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SENIOR INVESTMENT PRODUCTS: INVESTING FOR TODAY & TOMORROW

Moderator: JOSEPH E. BRENNAN
Panelists: VAN A. MUSSO*
TIMOTHY J. RUARK
ROSEMARIE SHOEMAKER†
Recorder: JOSEPH E. BRENNAN

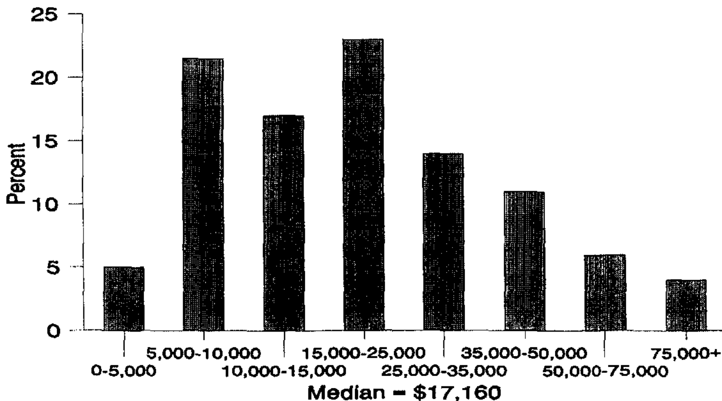
A review of senior investment products will be offered, such as deferred and immediate annuities, mutual funds, and reverse mortgages. Discussion will include product design, pricing administration, regulation, and marketing.

MR. JOSEPH E. BRENNAN: Rosemarie Shoemaker is vice president of financial institution marketing at Western National Life in Houston. She specializes in and will make her presentation on the annuity market. Tim Ruark is the life marketing actuary for Cigna Re, and he will discuss reverse mortgages. Van Musso is senior vice president of Dean Witter. He will explain, from an investment manager's standpoint, investing for retirement.

Before we begin, let me tell you about my parents. My parents are in their 60s, they own their own home, they have some money in IRAs, and the rest is in the bank—mostly in CDs and checking accounts. There is not much else in terms of financial assets. This might sound somewhat familiar to you. Your own parents might be in the same boat. Others in their 60s or 70s probably have a very similar story.

What I would like to do before we begin is look at a little bit of 1991–92 census data (Chart 1). It shows the income distributions for people age 65 and over.

CHART 1
HOUSEHOLD INCOME OVER AGE 65—U.S. CENSUS DATA, 1992



*Mr. Musso is Senior Vice President of Investments with Dean Witter in New Orleans, LA.
†Ms. Shoemaker is Vice President of Marketing with Western National Life in Houston, TX.

It shows that these people were not without financial resources, they had a median income of $17,000, and more than one-third of this group earned more than $25,000 per year.

Chart 2 shows the distribution of wealth by age. It's split into two components: the bottom half is financial assets, the top half is home equity. I think there are two very important points to notice. One is that people do not begin saving until they are in their 40s, and the second is that home equity is the asset of choice among Americans.

CHART 2
HOUSEHOLD NET WORTH—U.S. CENSUS DATA, 1991

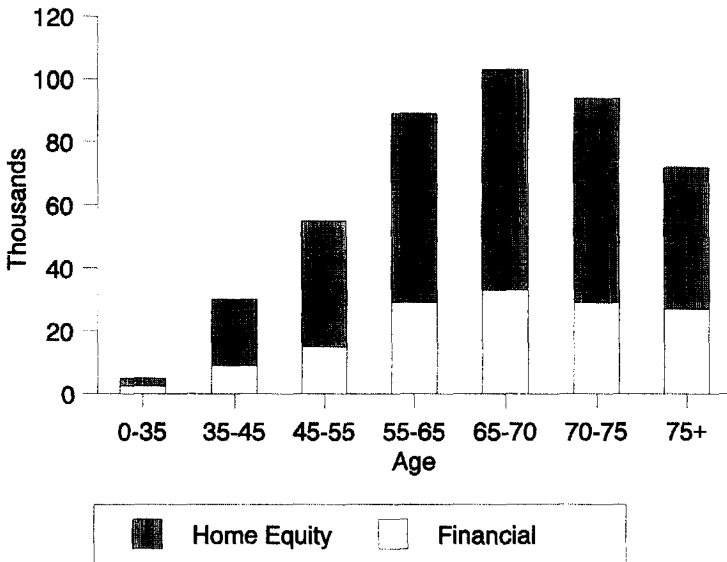


Chart 3 is a distribution of wealth for people age 65 and over. The median is near $90,000; more than 75% of the households over age 65 have wealth of more than $25,000, and 20% have wealth of more than a quarter of a million dollars. Again, there is no shortage of wealth among this group.

