



JML Financial Group, Inc.

Protect • Invest • Achieve

June 2010

FINANCIAL DEFENSE

With the turbulence in the economy over the past several years, many Americans were compelled to reevaluate their financial positions. Instead of maximizing retirement account contributions, pursuing high-flying investment returns, and leveraging equity to “trade up,” there is now a greater emphasis on the preservation of wealth. For a lot of people, their new financial priorities have become defensive: to keep their job, their home, and their retirement.

Preservation of wealth has always been an integral part of sound financial thinking. In this issue, several “defensive” strategies are discussed. While these items may not specifically address some of your wealth preservation issues, the underlying concepts should provide insight and perhaps prompt you to reevaluate your wealth preservation activities.

ACCELERATED DEBT PAYOFF

From 15 years to 18 months (but maybe 20 months is better)



A year-end report from The Federal Reserve found that credit card debt had been declining for 14 consecutive months. Revolving credit, the majority of which is credit card debt, decreased at an annual rate of 18.5% in November, 2009, the largest percentage drop ever recorded. After years of amassing higher levels of unsecured debt, many

Americans have decided it's time to stop paying high interest rates and get their financial houses in order.

One option recommended frequently in the financial press is to divert some or all of the dollars previously earmarked for saving and investing to now pay down debt. For these “experts,” paying off debt is equivalent to earning the interest rate charged – “when you pay off a credit card that charges 16% interest it's like earning 16% guaranteed.” Is this true? Are accelerated debt payments really the equivalent to high rates of return?

To begin this assessment of accelerated debt payments, let's look at the minimum-payment terms offered by a typical credit-card provider. Assume the following scenario:

- An \$8,000 credit card balance.
- An annual interest rate of 16%, compounded monthly.
- A minimum monthly payment equal to 3% of the outstanding balance, with a minimum payment of \$25.

Note: These payment terms are typical (although many credit card companies compound interest daily instead of monthly), and according to the April 30, 2010 report from Credit Card Monitor, the national average credit card interest rate was 16.74%.

In a minimum-payment program, here are the first 5 months of a schedule of payments, assuming no new purchases are made:

PLAN A: MIN. MONTHLY PAYMENT (Int. Rate 16%)				
Month	Beginning Balance	Monthly Payment	Interest Charge	Remaining Balance
1	\$8,000.00	\$240.00	\$103.47	\$7,863.47
2	\$7,863.47	\$235.90	\$101.70	\$7,729.26
3	\$7,729.26	\$231.88	\$99.97	\$7,597.35
4	\$7,597.35	\$227.92	\$98.26	\$7,467.69
5	\$7,467.69	\$224.03	\$96.58	\$7,340.24

Since the minimum payment decreases as the balance diminishes, the time it takes to fully repay the debt will be lengthy. How long? The final payment is made in the 175th month, which is slightly more than **14½ years!**

Even though the monthly payment goes down each month, paying the minimum payment for almost 15 years hardly qualifies as “speedy” debt reduction. Suppose you take the first month's **minimum payment of \$240** and **keep paying it every month** (see Plan B). This reduces the payoff period to 44 months. Here are the last five months of this amortization schedule:

PLAN B: \$240/mo. PAYMENTS (Int. Rate 16%)				
Month	Beginning Balance	Monthly Payment	Interest Charge	Remaining Balance
40	\$1,075.12	\$240.00	\$11.13	\$846.25
41	\$846.25	\$240.00	\$8.08	\$614.34
42	\$614.34	\$240.00	\$4.99	\$379.33
43	\$379.33	\$240.00	\$1.86	\$141.19
44	\$141.19	\$141.19	\$0.00	\$0.00

Paying off the credit card balance in 44 months is better than 175, but continuing to make today's minimum payment (while not adding additional debt to the account) isn't really accelerated debt reduction. Suppose you decide to pay extra dollars, perhaps a portion of what had been previously allocated for saving or investment. For simple calculation, let's add another \$260 each month to equal a \$500/mo. payment. Here's the math for Plan C:

PLAN C: \$500/mo. PAYMENTS				
<i>(Int. Rate 16%)</i>				
Month	Beginning Balance	Monthly Payment	Interest Charge	Remaining Balance
1	\$8,000.00	\$500.00	\$100.00	\$7,600.00
2	\$7,600.00	\$500.00	\$94.67	\$7,194.67
3	\$7,194.67	\$500.00	\$89.26	\$6,783.93
4	\$6,783.93	\$500.00	\$83.79	\$6,367.71
5	\$6,367.71	\$500.00	\$78.24	\$5,945.95
6	\$5,945.95	\$500.00	\$72.61	\$5,518.56
7	\$5,518.56	\$500.00	\$66.91	\$5,085.48
8	\$5,085.48	\$500.00	\$61.14	\$4,646.62
9	\$4,646.62	\$500.00	\$55.29	\$4,201.91
10	\$4,201.91	\$500.00	\$49.36	\$3,751.26
11	\$3,751.26	\$500.00	\$43.35	\$3,294.61
12	\$3,294.61	\$500.00	\$37.26	\$2,831.88
13	\$2,831.88	\$500.00	\$31.09	\$2,362.97
14	\$2,362.97	\$500.00	\$24.84	\$1,887.81
15	\$1,887.81	\$500.00	\$18.50	\$1,406.31
16	\$1,406.31	\$500.00	\$12.08	\$918.40
17	\$918.40	\$500.00	\$5.58	\$423.97
18	\$423.97	\$423.97	\$0.00	\$0.00

The numbers tell a simple story: **Extra payments dramatically reduce the time to fully repay the credit card obligation.** In the example, making extra payments changed the payoff period to 18 months from 175. This plan also significantly reduces the overall interest cost of the debt. In the minimum-payment scenario, the total payments are \$13,687.29 (\$5,687.29 is interest). In contrast, the total payments for the \$500/mo. plan are just \$8,923.97, an interest savings of \$4,763.32.

Mathematically, an accelerated paydown – assuming you have the resources to implement it – seems like a no-brainer. But wait, there's more...

PLAN D: There's not much difference between 1% and 16% (really)

Debt is really about control. When you owe a creditor, the creditor exercises a measure of financial control over you until the loan is satisfied. As long as there is a lien, they can lean on you. Paying the debt faster (making extra principal payments) without paying the balance in full does not decrease the creditor's immediate control over a portion of your finances. Even with extra principal paid, you still have an obligation to make next month's payment. The lender's control is not

removed until the loan is completely repaid.

In fact, you could argue that making additional periodic payments on debt obligations actually gives *greater* immediate control to the lender. Not only do you still have another monthly payment coming, but the additional debt repayment means more of your "discretionary" dollars are also in the lender's hands.

Considering the financial control issues, an alternative debt-reduction strategy might be to systematically fund an account for the purpose of accumulating enough to make a single balance-clearing payment. Rather than sending an extra \$260 to the credit-card company, a "control" strategy could be to deposit that same amount into a savings account, while continuing to make a \$240/mo. "minimum" monthly payment. When the savings account equals the remaining balance, you pay the loan balance off. In the interim, you maintain control over the "extra" money.

Yeah, but...

Some may point out that the interest earned in the savings account will not equal the rate of interest charged by the lender, thus you will "lose money" by not paying the additional savings directly against the credit-card balance. This is true. Saving in an outside account will take longer to fully pay off the obligation. But if the key financial issue here is control -- not rate of return -- then keeping the money under your control gives you greater current financial security and opportunity than if you send those dollars to a creditor. And guess what? The difference isn't that great. Read on:

Here's Plan D. \$260 each month is deposited in a savings account earning 1% annual interest. The balance accumulates until there's enough to pay the credit card balance in full. See "Plan D" below, including the "Remaining Net Balance" showing the credit-card payoff:

PLAN D: SAVINGS \$260/mo.				
<i>(Int. rate: 1%)</i>				
Month	Monthly Deposit	Monthly Interest	Ending Balance	Remaining Net Balance
1	\$260.00	\$0.22	\$260.22	\$7,603.25
2	\$260.00	\$0.43	\$520.65	\$7,204.46
3	\$260.00	\$0.65	\$781.30	\$6,803.61
4	\$260.00	\$0.87	\$1,042.17	\$6,400.68
5	\$260.00	\$1.09	\$1,303.25	\$5,995.63
6	\$260.00	\$1.30	\$1,564.56	\$5,588.45
7	\$260.00	\$1.52	\$1,826.08	\$5,179.10
8	\$260.00	\$1.74	\$2,087.82	\$4,767.56
9	\$260.00	\$1.96	\$2,349.77	\$4,353.81
10	\$260.00	\$2.17	\$2,611.95	\$3,937.82
11	\$260.00	\$2.39	\$2,874.34	\$3,519.56
12	\$260.00	\$2.61	\$3,136.95	\$3,099.00
13	\$260.00	\$2.83	\$3,399.78	\$2,676.11
14	\$260.00	\$3.05	\$3,662.83	\$2,250.87
15	\$260.00	\$3.27	\$3,926.10	\$1,823.25
16	\$260.00	\$3.49	\$4,189.59	\$1,393.22
17	\$260.00	\$3.71	\$4,453.30	\$960.75

18	\$260.00	\$3.93	\$4,717.23	\$525.81
19	\$260.00	\$4.15	\$4,981.37	\$88.37

At the end of 19 months, the savings account has \$4,981.37. If you take this balance and add a payment of \$88.37 at the start of the 20th month, the credit card is paid off.

How is it that there's only one month's difference between 16% interest charged and 1% interest earned?

Math doesn't lie; there is a significant difference between 16% charged and 1% credited. But other variables in this illustration make the interest rate numbers relatively irrelevant. The Plan B decision to make \$260 monthly payments means the debt already has a short amortization schedule – less than four years. Since interest expenses increase geometrically over time, the shorter payback period negates a large portion of the interest expense. The additional \$260, whether added to the credit card balance in Plan C or saved in Plan D, is more than double the scheduled payment and primarily becomes additional principal payments, with very little interest involved. Over 18 months, the interest difference between extra payments (Plan C) and saving at 1% (Plan D) is around \$300.

However, if the regular minimum payments were smaller, or the amortization period was longer, or the additional principal payments were proportionately lower in comparison to the minimum credit card payment, the spread between the time it takes to achieve full pay off could be much longer. The bottom line: **Every debt-reduction scenario is unique and deserves to be evaluated individually.**

But this financial exercise highlights an over-arching financial concept worth consideration, regardless what individual circumstances might show.

Paying down debt is not the same as saving. Sometimes financial commentators confuse the two ideas, or view them as interchangeable. They are not. When you save, you accumulate money under your control. You can decide where to put it, when to take it, what to use it for. As you repay debt, you reduce the amount of control the creditors have over you. But just because the creditors control you less, doesn't mean you have more financial control.

If all your "extra" funds are put toward debt reduction, and you have no savings or no capital reserves, how can you take advantage of financial opportunities, or meet unexpected financial challenges? Either you won't, or you will go back to your creditors — you'll run up the credit card to its limit, or visit the bank for another loan. When you must rely on borrowing to participate in financial opportunities or fight off financial challenges, the ultimate decision-making power (control) lies with the lender, not you. No matter what the interest rates are, paying off debt is not saving.

IF YOU WANT TO IMPLEMENT A DEBT-REDUCTION PROGRAM, BE SURE TO COORDINATE IT WITH YOUR SAVINGS PLANS.

RUN THE NUMBERS. AND GET INPUT FROM YOUR FINANCIAL PROFESSIONALS AND ADVISORS!

ASSET TRANSFERS:

From cash to Cash Values and Life Insurance in one payment



Perhaps coinciding with the economic fallout from the Great Recession, the past few years have seen some significant adjustments by financial experts in regard to cash value life insurance. Rather than being seen through a black-and-white lens as either "expensive life insurance" or a "poor investment," there is a groundswell of commentary that recognizes the unique position cash value life insurance holds in the financial universe.

One of the more prominent commentaries on this new perspective toward cash-value life insurance comes from a 2008 report by Richard Weber and Christopher Hause titled *Life Insurance as an Asset Class: A Value-Added Component of an Asset Allocation*. As part of their findings, Weber and Hause concluded that:

Permanent life insurance can optimize the risk/reward profile of an investment portfolio. That is, a portfolio with both fixed and equity components that includes life insurance intended for a lifetime, may deliver greater legacy and living values in conjunction with the investment portfolio – for a given risk tolerance and reward goal – than the portfolio without the intended life insurance.

