



First Financial Group
NOVEMBER 2007

Financial Times

401 Washington Avenue. Baltimore. MD 21204 (410) 828-5400 Fax: (410) 832-4292

"The road from someday always leads to nowhere." - Anonymous

Bill Gates Got Lucky

(How you can get lucky, too.)

Since the mid-1990s, Bill Gates has held the title of the wealthiest person on the planet. As the CEO and founder of Microsoft, his estimated net worth has at times exceeded \$100 billion, making him the world's first (and only) "centibillionaire."



Born in 1955 to well-to-do parents in Seattle Washington, Gates showed an early interest in mathematics and science. While attending private high school, Gates became captivated by computers. As a result of gaining access to corporate computer systems, Gates, along with classmate Paul Allen, formed a company to write computer programs for payroll services and traffic counting. (At the age of 14, the company earned \$20,000.)

Gates was accepted to Harvard as a pre-law student, but kept pursuing his interest in computers. In 1975, Gates and Allen founded Microsoft, and wrote an operating program for the Altair 8800, one of the first microcomputers. Gates dropped out of Harvard, continued writing programs for personal computers, and in 1980, the company developed an operating system for IBM's new personal computer called MS-DOS. As the market for personal computers took off, Microsoft's MS-DOS program became a best-seller in the PC market. MS-DOS upgrades led to the development of the first Windows operating system in 1983, and in 1990, Windows 3.0 gave Microsoft a breakthrough product that launched the company into the financial stratosphere. In 1995, based on the value of his ownership in Microsoft, *Forbes* calculated Gates to be the richest person in the world.

In 2006, Gates announced that he would be reducing his involvement in Microsoft to pursue philanthropic interests, but would continue to serve as chairman of the company. Gates married in 1994, has three children, and continues to live in the state of Washington.

*Sources include: www.investingvalue.com ("Business Profile" - Bill Gates); www.stockmarketsview.com (Oct. 29, 2007 "Mukesh Amani becomes world's richest man"); www.microsoft.com; www.wikipedia.com.

Here's a nutshell version of the Bill Gates story:

We like to believe that we live in a logical, orderly, cause-and-effect world. For every outcome, there's a clear-cut explanation and a direct connection. And once we understand the cause-and-effect connections, we want to believe that the same results will happen for everyone.

Water boils at 212 degrees, and $2 + 2 = 4$... for *everyone*. But even in hindsight, can we really determine how Bill Gates became the richest person in the world? And if we can, is it something that can be duplicated?

Two widely held perceptions about becoming rich (as opposed to inheriting wealth) are that you need to be smart and you need to work hard. So if being smart and working hard are the keys to making a fortune, then Gates wealth would make him the smartest person in the world, and the hardest working. Is that true? No.

This is not to say that Gates isn't smart. He is. It's not to say that he hasn't worked hard. He has. But the definition of smart is subjective. If he was a contestant on "Jeopardy," Gates might lose because he wasn't up on popular culture, or sports. Even in his field of specialty, it's likely there are several people who know as much or more than Gates about computer programming. As for working hard, a day laborer in a developing country may expend more physical and mental effort than Bill Gates every day, just to make ends meet. So, if Bill Gates doesn't owe his success to working smarter and harder than everyone else, how did he make so much money? Is there some other secret ingredient?

After deliberation and study, here's our conclusion: He got lucky. While much credit is due Bill Gates for having good ideas and following through on them, the biggest factor in his mind-blowing financial success is that he was fortunate enough to be in the right place at the right time.

He was born in the United States, to parents that could afford private education, just as computers were becoming commonplace in business and commerce. Those are just three factors in the Bill Gates story that were entirely beyond personal control. Yet if you changed any one of those variables (or a dozen others in his life), Bill Gates, even with his intelligence and work efforts, wouldn't be the richest person in the world.

Here's an analogy to help explain the interplay of effort and luck. Imagine that Gates applied his intelligence and work to buy a lottery ticket. Other people used their smarts and work to buy a ticket, too. At the end of the 20th century, Bill Gates just happened to have the winning ticket. Call it fate, karma, destiny, random chance, the hand of God, whatever, but the financial rewards that Bill Gates has received far exceed his talent or effort. Like a lot of "success stories," luck played a significant role.

