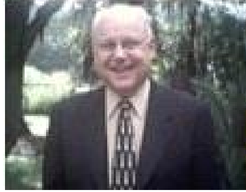

Hank Progar, MBA AIMSafely.com

14547 Whitemoss Terrace | Lakewood Ranch, FL 34202 | (941) 355-4362 | (888) 820-SAVE

The Secret Alternative to CDs

Because I know you value your time, I have packed this report full of alarming and actionable information. Because I believe that you will value my expertise, I respectfully ask that you read it from front to back.

What is this report about anyway?

After interviewing hundreds of people in my practice, I have found that most have a sincere desire to invest their money in the most efficient way, based on their tolerance for risk. What these people don't know are the various options available to them to correctly match their desire for investment returns with their inherent fear of investment losses.

What I found, is that when a client became aware of the various vehicles available for their investment, one type rises to the top, like cream in milk, over and over. What I hope to accomplish in this report is to provide you the answers to the following questions.

1. How do taxes and inflation affect my investment performance,
2. When can an investment return actually cost me money,
3. When is a 5% return better than a 6% return,
4. The safest investment you should never own,
5. What is the magic investment that can solve your darkest fear,
6. How you can invest **tax-free**

Knowing the answers to these six questions will put you miles ahead of your friends and more knowledgeable than many so-called investment professionals. So, unfortunately, we must delve into a little not-so-interesting stuff in order to really grasp the importance of the really exciting ideas later. Without any further ado, let's get going

1. Taxes and inflation—your two worst enemies

Taxes and inflation are the two leading causes of poor investment performance. Even investments that appear to be doing well, once factored for these two hidden expenses, can prove to be poor performers.

Taxes. There are whole books written on this subject. In fact the IRS tax code is over 70,000 pages. Taxes figure greatly into any measure of investment performance, but, very simply, there are really five categories of taxation for investments:

1. Tax on interest
2. Tax on the interest on the interest

3. Tax on capital gains
4. Tax on the provisional income (for those receiving Social Security)

5. Estate tax (minus exclusions)

A person in a high tax-bracket must be exceedingly aware of the impact taxes will have on their investment return. Uncle Sam has a large appetite. Even those of modest means should be aware that taxes can eat a large portion of their investment returns.

Inflation. Over the last forty years, inflation has averaged around 3%-4% per year. Inflation has the subtle quality of eroding your buying power. For example, a loaf of bread that cost $1.00 last year will cost $1.04 this year, due to nothing more than inflation. Unless you are an economist you can't really track inflation—but, you, as a consumer, can feel it in your wallet because everyday items cost more and more. When is the last time you could buy a soda for a quarter or could throw a 7¢ postcard in the mail.

2. When an investment return can cost you money

Seems crazy doesn't it. You can sign up for an investment that pays a 3% return and **yet can lose you money every year.** It's like a bad horror film—you invest your whole life and find out when you retire that your investment won't buy the retirement you planned and, more importantly, **won't last your lifetime!** How can this be? Let's see.

Let's assume that a couple Jane and John Doe are saving for their retirement. They are very concerned for their money so they have $20,000 invested in bank certificates of deposit earning 3%. (That's pretty generous for today's interest rate climate but just watch). John and Jane also have a comfortable income and are in the 28% tax bracket.

So, each year, John and Jane receive from the bank a total of $600 ($20,000 * 3%). They also receive a Form-1099 from the bank on the interest they have earned. Because they are in a 28% tax bracket, that converts to a $168 tax liability. This leaves only $432 return ($600 - $168). Wow, that drops their real return to only 2.16%. But wait! There's more!

We haven't looked at inflation yet. Inflation has run around 3%-4% per year for decades. Let's be generous and assume there's only a 3% inflation rate. At that rate, John and Jane's CD must be worth at least $20,600 next year in order to maintain its buying power. Since, after taxes, it is only worth $20,432, the real return is actually -0.8%.

