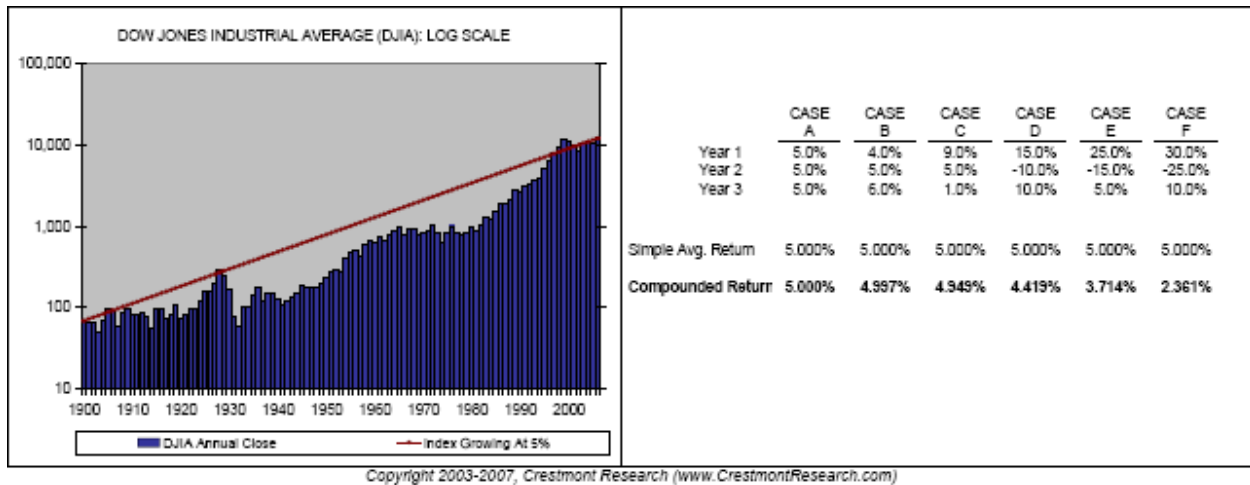


# Investing Secrets of the Wealthy

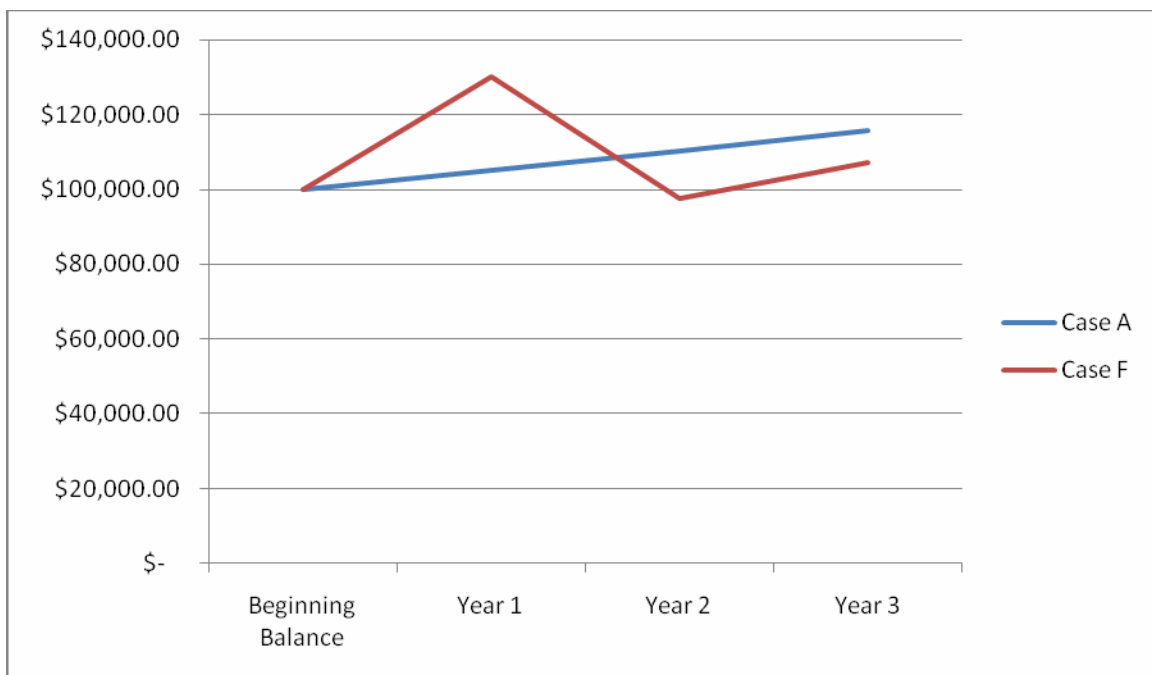
**by Jim Ciurlik, CPA, MBA, CTC**

# 1. Understand the Difference between Average Annual Returns and Compound Average Annual Returns.

A common mistake investors make is assuming a certain rate of return and the impact it has on their portfolio growth. This is illustrated with the chart below:



Upon review, what you'll notice is the effect volatility has on investment returns. In case A and case F the simple average return is 5% (the simple average return is the sum of three years divided by 3). However, here's how \$100,000 would compound over 3 years given both scenarios:



## Investing Secrets of the Wealthy

What you'll also notice in the first chart, is how the Dow Jones Industrial Average has performed over the years 1900 to 2000. In a period many assume stocks grew at a rate of 10% or more, the actual growth rate less dividends was very close to a 5% compound annual return. Because many investment rates of return are calculated on a simple average basis, investors are often over confident in what their portfolio will grow to. Most retirement planning software programs used by financial planners work on this premise; i.e. a simple average return is assumed in the calculation of the growth of a portfolio.

**Big mistake!**

If you don't know what the actual compound rate of return is of your investments, or if you are assuming a high rate of return (perhaps 10% or greater), you are not taking into account the affect volatility of returns will have on the actual growth rate of your investments.

This is the argument for asset class diversification and one of the many reasons high net worth investors utilize alternate asset classes into their portfolios – to attempt to grow assets in as consistent fashion as possible.

## 2. Utilize Regular and Understandable Performance Reporting and Accountability Measures.

Do you have an Investment Policy Statement? If not, do you know what one is?

Do you receive regular Portfolio Performance Reports (not account statements) that clearly measure your performance against the appropriate benchmarks and disclose exactly what you pay for the performance of your investments?

