically speaking an annuity is a stream of payments over a finite period of time, or over one's life. Pension plan payments are classic examples. Except for public employee retirement plans and Social Security payments, most are fixed payments for life and not indexed for inflation.

Insurance companies also offer immediate annuity payments. In fact, many corporate pension plans purchase an immediate annuity to cover the lifetime payments for a retiree. Because there are the elements of risk associated with when you die, annuities have an insurance component to them. An immediate annuity is just the opposite of a life insurance contract because the company is betting that you will not live for a long time.

When you purchase an immediate annuity, your monthly payment depends upon your life expectancy, gender, and the insurance company's assumptions about interest rates. The older you are, the higher your payments. You receive the most money if you select the life only option and live for a long time. But if you die early, the company keeps the money and "wins." You can hedge this risk by accepting a lower monthly payment with the "joint and survivor" option that would continue payments to your beneficiary if you died early. You could also select a "period certain," say, for 10 years. If you died in year two, your beneficiary would receive payments for eight more years.

Sample Monthly Annuity Payments Per \$100,000 Single Premium

	Life Only	Life With 10-Year Period Certain	Life With 20-Year Period Certain
Male, Age 70	\$712	\$668	\$573
Female Age 70	\$651	\$627	\$562
Joint, Both Age 70	\$569	\$567	\$542

Rather than purchasing an immediate annuity, you could probably invest the money in a prudent asset allocation of mutual funds, take higher monthly distributions than you could with an immediate annuity, and still have money left over when you die. But that depends upon how well you do in the market and when you die. And those cannot be guaranteed.

Besides, it's not the point. **Immediate annuities are designed to provide a guaranteed income and hedge the risk that you may live for a long time.** The insurance company spreads the risk over a large pool of individuals, some of whom may die early to help fund the payments to those who longer.

Within the past three years, a number of studies have been published in various financial planning journals about the effect that annuity payments have upon portfolio survival rates under different withdrawal rates and portfolio allocations. Surprisingly, those retirement portfolios that included both a prudent asset allocation and some money taken "off the table" to purchase a stream of predictable annuity payments generally had a longer "survival rate" than arrangements with more assets initially and no annuity payments. At a reporter's request from the Sunday Wall Street Journal last year, we ran some different scenarios and came to the same conclusion.

With the low implied interest rates of annuities these days, why would that work? The answer lies in market volatility. When you have a source of guaranteed income payments from an annuity contract, pension, or Social Security, you need to withdraw less from your portfolio each month to meet your needs when the markets are down. Because you haven't taken as much out at the market bottom, your portfolio can recover easier than if you relied on your portfolio for all of your income needs.

Immediate annuities can be an important part of retirement income, especially those with longevity genes wanting predictability. But they are not for everyone. Yes, when you die, the money reverts to the insurance company. But this happens every day to people with secure pensions and Social Security, and no one gives it a second thought.

## THE KELEMEN-WAY ADVANTAGE

Ron Kelemen and Mary Way are independent Certified Financial Planner™ certifiants and jointly serve their clients as a team with over 33 years of combined experience. Their fee-based practice focuses on wealth planning and management for professionals, business owners, and retirees. Together, they have developed The Planning Vision Process® and several other unique processes. They are both advisory associates of The H Group, Inc., one of the largest independent fee-based registered investment advisory firms in the Northwest with 18 professionals and over \$400 million under active management. They are also registered with Financial Network Investment Corporation, (unaffiliated with the H Group, Inc.) a national broker-dealer with offices throughout the United States, Member SIPC.

### About Ron Kelemen, CFP®

In practice since 1981, Ron Kelemen, CFP® is a contributing author of the 1998 definitive book on retirement planning: *Ways and Means: Practical Answers from America's Foremost Financial Advisors and Retirement Planning Attorneys*. His other contributory book, *Strictly Business—Planning Strategies for Privately Owned Businesses*, was published in 2002. His next one on retirement and education planning will be published in July 2005. He is President of the Willamette Valley Estate Planning Council, active in mentoring and in several local charities, and is frequently quoted in the national press.

### About Mary Way, CFP®, CPA

Mary Way, CFP®, CPA is a professional team member on Ron's team for 11 years. She is also a non-practicing CPA with 16 years experience in banking, business, and finance. She is active in Salem Rotary, the Financial Planning Section of the Oregon Society of CPAs, The Oregon Financial Planning Association, and The Willamette Valley Estate Planning Council.

