



Vol. 2 2007



First Financial Group

Financial Times

Very few people apply a level of accounting to their personal finances that would equal the accounting standards used in managing a small business.

Financial Precision:

Do you need it?



For a lot of Americans, many “big” financial decisions follow this format:

One: “Ooh! I like that!”

Two: “I do too! Do you think we can afford it?”

One: “Well...I dunno. I suppose we could if we cut back on a few things.”

Two: “Like what?”

One: “Oh, I dunno. Y’know, maybe not eat out as much, or come back a few days earlier from visiting your parents at the holidays. Y’know, stuff like that.”

Two: “You never did like my parents, did you?”

One: “I didn’t say that...I just said we could probably afford it if we cut back on a few things.”

Two: “Whatever. So, do you want to get it?”

One: “Uh, I dunno. I guess so. We could at least try. If the bank says yes, why not?”

When it comes to personal finances, most people don’t really know what they’re doing. Oh, they may have a general idea, and if pressed, could probably even deliver the details after a little bit of digging. And most

of their big financial issues (buying a house, saving for retirement, providing college funding for their children, etc.) have probably been addressed in some manner.

Further, many of their decisions may have been based on sound financial principles. But very few people apply a level of accounting to their personal finances that would equal the accounting standards used in managing a small business. They really don’t know what they are doing with their money.

And yet, aren’t your personal finances essentially a “small business?” If so, doesn’t it follow that good “business owners” would strive to increase their profitability through better management? So shouldn’t most people want a higher level of accounting in their personal financial lives? To coin a phrase, shouldn’t they want some “financial precision?”

A Definition of Financial Precision

When you have financial precision, you are able to accurately identify and quantify the important aspects of your financial life. You know how much of your income is spent maintaining your standard of living. You know the price of the “carrying costs” – such as taxes, interest and insurance – that come with your lifestyle. And you know the status of your assets; the equity in your home, the accumulation amounts and rates of return on money in investment accounts, the percentage of your assets that are liquid, etc.

When you have financial precision, you can monitor changes to your financial life as they occur, instead of after the fact. You are able to quickly and accurately assess the impact of proposed changes. Because you can identify both your saving and your spending, you have a much better idea when you can spend and when you should save. With this knowledge, you can regularly check yourself and ask “How am I doing?” – and you can get an answer. →

Two Reasons for Financial Precision

1. It is profitable. The most obvious reason for implementing financial precision is to improve your financial situation. Financial precision makes it easier to make good financial decisions, and better decisions lead to better results – more money, more benefits, more enjoyment.

2. Increased complexity demands it. 50 years ago, the financial options available to the average American were quite limited. Most borrowing options started and ended at the local bank. Few people used credit, and if they did, it was usually in the form of personal agreements with individual merchants. A small fraction of the population held paper assets such as stocks, bonds or mutual funds.

In contrast, today's American has an abundance of choices.

- Besides the conventional 15-, 20- and 30-year fixed mortgages, there are ARMs, interest-only mortgages with balloon payments, and Option mortgages (you choose the type of payment you want to make each month).
- When it comes to transportation, you can lease it or buy it. You can stretch the payments over 72 months, and if you're upside down on this car, you might be able to roll the unpaid balance into the loan agreement on the new car.
- Besides whole life and term policies of various lengths, there are universal and variable policies, some with no-lapse guarantees, not to mention riders for spouses, children, terminal illness and accidental death.

- Mutual funds have multiplied at a pace that makes even rabbits envious.
- And unsecured credit has never been so easy to obtain. Everyone is approved, and no one has to pay for at least six months!

Individually, these potential transactions are not necessarily overwhelming or hard to understand. But taking advantage of all the choices requires keeping track of them too, and that's where things can get out of control. (*"Oh my goodness! I forgot we had to pay off the furniture this month!"*)

3 Common Objections to Financial Precision

Financial precision might be a good idea, but empirical evidence suggests very few people do it for their personal finances. Why not?

1. It isn't necessary. All of us have some required financial accounting in our lives; it's the Internal Revenue Service. Once a year, everyone has to provide a report on their earnings and an assessment of the tax that is due on them. Occasionally, a bank or other lender may require some accounting as part of the loan process.

