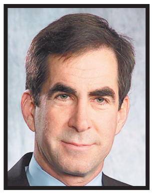
The Colorado Springs
BUSINESS JOURNAL

August 3, 2007

Bad books can make good investment lessons



ALLAN ROTH

There are shelves of books out there that claim to be able to teach us the keys to financial success, and sometimes we can learn the most from books that give us bad advice.

This month's column is about two books that I found gave particularly bad, not to mention dangerous, advice. They are "Missed Fortune 101" and "LEAP (Lifetime Economic Acceleration Process)".

Before writing this column, I discussed the contentions made by these books with Jonathan Clements of The Wall Street Journal. He said that it would be impossible to deconstruct all of the faulty logic in a single column, so I'm only going to tackle a few of their pearls of wisdom.

Pretax retirement plans do not save income taxes. In fact, you end up paying far more in taxes which is just what the government wants.

The logic these books go through truthfully compares the amount of taxes investors would have to pay today if they didn't use an IRA or 401(k) with what they would have to pay decades later after the tax-deferred money has grown.

Naturally, you end up paying far more taxes in the future. The conclusion drawn is that, by following conventional wisdom, you are far worse off because you pay more taxes.

So let's take a closer at that logic, shall we?

For starters, both books confuse the goal of minimizing the taxes you pay with what is a much better goal, maximizing those after-tax dollars you get to keep. Sure, if your retirement portfolio grows to many times its size through the magic of compounding, obviously you'll pay more taxes.

But what seems to have slipped the authors' minds, is that it also leaves you with far more money, even after paying those taxes.

The most expensive way to own a house is with cash. Take out the largest mortgage you can and pay it back slowly.

"Mortgage interest is your friend, not your foe" says one book. They both attempt to prove that a mortgage can accelerate your financial success.

Personally, I think "LEAP" did a superb job of quantifying the quarter million dollar savings the couple who took out a long mortgage made versus the couple that bought with cash. Even the math was absolutely right.

Where the reasoning went astray, was that the assumptions had the mortgage rate at 5 percent and a tax-free return on the use of that money at 7 percent. If I could get a tax-deductible mortgage at 5 percent and turn around and get a guaranteed tax-free 7 percent return, I'd max out my mortgage and burn rubber to the nearest broker!

Unfortunately, the reality is that if banks could get tax-free returns of 7 percent with less risk, they wouldn't lend you the money at 5 percent, and have to pay taxes on it. The banks sort of want to make some money, too.

The solution is to take all the cash you freed up in the first two recommendations above and buy permanent insurance products.

Once you've amassed this pile of cash from stopping your retirement plan contributions and maximizing your mortgage, what should you do with it?

Well, "LEAP" is partial to whole-life insurance as a vehicle to systematically accelerate wealth. In fact, according to this book, everyone should own life insurance, whether they need it or not.

"Missed Fortune 101" on the other hand is bullish about something called Universal Life Equity Indexed Annuities. This book professes that, if structured properly, they can give you an incredibly high return.

Lest anyone think I'm anti-insurance, I'm all for buying insurance for something you can't afford to lose. What both books conveniently leave out, however, is the fact that insurance companies, just like banks, are in it to make money.

Neither mentions that these insurance companies have to pay you less than what they make on their investments, less commissions, costs, and profits.

One more thing these books have in common

You might be wondering how I got these books. Well, each was given to me by a financial planner who tried to sell a client permanent insurance they didn't need.

See, some planners love this stuff because it works for them, though not necessarily for their clients. And what's not to love? If you're the planner, I mean.

By maximizing the client's cash to buy permanent insurance, advisers can truly accelerate their own lifetime financial success.

Believing that banks and insurance companies exist to give you money is a myth only slightly more logical than believing in the Tooth Fairy. If you want to maximize your nest egg, then my advice is to start by not making other people rich.

Put as much as you can in your tax-advantaged retirement accounts and work toward paying off your mortgage. Buy only the insurance you need and make sure it's low-cost term insurance.

I can't stress enough the importance of doing your investing directly rather than buying through insurance products. As I said earlier, bad books such as these can be very helpful — as doorstops.

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Faulty Advice

Advice From These Books	Why The Advice is Wrong
Putting money in 401(k)s increases your tax bill — don't do it.	A better goal is increasing your after-tax dollars. Tax-deferred vehicles do just that.
Take out the largest mortgage you can and pay it back slowly — interest is your friend, not your foe.	Banks lend you money to make money. The more you give them, the less for you.
Buy permanent insurance, whether you need it or not.	How can buying a product you don't need that takes away most of your real return make you rich?

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