Table 1 shows the distribution of where people over age 65 have their money. Most have home equity, most have money in financial institutions, and most own a car. A few have money in mutual funds, investments, and IRAs, but that's about it. What are the opportunities for senior investing? That's what our panel will discuss. I'll, of course, be taking notes for my parents.

CHART 3
HOUSEHOLD NET WORTH AGE 65+ U.S. CENSUS DATA, 1991

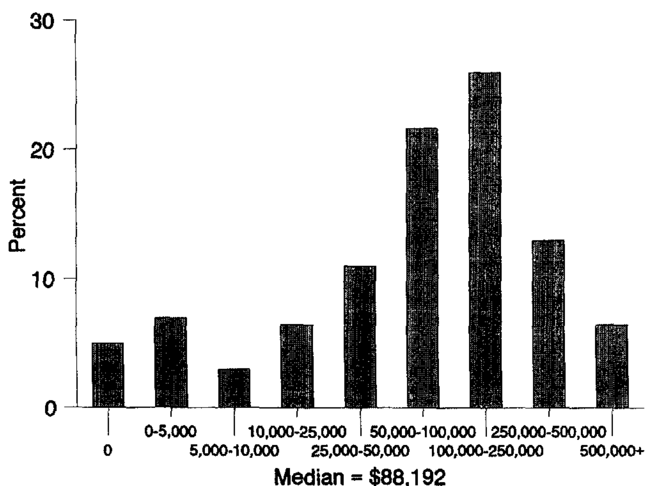


TABLE 1
MEDIAN VALUE OF HOLDINGS, OVER AGE 65: 1991

	Median Value	Percentage of Households
Home Equity	$63,284	77%
Assets at Financial Institutions	15,337	78
Cars	4,753	76
Checking Accounts	625	40
Stocks/Mutual Funds	19,938	24
IRAs	15,136	18
Financial Assets—Other	31,577	14
Savings Bonds	1,625	12
Other Real Estate	30,607	11
Rental Property	30,100	10
Equity in Business	8,493	5
Other	$26,379	3%
20.6 Million Households	Median Net Worth—$88,192	

Let me introduce our first speaker. Rosemarie Shoemaker is vice president of financial institution marketing for Western National Life. She specializes in annuity markets and has been involved in the insurance industry for more than ten years. She has put programs in place in more than 400 banks and spends a great deal of her time training bank personnel on financial product sales.

MS. ROSEMARIE SHOEMAKER: Coming from the marketing perspective, I was trying to get an idea for what kind of information you would be interested in. I brought statistics

as well. If you were at some of the other sessions, you've been bombarded with the senior market and the aging influence and all their numbers. But what I thought might be of interest to you, because most of you are on the side of manufacturing products and you don't always talk to the end user, is the consumer, the customer who's buying. The biggest growing market is actually in the financial institutions, in the banks and thrifts. I want to take you through that avenue; why banks are in the business, why their partnerships with insurance companies have become so important, and then what these consumers are looking for. Because the bells and whistles on fixed annuities and variables have changed a great deal in the last ten years, the product is looking more and more like traditional savings products than those that were being bought at the bank.

Annuities are the fastest growing insurance product right now. They are the second most popular savings vehicle in the United States, the first being CDs. When I talk about savers, I mean Mom and Pop who go into their local thrift or savings institution. They do not want to give up safety, and they're also looking to have more income later on. If they do have relationships with brokers, they will buy mutual funds, oftentimes in banks as well. But this is the first step for them. These are people who have always had their money in the bank, but they are looking to do a little something more.

A "savings vehicle" is an important term in our industry. It's not an account; it's not a deposit. We have to be very careful not to mix this up. Even though we are sitting in the lobby of the bank selling these products, this is not FDIC insured; it's not a bank product. Many regulatory entities get involved, as you can imagine. Individual annuity sales have increased dramatically and will continue to. And the target saver market will increase, which I think you have heard and will hear more about.

The financial institution industry has been selling annuities for about the last 12–15 years. This took off in the early 1980s in the Pacific Northwest. A company called Great Northern Insured Annuity got the bright idea that if people were pulling out money to buy annuities with life insurance companies through their brokers, why not give the banks the opportunity to retain that money and earn the income off it. I don't think you can find a bank in the country right now that doesn't have some type of insurance program. And it has gone beyond annuities; they are now selling variable annuities and mutual funds. They are looking at all types of other life insurance as well.

