

The Improved Three-Legged Stool of Financial Security

“The significant problems we face cannot be solved at the same level of thinking that we were at when we created them.” — Albert Einstein

One of the most significant problems Americans face is how to accumulate or preserve enough wealth to maintain their standard of living as they get older. According to a July 2008 study by the Pension Rights Center, half of all Americans age 65 and older have an income of less than \$17,000 per year (that’s the equivalent of \$8.17 per hour in a normal 40-hour work week). They further state that approximately 50% of older Americans receive income from financial assets, but half of those get less than \$1,700 per year. But, it isn’t only modest income earners who face this problem. In fact, the situation for high income retirees may be magnified because they are accustomed to a six-figure lifestyle which they’ll no longer be able to afford as they age out of the workforce. Many Baby Boomers face these issues in part because they relied on the so-called “three-legged stool of retirement.” What is this “stool” and why is it important? Let’s take a look.

THE OLD STOOL

There was a time when the three legs of the retirement stool were Social Security, pensions, and personal savings. But with doubts about Social Security’s continued solvency, the decline of traditional pension plans, and savings rates at or near zero, these legs look a little wobbly. So, what’s the solution?

We believe that paper assets, income producing real estate and ownership in an operating business provide a more stable foundation for achieving your retirement goals. In this issue, we are going to take a detailed look at this improved three-legged strategy for financial security one leg at a time. But first, let’s examine why the old stool doesn’t stand on its own three legs anymore.

Social Security

As you probably know, Social Security is financed primarily through the collection of payroll taxes from which benefits (retirement, survivor and disability) are paid to qualified workers who meet certain age and minimum work requirements. In the late 1950s, there were just over eight workers for each beneficiary. Today, there are approximately three. By 2030, we’ll be down to two. This means that by 2032, benefit payments will exceed the amount of assets needed to cover them. At this rate, Social Security as we know it is not sustainable.

Pensions

For decades corporations offered their employees defined-benefit pension plans that provided retirees with a regular and reliable payment to see them through their golden years. Today, more and more employers have switched to defined-contribution retirement plans (401(k), SEP, Simple, etc.). Some offer both, though many of these have announced a freeze in contributions to their pension plans—typically a precursor to the elimination of the plan. Unfortunately, due to funding shortfalls, state and local pension plans are not faring much better. In fact, in

some cases government employees are actually being asked to make contributions to their pensions.

Personal Savings

Despite recent increases in the savings rate, Americans typically lag behind their counterparts in other developing nations. When we do save, retail banks rarely offer competitive rates of return and the old “buy and hold” model in stocks and bonds has proven not to be a reliable, stand-alone strategy for growing retirement assets. When you add inflation to the mix, it’s clear that the old three-legged stool is no longer a viable solution to achieving long-term financial goals.

THE IMPROVED STOOL

Einstein’s insight can be applied directly to investing, especially when it comes to retirement planning. To paraphrase Einstein, we need a new way of thinking. A new paradigm to solve the problem of wealth accumulation and preservation.

Our solution is a three-legged strategy consisting of approximately equal parts paper assets, income producing real estate and ownership in an operating business. This concept is not new. The Talmud (ancient rabbinic writings on Jewish law and tradition) advises putting one-third of one’s assets in business (buying and selling things), one-third kept liquid (e.g. gold coins), and one-third in land (real estate). As with this venerable formula, each leg of our new model produces income and reacts differently to various economic envi-

In This Issue

- ◆ *The Improved Three-Legged Stool of Financial Security*
- ◆ *D. L. Blain & Co., LLC Launches Radio Show*
- ◆ *Inside the Company and In the News*

continued on page 2

The Improved Three-Legged Stool of Financial Security cont.

ronments. Thus, if an investor is diversified within each leg, the “stool” can provide a healthy, ongoing and increasing stream of income.

When it comes to the new stool, we believe true financial security can only be obtained by an individual in the presence of opportunity. It will not be achieved for you by someone else or some government entity. Certainly, there will always be people who can't make it on their own and will need financial assistance from private sources or public programs like Social Security.

But for many investors, our three-legged strategy can provide a solid base to help them take control of their financial situation and be better equipped to deal with the changes that the future will certainly bring. In forthcoming publications, we will examine specific strategies for investing in these asset classes, but for now we'll limit our examination to the basic types and their general characteristics.

Paper Assets

Paper assets are a category with which most of you have some familiarity. Generally speaking, a paper asset is either an ownership (US, foreign and emerging market stocks, small cap stocks, private equity funds, preferred stock and public REITs) or income producing asset (savings accounts and CDs, Treasury bills and TIPS, municipal bonds, corporate bonds—both foreign and emerging market, agency issues and mortgage-backed securities).