In determining how to pay for permanent life insurance, Weber and Hause make another important statement:

...consumers may wish to consider paying premiums from portfolio resources rather than from income resources.

This is the idea of acquiring life insurance through asset transfers. A simple example of asset transfer would be using the earnings (such interest or dividends) from one asset to pay the premiums to establish a new asset (the permanent life insurance policy). In fact, Weber and Hause take seven pages of their 100-page report to conduct an in-depth financial analysis of this asset-transfer approach, using earnings from a bond portfolio. The end result: greater accumulation, plus increased benefits.

Other methods of asset transfer:

Single Payments -- Depending on the makeup of the assets in one's portfolio, using earnings to fund annual premiums may not be feasible. Perhaps the principal is not large enough to generate the necessary earnings each year. Or maybe the other assets appreciate in value, but do not distribute interest or dividends. Even if the principal is large enough, some assets may be volatile, and market fluctuations could make it hard to rely on them for ongoing premiums. Also, any transfer from a qualified plan may include an ordinary income tax consequence and a tax penalty on the transferred amount.

In any of these circumstances, it might be desirable to transfer the asset into permanent life insurance in one transaction, i.e., a one-time payment instead of a gradual year-by-year series of transfers. This can be done; the challenge is determining how best to make the transfer.

Single-premium life insurance policies can be used for asset transfers. With this type of policy, one premium secures the life insurance benefit, and establishes a cash value account which grows over time as nonguaranteed dividends are credited. However, current tax law on single-premium policies restricts or diminishes some of what Weber and Hause term the "living benefits" of a permanent insurance contract, specifically the tax-favored access to cash values via either partial surrenders or loans. These restrictions apply not only to single-premium policies, but any cash-value life insurance policy classified as a Modified Endowment Contract (MEC). The MEC guidelines are quite complicated, and exist to discourage the manipulation of permanent life insurance policies into artificially tax-favored "investments" instead of true insurance policies. For most individuals who want to include permanent life insurance in their financial portfolio, avoiding the MEC classification is preferred.

Premiums Paid in Advance -- To avoid the MEC classification, yet allow policyholders to fund a permanent policy with one payment, some life insurers offer another option: premiums paid in advance. The rules vary with the insurance company, but usually follow this format:

After underwriting approval for an insurance policy has been authorized, the insurance company will allow the policy owner to "pre-pay" future premiums to an account with the company. These premiums will be credited with interest, and gradually transferred to pay future policy premiums. Here is an example from a leading life insurance company, reflecting current rates.

Suppose the annual premium for a 10-pay whole life policy is \$5,000. Under normal payment methods, the

policyowner would pay a total of \$50,000 over ten years to fully fund the policy, but not achieve MEC status. In an arrangement to accept the ten years of premium in advance, the insurance company gives a discount to the policyowner reflecting the interest the company will add to the deposit. In this example, the insurance company is crediting a 4.75% annual return for the first 10 years of the agreement. Thus, instead of requiring \$50,000 over ten years, the one-time premium-in-advance amount is \$40,938. Each year on the policy's anniversary, \$5,000 is transferred from the advance premium account to the policy. At the end of ten years, the advance premium account is empty, and the policy is fully funded. This arrangement allows the policyowner to establish the permanent insurance policy with one payment – with all of the legacy and living benefits – even though the policy will not be fully paid-up for 10 years. Note: ordinary income taxes apply to the interest earned in the premium account.

There are other important details in connection with this advance premium arrangement which will vary by company. Typically, there is a limit on the amount that can be deposited, as well as a limit on how many years can be paid in advance. With this particular agreement, the policyowner cannot withdraw the balance from the premium account without also surrendering the insurance policy. If the policy is surrendered, the company may charge a surrender fee against the advance premium balance. Also, the interest credited to the account will be reported as income, which may or may not result in additional taxes.

Why would someone use the advance premium payment option?