But the rest of the time, no one really cares if you are financially precise or not. As long as you pay your bills, your creditors don't care. And there are no shareholders in your "small business" that require it.

Finally, if you are doing the right things financially – saving money, avoiding debt, living below your income – the end results should be pretty good. So where's the need for getting obsessive about it?

2. It takes too much time. Considering the →



How Precise Do You Have To Be?

The goal of financial precision isn't to account for every penny, but to account for all the things that really matter. And what really matters will be different for everyone. That said, there are several items that will almost certainly be part of most people's individual accounting. For example:

Gross income: Even if you are a W-2 employee for whom taxes, insurance, retirement contributions, etc. are automatically deducted, you need to understand how much money is being earned (it may also document changes, such as withholding exemptions).

Taxes: This is not only income taxes, but property taxes, and possibly sales taxes. Most people are surprised to see the percentage of earned income that goes to taxes. Knowing this gives a much more realistic assessment of the true economic benefit from raises or increased earnings.

Interest: The total (combined) interest paid on mortgages, auto loans and credit cards can easily exceed 20% of every dollar earned.

Housing and Transportation Costs: Most people know their monthly mortgage and car payment amounts, but what about all the incidental costs, like maintenance, insurance, taxes and licenses?

Medical Expenses: Especially if you are considering a high-deductible plan in combination with an HSA (Health Savings Account), it could be very helpful to have an accurate record of expenses you have incurred.

Hobbies, entertainment and recreational activities: This isn't meant to make you cut back on these activities, but when you get precise, it may be an eye-opener (*"We spent how much on gymnastics?"*)

Wealth Accumulation: From year to year, how much is added to your net worth, either through additional deposits, or appreciation? (The money that gets "saved" for a trip to Disney World doesn't count, but what about the home improvements?)

complexity issues stated above, keeping track of everything could be a very time-consuming (and boring) hobby, if not another full-time job. The principal motivation for improving your current standard of living and saving for the future is to enjoy a better life, not make an accounting job for yourself. If you have to spend all your time getting financially precise, when is there time to enjoy anything?

3. It costs too much. If you don't do it yourself, you'll have to pay someone else to help you with financial precision. That means additional carrying costs – the very things you are trying to eliminate. Especially if you aren't profitable right now, paying someone to clearly define your financial struggle is discouraging.

Three Comments on those Common Objections

1. It might be necessary. People waste money constantly. Most of the time, the consequences aren't dramatic. There are a few late fees, some additional interest, and the emotional stress that comes from feeling like things aren't quite under control. It's aggravating, but tolerable. But sometimes, the result of sloppy oversight in your personal finances can be devastating – wrecked credit, foreclosure, bankruptcy.

Waste or mismanagement of even a single dollar is destructive. Anyone can say, "Hey, it won't make a difference," but no one, not even the richest individual, can guarantee the validity of that statement. When two or three wrong financial decisions can lead to trouble, the best thing to do is not make the first mistake.

2. If you keep it simple, and do it regularly, it doesn't take much time. Most of your financial transactions come with a built-in paper trail. All you really have to do is collect the paper along the way. Save your utility bills, credit card statements and the like. Ask for receipts on cash purchases. If you do this, and also take advantage of comment #3, you can establish a very simple procedure for maintaining financial precision.

3. Good help doesn't have to cost a fortune. Given the right structure, a laptop computer with a financial program is a wonderfully efficient tool for achieving financial precision. As John T. Reed, an investment real estate guru says,

*"If God wanted us to have bookkeepers,
He wouldn't have created Quicken."*

Excepting some unique and complex financial transactions, most of the financial precision you require can be produced by using Quicken or a similar financial program, which takes your raw data and allows it to be sorted according to whatever parameters you require. You input the data, and the program does all the heavy lifting.

The most challenging parts of using a computer program are learning how to use it and how to set the

parameters to reflect your individual situation. But you can get someone else to help you – and it doesn't have to be a CPA. Most of us know a techie – at work, a neighbor, the club – who does this stuff "just for fun." They can help you with the program set-up. After that, simple data entry isn't expensive to hire out.

