# INVESTMENT PRODUCTS

I am assuming you know what these products are and how they work. This section is designed to simply give you my opinion of these products so you can see how my thinking differs from others. If you need more information on how these products work, please contact us.

## 401K PLANS

401k plans sound great in theory. You contribute to them, your employer matches a portion of your contribution, all the money is tax deductible – all of these should result it tremendous profits. The truth is, as anyone that has ever owned a 401k knows, that this doesn’t always result in profits. Much of the time your account grows simply because of your continued contributions. Why? 401ks are almost always tied to mutual funds. Mutual funds follow the buy and hold strategy. Therefore they are dependent on the market going up. As in any investment that follows the buy and hold strategy, it will work but only if you leave it alone long enough (an undefined time period).

What are the negatives of a 401k plan? Limited investment choices. Most 401k plans are tied to a very short list of mutual funds. A list that will rarely allow you to make money when the market is declining. If the market is going to decline 5 times in the next 10 years, don’t count on make any money in your 401k.

Another negative. Although you get a tax deduction for contributing to the plan, you do not get to take any tax losses should the account go down in value. If the account goes down 5 years out of the next 10, and you can’t deduct the losses, then what are you really gaining by deferring taxes on the 5 years it goes up?

Bottom line is that 401k plans are good if your employer makes a decent contribution to them and you keep up systematic contributions. You should still try and move between mutual funds as the markets dictate and definitely move your money into an IRA at the first available opportunity. Some companies allow you to move money out of your 401k and into an IRA once a year. Others will not allow this until you retire or leave the company. Check with your administrator and financial planner to see which is right for you.

## IRAs

IRAs, or Individual Retirement Accounts work very similar to 401k plans. Your money is deferred from taxes until you withdraw it. However, you obtain no employer match. But the good news is your investment choices are unlimited. Therefore you can make money in a down market as you are not limited to mutual funds as your product of choice. However, in today’s tax climate, IRAs are not as attractive as they once were.

IRA gains are deferred until withdrawn and then become taxed at ordinary tax rates. Losses are not really considered as it is assumed you will make money on your IRA. IRA losses are not currently deductible (although they can be in some situations, check with your tax advisor or financial planner). Taxable accounts outside of an IRA can deduct all investment losses, plus long-term gains (those held over 1 year) are taxed at a maximum rate of only 15%. So if you anticipate being in a tax bracket greater than 15%, then you can anticipate your IRA withdrawals being taxed at your higher tax rate.

Let’s assume you are married and making $75,000 a year. This puts you in a 27% tax bracket. IRA withdrawals would be taxed at 27%, while non IRA long-term gains are taxed at 15% (short-term gains would be taxed at 27% also). You would be better off not having your money in an IRA.

## Roth IRA Account

Roth IRAs are IRAs that are made with after tax dollars. This means the tax was paid before contributing to the account. All gains afterward are tax-free. Roth IRAs are definitely a good thing. No minimum withdrawals are ever required and they can be transferred to your heirs for long-term tax-free growth. The only negative about Roth IRAs are that you cannot deduct your losses, but you eliminate taxes on your gains completely. Everyone that can qualify for a Roth IRA should have one. Check with your financial planner or tax advisor for qualification details.

## Annuities

There are several different types of annuities.

Fixed annuities

Equity Indexed Annuities

Variable annuities

## FIXED ANNUITIES

Fixed annuities pay a fixed rate of interest and are not subject to market risk. They work a lot like CDs (that you get from your bank), but you do not pay taxes on the gains until you withdraw the money from your annuity. At that point your money is taxed at ordinary income tax rates.

Since you won’t have any losses, we don’t need to worry about not being able to deduct losses. However, once again, gains are taxed at your ordinary tax bracket as opposed to the 15% maximum capital gains long-term tax rate that taxable investment accounts could provide.

In addition, all fixed annuities carry surrender charges. This means there is a substantial penalty for taking your money out early. Most people are purchasing annuities because they don’t have a real purpose for their money yet, but want it available in case they do. But what happens if they did need to take out their money. They would pay ordinary tax rates on any gains as well as a substantial penalty for the early withdrawal. This usually more than uses up any profits that they ever made on the account to start with!

Interest rates on fixed annuities are usually slightly higher than CDs. Which means right now, the rates they pay are very low. The longer your surrender charge period, the higher your interest rates are likely to be. By tying your money up for long periods of time, if rates were to rise, then you cannot take advantage of the increase in rates. This is called reinvestment risk.

Since most people are purchasing annuities to defer taxes on money they had no real purpose for, fixed annuities do not make much sense. If you did have to access the money, you would give back most or even all of your profits in the form of taxes and surrender charges. Plus with the rates so low, you are barely able to beat the inflation rate as it is. Plus the safety of your money is left up to the financial stability of the insurance company and the Government guarantee funds. If a bunch of insurance companies go broke all at once, do you really believe the government can cover them all?