Paying insurance premiums from existing portfolio assets *on an annual basis* usually requires holding some funds in a safe and liquid account. Currently, these types of accounts may not offer annual returns or guarantees as attractive as the crediting rate in the insurance company's advance premium account. If you already know this money is earmarked for premiums, and when adding permanent life insurance to one's portfolio is the objective, using the advance premium payment option may be another way to increase returns and benefits, while minimizing financial risk.

Or suppose you just realized a large gain from another asset in your portfolio; a property was sold, a stock position was liquidated. You have a significant gain you want to transfer to a secure asset, such as permanent life insurance. The advance premium account serves as a conduit to affect the transfer in a clean and efficient manner. With one deposit, the life insurance program is either established or secured (the agreement can be used to pay for existing policies, not just new ones).

Of course, whether an advance premium payment option is appropriate depends on your unique circumstances. But if you are currently paying insurance premiums from other existing assets rather than income, you may want to see if this approach could enhance your asset transfer process.

Bugged by Gold?

It's baaaack! The foundation of monetary systems for centuries, gold has been considered an anachronism in modern financial philosophy, something that computers and sophisticated monetary models had made irrelevant. With the exception of a few contrarian "goldbugs" who market a doomsday view of the financial future, gold is now seen as a precious industrial metal, and its value depends on how it is used – in jewelry, dentistry, electronics, glass-making, etc. But as the shake-outs continue from the global financial crisis that began two years ago, gold has resurfaced in the financial arena. Two news items during the same week in May highlighted a return to prominence for an ancient financial asset.



- Beginning May 13, 2010, *CBS News* and the *Wall Street Journal* were among several news outlets to report on an ATM in Abu Dhabi that dispenses gold in exchange for paper money. The ATM provides updates of gold prices every 10 minutes, and dispenses both coins and bars of gold in exchange for paper money.
- Later that week, on May 17, a high-profile television stock market guru (known for his loud and animated opinions) weighed in that now was the time for investors to consider gold as an investment. Citing "Six Reasons to Buy Gold Now," this investment expert was enthusiastically recommending gold as a "buy."

At the same time, there is a proliferation of commercials on radio and television urging consumers to exchange their "unwanted gold" (usually jewelry) for money. So...there's a group that says "now is the time to buy gold", and another that says "now is the time to sell". What to think?

Because of its chameleon-like characteristics and long history, gold holds a unique place in the financial world. It is truly a one-of-a-kind financial asset. And there are numerous ways to view gold in a financial program.

Gold as Money

One of the most common uses for gold through history has been as money. In coins or bars, gold has been a preferred medium of exchange. Historically, several characteristics have made gold well-suited as money. First, gold itself, in any form, has an almost-universal appeal. It is attractive, durable, and malleable. This means gold can be converted from its function as money into another type of asset without an exchange taking place. A person with five gold coins can melt them and recast the metal into a bracelet, or gold thread or a crown for a tooth. Second, gold is a fungible commodity, i.e., one ounce of gold is considered interchangeable with another. Possessing these two traits, almost every society was more than willing to accept gold as payment for any type of transaction. The face or national symbol stamped on the coin might vary, as would the measures of weight, but for most of the past twenty-five centuries, gold has been the universal currency. (In the early years of the United States, all sorts of gold coins circulated as money, from Spanish doubloons to American double eagles.)

While other items (such as shells or animal pelts) have also served as money, the proponents of gold argue that no other item, including all types of paper currency, is a better medium for financial exchange. Because gold is relatively rare (it is hard to extract and hard to refine), and has real value besides serving as money, there's not enough in circulation for governments, institutions, or individuals to manipulate its value. In contrast, governments and central banks can "re-price" their money in a variety of ways, typically by increasing or decreasing the amount of paper money in circulation.

Currency manipulation is a primary cause of inflation. In the past, countries and banks have so drastically manipulated either their currency or notes of credit that they became worthless. In the 20th century Germany, Argentina and several African countries experienced periods of hyper-inflation such that their paper money systems collapsed. Instead of serving as units of value, the "money" was nothing more than small pieces of printed paper. Because of the possible dangers of paper money, some economists advocate that all paper money be backed by gold, i.e., you can always exchange a paper note for a corresponding amount of gold. Today, no countries operate on this gold standard, but in times of financial unease, gold may become "money" for people who don't feel secure making transactions with the paper currency of a particular nation.

