

5 Powerful Strategies for Business Owners Who Want to Build Wealth and Retire on Schedule

As a business owner, part of your retirement plan will probably include your business itself. And as a business owner, you may have already started making some retirement investments outside your business.

These strategies are designed to help you plan for retirement using both your business and those other investments.

Strategy #1: Don't Assume The Sale Of Your Business Will Pay For Retirement

One error that many business owners make is to put all their retirement eggs into one basket. And most often that one basket is their business.

Counting on the sale of your business as your exclusive source for retirement savings is foolhardy, says Sean Cherry, a financial adviser with Financial Asset Management Corp. in West Palm Beach, Fla. "No one company is fail-safe," he says. "You cannot depend on your company. You don't know where it will be when you want to retire."

When you're self-employed you have more choices about when you retire and how to save for retirement. That means no mandatory retirement age unless you set one. And you choose your retirement saving vehicle rather than using the 401(k) plan selected by your employer.

That flexibility is nice, but it also carries a lot of responsibility. It's up to you to design the retirement plan that's right for you and your family.

Make sure you have a written plan for how you're going to sell, liquidate or pass on your business at retirement. Then use this checklist to help you focus on other key retirement strategies:

- Consider an IRS-sanctioned retirement savings program like a Keogh, IRA, SEP, SIMPLE and Solo 401(k).
- Remember that which program you choose can affect your tax situation now and when you're ready to retire.
- Use Asset Allocation to reduce risk and maximize returns on your retirement savings. (See Strategy #4).
- Don't forget about those non-investment essentials like your will, having the right life insurance and long-term health care insurance.

The bottom line: Instead of only depending on the sale of your business to fund your retirement, reduce your risk by exploring all your options.

Strategy #2: Never Make Investment Decisions Based On Emotion

The best way to insure your financial future is for you not to be emotionally involved in your investments. You must be involved, but not emotionally.

The reason is simple. It's because the Market is volatile. And volatility leads emotional investors to make poor choices when it comes to buying and selling. Unfortunately, those poor choices add up to huge losses for many retirement portfolios.

Here's a study that shows how those losses happen:¹

The study compares what investors have done in reaction to movements of the market. Its findings are that investors increase their investments when prices are high in an attempt to participate in market appreciation. Findings also show that withdrawals from investments increase when prices are low as investors seek to limit their losses. Unfortunately the results show that investors earned significantly less than they could have.

- The average equity investor earned a paltry 2.57% annually; compared to inflation of 3.14% and the 12.22% the S & P 500 index earned annually for the last 19 years.

- The average fixed income investor earned 4.24% annually; compared to the long-term government bond index of 11.70%.

Investors are not swayed by major political events. The market is the force driving the behavior to hold equity funds for a little over two years – shorter even than the average for fixed income funds.

Louis S. Harvey DALBAR, Inc

The bottom line: Emotional investing (reacting to the Market) means you actually end up buying high and selling low.

Strategy #3: Take Control Of Costs

Here's an example of how seemingly insignificant costs can drain literally hundreds of thousands of dollars from your portfolio. This example is based on mutual fund operating expenses.²

Who cares if a fund charges 0.6 % a year or 1.3% a year? The difference between the two operating expenses is 0.7%. It's hard for most of us to get fired up over a number like that.

But look what happens when you convert the percentages into dollars:

Let's say you have \$10,000 invested in a fund that earns an average of 8% (the historical norm) on its holdings over a 30 year period. If the fund's operating expense is 0.6% you're actually getting paid 7.4%, so at the end of 30 years you have \$84,570.

But if the fund's operating expense is 1.3%, you're only getting paid 6.7%. You wind up with \$68,957 at the end of 30 years.

The lower operating expense leaves you with almost \$16,000 more cash in your pocket.

The bigger your investment, the more dramatic the numbers. Maybe you're closing in on your retirement goal and, in addition to your other investments you have \$500,000 in mutual funds. If you weren't drawing any money out, the difference between fees of 0.6% and 1.3% would leave you with an additional \$780,000 at the end of 30 years. Now that's a number you can get excited about.

According to Lipper, Inc. the average US mutual fund has an expense ratio of 1.35%. That means for every \$1,000 you have invested, you are paying \$13.50 per year just for the privilege of owning shares in the fund.

But you can find good funds with operating expenses under 1%. In fact, some of the highest-rated mutual funds have expense ratios in the 0.2% range.

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The bottom line: It's tempting to purchase mutual funds as a conservative, buy-and-hold investment and let them sit quietly away somewhere...not really noticing as they slowly gain a few dollars now and then, while fees devour much of your profits.

But over 30 years, a small difference in fees can add up to hundreds of thousands of dollars. Take a few hours to review your portfolio now and that money could be in your pocket instead.

Strategy #4: Plan For Volatility Through Asset Allocation

At least 90% of the return on your long-term investments is determined by asset allocation, which means less than 10% of your return is determined by your choice of individual investments.³

That's a powerful statement. You might want to read it again.

As you probably know, asset allocation is the strategy you use to distribute your total investments into broad categories which include stocks, bonds, cash, real property or natural resources. And it may shock you to think asset allocation will determine 90% of your long-term investment returns.