Ownership assets entitle you to a portion of the profits or price appreciation of the investment. Income producing assets are effectively a loan where you have the right to receive a fixed or variable rate of income and your principal back at a future date (some assets have both equity and income characteristics such as preferred stock). Other paper assets include commodities, currencies, options and futures, and hedge funds.

A defining characteristic of paper assets is that they are typically held at a financial services company such as a brokerage firm, bank or mutual fund company. You receive regular statements from the institution outlining your holdings, hence the name. In the old days you actually received a paper certificate as evidence of your ownership, but today your ownership almost exclusively exists in the world of computers and binary code (perhaps we should call them “binary assets”).

There are many vehicles for investing in paper assets such as IRAs, 401(k)s, individual issues, mutual funds and ETFs. There are also a number of companies who can assist you in this endeavor including wire houses, independent broker/dealers and discount brokers, mutual fund companies, banks and independent advisors.

Income-Producing Real Estate

Like paper assets, real estate can be an invaluable asset as part of an overall wealth creation strategy. However, as many investors have found out over the past several years, real estate is not a sure thing and can decline in value quite rapidly. It is not an investment to be entered into lightly, but with careful planning, research and advice it can be quite rewarding.

As an aside, in the past we've discussed what some might consider a controversial opinion, namely, that a home is not an investment, it's just a place to live. After expenses such as mortgage interest, taxes, upkeep, etc., actual returns on homeownership are modest at best. We whole-heartedly endorse buying a house and paying it off at some point, but to have your whole real estate allocation tied up in your principal residence is—in our opinion—a mistake.

The key point to this topic is the phrase “income producing.” Successful real estate investing requires the identification of properties that can be bought at a reasonable value, produce spendable

cash flow each month and appreciate at a nominal rate.

There are situations involving real estate that we would never consider to be “investing.” For example, buying a lot at the beach in the hope that someone will offer you more for the sand than you paid is not investing. Nor is buying a rental property with no money down that doesn't cash flow with an eye toward flipping it sometime in the future for a quick profit. Finally, if you have to sell a property to make a profit, then it really does not qualify as income producing real estate.

Of course, there are benefits of real estate investing that are tax related. For example, ongoing depreciation of the property creates cashless deductions. Also, the ability to do 1031 tax-free exchanges adds to real estate's allure. Finally, the income produced through real estate investment is free from the 15.3% Social Security and Medicare tax that accompanies wage income.

There are many types of properties with the potential of producing income including single family homes, vacation rentals, multi-unit apartments, office buildings, medical facilities and hospitality-related properties. For investors that do not have the time, inclination or money to own physical property, REITs can provide a decent substitute. And, for investors that qualify, a better option is to invest with larger, reputable real estate companies through pooled funds.

continued on page 3

Financial Focus is a publication of D. L. Blain & Co., LLC. All articles and opinions are for general information and not intended to provide specific investment, financial, or tax advice. If you have questions or would like to discuss how these articles may apply to your specific situation, please contact D. L. Blain & Co., LLC. *Financial Focus* is published in both print and email formats. We will gladly send the newsletter in the format you prefer.

The Improved Three-Legged Stool of Financial Security cont.

Ownership in an Operating Business

The final leg of our strategy, ownership in an operating business, refers to ownership in privately held companies not typically traded on organized public exchanges. Private ownership is important because it means the company isn't subject to the vagaries of shareholders or to the volatility of the stock market. Such companies represent a wide variety of business sectors, industries and organizational models. Some of these companies, such as Mars Inc., can be quite large. Others such as a local service station or building supply company can be quite small. But size doesn't matter, success does.

Another important aspect to private ownership in an operating business is that you don't necessarily have to go to work on a daily basis. While you may have some responsibilities within the company, you don't have to show up at an office or workplace everyday in order to generate income. The important thing is that you are ENTITLED to a portion of the ongoing profits of the company. But how do you claim such an entitlement?

Participating as an investor in an operating business is pretty straightforward and typically involves one or more of the following five scenarios: 1) Start the company but no longer have day-to-day responsibility, 2) Inherit stock in a family run enterprise, 3) Buy into an existing company directly or through

friends and/or family, 4) Be a large franchise operator, and/or 5) Participate through a private equity fund.

Now that you know how to invest in an operating business, it's important to understand how to maximize your participation. To fully benefit from such an investment, there are three criteria you must meet. First, the business must be privately owned. Secondly, you must have proximity to and/or influence with the decision makers who run the company (remember you don't have to work at the company). Finally, it's critically important that the business is producing income now. It's not enough just having a chance to sell the business for a profit later.