Better yet, many financial service companies are beginning to make such programs available to their clients, sometimes on a complimentary basis. In that situation, the financial representative may be able to assist you with both the setup and data entry – and easily integrate it with the business you already have with them.

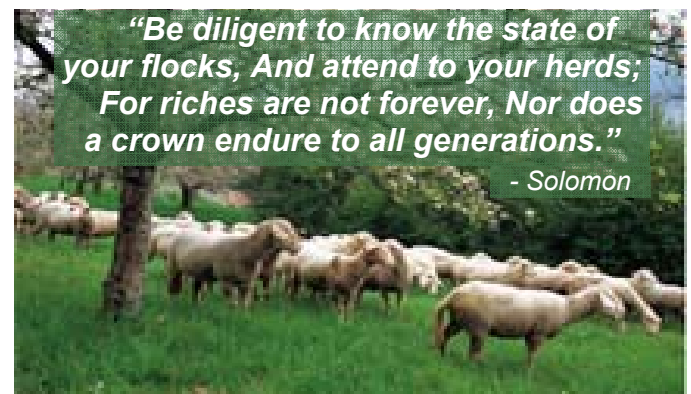
The Final Questions

Financial precision is a good concept. Adding financial precision to your life can mean more increased wealth and decreased financial stress. In some form, everyone can do it, and everyone can benefit from it. The only questions:

Do I need financial precision? Given the particulars of their financial situation (their income, obligations, aspirations) some people aren't going to "make it" unless they get a better grip on their finances. They either can't afford to be sloppy, or they are already suffering from past mistakes. For these people, financial precision is a necessity. It is something they must establish.

If I don't need financial precision, do I want it? Just like some people can eat whatever they want and not gain weight, some people can live undisciplined financial lives and still do okay. For them financial precision isn't a necessity. For them, the reason to pursue financial precision has to be driven by something greater than need.

If you are one of those people, it's worth asking: What would make my financial life better than it is right now? Would it be...retiring earlier, owning a vacation home, traveling more, giving more to charities? Financial precision could be the key that allows you to open the door to possibilities and opportunities that have previously been just beyond your reach.



STATISTICAL ILLUSIONS – PART I



***Stock Market Indicator
Has 80% Accuracy –
And is Completely
Unscientific.***

It was a small article buried on an inside page of the January 23, 2007 edition of the *Wall Street Journal*, so it's safe to assume the information isn't really critical for investors, but the article began with this upbeat announcement...

“Based on Sunday’s football results, stocks should rise in 2007, according to one of Wall Street’s favorite, most accurate (and yes, totally unscientific) indicators.”

This indicator is called the Super Bowl Predictor. If an “original” National Football League team wins the Super Bowl, the Dow Jones Industrial Average (DJIA) will go up. On the other hand, if the winner is a team that joined the league after 1970, the DJIA will fall. In 40 years of Super Bowls, this indicator has been correct 32 times, an accuracy of 80 percent. So...

Since this year’s game featured two “original” teams (the Colts and Bears), the game is “giving us an early signal for bullishness,” says Robert Stovall, a strategist for Wood Asset Management, who according to the WSJ, has “long tracked the indicator.”

PART II

Now That 2002 is Five Years Ago, Our Mutual Fund is Better!

For many mutual-fund managers, 2007 is shaping up to be a much better year, and not just because the Super Bowl Predictor or some other prognosticating calculation says so. In fact, the reason has a lot more to do with the past than any assessment of the future. According to Diya Gullapalli in the January 26, 2007 *Wall Street Journal*:

“2007 marks a milestone that could greatly help their funds: It will have been five long years since the late-2002 bear-market bottom. This means that five-year performance numbers no longer will include the market’s steep slide. Instead, they will capture the market’s upswing since then.”

Even though all mutual fund companies are careful to warn that past performance is no guarantee of future results, five-year return numbers are considered the closest-watched measure of mutual fund performance. For many funds, their 2002 results were so poor that four years of gains couldn't undo the statistical damage.

