

## *Evaluating the financial and tax consequences of decisions made*

I approached this month's topic with much trepidation. I did so because I realize that some folks have already made decisions that unfortunately have had long term consequences. To understand what some of these decisions were we have to look back to September 2008.

In September 2008 our country experienced what could be essentially be viewed as a "Financial 9/11". Suddenly we were awakened from our warm, cozy life of easy living, easy credit, and successful financial investing to realize that the world that we knew before had vanished before our eyes. Initially most of us (myself included) did not understand the severity of the problem that our country faced. However, within a few short weeks of seeing 401K's and IRAs lose up to 30% of their values, we began to realize that what we were experiencing was something that few, if any, of us had ever experienced before.

Having studied financial markets over many years, I estimated that, while the market had been jolted severely, it would eventually regain some, if not all, of its basis. And with some patience and probably some sleepless nights, things would right themselves and we would once again see gains in our portfolios.

How long would it take to do this? Historically, most recessions, even the most severe ones, last between 6 to 18 months. But, because of the severity of this economic calamity, it was difficult to say how long it would take to come out of this one. The key to this particular recession was to find the bottom of the housing crisis that was the culprit behind the whole collapse.

However, prudence and understanding the nature of markets helped me to know that the worst time to move out of the equity market was in the middle of a recessionary trough. I advised my clients (who called me concerning what to do about their eroding 401K's) to step back, breathe, and allow the market to get through the wild ride of the initial months of this recession before making any financial decisions that could affect their savings which, not may, but would never be recovered. As I reminded them---- paper losses are just paper losses until you sell the investment.....then, paper losses become real losses.

During this time I also received calls from some folks who wanted to determine the tax consequence of closing out their market investment and put it into a fixed income investment. However, in many of these cases, I received the calls after the decisions had already been made. What was difficult at that time was to refrain from telling these folks that the tax consequence of the decision was the least of their worries. The real financial loss they experienced could never be regained through a fixed income investment program. Through their decisions, thousands of dollars of paper losses became thousands of dollars of actual losses. It still makes me sick to my stomach to know that years of their saving and investing were suddenly wiped out by decisions made during a time of duress.

If you remember anything from these newsletters, please try to remember this:

Financial decisions during tough economic times are likened to driving your car in a rain storm. If your car starts to skid, the worst thing you can do is to step on your brakes.....instead, try to remain calm, get off the gas, steer in the direction of the skid, and eventually your car will right itself. Similarly, instead of cashing out your equity investments during an economic slide, step back, review your portfolio, rebalance to maintain your long term objectives, and eventually the market will right itself. I firmly believe that, regardless of the political and economic conditions we find ourselves in, real long term growth can only come from a healthy mix of equity and fixed income investments. But please remember .....The proper mix, referred to as asset allocation, for you may not be the same for someone else. Proper asset allocation needs to be determined by the following factors:

1. Your age and the stage in your career
2. Your need for liquidity
3. Your cash flow needs
4. Your income tax bracket
5. Your required rate of return
6. Your risk tolerance

And while this newsletter is not meant to be a lesson in prudent investing, the above principals are the basis in which any investing decision should be made. Often as not, financial decisions made out of fear or haste wind up costing you a tremendous amount in the long run. I personally have made both of these types of mistakes in the past. And, without fail, I have always regretted financial decisions that were not methodically approached and carefully evaluated. As a result of my own personal mistakes, I have come to live by the following Kipling line:

**“If you can keep your head when all about you are losing theirs.....”**

Simply put, always resist the temptation to make financial decisions hastily out of fear or even excitement because of the long term consequences associated with them.

Financial decisions should be made only after careful, methodical, and unemotional evaluations have been completed.

I've been asked a lot lately about gold as an investment. While I do not normally get into the specifics of asset allocation in a monthly newsletter, this may be a good opportunity to keep some of you from making a terrible mistake. You, no doubt, have been inundated with commercials over the past several months strongly pushing gold as the only solid investment in these times.