The opinions expressed in this newsletter are those of Ron Kelemen, CFP® and Mary Way, CFP®, CPA. They do not necessarily reflect those of The H Group, Inc. or Financial Network. They are general comments that may not be appropriate for every individual. They should not be construed as legal or tax advice. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. All economic information is historical and not indicative of future results.

# Team Update

Well the big news from the whole team since our last issue has been the selection, arrival, and orientation of Alex Sheppard. We decorated and furnished his office then stripped the wallpaper in Mary's office and repainted it. We survived a surprise compliance audit with flying colors. We are also going through a team development process of identifying each member's unique abilities. Thanks to those of you who have helped us with that project.

Lani Moore is now working full time, and that has made a big difference in her ability to help us keep up with all of the additional client activities surrounding tax time. She and her family took an extended road trip to Monterey Bay over the Easter weekend.

Debbie Renggli managed to squeeze in two weekend trips to Washington State. Unfortunately, one of them was for her mother-in-law's funeral. As this goes to press Debbie and Bob are in Paris for a week celebrating their 25th wedding anniversary. How romantic! We'll have to see how calorie neutral it was.

Mary made a presentation for the Leave A Legacy's Estate Planning Forum, entitled "Leaving a Legacy With IRAs And Other Retirement Plans." She has spent a lot of time orienting Alex and helping him reconfigure our software. She and Steve spent a week at Jekyll Island, GA and are looking forward to a week of sailing lessons on Puget Sound in June. She religiously keeps up with her yoga and weight training classes each week.

Ron attended an advanced planning conference in San Diego and his 42nd consecutive Strategic Coach session in Chicago. He was the keynote speaker at the Silverton Hospital Foundation's Annual Morley Society dinner, with a presentation similar to our article on page 1. As President of the Medical Foundation of Marion and Polk Counties, he was involved with bringing Dr. Jane Goodall to Salem for a very successful fundraiser for the Foundation's Med Assist Program. He signed up for next September's Cycle Oregon and has been trying to log some serious miles on weekends. As this goes to press, Ron and Kathy will be in Nevada, MO attending their foreign exchange daughter Feruza's graduation from Cottey College.

## What Do You Want Your Legacy To Be? . . . continued from page 1

7. Between now and when you die, what are the most important things you must do to create your legacy vision? Certainly thinking about the above items and taking action on them should be high on your list. But leaving a legacy while you are still living by positively affecting the lives of others should be a top priority.

So this summer think beyond mere money and your "stuff" in your wealth transfer planning. It's not what you own that counts, it's what you value. Think outside the family box and discuss your vision with others. Your challenge now is to transform your financial and personal success into lasting significance. We would welcome the opportunity to help you with that noble process.



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## Cutting Through the Annuity Confusion . . . continued from page 2

beneficiary will receive the greater of your account value or the amount you invested. Some companies even guarantee that the beneficiary will receive the greater of the amount you invested plus 5% per year, or the account value.

One popular author and financial TV and radio show host conceded, "These benefits might be okay, but only in the unlikely event of death." (Excuse us, but last we checked, death is highly likely for all of us at some time or another, and so are down markets.) Many widows and widowers in 2000-2003 were darn glad to have the annuity death benefit when their spouses died in a down market. These extra death benefit claims placed a huge financial strain on some large companies in 2002, resulting in mergers and takeovers by stronger companies in 2003.

### Withdrawals

How do you get your money out of an annuity? Annuitization is the traditional, but not very common way, which we will discuss that in Part II. The second way is way is to die with the contract in force and have the account transfer to a beneficiary, probate free—and possibly tax-deferred to your spouse. Unless you set it up correctly, the gain is taxed as ordinary income. (We'll discuss proper structuring and unintended consequences in a future issue.) Unlike stocks or mutual funds, there is no step up in basis.

The third way is through withdrawals. If you take money out before age 59 1/2, not only is the gain taxed at ordinary income rates, but also a 10% income tax penalty is applied to the gain. Regardless of your age, most contracts have a declining early surrender charge. On average, they start at 7-8% and decline each year for about 7-8 years. Most companies will permit a 10% free withdrawal of either your purchase payment or the account value.

As you can see, annuities are complex. Just like a prescription drug, they can be over prescribed and misunderstood by the seller and purchaser. They fulfill specific needs, and are not right in all situations. Make sure you know what you're getting, why you are doing it, and then make sure you structure the ownership properly. If you have questions about one you own, we would be happy to review it with you.