Conclusion

While each leg of the improved stool for financial security is valid as a stand-alone investment, they are more effective in helping you achieve your long-term financial goals when used in association with each other. But, as with other investments, they are not a magic bullet. Allocation of assets among the three legs requires proper diversification and careful risk management. So,

DID YOU KNOW?: According to T. Rowe Price, in non-US markets you will find 8 of the 10 largest electronic equipment and instrument companies, 8 of the 10 largest metals and mining companies, 7 of the 10 largest automobile companies, 7 of the 10 largest telecommunications companies, and 5 of the 10 largest diversified financial companies.

when we advise our clients on the improved three-legged strategy, we focus on two important factors.

First, we advise our clients to forget the notion that there exists an ideal investment that will grow their money without some type of risk or volatility. There are no investment alternatives with stable, guaranteed principal values that always beat the combined impact of inflation and taxes. There are some investments that do better in the short-term, some that do better in the long-term and some that are relatively safer than others, but no investment is perfectly and perpetually safe.

Secondly, we consider a more global menu of options than some traditional investment strategies. As the US financial markets and economy continue to mature, there will be opportunities for US investors domestically. Further, we believe the US will still lead the world economic recovery in many investment categories. However, we can't and won't ignore non-US markets and the opportunities they present.

In summary, our biggest challenge is to create a balance in your portfolio among the three legs of the improved stool for financial security to ensure you meet your long-term financial goals. And, because the investment environment changes over time, we carefully and constantly monitor and adjust the legs over the life of the portfolio.



D. L. Blain & Co., LLC Launches Radio Show



D. L. Blain & Co., LLC is pleased to announce that David L. Blain, president and chief investment officer, will host a weekly half-hour radio show, *All Things Money with David Blain*, on 94.1

FM WNB� beginning September 10, 2009. The show will focus on wealth management topics such as investing, taxes and real estate. *All Things Money with David Blain* will air each Thursday at 6:30 pm Eastern Time and reach listeners throughout Craven and Carteret counties in Eastern North Carolina. 94.1 FM WNB� is New Bern's

first community radio station featuring a Talk radio format. The station's on air personalities include Glen Beck, Clark Howard, Neal Boortz and Mike Savage. WNB� also features regular newscasts from local NBC affiliate, WITN-TV.

Archived broadcasts of *All Things Money with David Blain* are available on our website at www.dlblain.com.

FINANCIAL FOCUS

D.L. BLAIN & co.
PRIVATE WEALTH MANAGEMENT

Just like no one else...

◆ *Investment Management* ◆ *Wealth Planning* ◆

D. L. Blain & Co., LLC ◆ PO Box 13845 ◆ New Bern, NC 28561 ◆ 252.633.0107 ◆ www.dlblain.com

BUILD • PRESERVE • ENDOW
Wealth Manager

D. L. Blain & Co., LLC was named one of *Wealth Manager* magazine's Top Wealth Managers for 2009. This is the second year in a row the firm has been included in the exclusive survey.

Inside the Company and In the News

D. L. Blain & Co., LLC will be moving into new headquarters during the fall of 2009. The firm recently purchased a suite of offices at 2131 S. Glenburnie Road, New Bern, NC; but will maintain our current telephone, facsimile and P.O. Box. Our new location will enable us to meet with clients and otherwise conduct our business in a more inviting and comfortable atmosphere. There will be no disruption of service during the relocation process. A formal announcement will be forthcoming once a move date is finalized.

D. L. Blain & Co., LLC is pleased to announce that the firm has been named to *Financial Advisor* magazine's fourth annual independent Registered Investment Advisor (RIA) Survey for 2009. *Financial Advisor* annually publishes its survey of the top independent RIAs in the country based on assets under management. D. L. Blain & Co., LLC is one of four North Carolina RIAs—and the only RIA in Eastern North Carolina—to be included in the survey. To be considered for the 2009 RIA survey, firms must be registered investment advisors and provide financial planning and related services to individual clients. All firms must be either independently owned or be a freestanding subsidiary of another business. *Financial Advisor* magazine reaches more than 90,000 qualified readers each month and delivers essential market information and strategies that advisors need to succeed in their increasingly complex environment.

David Blain was profiled in the September 2009 issue of *NAPFA Advisor Magazine*. In the profile, David emphasized risk management as his number one priority in the portfolio construction process. *NAPFA Advisor* is the official journal of the National Association of Personal Financial Advisors. NAPFA is the nation's leading organization dedicated to the advancement of Fee-Only comprehensive financial planning.



Named to *Financial Advisor* Magazine's
Top Registered Independent Advisor Survey
2009