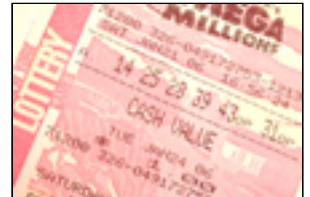
- Protect/insure your assets, including your economic value
- Be vigilant – stay on top of your plans

Some people see the two lotteries as being separate games requiring separate solutions. As a result, they may ignore or overlook some of the actions. An entrepreneur focused on winning big with a business opportunity may take on too much debt, or not bother with insurance. Conversely, some people are so concerned about losses they may shun opportunities for great gain. They might turn down a lucrative job offer, or pass on a chance to buy a discounted property.

But the two lotteries are interrelated. The more you do to stay out of the bad lottery, the more chances you have in the good lottery. And while there are no guarantees of winning big, every good action improves your odds for success, and for avoiding failure.

Planning your Financial Future: Earning Your Luck

The essence of "planning" for your financial future is making decisions that improve your chances for success, while acknowledging that factors beyond your control



may render some decisions irrelevant. This doesn't mean planning your financial future is a futile exercise. Rather, it provides a framework for realistic expectations.

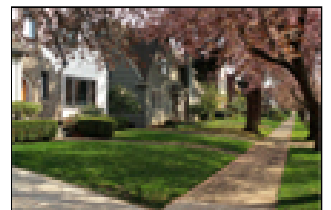
In the face of the uncertainties of life, there is an understandable desire for security and stability. This desire can make people susceptible to promoters of financial vehicles and strategies that promise "no-risk secrets" and "guaranteed results." (When that booklet arrives in the mailbox with the headline "Let me show you the insider's way to capture large profits – guaranteed!" we want to believe there really is a fool-proof formula for great wealth.)

But great wealth isn't achieved through a secret formula. There are no secrets, there are no guarantees. The only practical approach is good financial management, but even the best management can't guarantee great wealth. However, good management will usually result in more opportunities for good fortune.

Returning to the richest person in the world: On one hand, Bill Gates got lucky. On the other, Bill Gates earned his luck. Are your financial decisions putting you in a position to get lucky?

What's At The End of Your Housing Curve?

After air, water, and food, SHELTER is a basic living requirement. Because



Everyone Plays In Two Lotteries

Continuing the lottery analogy, it's accurate to say there are two games of financial chance. The

first lottery is the same one Bill Gates entered. Through certain productive behaviors, you can "buy a ticket" for the chance at **happy financial circumstances**. Although you may not always "win big," at least you are in the game.

The second lottery is one that delivers **financial tragedy**. There's not always a clear-cut cause-and-effect explanation, but some people just end up in the wrong place at the wrong time. They buy investments just as values are dropping, have an accident that wipes out their savings, get downsized out of the best job they ever had. Even the smartest, hardest working people can be overwhelmed by financial bad luck.

Considering the impact that random events can have on your financial life, the realistic goal of any financial strategy should be to give you as many chances as possible in the good lottery, while minimizing your exposure to the bad one.

How to get in the "good" lottery:

- Develop a valuable skill in a field that you enjoy
- Accumulate assets (i.e., Save)
- Find opportunities to be an owner
- Be diligent – stick with your plans

How to stay out of the "bad" lottery:

- Take on minimal, manageable debt
- Discipline your lifestyle – live within your means

it is a necessity, everyone has a “house payment.” It could be rent, or perhaps a mortgage. Even if your house is mortgage-free, there are still ongoing housing expenses – utilities, taxes, repairs and upkeep. The sum total of these costs can vary greatly, depending on the specifics of one’s situation, but in simplest terms, everyone has some sort of a regular, ongoing housing expense.

Conventional financial wisdom says the preferred track is to own your home free and clear by the time you retire – it’s one less monthly bill in retirement, which leaves more available for daily necessities, travel, etc. Having the house paid for makes one aspect of your standard of living fixed, because regardless of what inflation does to the price of other goods and services, your housing cost remains the same – zero.

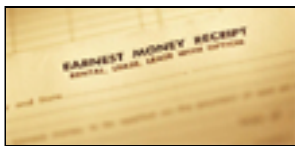
But there are those who would disagree, arguing that the equity in one’s home could be put to better use elsewhere, and that having a mortgage, even in retirement, is a sound financial strategy. As Douglas Andrew says in *Missed Fortune 101*, “Equity is good, but maybe it shouldn’t be all trapped inside the home.”