The demographics are favorable to the financial institution marketplace. They still have that free cup of coffee and financial counselors to talk to. I myself go to the bank maybe once a year. Either I have a problem with my checking account or I have to go in to do something. The senior market still walks in. They want to talk to their banker, they want to know what else is available to them. The other interesting thing about all this is, when I first was involved in this ten years ago, the big ugly word was *disintermediation*. The bankers were saying, "Well OK, we'll have this as the last resort. We'll sell other products, but we don't want our deposit base going through an insurance company. We still want to retain those customers." And they found, when they took a long hard look, that if the money was going to move, it was going to move anyway. People are getting smarter. Also, if a CD came due when they were looking for a better rate, yet they wanted the money to stay somewhere safe and conservative, this was a great alternative. The banks put their money into a fixed annuity and found that 60–70% of those people would replenish the funds that they took out of the bank. Now the bank had two relationships with that customer.

The fee income that the bank makes is substantial. Think about this: if people open a CD at a bank, they'll typically do a six-month or a one-year CD. Because rates are always going up, right? They don't want to miss out on that! And if rates go up, they want to make sure that they're liquid. What we found, though, was that people were buying a six-month—ten-year CD. They would come in every six months to renew and, depending on inflation and what tax bracket they were in, they weren't making a great sum of money. Annuities were a win/win situation. They were making more money, the bank retained them as customers, and the fee income that the bank was making was equal to keeping that deposit on the books for seven years. Now that was unheard of because the customer had opened a CD for six months and then would shop. The loyalty wasn't there. My grandmother would go through the yellow pages and call every bank in town. She wanted to know if they were giving away anything free. She wanted a toaster like the one she got in 1970. They were able to retain the customers and build the relationship. The bankers were finding that when they had three relationships with clients they were truly their clients. Bankers were getting smart about actually teaching their branches, from the tellers on up, how to sell and not just be customer service order takers.

Now to the profile of who buys. I don't know if you own a fixed annuity; most people have one and don't even know it. Maybe it's part of their 401(k). Teachers in Texas don't pay Social Security; they actually pay into a system that gives them a fixed annuity. Most people have one. But typically we see people age 50 and over as being very conservative. These people might not have a brokerage relationship, or this is the first step. This is Mom and Pop; these are not sophisticated investors.

In the bank marketplace we found the opportunity "line." For those people who are shopping rate, what are you doing with the money? Is there something that you could do that might be better for you? If someone is concerned about taxes, it seems silly to roll over that certificate every six months for 10 or 12 years when you don't have to be paying taxes on it. If you're not going to use it, why pay taxes on it?

For someone who continually rolled that CD, someone with excess liquidity, someone concerned about having enough at retirement—this was the first step. People started with the fixed annuity, then looked at variables, then looked at mutual funds, and then started diversifying. Ten years ago I would sit down with people and they'd say, "I am diversified; my money is in six different banks." Sometimes it would be in the same instrument. They would be underinsured because they had a limit of FDIC insurance to $100,000. Other people would contribute to an IRA; not many people can do that anymore. The next question is, obviously, is there other money you want to tax-defer? Now the bank can retain those customers and help them with their 401(k)s, their profit sharing plans, their pension plans. It was very interesting to see that when someone was laid off from a job, or was changing employers, they were more apt to talk to their banker than to make a cold call for the first time in their life. They didn't have an outside relationship.

For someone accumulating an estate for their heirs, there are five reasons for buying annuities. First and foremost is tax deferral, obviously. There are many clever ways to say that. I think the best is "triple compounding," which is what marketing people call it. Earn interest on your principle, interest on your interest, interest on your unpaid tax dollars. That doesn't make sense to many people. What you're saying is, if you earn $100 in interest and you're in a 30% tax bracket, $30 goes back to the IRS. If you're not using it, keep it in there and let it start growing.

The second reason is safety. The number-one reason why people are in banks is because they don't want to lose their money. They want to be able to sleep at night. The big question in the bank for the consumer is, is this a safe product? They'll ask, is this FDIC insured? No. But if they ask if this is a safe place to put their money, absolutely. This is insured like their life insurance. Then they are very interested. It was quite an education. The senior savers would then tell me about the Depression: how their neighbors lost everything in the thrift and savings and loan, but their family lived off life insurance; how good life insurance was and how comfortable they were with that. They felt comfortable in that the insurance industry has a reputation and it was a good match.

Liquidity is the third reason. I want to know I can get to my money if I have to. The fixed annuity does not seem like a liquid product. In reality, the annuities that are out there in the financial marketplace are liquid. You can get an interest check on most of them. You can get some amount, at least 10% each year. And the ones that you find in the bank market usually have a surrender fee schedule of about five years, seven at the most.