These are important questions that should be: Yes and Yes.

Many great business, political, and spiritual leaders are great at setting goals and holding themselves and others accountable to them. While the average investor may have no clue why this is being brought up, the ultra successful know exactly where this is going.

In order to make good financial decisions it's important to try as best you can to remove emotion from the picture. The only way this can be done is to:

1. Set clear and realistic goals
2. Create meaningful measurement
3. And have defined consequences for failure

Most investors do not even take care of step 1. Thus, there is no meaningful measurement and no defined failures or consequences thereof. Ultimately this leads to all decisions being emotional in nature; a potentially devastating flaw.

Keep in mind that what is being referred to here has nothing to do with what stock to buy or sell. It has everything to do with how you manage people and strategy. And this is how it can be applied successfully:

### **1. To Set Clear and Realistic Goals - Have an Investment Policy Statement**

An Investment Policy Statement (IPS) should contain at least the following information:

- Time horizon for your investment strategy
- Income needs from your investment amount
- Liquidity needs from your investment amount
- Decision making policy for how investments will be made and whom will be involved
- Asset allocation (diversification) model by which your investment should follow
- A provision for how frequently and by what methods your investments will be monitored and reviewed
- Realistic rate of return goal relative to an appropriate benchmark

An IPS should absolutely be recommended by financial advisors and money managers to their clients. Without it, there is no clear communication between client and advisor with regards to

what is expected and how those expectations will be met. **Good leaders and wealthy investors do not blindly trust anyone!**

Investing without an IPS is like driving across a foreign country with no map, no directions and no preferred destination.