Kevin Divney, a manager for Putnam New Opportunities Fund, said brokers and financial advisors told him “No one wants to talk to you, because of your five-year number.” In Divney’s case, his fund’s annualized five-year rate of return will change from –4.88% (a negative) to (a positive) 3.9% with the advent of 2007.

This reliance on the five-year average could potentially lead to two false conclusions. The first is that the fund is not a good investment for the future because of its past performance. Especially for new investors, how relevant is one bad year, especially if it happened five years ago?

On the other hand, did this fund suddenly become a better investment option the day its five-year number improved? No. Most likely, no fundamental change occurred; management didn't change its investment objective or strategy. Especially for new investors, the five-year information is almost irrelevant – it's past history, successes or failures that occurred for other shareholders, and has nothing to do with forecasting future results.

And yet, according to Gullapalli, mutual fund companies are reporting a marked increase in calls from brokers and pension consultants. Also, after experiencing cash outflows for several years because of shareholder redemptions, funds are seeing a surge in new deposits.

A Fool-Proof Stock Market Strategy: Save More Money

Charles Farrell is an attorney and financial adviser from Medina, Ohio. Over the past decade, Farrell has authored several articles for professional journals and been frequently quoted in national publications. For the September 23, 2002 issue of *Medical Economics*, Farrell produced an interesting piece on the realities of investing, titled *The Great Stock Market Myth*. Although some of the data for the article could be updated to reflect market performance, Farrell’s conclusions remain the same, and should generate some serious reflection on the part of potential investors.

Farrell begins by stating:

“Financial gurus keep telling us that over the long run, the stock market provides the greatest consistent financial returns, and that long-term returns average 10.7% on an annualized basis. Many investors buy stocks assuming they’ll ultimately earn around that figure.

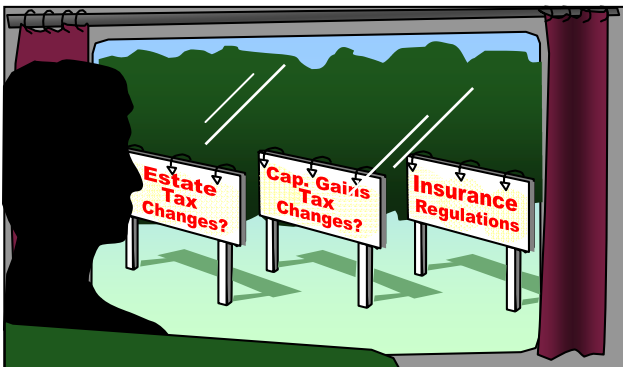
There’s one big problem: It’s a myth.”

Farrell goes on to explain that the annualized long-term rate of returns cited usually covers time periods of 50 to 75 years. But very few (if any) individuals stay →

invested for that long. Given the constantly changing nature of life, a more reasonable investment time period would be perhaps 10 years, maybe even less. And once you start evaluating returns over shorter periods, the results begin to vary greatly. For example, Farrell notes that the annualized rate of return for those invested in the S&P for the 10-year period from 1950-59 was 19.4%, while the 10-year period from 1965-1974 was only 1.2%. For a 10-year period, that's quite a fluctuation.

Since every investor will enter the market at different times, "nobody can tell you whether the next 20 years will produce a 17% return, a 3% return, or something in between. Or even whether your returns will match the average."

Armed with this knowledge, Farrell concludes it is prudent to lower return expectations, consider fixed income investments, and position yourself for a range of possible outcomes. In the end, Farrell notes that **"You should also save more of your paycheck, because of the stock market's potential to under-perform. If the market turns in a lower-than-expected performance, but you've saved more money, you can still end up in the same place. If the market overperforms, terrific! You'll have that much more to live on when you retire."**



The Ever-Changing Landscape of Taxation and Government Regulation

Benjamin Franklin supposedly said life's two certainties were death and taxes. One additional certainty not mentioned by Franklin is that tax laws will change. And in the aftermath of last November's mid-term elections, some financial pundits see tax-law changes as highly likely, if not inevitable. The question is what aspects of the tax code will be "reformed" and to what extent. As David Stertzer, CEO of Association for Advanced Life Underwriting noted in the December 18/25, 2006 issue of *National Underwriter*, "Serious consideration of tax reform is coming, we just don't know when or how."