So, John and Jane are losing money every year. Do the math with your own CDs. How much are you losing? What about the banks? What are they doing with your money? They are investing it. They are effectively borrowing your money from you and paying you a paltry 2-3% interest rate while they invest it making over 16% net return[1]!

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[1] On December 28, 2004, the average Return on Equity for all publicly traded banks was 16.2% according to Yahoo! Financial

Therefore, what most people believe to be the safest, most conservative method of increasing their wealth, over time, is actually a trap, destined to make the *banks wealthy* and *you poor*.

3. When a 5% return is better than a 6% return

Real investment return boils down to what portion of your return you can keep after taxes and expenses, inflation, etc. Let's go back to Jane and John Doe. Let's explore their case once more, except that now, they will earn a 6% return on their CD. Everything else stays the same.

Let's figure out only the tax-adjusted return.

Interest = $1200 ($20,000 * 6%)

Taxes = $336 ($1200 * 28%)

Adjusted return = $864 ($1200 - $336)

Adjusted % return = 4.32% ($864 / $20,000)

Now, let's look at performance of one of the instruments I will explain later.

Interest = $1000 ($20,000 * 5%)

Taxes = $0 (Tax-deferred investment)

Adjusted return = $1000

Adjusted % return = 5%

WOW! I not only beat it, I beat it by a lot (almost 16%)! It's not magic. It's merely the power of tax-deferral. We defer the payment of taxes until we remove the money from the account. Some investment vehicles are more tax-efficient than others. Therefore, even if they don't return as high an interest rate, they outperform those that are not as tax-efficient. If you are not investing in one of these tax-efficient vehicles, your money is not working as hard as it could be.

4. The safest investment you should never own

This type of investment is taxed four out of five possible ways (only mutual funds are more highly taxed). It underperforms the market nine out of ten years. In my opinion, it is the most misunderstood of all investments. Having it in your investment portfolio is almost always a mistake. We've mentioned it several times already in this report—it is the seemingly-innocent bank certificate of deposit.

The Venerable Certificate of Deposit

In my practice, I must be knowledgeable on a number of different topics but I try not to reinvent the wheel. I found the following Certificate of Deposit definition issued by the FDIC and it was frankly too good for me to change it.

A CD [certificate of deposit] is a special type of deposit account with a bank or thrift institution that typically offers a higher rate of interest than a regular savings account. Unlike other investments, CDs feature federal deposit insurance up to $100,000.

Here's how CDs work: When you purchase a CD, you invest a fixed sum of money for fixed period of time – six months, one year, five years, or more – and, in exchange, the issuing bank pays you interest, typically at regular intervals. When you cash in or redeem your CD, you receive the money you originally invested plus any accrued interest. But if you redeem your CD before it matures, you may have to pay an "early withdrawal" penalty or forfeit a portion of the interest you earned.[2]

That is about as good a definition as you'll ever get. The report[2] goes on to caution those considering investing in CDs to beware of the following items:

1. **Find Out When the CD Matures** – As simple as this sounds, *many investors fail to confirm the maturity dates for their CDs and are later shocked to learn that they've tied up their money for* **five, ten, or even twenty years** *(emphasis added).* Before you purchase a CD, ask to see the maturity date in writing.

2. **For Brokered CDs, Identify the Issuer** – Because federal deposit insurance is limited to a total aggregate amount of $100,000 for each depositor in each bank or thrift institution, it is very important that you know which bank or thrift issued your CD. In other words, find out where the deposit broker plans to deposit your money**.** *Also be sure to ask what record-keeping procedures the deposit broker has in place to assure your CD will have federal deposit insurance (emphasis added).*

3. **Investigate Any Call Features** – *Callable CDs give the issuing bank the right to terminate the CD after a set period of time, but they do not give you that same right (emphasis added).* If the bank calls or redeems your CD, you should receive the full amount of your original deposit plus any unpaid accrued interest.

4. **Understand the Difference Between Call Features and Maturity** – *Don't assume that a* "federally insured one-year non-callable" *CD matures in one year (emphasis added).* If you have any doubt, ask the sales representative at your bank or brokerage firm to explain the CD's call features and to confirm when it matures.