## 2. For Meaningful Measurement - Use Purposeful Portfolio Performance Reports

Monthly statements are not adequate for most reporting. High-end private asset management firms to the very wealthy utilize customized performance reports, typically issued at least quarterly. They should contain detailed performance summaries so you know exactly what your rates of return are:

As of: 06/30/07		Since Start Date(\$)	Last Year(\$)	YTD(\$)	Last Qtr(\$)	Selected Period(\$)
<b>Portfolio Value</b>		06/29/06	2006	06/30/07	Q1,2007	06/29/06 - 06/30/07
<b>\$515,203.06</b>						
Beginning Value		0.00	0.00	460,101.79	460,101.79	0.00
Net Contributions		388,038.20	414,010.37	-25,972.17	455,369.94	388,038.20
Change in Value		127,164.86	46,091.42	81,073.44	20,665.86	127,164.86
Ending Value		515,203.06	460,101.79	515,203.06	936,137.59	515,203.06
Investment Return		21.83%	10.86% <sup>e</sup>	10.34%	2.28%	21.83%

And they should contain detailed and simple descriptions of your asset allocation, to ensure your balance is as suggested in the IPS:

Investment Objective		Amount(\$)	Alloc(%)	Asset Type		Amount(\$)	Alloc(%)	
CASH	5,986.13	1.2	BONDS	384.16	0.1	CASH	15,951.23	3.1
CASH OR EQUIVALENTS	9,971.15	1.9	EQUITY	2,440.21	0.5	NON-US STOCKS	36,434.91	7.1
COMMON STOCK	5,666.91	1.1	OTHER	28,060.05	5.4	US STOCKS	431,932.51	83.8
NON-US DEVELOPED	32,843.72	6.3						
NON-US EMERGING MARKETS	5,042.79	1.0						
OTHER	4,000.78	0.8						
UIT - TAXABLE	28,537.87	5.2						
US LARGE CAP CORE EQUITY	47,379.15	9.2						
US LARGE CAP GROWTH	38,743.37	7.5						
US LARGE CAP VALUE EQUITY	130,729.90	25.4						
US MID CAP EQUITY	111,680.13	21.7						
US SMALL CAP EQUITY	98,821.16	18.8						

The reports should also show each holding in each account that makes up your total investment portfolio. This way if you have 1 or 100 accounts, you're always looking at the big picture and can easily identify if you are achieving your goals.

Many firms are hesitant to provide this type of service as it is both expensive to administer as well as revealing of the true results each investor is obtaining. Without this type of reporting, however, it is impossible to make it to step 3 of the process – Accountability.

### **3. For Defined Consequences for Failure – Hire Slow and Fire Fast**

There has never been an argument for why a company should fire slowly. If they did, many would go out of business due to lazy employees, dishonest employees, or simply an economic slowdown. Investors should react no differently if their portfolios are not doing what they were intended to do.

As an example, if your Investment Policy Statement says your time horizon is 3 to 5 years and your rate of return expectation is to exceed that of the S&P 500; you should give your chosen investment plan 3 years to identify whether or not it is reaching the stated goal. If it is not, remember this definition of insanity: To continue to do the same things over and over again and somehow expect different results.

Giving an investment strategy of plan 3 years to perform should be ample enough to determine whether or not it is meeting most investor goals. The exception may be highly illiquid and speculative investments. For most, though, if you are following steps 1 and 2 you will know definitively what to do for step 3. The key is to follow through on your plan, be methodical and do not let emotion interfere with your better judgment.

### 3. Know exactly what you pay for Investment Advice, Financial Planning and Asset Management.

Most people have heard the saying “Don’t believe everything that you read (hear)”. This is absolutely true with regards to investing. Sam Walton, the founder of WalMart was known to watch the expenses of his company very closely. He realized that for every dollar wasted they had to sell the goods in their stores at a higher price to make the same profit (not the Walmart Way). While it’s possible to be so cheap that you truly get what you pay for; it is ludicrous to be making financial decisions with disregard to what they are costing and what you are getting in return.

**For example:**

Many investors work with a broker or financial advisor (which are technically registered securities representatives – but broker/advisor is more marketable). This is normal and acceptable so long as the investor understands what their chosen professional is doing for them, how they get compensated for that activity and whom they actually work for.