There are a number of areas where the potential for change in tax treatment could significantly impact the financial services industry. Among them:

The Estate tax – what happens in 2011? The current federal estate tax provisions call for increased exemptions of assets subject to estate tax, culminating with the elimination of the estate tax in 2010. However, the law also states that, barring amendment, these standards will expire and the estate tax will return. The expectation is great that some alternative approach will be enacted before this "sunset provision" takes effect.

Capital Gains Tax. Lowered in the 1997 and 2001 tax changes, some politicians have been pushing for capital gains taxes to at least match the rates of tax applied to ordinary income.

The inside buildup in life insurance policies. According to the Online TaxGuide (www.cbo.gov), the practice of exempting death benefits from taxes and deferring taxes on the inside build-up, dates to the introduction of the income tax in 1913. The only significant modifications were in 1984 and 1988, which regulated the balance between the accumulation and insurance components of policies, but further modification is a topic that regularly pops up in Congressional committee discussions.

Health insurance provisions. In a different article from this issue of the *National Underwriter*, Arthur D. Postal notes that the new Congress "has made no secret of its desire to have the government intervene more directly in healthcare policies and budgets." In particular, many legislators are calling for the government to set prescription drug prices for Medicare participants, along with other measures designed to guarantee medical service for all Americans.

All of these issues highlight how changing tax law and government regulation can impact financial planning. First, it illustrates the need for continually reviewing your current program. Second, whenever taxation or regulation plays a prominent role in selecting a particular financial product or strategy, be sure to ask the question:

"How can I respond if the government changes the rules?"

Evading The Phisher's Hook The IRS Audits - But Never By E-Mail

Phishing scams are attempts to trick people into providing sensitive personal information such as credit card or banking details and Social Security numbers. Once in the possession of this information, criminals may use it to access existing accounts or establish →

new ones under false identities. In the past, phishers used a variety of phone scams, but recently, the Internet has become the preferred mode of contact. In fact, some hackers have by-passed individuals and gone directly to the financial institutions, seeing if they can do “one-stop shopping” for both information and funds. But the ultimate in phishing boldness may be those who use the IRS as a guise for their scam.

A little over a year ago, reports first surfaced of individuals receiving an e-mail with an address such as “admin@IRS.gov” or “tax-refunds@IRS.gov.” The e-mail that followed said the recipient was either being audited by the IRS or was due a refund. The note further instructs the recipient that if a reply to a questionnaire was not made within 48 hours, the recipient faced interest charges and penalties.

In both instances, the e-mail was accompanied by a link to an official-looking web site, one that was identical in appearance to the real IRS site. According to Walter Sorg, an identity-theft expert from DeWitt, MI, “the graphics are perfect.” The questionnaire, of course, asks for the kind of personal information phishers need to execute identity theft. “The e-mails take advantage of our fear of the IRS, hoping you will respond without thinking” says Sorg. “If you respond, you’re hooked.”

The website www.foax-slayer.com notes that since December 2005, the IRS has released several announcements warning citizens of this scam (but how many people read IRS press releases?). According to Sorg, the Treasury Inspector General for Tax Administration says at least 20 off-shore websites are continuing to run this scam in some form or another.

The definitive word from the IRS press release:

The IRS does not ask for personal identifying or financial information via unsolicited e-mail. Additionally, taxpayers do not normally have to complete a special form to obtain a refund.



Do not open any attachments to these e-mails. If you are so inclined, you may forward the suspicious e-mail to: “phishing@IRS.gov.”



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)
Email: dennis_eckels@glic.com

Dennis R. Eckels, Registered Representative and Financial Advisor Park Avenue Securities LLC (PAS). Securities products/services and advisory services are offered through PAS, a registered broker-dealer and investment advisor. Associate General Agent, 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 NASD, SIPC.

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.