5. **Ask Whether the Interest Rate Ever Changes** – If you're considering investing in a variable-rate CD, make sure you understand when and how the rate can change. Some variable-rate CDs feature a "multi-step" or "bonus rate" structure in which interest rates increase or decrease over time according to a pre-set schedule. Other variable-rate CDs pay interest rates that track the performance of a specified market index, such as the S&P 500 or the Dow Jones Industrial Average.

6. **Research Any Penalties for Early Withdrawal** – Be sure to find out how much you'll have to pay if you cash in your CD before maturity.

7. **Ask Whether Your Broker Can Sell Your CD** – Some brokered CDs are issued in the name of the "custodian" or deposit brokers. In some cases, the deposit broker may advertise that the CD does not have a prepayment penalty for early withdrawal. In those cases, the deposit broker will instead try to resell the CD for you if you want to redeem it before maturity. If interest rates have fallen since you purchased your CD and demand is high, you may be able to sell the CD for a profit. But if interest rates have risen, there may be less demand for your lower-yielding CD. That means you may have to sell the CD at a discount and **lose some of your original deposit** *(original emphasis).*

[2] Text is borrowed from the FDIC website

We all know that CDs have four known features:

1. accounts are FDIC-insured,
2. principle is guaranteed,
3. interest is simple and fixed
4. penalty for early withdrawal

When you read the FDIC report, were you as shocked as I was to learn that some CDs are:

1. **not** FDIC insured,
2. **not** guaranteed to return your principle,
3. **not** fixed interest

To paraphrase a successful credit card commercial, "What's in *your* bank CD"?

I included these FDIC caveats to illustrate that the safe, secure, and simple CDs that the banks are selling are really not safe, secure, or simple. As with any investment, *caveat emptor*—let the buyer beware. If you are going to spend the time understanding the complexities of certificates, why not include in your research the truly safe, simple and secure alternatives?

There are two reasons most people purchase CD, 1) the investments are FDIC insured, and 2) they don't know or understand the alternatives. Now, I will admit that insurance, especially a principle-loss guarantee, is a valuable part of any investment, but let me ask you—**does it really matter if the FDIC stands behind an investment that is guaranteed to lose you money every year?**

What if you could get the same guarantees on an investment that has a **positive** return? You would want to know more, wouldn't you?

5. The magic investment that can solve your darkest fear

At retirement, a person switches gears from living off their labor to living off their accumulated wealth. This is a big, scary change. No one knows when they will pass away and the biggest question is sensibly "**Will there be enough money to last me until I die.**"

My clients do not have this worry. They have invested in a retirement instrument that guarantees a lifetime payout of funds, even if the funds in the account have run out! Try that with a certificate of deposit.

There are a thousand and one types of investment opportunities out there, but they can all be sorted into two groups—those that generate income now and those that generate income in the future. But what is the purpose of this income? In 99% of all personal investment, the income is designed to either supplement retirement income or *be* retirement income. Since the common objective of most investment goals is to provide for retirement, **doesn't it make sense that you invest in a vehicle that not only treats your money in a tax-**

efficient manner, but also can provide a life-time of income, free from financial worry?

What is this magic investment? It actually is a class of investments called annuities.

Annuities are financial contracts with an insurance company that are designed to be a source of retirement income. They come in many shapes and sizes, because each type of annuity is designed to give the maximum benefit for different life events. For example: a variable annuity would be a great way to get market-based returns for someone with 10-20 years to let the money grow. A fixed annuity, on the other hand, would be a much better vehicle for those near, at, or beyond retirement who are looking to defer taxes, protect principle, and grow their interest faster than a bank.

Most people have heard of annuities but because they think of them as a "rich persons" product, they have never really looked at what benefits an annuity might hold for them. For example, you can invest in an annuity for as little as $5000. If you set it up as an IRA many companies will work with you for as little as $50-$100 per month. This puts an annuity within the grasp of just about anyone.