The other two reasons are interest income and estate planning. This is neat. Instead of having to go to an attorney or set up a trust, they set up an annuity. They can put whomever they want to on that contract. That is a legal and binding contract that is not going to go through probate, which is a big deal to many older customers. Without a fee, no commission, it makes a lot of sense. Annuities have just been incredibly attractive to both them and to the banks. It is their customer who walks in the door, and they're making fee income off of what used to be walking out the door. Households aged 65–75 represent 12% of all households, but they possess 35% of the wealth. These are savers; these are the people who have money.

This is the fastest growing segment of the population. As a whole, they are more wealthy than any other segment of the population, currently possessing 40% of the nation's total personal financial assets. That's distributed in many different arenas. This is one of the reasons that banks have gotten so interested in tapping into who their customers are. Think about that. They have them walking in the door. They do not have to make cold calls or do direct mail. Here is a banker in small-town America who has been there for 20 years. And either that banker will go out and get a life license, or he or she will hire someone from the local brokerage firm to sit in that branch and represent all products. And that customer has an instant place in that relationship. Because that person has been banking at that branch for a long time, immediately there's an explicit trust.

The prime asset accumulation years, according to the Investment Company Institute, are 45 to 65. We're seeing those ages getting older and older because people are putting off retirement. Who are these people? Have you heard them called the aging affluent? They're over 55, pre- and postretirement, and they have household incomes of more than $100,000 and financial assets of more than $250,000. I think the aging affluent should be in that next level after the fixed annuity. These are the people who now want to get a little more sophisticated. If they don't have a relationship with a broker or some type of financial manager, it behooves the bank to start that relationship with them.

The American Association of Retired Persons (AARP) surveyed its members about three years ago about their three biggest concerns. What would you think? Health obviously; what else? Death with dignity was very important and so was outliving their assets.

People are living longer. An amazing thing that I've seen is that the annuitant's age and the owner's age keep creeping up. When I started working with annuities, the maximum issue age was maybe 70. Now in many products it's 90. There are definitely 90-year-old customers. That seems like an unsuitable sale. A five-year or seven-year fixed annuity for someone that age? What will he or she do with the money? If he is not using it, why pay taxes on it?

Those marketing people always come with all these acronyms. You've heard about YUPPIES, I never thought they were a very good market because they spent all their money in the 1980s. It was kind of the shop-till-you-drop syndrome. Then there are the DINKs: dual income no kids. They definitely have money, and that's a market to look at, but I don't think this is necessarily our industry. The DOBYs—dad older baby younger—would be the second marriage, starting the second family. That is an interesting market. They have college, retirement, and maybe their parents who are older and who need help, all at once. The most interesting one, the marketing buzzword of the next decade, is the WOOPI: well-off older people with income.

MR. BRENNAN: You heard mentioned a little bit before that home equity is the asset of choice for Americans. The question very simply is, if older Americans needed money or needed income, how could they tap that resource? And to answer that question is Tim Ruark from Cigna Re.

MR. TIMOTHY J. RUARK: I work as a life marketing actuary at CIGNA. I'm responsible for pricing and product development of all our traditional life business, and also nontraditional life business. We will talk a little bit about nontraditional life opportunities because we will talk about reverse mortgage. I gather most of my limited expertise from discussions that I've had with prospective clients who have come to our company asking for help in getting them into the reverse mortgage marketplace. That's where I'll draw most of my comments from.

We will spend a little bit of time talking about the senior housing market. We'll then talk about the reverse mortgage concept: what it is and how one might design it. We'll then move on to actuarial considerations. And that's mostly a look at what some parallels are to products that we might be more familiar with, and how we might relate as insurance companies or reinsurance companies with lending institutions.

Now I do have a goal. My goal is to make sure that everyone here leaves as a proponent of the reverse mortgage. I think this is a good product, and I at least want to remove some of the doubts and some of the preconceived notions some of you might have when you think about reverse mortgages.

I apologize for using the word *elderly.* I have a feeling that may not be a politically correct term to use, but I did it. We'll define the senior market as ages 50 and above. We will define the elderly market as perhaps the upper tier, certainly above age 65, maybe above age 75. That may be where the market is.