A 2007 survey of retirees by the Principal Financial Group found that 60% of them owned their home free and clear, that is, there was no mortgage or home equity line of credit as a lien against the property. But what about retirees in the future? A September 19, 2007 article by Jonathan Clements in the *Wall Street Journal* (“Retiring With a Mortgage? Here’s What You Should Do”) notes that the number of retirees with mortgages in retirement is increasing. Will most of them own their homes free and clear? Should they want to?

The “normal” curve of housing costs

The question of whether to pay off the mortgage by retirement comes as a result of a lifetime of housing decisions. The typical retiree (if there is such a person) probably has a housing history that roughly follows this format.

Lease. Just out of college and/or beginning their working life, most individuals have neither the income nor the savings to buy a home. If living with the parents isn’t an option, the typical starting point for housing is to rent.



Buy a “starter home.” At some point, there’s an awareness that a monthly mortgage payment would be about the same cost as renting upgraded living quarters. With a down payment (or assistance from a federal program), a home is secured by taking a mortgage against the property. Now monthly payments begin to build equity.



Trade up. Between making regular payments and



market appreciation, many homeowners find their home equity growing. Perhaps prompted by a growing family, or an increase in earned income, homeowners may consider

using the equity as the down payment on a more expensive property.

Settle in, and use the equity. Career and family hit a



point of stability, and as equity again increases, there are opportunities to use the equity to finance other projects. It might be a refinance to clear up other smaller, higher-interest debts, or a home equity

line of credit to pay education expenses.

Then what?

The kids are out of the house, retirement looms. Between market appreciation and payments, the amount of equity in the house may be substantial. But because of refinancing, the term of the mortgage may still have 15-25 years to pay-off – and the monthly payments may be fairly steep.

In a static world (where everything is certain, and nothing changes), the best scenario would seem to be one in which you own your house free and clear. You wouldn’t have to pay rent or make a monthly mortgage payment to keep your housing, just bear the costs of living in the house/apartment/condo. Psychologically, this is perhaps the most appealing approach for those contemplating life on a fixed income or limited assets.

But who lives in a static world? Even some retirees who are mortgage-free find themselves unable to stay in their homes because rising property values often result in rising property taxes. Combined with increased maintenance expenses, their housing costs have outpaced their retirement income – even without a monthly mortgage obligation.

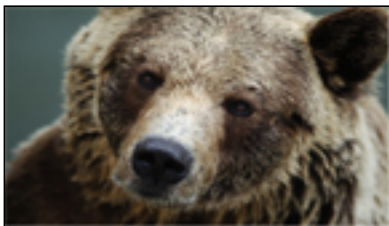
Clements’ acknowledges the conventional reasons why individuals might try to use accumulated savings to pay off their mortgage before retirement, but also says that restructuring an existing mortgage to achieve lower monthly payments may be a better option. In addition, he notes that while senior citizens may have some aversion to taking on a mortgage in retirement, banks don’t feel the same way. If the borrower appears capable of making the monthly payments, age isn’t an issue since the property stands as collateral. Andrew goes further. He argues that home equity is a poor asset because it does not meet his requirements for safety, liquidity and rate of return. For those reasons alone, he would hesitate to convert “good”

assets into home equity – even if it would pay off the mortgage.

The deciding factor in determining whether to pay off your mortgage before retirement probably hinges on what other purpose the “extra money” – i.e., the money used to retire the mortgage – could be used for. In conclusion, there isn’t a hard and financial rule to apply. Rather, individual circumstances will dictate which approach works best.

What is your mortgage strategy? Given the particulars of your situation, are there ways to make it profitable to own your home free and clear, or would your assets be better utilized in a different way?

Those are the types of questions your financial professionals should be able to help you answer! Why not ask them?



RETIRING? BEWARE THE BEAR!

If you are like many Americans with retirement accounts,

you may have placed a big chunk, maybe all, of your savings in the stock market. Statistically, this strategy has made sense for the past two decades, because the stock market has outperformed most other investment options.

Of course, these returns aren’t guaranteed. But the prevailing conventional wisdom states that it’s not what happens in one year that makes or breaks your results. Rather, the thinking is that staying invested in the market over the long-term tends to help neutralize most of the risk, and in the end, provide higher returns. This is the essence of the “buy and hold” strategy: as long as the average rate of return is acceptable, it’s not necessary to fret so much over the performance in one particular year.