Remember those five ways that investments get taxed? Annuities are only taxed one way. However, beyond tax advantages, there are important reasons to invest in an annuity, especially when you consider the limitations of other types of investments. Annuities can provide:

- **Guaranteed income.** An annuity can provide you with a guaranteed lifetime income, regardless of how long you live. No other investment instrument can provide this guarantee.
- **Unlimited contributions.** Unlike other tax-advantaged investments, such as IRAs, you can contribute an unlimited amount of money to an annuity during the year, whether in periodic installments or a lump sum. Individual carriers may place a ceiling on the total amount you may put into an annuity without approval.
- **No risk of loss** ("fixed" annuities). Unlike other forms of stock or fund investments, annuities that are invested in mutual funds or are tied to the stock market performance may include minimum guarantees to limit the amount of investment risk.
- **No-penalty annual withdrawals.** Most annuities have a provision that allows you to withdraw a certain amount per year penalty free.

- **No-penalty rollovers.** Company pension or profit-sharing plan payouts may be reinvested *without* incurring current taxes or penalties.
- **No probate in case of death**, as long as you specify beneficiaries. Which means your family will find it easier and less costly to obtain the value of the annuity.
- **No initial sales charges ("no load") or annual fees.** Annuities are generally no-load, no-fee investments. This means more of your money is actually invested than with investments where some money is used to pay an initial or annual charge.
- **Shelter investment earnings.** Retired people can use annuities to shelter investment earnings that would otherwise lead to taxation of Social Security benefits.

Annuities are far and away the best investment vehicle for lifetime retirement security. If you haven't explored the possibilities, give me a call using the number at the end of this report. I would gladly sit with you for 20 minutes and answer all your questions—free of charge.

6. How you can invest ***tax-free***

This is one of the most misunderstood instruments in the financial industry. I daresay that 50% of the people employed to sell this vehicle don't know its real power. If the salesmen don't understand it, what are the chances that their clients understand it? It has a living benefit as well as a death benefit, much like an annuity. But its power is in the **tax-free** nature of its distributions. Because of the requirements for entering into this instrument, many of you will not qualify. However, it is still valuable to understand that it exists and why it exists.

This special vehicle is established and money contributed periodically, usually monthly or annually. The sums are defined when the account is set up, but the amount of the contribution can be changed at any time. After a period of time, the account is full and the money can either grow with no further additions, or you can continue to contribute, growing the account at an even faster rate. There are restrictions on how much may be contributed to this account, unlike an annuity, but the levels are high enough that most people fall below this threshold.

When you decide to switch from a pay-in phase to a pay-out phase, you borrow the desired amount from your account—**tax-free**. Based on the amount withdrawn, you can typically borrow from this account for 10-15 years before the faucet gets turned off. There are some restrictions to this account, so, although it is the safest form of principle growth, it is by no means appropriate for everyone who qualifies.

The advantages to this account are too numerous to mention but suffice it to say that money grows **tax-deferred** and is taken out **tax-free**. If you would like to learn if you qualify for this account, give me a call using the number at the end of this report. I can

make a preliminary determination within about 20 minutes or so about whether you qualify for this type of account.

7. What now?

We have determined that there are real alternatives to the “safe, secure, and simple” CD. Alternatives that pay more interest, require no yearly tax payments, and ease your worries over whether you will live longer than your money holds out.

In this report, I have purposely limited the discussion to alternatives to CDs as an investment vehicle. But you must know that the investment alternatives available are many and varied and no solution fits every situation. Additionally, steps taken to mitigate risk, specifically life insurance, disability insurance and long-term care insurance, greatly impact the types of investments best suited to you.

To find out if any of the ideas presented here would be beneficial to your situation, I am offering, for a limited time, a **free, no obligation**, financial interview.

Call (352) 690-9574 to set up this interview. ***You have everything to gain and nothing to lose.***

P.S. Other strategies, not detailed in this report, are worth thousands. You really owe it to yourself to hear about these exciting approaches to investing and financial organization.