A lot of stock/bond/mutual fund brokers are very pleasant and knowledgeable. Some work solely in a brokerage capacity, though, and this means they are not supposed to give advice. They are in fact compensated solely through the transactions they solicit and are not required to represent the clients’ best interest in these transactions. While we all would like to believe they do; it is simply not the case. Often times investments transacted through brokers carry commissions. The commissions are not always fully disclosed and certain transactions will carry continuous fees that are again not fully disclosed. (think Goldman Sachs in 2008)

At the end of the day, if the cost is transactional and the best interest of the transactions are not required to be in the investors favor – a lot of problems can occur and investors should be careful to ask very detailed questions of every cost and exactly how much compensation will be received by the broker prior to agreeing with any transactions.

**Another common pitfall is listening to free advice.**

If you have a financial plan (the multiple pages bound type); how much did you pay for it? Many professional offer these for free as a way to obtain new clients. It’s okay to be skeptical and ask how and when they get paid. Think about how skeptical you’d be if an attorney did your entire estate plan for free? Or if your CPA did your tax returns gratis?

When something is free, it never really is. There must be some motivation for the free advice. Generally speaking it’s because what you just received for free is designed to sell you something for a larger profit. In the car business they call this a slack adjuster. What they do is sell cars at the sticker price, then add on warranties, detailing services, oil changes, etc. - all items that carry larger profit margins for the dealership.

## Investing Secrets of the Wealthy

When someone of significant wealth is looking for a financial plan or investment advice; they fully expect to pay for it. Many of the Nations leading money managers require performance incentives that can drive their annual fees over 10%. Some of these firms require minimum investment of over \$20 million. 1% of \$20 million is \$200,000 per year.

### **Lesson to be learned:**

Anything good has a cost. The cost should be fully disclosed and understandable. Don't be surprised if you own investments right now that have costs you are not aware existed or are higher than you think. Costs are actually a good thing so long as you are receiving an economic that is agreeable with the costs associated.



## 4. Realize that Most Investments are not Good

One of the more common investments is *Loaded* Mutual Funds. As a whole, mutual funds are a great idea and can work very well for most people.

The very rich, don't generally use loaded funds.

Something that a lot of financial people are selling their clients these days is deferred annuities. They come in many varieties and most sound too good to be true.

The most successful money managers – do NOT use them.

And there are countless scams, shams and schemes out there. Again, they sound great – most of the people selling them appear to be honest people.

For some reason, though, we don't hear about people on the Forbes 400 list pouring money in (or falling off the list as a result).

In order for investors to be successful they must understand that most investments average people put their money into are not very good. To think otherwise is foolhardy when considering these facts and article excerpts:

### **John Bogle, founder of Vanguard Funds explains the costs of Mutual Funds**

He was asked by an interviewer with the TV program "Frontline," "What percentage of my net growth is going to fees in a 401(k) plan?" Bogle replied, "Well it's awesome. Let me give you a little longer-term example. An individual who's 20-years old today [is] starting to accumulate for retirement.... That person has about 45 years to go before retirement -- 20 to 65 -- and then, if you believe the actuarial tables, another 20 years to go before death mercifully brings his or her life to a close. So that's 65 years of investing. If you invest \$1,000 at the beginning of that time and earn 8 percent, that \$1,000 will grow...to around \$140,000."

He continued: "Now the financial system -- annuities in this case -- will take about 2.5 percentage points out of that return, so you'll have a net return of 5.5 percent, and your \$1,000 will grow to approximately \$30,000 to you the investor."

"Think about that. That means the financial system put up zero percent of the capital and took zero percent of the risk and got almost 80 percent of the return. And you, the investor in this long time period, an investment lifetime, put up 100 percent of the capital, took 100 percent of the risk, and got only a little bit over 20 percent of the return. That's a financial system that's failing investors because of those costs of financial advice and brokerage, some hidden, some out in plain sight that investors face today. So the system has to be fixed," said Bogle.

In other words, the longer you invest, the more the investment house makes. That's why the financial institutions recommend you invest for the long term.