A simple mathematical example illustrates this approach:

FIGURE 1 – THE BEAR COMES FIRST

YR	STARTING BALANCE	ANNUAL RETURN	ENDING BALANCE
1	\$100,000	- 5%	\$ 95,000
2	95,000	- 5%	90,250
3	90,250	- 5%	85,738
4	85,738	+ 12%	96,026
5	96,026	+ 12%	107,549
6	107,549	+ 12%	120,455
7	120,455	+ 12%	134,910
8	134,910	+ 15%	155,146
9	155,146	+ 15%	178,418
10	178,418	+ 15%	\$205,181



Starting with \$100,000 in an accumulation account, watch what happens when the investment results are mixed over a ten-year period (Figures 1 and 2).

In the first example, the account owner experiences three consecutive down years (a bear market) losing 5% each year. But the market rebounds, with years 4 through 7 earning 12% annually, and the return rising to 15% for the last three years. The result? The \$100,000 has more than doubled, growing to over \$205,000. This represents an average annual rate of return of approximately 7.5%.

The second example is just the reverse of the first. The bull market years come first, starting with three years of 15% annual returns, followed by four years at 12%, and the negative years come at the end. Take a look at **Figure 2.**

FIGURE 2 – THE BULL LEADS OFF

YR	STARTING BALANCE	ANNUAL RETURN	ENDING BALANCE
1	\$100,000	+15%	\$115,000
2	115,000	+15%	132,250
3	132,250	+15%	152,088
4	152,088	+12%	170,388
5	170,388	+12%	190,779
6	190,779	+12%	213,672
7	213,672	+12%	239,313
8	239,313	- 5%	227,347
9	227,347	- 5%	215,980
10	215,980	- 5%	\$205,181



The accumulation results are the same for both situations. This demonstrates a key concept: **While you are accumulating, the timing of the downturns in the market isn’t critical. It’s the long-term average return that counts.**

But it’s a different story when you decide to start withdrawing the money. Suppose you decide to withdraw \$10,000 each year from the \$100,000 beginning balance. Now, whether you retire into a bear or bull stock market makes a big difference! Here’s the math:

FIGURE 3 – RETIRING INTO THE BEAR

YR	STARTING BALANCE *	ANNUAL RETURN	ENDING BALANCE
1	\$100,000	- 5%	\$85,500
2	85,500	- 5%	71,725
3	71,725	- 5%	58,639
4	58,639	+ 12%	54,475
5	54,475	+ 12%	49,812
6	49,812	+ 12%	44,950
7	44,950	+ 12%	38,741
8	38,741	+ 15%	33,052
9	33,052	+ 15%	26,510
10	26,510	+ 15%	\$18,986



*includes withdrawing \$10,000 a year at the beginning of each year.

Ow! At this rate, you are two years away from going broke. Now compare the results of withdrawing at the start of a series of good years:

FIGURE 4 – DRAWING FROM THE BULL

YR	STARTING BALANCE *	ANNUAL RETURN	ENDING BALANCE
1	\$100,000	+15%	\$103,500
2	103,500	+15%	107,525
3	107,525	+15%	112,154
4	112,154	+12%	114,412
5	114,412	+12%	116,942
6	116,942	+12%	119,775
7	119,775	+12%	122,948
8	122,948	- 5%	107,300
9	107,300	- 5%	92,435
10	92,435	- 5%	\$78,313



*includes withdrawing \$10,000 a year at the beginning of each year.

With a little more than \$78,000 left, you would probably have to adjust your financial plans, but the remaining balance is four times greater than the \$18,000 left in Figure 3!

This is a mathematical exercise. It doesn't take into account a lot of real-world factors that could make the results different than those generated by simple math. But there are some conclusions that can be drawn from the math, even if it's simple.

First, accumulation and spending are not the same, and probably shouldn't use the same strategies. Buy-and-hold may work great as money accumulates, but the results can be less-than-positive when regular liquidations are part of the plan.

Second, avoiding loss has greater significance in retirement. Each losing year hurts because you don't have the time to catch up for the loss.

Third, mathematically projecting future returns from past performance is a risky proposition, especially if the projection uses a flat rate of return each year. It makes a difference in retirement if the bad years come first.

The financial press has just discovered this issue, and it seems like everyone is touting retirement programs that provide "probability scenarios" instead of projected results. Now, instead of providing a number, the computer calculation delivers a probability percentage – for example: if the retiree withdraws a certain amount, the probability of still having money at a date in the future is 40%, while the probability of going broke is 12%, etc.