The following chart shows the effect volatility and negative returns can have on your portfolio. It compares two portfolios that each start with \$100,000. Portfolio A is allocated without regard for volatility. Portfolio B is allocated for maximum return with minimum volatility. Note that even though the average annual return on Portfolio A is higher, the actual value of Portfolio B is greater.

Portfolio A			Portfolio B		
Annual Returns	Value		Annual Returns	Value	
Year 1	15%	\$ 115,000	Year 1	10%	\$ 110,000
Year 2	15%	\$ 132,250	Year 2	10%	\$ 121,000
Year 3	30%	\$ 171,925	Year 3	15%	\$ 139,000
Year 4	80%	\$ 309,465	Year 4	40%	\$ 194,810
Year 5	-35%	\$ 201,152	Year 5	10%	\$ 214,921
Year 6	-10%	\$ 181,036	Year 6	-1%	\$ 212,148
Average Annual Return	15.8%	<u>\$ 181,036</u>	Average Annual Return	14%	<u>\$ 212,148</u>

At the end of 6 years, Portfolio B has \$31,120 more value.

The bottom line: Save yourself a lot of worry and anxiety by focusing most of your energy on where to allocate your assets—not on which specific investment to buy.

Strategy #5: Don't Get Blindsided By Taxes

Even if you manage to keep expense ratios low and sales fees (loads) at zero in your mutual fund portfolio, taxes can siphon off as much as 45% of your fund's before-tax earnings. That means if your fund earns 10% before taxes, you only get 5.5%, minus expenses, of course.

Here's what a Lipper, Inc. report entitled "Taxes in the Mutual Fund Industry" revealed on April 15, 2004:

- Taxes remained the primary drag on mutual fund returns in 2003.
- Over the last ten years, taxable equity and fixed income mutual fund shareholders gave up, on average, approximately 25% and 45%, respectively, of their before-tax returns to Uncle Sam.
- U.S. fund investors lined the government's coffers with an estimated \$6.5 billion in 2003.

The bottom line: Check your fund's turnover rate (the rate at which the fund buys and sells stocks; expressed as a percentage) for the last few years. A high turnover rate almost always means higher taxes.

The same holds true for many of your other investments, as well. Whenever you sell an investment you need to remember that you may be creating a "taxable event."

Bonus Strategy #6: Commit To A Strategy And Stick With It

This is the opposite of being an emotional investor. In fact, you could say this is the only way to be a true investor. Reacting to the market or chasing hot stock tips is pure speculation—also known as gambling.

If you want to take your life savings to Las Vegas and wager it on a few rolls of the dice, that's certainly your prerogative. But many people are doing the exact equivalent of this and they think they're investing.

Here's a comparison between investing and speculation by a well-known financial expert:

"An investment operation is one which, upon thorough analysis promises safety of principal and an adequate return. Operations not meeting these requirements are speculative."

David Graham, *The Intelligent Investor*

The bottom line: Once you have analyzed your unique situation and determined how your portfolio should be allocated, stick with your plan. Failure to do this, i.e. improper asset allocation and buying and selling on a whim, could cost you thousands of dollars.



About Michael Meara and Pacific Mountain Advisors

Michael is founder and President of Pacific Mountain Advisors. After graduating from the University of Missouri with a BA degree in Economics and Political Science, Michael began his career in financial services in 1984 with IDS American Express, the financial planning subsidiary of American Express. In 1990, he formed his own firm, and has been successfully operating his own financial planning business ever since.

Michael has always been active within the local community, serving as President of the St. Louis FPA chapter before moving to Santa Cruz County. He now offers financial literacy programs to area high school students and currently serves as a director for SLV Youth First, a non-profit organization that offers educational and recreational programs to the youth of San Lorenzo Valley. Michael and his wife Regan reside in Boulder Creek with their two sons, Connor and Ian.

Michael founded Pacific Mountain Advisors to operate under these five principles:

1. Put our clients first. We are fee-based planners, which allows us to focus primarily the prosperity of our clients and not on commissions.

2. Design meaningful plans. Our plans will reflect our clients' unique goals and situations and result in expanded possibilities and satisfaction in the present and future.

3. Minimize risk and volatility. PMA's investment discipline will be stewardship that builds wealth and preserves the capital of our clients. We will invest with the minimum amount of risk and volatility necessary to help our clients achieve their financial goals.

4. Collaboration. Our network of trusted advisors is a valuable resource which our clients may choose to use to help implement the various aspects of their wealth management plan.

5. Create a lasting impact. We will seek to create peace in our clients' lives, free from the daily worry that may accompany uncertainty in their financial future. Our clients' financial plans will positively impact their lives as well as the lives of their families and others they care about.

¹QAIB examines real investor returns from equity, fixed income and money market mutual funds from January 1984 through December 2002. The study was originally conducted by DALBAR, Inc. in 1994 and was the first to investigate how mutual fund investors' behavior affects the returns they actually earn.

²52% of US households own mutual funds, according to Investment Company Institute.

³Gary P. Brinson, Brian D. Singer and Gilbert L. Beebower, "Determinants of Portfolio Performance II: An Update," Financial Analysts Journal, May-June 1999.