### **E-Mails Show ING Allowed Market Timing**

*Money Management Executive, 6/15/06*

ING paid a \$1.4 million fine to the NASD for allowing market timing in several of its retirement programs, including the one it runs in its own state of New Hampshire. Regulators made the discovery through company e-mails, where a number of ING employees expressed concern that market timing by a few large clients was hurting returns for long-term shareholders. ING fired a number of employees in 2004 for market timing infractions.

[www.mmexecutive.com](http://www.mmexecutive.com)

### **Ameriprise Pays \$22 Million to Retirees**

*Star Tribune, 5/17/06*

Ameriprise has been ordered by the NASD to pay 32 Exxon Mobil retirees \$22 million. The retirees accused the unit and a broker of fraud, citing breach of contract, unauthorized trading and failure to supervise. A broker was accused of investing the group's retirement funds in risky accounts that paid him commissions. Ameriprise said it plans to appeal the ruling.

[www.startribune.com](http://www.startribune.com)

### **Morgan Stanley Agrees to Pay \$15 Million Fine**

*Yahoo Finance, 5/10/06*

Morgan Stanley & Co. Inc. has agreed to pay a \$15 million civil fine to settle federal regulators' charges that the firm repeatedly failed to provide tens of thousands of e-mails which they sought in several major investigations over prior years. Morgan Stanley has neither admitted nor denied the allegations, but did consent to a permanent injunction against future violations of the securities laws. The \$15 million penalty is among the biggest fines ever levied on a brokerage firm for failing to produce documents.

### **An Annuity for Grandma? Say It Isn't So**

*Wall Street Journal, 3/06/05*

Elderly investors are continuously sold annuities and products that are unsuitable for their needs. Commissions are typically high priorities for salesman over the interest of the investor when it comes to Annuities, specifically variable and deferred annuities. Annuities can be complex, confusing, and misleading to investors who are looking for a stable source of income in their later years.

### **NASD to Take Hard Look at Sales Contests**

*Money Management Executive, 3/23/05*

The NASD is reviewing its policy on sales contests. Contests are commonly used to promote sales but only non-cash rewards are allowed. The current rule allows contests only if they are based on the total production of all securities or all of one type of security. Favoritism towards a company's brand is not allowed. Annuities are a concern for consumer advocates because they argue that the product is inappropriately sold to senior citizens to inflate sales thus creating a conflict of interest.

[www.mmexecutive.com](http://www.mmexecutive.com)

### **LPL, Morgan Hit with Class-Action Annuity Lawsuit**

*Money Management Executive, 1/31/05*

Morgan Stanley and Linsco/Private Ledger failed to disclose fee arrangements they had made with companies. Consumers were unaware that Morgan and LPL were giving preferential treatment to Variable Annuity companies who paid them to produce customers for the annuity companies.

[www.mmexecutive.com](http://www.mmexecutive.com)

### **Morgan Stanley Sued Over Annuities**

*Forbes Magazine, 1/21/05*

A class-action Lawsuit has been taken against the company because of secret payments it received and offered to brokers as incentives to sell variable annuities. This information was not disclosed to investors and is considered abusive. The company denied any wrongdoing.

[www.forbes.com](http://www.forbes.com)

This list could literally go on and on and on. And it's not just the constant barrage of legal problems and questionable sales practices...

### **Consider these performance facts:**

Dalbar Inc., a consulting company, found that during the 16-year period through 2000, the average stock fund returned 14 percent. During that same period, the typical mutual fund investor had a 5.3 percent return. This is due to the fact most investors (self inflicted or broker led) continued to buy high and sell low; ***most likely from chasing funds that performed well in the last year.***

According to Lipper, Inc. Data, as of June 30, 2006 the S&P 500 Index Performed Outperformed Actively Managed Large-Cap Equity Mutual Funds:

- 63.9% the last year
- 67.6% the last 5 years
- 77.9% the last 10 years
- 82.6% the last 20 years (meaning over the past 20 years only 18 of every 100 managers produced better returns than their benchmark)

## 5. Choose the Right Advisor

If you have an investment portfolio of \$250,000 to \$500,000 there are a lot of suitors for your business. If your portfolio is \$500,000 to \$2 million – and the potential managers will line up. If your portfolio is \$2 million or greater; most will practically beg.