Gold as an Investment

Since gold has a long history as real money, it is possible to use gold as a gauge of the value of other forms of money, and to make bets as to which forms of money may fluctuate in value. For example, the market price of an ounce of gold in US dollars on May 21, 2005

was \$416.27. Five years later, on May 21, 2010, the price was \$1,187.80. An individual who bought 100 ounces of gold five years ago for \$41,657 and sold it on May 21, would have realized a gain – in US dollars – of \$76,889, which equates to an annual rate of return of slightly more than 23.3%. That sounds like a pretty good investment decision. However...

If you bought 100 ounces of gold 15 years ago, in May 1995, the price was just under \$400/ounce. During the 10-year period, from May 1995 to May 2005, the rate of return on a gold investment – in US dollars – was close to 0 percent. From an even longer perspective, the price of gold compared to US dollars dropped from a high of \$850/ounce in January, 1980 to \$481.50 two months later, then stayed in a range between \$500 and \$300/ounce for the next 15 years. This isn't the type of long-term performance that most investors are seeking.

From an investor's perspective, gold usually delivers returns when the bet is against the economy. As the TV stock guru put it, gold is for "when the mentality toward the market becomes negative." But the trend of a nation's economy, and human activity in general, is not downward. Down cycles are corrections, followed by new growth. This makes investing in gold primarily a timing strategy. You have to believe you know when to get in, and when to get out.

Statistically, most of us, even the experts, are poor market timers, whether the investment is gold or something else. A cynical observation is that the only people who consistently profit from market timing are those who market the idea.

A "Classic" Idea: Gold as "Insurance"

Besides the use of gold as money and as a speculative investment, there is a long financial tradition of gold as a small, permanent fixture in a financial portfolio. In the form of jewelry, coins and other physical forms from works of art to bars, gold has been viewed as another real asset, like real estate, equipment or art. These gold items were not intended to be bought and sold – they were purchased for collections, for artistic and personal reasons, and were intended to be passed on as family heirlooms.

But just in case...there was always the security in knowing that as a last resort, these items could be liquidated in the event of an extreme financial emergency. This was not an investment strategy, like a collector who buys in order to sell later. This was financial "insurance", because regardless of whatever might happen to the collectible value of coins or jewelry or other gold objects, there was the assurance that the gold gave it some underlying value. In this context, many individuals would routinely acquire some gold or similar precious metals, primarily as things to enjoy, but with a perception of "financial security."

Ultimately, gold is a real asset. While it is fungible and accepted by almost everyone as being valuable, its value depends on all sorts of other variables. While it can function as money, and be used to speculate on the relative value of other types of money, a case can be made that the classical perspective on gold – small amounts purchased for enjoyment, inheritance and rare financial emergencies – is one that can be most applicable to everyone.

Material discussed is meant for general illustration and/or informational purposes only and it is not to be construed as tax, legal or investment advice. Although the information has been gathered from sources believed reliable, please note that individual situations can vary, therefore the information should be relied upon when coordinated with individual professional advice. Links to other sites are for your convenience in locating related information and services.

The Representative(s) does not maintain these other sites and has no control over the organizations that maintain the sites or the information, products or services these organizations provide. The Representative(s) expressly disclaims any responsibility for the content, the accuracy of the information or the quality of products or services provided by the organizations that maintain these sites. The Representative(s) does not recommend or endorse these organizations or their products or services in any way. We have not reviewed or approved the above referenced publications nor recommend or endorse them in any way.



1864 Rt. 70 East
Cherry Hill, NJ 08003
856-751-1771
www.jmlfinancialgroup.com

2431 Atlantic Avenue
Manasquan, NJ 08736

Joseph M. Yocavitch, Registered Representative and Financial Advisor of Park Avenue Securities, LLC. (PAS), 2431 Atlantic Avenue, Manasquan NJ. Securities products/ services and advisory services are offered through PAS, Registered Broker Dealer and Investment Advisor, 732-528-4800. Financial Representative, The Guardian Life Insurance Company of America (Guardian), New York, NY. PAS is an indirect, wholly owned subsidiary of Guardian. JML Financial Group is not an affiliate or subsidiary of PAS or Guardian. PAS is a member of FINRA/SIPC