But while the probability approach is "less wrong" than projecting with a simple number, it's still not right. The probability assessment comes from past numbers. Future performance may be outside the range of previous performance, both positively and negatively. If that happens, the probabilities will be wrong.

The only logical approach is to:

- Make an assessment year-by-year regarding withdrawals.
- Consider guaranteeing some withdrawals by annuitizing some of the funds.
- Use an approach that emphasizes capital preservation, since losses hurt more in the distribution phase.

It's Ba-a-a-ck. The Social Security Problem Returns (Not That It Ever Went Away)

Born in Philadelphia on January 1, 1946 at 12:00:01 am, Kathleen Casey-Kirshling is generally recognized as the first member of the Baby Boom generation. As a 61-year-old, Casey-Kirshling recently merited an article in *USA Today* (Oct. 19, 2007) when she registered to begin receiving Social Security benefits at age 62. And even though the problem never went away, the statistical dilemma that is Social Security is returning to the spotlight.



Most Americans are familiar with the Social Security issue: As the Baby Boomers leave the workforce and begin to draw benefits, a decreasing number of workers (whose taxes provide the funding for benefits) will be required to support an increasing number of retirees. Although the Social Security trust fund has a surplus, this mix of fewer workers and more retirees is estimated to bankrupt the program by 2041. (Medicare, a companion program, is predicted to go broke in 2019.)

Established in 1935, government officials envisioned Social Security as a "comprehensive package of protection" against the "hazards and vicissitudes of life," and for better or worse, many Americans have come to rely on the assistance they receive from Social Security. Consequently, the prospect of a collapse of this program is "the single greatest economic challenge of our era," according to Brian Reidl of the Heritage Foundation.

The mathematical solutions to this dilemma are fairly simple: Reduce benefits or increase taxes. But because either of these options will impact large groups of voters, politicians have been hesitant to make any changes. In

The prospect of a collapse of this program is "the single greatest economic challenge of our era."

fact, the Social Security issue is often called a "third-rail issue" for legislators. (The third rail in a train system is the exposed electrical conductor that carries high voltage power. Stepping on the third rail usually results in electrocution.) The eventual bankruptcy of Social Security has

been an ongoing topic of discussion since the 1960s, but rather than propose any changes, the pragmatic political response has been to leave the hard decisions to future members of Congress.

Well, the time for hard decisions is imminent. Beginning next year, 3.2 million Baby Boomer turn 62, and become eligible for early retirement benefits. Since estimates are that almost 50% of these Boomers will elect

to begin receiving benefits, the necessity for making hard decisions is fast-approaching.

An October 12, 2007 *Washington Post* article titled "Tiptoeing on the Third Rail" indicates some of the 2008 presidential candidates are making Social Security reform a part of their campaign conversations. Among the possible solutions mentioned: increasing the payroll tax for higher incomes, pegging benefit levels to different indices. While promoted as minor "tweaks," each approach is essentially the same raise-taxes-or-reduce-benefits scenario. In recent years, other proposed fixes have included a phased change to a voluntary system, or a switch to private accounts with options for individual investments.

However the Social Security issue plays out, the financial impact will likely be felt by almost every American. But even if your sense of urgency is greater than the politicians, planning in anticipation of future changes is problematic. For example, if the criteria for receiving benefits becomes more needs-based, saving more money might actually diminish your chances of getting anything out of a program you paid into for 30-40 years. While it's better to plan in advance, most Social Security-related planning will have to be flexible.



Material discussed is meant for general illustration and/or informational purposes only and it is not to be construed as tax, legal or investment advice. Although the information has been gathered from sources believed reliable, please note that individual situations can vary, therefore the information should be relied upon when coordinated with individual professional advice.



First Financial Group



Dennis R. Eckels, CLU, ChFC
President
First Financial Group

401 Washington Avenue, Suite 600
Baltimore, MD 21204
(410) 828-5400
(410) 832-4219 (FAX)
deckels@firstfinancialgroup.com

Dennis R. Eckels, Registered Representative and Financial Advisor of Park Avenue Securities LLC (PAS). Securities products/services and advisory services are offered through PAS, a registered broker-dealer and investment advisor. Career Development Manager, The Guardian Life Insurance Company of America (Guardian), New York, New York. PAS is an indirect wholly owned subsidiary of Guardian. First Financial Group is not an affiliate or subsidiary of PAS or Guardian.

PAS is a member of FINRA, SIPC.