So know you are always in the driver's seat even if you don't have an 8 or 9 figure portfolio.

Here's a short list of the professionals that will likely be offering their services to you:

**Bank Money Managers** – Inside the banking industry are thousands of money managers. This would lead one to believe there should be hundreds of very suitable options; but it may be the contrary. Within the industry banks have a historied reputation of paying employees less than industry standards. In a highly competitive and lucrative field – it is hard to attract and retain high quality employees with low paying salaries. Which begs the question: If bank managers were really good, why would they be working for the bank?

**Brokers and Financial Planners** – while on a whole we've found this group to be very likeable and pleasant to work with, there's one obvious reason many wealthy investors look elsewhere for investment management. The reason is most are very talented salespeople and they spend the majority of their time selling, i.e., looking for new clients. Most would agree that the people responsible for managing your money should not consume the majority of their time selling, but instead thinking about how to better manage your money. In order for most brokers and financial planners to earn a good living they must be well trained at managing relationships and selling – there is little time for portfolio management training; even for those who've been in the industry for many, many years.

**Wrap Accounts** – have become very popular among brokers the past few years. In a wrap account, a broker or financial planner recommends money managers for client funds and then focuses on cultivating new relationships and opening new accounts. However, you don't work directly with the money manager and the brokers rarely have personal communication with the managers. Because the money manager doesn't know the end client – the broker ends up making the really important decisions of what markets you should be invested in. If they choose the wrong managers the convenient excuse is to blame the manager and hire a new one; when the reality is most brokers choose managers for the wrong reasons and fail to do due diligence on their clients behalf. At the end of the day, both the broker and the money manager have to be paid, which can lead to above average costs when compared to dealing with just one or the other.

**Private Wealth Management** – this is the preferred method for many wealthy investors. When working with a Private Wealth Management firm, the financial planning and asset management are done at the same location and done exclusively on a fee basis. There are multiple professionals that each have defined responsibilities so getting good service from someone that only does service is not an issue; yet having access to the money manager is also

## Investing Secrets of the Wealthy

available. By having the varying components of the wealth management team in the same location, it is very easy for them to interact and provide a seamless service offering with a high level of customization. The drawback to this type of service is the limited number of clients firms can work with and thus the minimum required investment. Most firms require no less than \$250,000 and many require amounts over \$1 million.

## Investing Secrets of the Wealthy

Dear Reader,

Thank you for taking the time from your schedule to read this report. It brings me great joy to share this type of knowledge and I sincerely hope it is beneficial to you. Over the years I have found many people are very capable of doing better financially; but cannot seem to get over the proverbial hump.

Often times they just need a little motivation, clarity and direction.

With this in mind my firm would be happy to introduce our Private Wealth Management Services to you in a professional and courteous manner.

If you have questions, please do not hesitate to call our offices toll free at 414-688-3553. While we are not always able to accept new clients, we may still be able to provide some analysis and direction.

Thank you again, and may you find much success in all your endeavors.

Regards,

**Jim Ciurlik, CPA, MBA, CTC**  
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*About Jim Ciurlik, CPA, MBA, CTC*

*Since leaving corporate America 14 years ago, Jim Ciurlik has provided business accounting, tax planning and advisory services to self employed entrepreneurs, small businesses and individuals. Jim has extensive experience in corporate and personal tax saving strategies, financial planning for family owned businesses, business purchases and sales, fringe benefits and retirement plan/pension plan selection and installation. He has worked with businesses in virtually all industries, including many personal service providers, the trades, retail and wholesale. He has also worked with individuals in the areas of income tax preparation and planning, retirement planning and IRS representation.*

*Jim's prior corporate experience was with Arthur Anderson, Ernest Young, Miller Brewery, Oscar Mayer and the National Bank of Commerce (bought by Sun Trust). He acquired General Management or ownership experience with a greeting card company, a wine and beer distributor and importer, and three start-up web companies including one consumer package goods company, a printing company and a payment processing company. Before this, Jim spent countless hours as a child in his family's specialty grocery store learning what it takes to run a small business from his parents.*

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