The fact is that historically, gold has been a good hedge against the pressures that typically negatively affect the equity market during a recessionary period. However, under no circumstances should you allow gold to be more than 10% of your portfolio. Gold should only be used as a balancing agent in your portfolio because of the radical swings that commodities like gold are subject to. For example, gold was selling for approximately \$1100 an ounce at the first of the year, it is currently selling for \$975 an ounce and while the value of gold may have “never been worth zero”, if you bought at \$1100 an ounce and sold for \$975 an ounce you would have lost money on the investment.

The fact also is that the equity/bond market has overwhelmingly outperformed gold as a long term investment vehicle over the past century.

My experience has taught me that by the time something is being highly touted in the marketplace, it's too late for the average investor to see any appreciable growth, because the real gains have already been

taken by the large institutional investors. That is why it is, not possibly, but absolutely, impossible to time the market.

I think Warren Buffett summarized the way a large institutional investor operates when he said,

**“We simply attempt to be fearful when others are greedy and greedy only when others are fearful”**

That is why I always advise my clients to develop a balanced long term portfolio based on the investment factors mentioned above and methodically invest into it, if at all possible, regardless of what the current conditions are. Doing so, will ultimately minimize the average investment over the long haul and potentially produce the greatest possible gain when need to start drawing from it.

And while I believe that these investment principals are sound, regardless of economic conditions, clearly they work the best in a free market society. And while I believe that there are times when the government should step in to help stimulate our economy, historically, only two things have been effective in stimulating the economy out of recessionary periods: Tax Cuts or War.

It was World War II that brought us out of The Great Depression, not the social programs enacted during FDR’s presidency. And it was the Reagan tax cuts that brought us out of the recessionary period of double digit inflation and double digit unemployment, not the social and regulatory programs enacted under the Carter presidency.

I recently read a book authored by Dr. Arthur Laffer, Stephen Moore, and Peter Tanous entitled **THE END OF PROSPERITY**. And while the title is ominous, it is full of great possibility if the proper steps are taken to avert the dismal results that could befall this country if we continue along the path of social spending practices of the current Congress and Administration.

Dr. Laffer, the architect of the Reagan tax cuts, illustrates quite convincingly how tax cuts actually increase federal revenues by stimulating investors and businesses alike to invest because it is in their self interest to do so. He also shows the facts and figures to support the evidence that tax increases actually decrease federal revenues because they create more unemployment and penalize successful investing.

I also recently completed the book **COMMON SENSE** by Glenn Beck. This book is based on the treatise of Thomas Paine’s Common Sense which emphasizes the need for a government that is accessible and respondent to the desires of the majority of its people. In this book, Beck continually illustrates how our current law makers closely resemble the practices of the Monarchy during the foundational days of our country. It emphasizes that how some of the laws enacted today defy common sense and are clearly enacted to strengthen the power of the federal government by reducing the freedoms of we, the people.

I highly recommend both of these books. They will enlighten you to the current state that we find ourselves in as a country, and offer practical solutions that you can follow to help lead us out of the current difficult times that we are experiencing.

You may ask what these have to do with evaluating the financial and tax consequences of decisions made. My reply to you would be.....**THEY HAVE EVERYTHING TO DO WITH THEM.**

For a society that penalizes success will ultimately limit the amount of potential success that its people may be able to achieve. What is the motivation to achieve more success if a greater percentage of that will be taken from you and given to someone who is unwilling invest the same amount of energy, take the same risks and employ the same discipline required to produce that success. The bottom line is that this type of society produces an atmosphere of mediocrity rather than excellence.

And until we wake up and realize that the future of this country requires the active involvement of all of us to carefully, methodically and unemotionally evaluate the actions of our law makers and to hold them accountable for the decisions that they make, we will continually lose more and more individual freedom and potential for individual success.

*Til next time,*

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