## Equity Indexed Annuities

These annuities are fixed annuities that offer a twist. The twist is that the interest rate paid is tied to a market index (such as the S&P 500). So if the market goes up, you can make a higher rate of return. However, if the market goes down, you are guaranteed to make a minimum rate of return (usually around 3%).

How do these annuities work in reality. The truth is they work very much like fixed annuities. Your interest rate remains very low for most of the time periods you are invested. Again if you have to take your money out, you will pay surrender charges and taxes on any profits at ordinary income tax rates. Thus eating up most if not all of your profits.

Is it possible the markets could go up? Certainly, but usually when the market goes up, the annuity companies limit the amount you can make (usually somewhere around 12%). So even if the S&P 500 goes up 25%, you would only make 12%. While this is better than the fixed annuity, the average rate over a length of time goes down because you are only earning 3% in the bad years when a fixed annuity might be paying slightly higher. In addition, the expenses on these types of annuities are usually a little bit higher.

Will Equity Indexed Annuities work? Yes, and they actually work a little better than fixed annuities. However, they don’t work particularly well if you have to take your money out. I certainly believe that there are better options.

## Variable Annuities

Variable annuities do not offer a guaranteed rate of interest. Instead your return is based on what the investments you have chosen inside the annuity earn. Usually they are mutual funds tied to the stock or bond markets. This is just like investing in these same mutual funds outside of the annuity except your money is protected from taxes until such time as you take the money out.

When you take the money out, your earnings (earnings only, not your original contribution) will be taxed at ordinary income tax rates. Most variable annuities also come with surrender charges, however there are a few that do not.

Again, I can’t see the advantage of deferring taxes when tax rates right now are so low. The chances are you withdrawing the money in a higher tax bracket than what you would pay now are fairly high. However, if you are investing your money for a very long time period, I can see where a variable annuity (one with no surrender charges) could be an appropriate investment.

The other problem with variable annuities is that they align themselves with mutual funds. There are very few mutual funds and only a small handful of annuities that will allow you to make money should the market go down. If variable annuities are appropriate for your situation, be certain you obtain one of these annuities. Please see my opinion of what I think the market will do over the next twenty years, and you can see how important it is for you to make money in spite of a declining market.

## OTHER FIXED INCOME INVESTMENTS

These would include CDs (Certificate of Deposits as issued by a bank), preferred stocks, bonds, municipal bonds, etc. Any of these could be appropriate for your situation and provide you with adequate income during your retirement years. They do not work well for growth (with the exception of bonds that can work for growth if invested properly) of your account but can provide above average income returns if income is needed to supplement your retirement. A competent financial planner can help you pick out the best investments for your income needs.

We do a great deal of research to find the most appropriate fixed income investments for your situation. Everyone wants the higher rate of return for the least amount of risk. We search diligently to find those opportunities. Most of the time, these opportunities coordinate with our timing program. Fixed income investments are just like any other. They are good at times and present little risk and at times they are very poor and can present a great deal of risk.

Take CDs for example. At times CDs have very low interest rates with little likelihood of rising. Is this a good time to lock your money up in long-term CDs? But at other times, CD rates are rising while long-term rates are very low. Is this a good time to own short-term CDs? Fixed income investments fluctuate in their performance and risk levels just like all other investments and it is important to always be choosing the right ones at the right time.

## MUTUAL FUNDS

If you have read the section [The Trouble With Mutual Funds](http://www.cliftonmyers.com/members/1556919/uploaded/TEXT%20KC%2013.doc) then you know that I am not a big fan of mutual funds. Most are terribly expensive and seldom offer market beating returns. Nevertheless, at times it is appropriate to own a mutual fund. Since there are so many funds, sometimes there may be a fund available that will invest in the proper place when other investments will not work. I will occasionally use a mutual fund in my investment program when I cannot find a comparable exchange traded fund. However, I only use mutual funds that are easy for a market timer to work with. That is, their expenses are low, they don’t carry sales charges, and they are easy to get out of.

## EXCHANGE TRADED FUNDS

These are the wave of the future for index investors. And this is the investment of choice I use in my market timing program. Exchange traded funds work like index mutual funds. They follow a particular index very closely, however they trade like stocks instead of mutual funds. This means that their expenses are considerably lower making these investments the cheapest way to follow a particular market.

For example, if I wanted to invest in gold, I don’t have to go out and actually buy the yellow metal, and then pay storage costs and security costs to protect the investment. Nor do I have to buy gold mining companies. Instead I can buy the gold Exchange Traded Fund. It will provide a rate of return very closely to what owning gold directly will do, all without the expense or the hassle of actually owning gold.

Because these investments trade like stocks, they carry no expenses other than the transaction cost of buying it or selling it.

## OTHER PRODUCTS

There are numerous other products available and space and time keep me from addressing them all here. If other products are appropriate for your situation I will of course consider them. All questions on other products will be addressed on a one on one basis.

As you can see, my view points on IRAs and other retirement plans are different than most other financial advisors. I do not believe IRAs are as appropriate as they used to be. With our current tax environment, it is going to be better for a lot of people to pay their taxes as they go. Most important is choosing the right product for the investment philosophy you wish to follow.