There are some attitudes that I want go into relating back to the housing market. For those of you who don't know, the elderly as a group are skeptical. If you doubt that, I suggest you go to the produce section of any supermarket on senior citizen day and take a look for yourself. I'd be remiss if I didn't mention my father. I've been with my dad in

the supermarket. My dad will go to the cantaloupes, grab a cantaloupe in one hand, and grab one in the other hand. And he'll just look at them for the longest time. He will squeeze them, shake them, and move them around. He will take one cantaloupe and put it on the scale. He will look at the cantaloupe, see how much it weighs, and think about it. He will take that off and put the other cantaloupe on the scale and he'll think about that for a while. The next thing you know, he has two cantaloupes on the scale. He wants to do a little testing of the scale I guess. He'll look at that for a while. Ultimately, he'll just leave the cantaloupes there and go over to the cabbage. And that's it. It has nothing to do with cantaloupes. Like many seniors, my dad is skeptical. I give you a slight stretch of truth, but this is a case in which seniors will be skeptical over pennies and dollars. And yet we're talking about home equity wealth in the trillions. You can imagine how skeptical some of these folks can be.

Very quickly, regarding some of the other attitudes, seniors prefer information to imagery. They think they have plenty of time. Give them the facts, they will go over the facts in great detail. Speak of solutions not problems. They do not want to hear you tell them what their problems are, but they do want to hear what you perceive to be the solutions. Older people will speak about their own problems, but don't you speak about their problems. There is a subtle distinction there.

Let's talk about an application for this market. When you think about the elderly or the senior housing market, you think about people who are looking for independence. They are looking for cash. It's not like they are going to spend like crazy and come to New Orleans;they just want cash to go out to dinner. They want cash to travel, they want cash for gifts to the grandkids, and they want cash for gifts to themselves. The reverse mortgage is perceived to be a product that might deliver that cash. I want to go over some of the details of it, because I know everyone is not familiar with it. The idea is simple. You have a borrower and a lender, the borrower being the senior and the lender being maybe a bank. The borrower is either going to receive monthly payments or have access to a line of credit from the lender. In exchange for that, the lender will place a lien on the home of the borrower. The payments or the access to a line of credit will continue until this loan terminates. It could terminate through death; or it could terminate because the borrower gives up the principal residence, either by moving or selling. Whatever it may be, the loan program will terminate at some point. It is at that point that the borrower, or often the heirs of the borrower, will have to pay back the loan. When the borrower is receiving monthly payments or drawing from a line of credit, the lender is accumulating interest on those monies that the borrower is receiving. Interest could be accumulating through a fixed or variable interest rate. Either way, it is accumulating. At termination, the bank expects to get its money back.

With a reverse mortgage, it's critical for the lender to expect to profit from this deal. It's critical for the lender to get plenty of money from the sale of the home so that it can cover this accumulated loan balance. In a standard loan, if the amount borrowed plus interest exceeded the equity, the bank would lose. This ends up being quite powerful in the way that reverse mortgages are designed; specifically, how large a line of credit can you access and how big are the monthly payments paid to you? Both those contribute to the loan value. Does anyone know of some design features that would be important for a product?

FROM THE FLOOR: Independence?

MR. RUARK: That's right, very good. The idea of independence is very important here. Some reverse mortgages were on a term basis. You would receive these monies for ten years, but then it would stop and you had to pay back the loan after ten years. For seniors, that is like a time bomb ticking away. From the day that they close on this loan, they hope their home sells in ten years. Having lifetime provisions allow the senior to stay in the home until the time he or she dies.

FROM THE FLOOR: Access to remaining equity.

MR. RUARK: Yes. Did everyone hear the idea of including the equity line of credit in the loan? Remember that the need here is cash. The need isn't $500 in cash every month. The need is cash. That has to have some flexibility. Sometimes you will only need $100 in a month; other times you may need $4,000. Also, some heirs believe they are entitled to the equity in their parents home when their parents should move on. But perhaps more important, it's vital that the heirs be involved in the discussion so that they understand how this product is working.

FROM THE FLOOR: Transferring the mortgage when you move.

MR. RUARK: Someone may choose to leave one home and go to another. Would it be possible to have the loan transferred over to the other? It is very challenging to do that because a reverse mortgage is more than a product such as an annuity or a CD, which one just buys at the drive-through at the bank. There is a formal closing just like any other mortgage. I think that's a good observation, but I think it would be very challenging to put in place.

I want to continue moving ahead. Unfortunately, we don't have the time to go through all the details of reverse mortgage. Very quickly, in the operation at CIGNA, we have to gain some comfort with some things that perhaps traditionally are not very comfortable for us. The first one, from the lender's point of view, is home appreciation. You need to make some assumptions with reverse mortgages on how homes are going to appreciate over time. I don't see a lot of that in my actuarial work. Even more important, I don't think my boss sees very much of it, so how am I going to explain it? Fortunately, I think lenders have more comfort in something such as that. It has been our experience in talking to some potential issuers of reverse mortgages that they're very willing to take on some of that risk.

Suppose that I'm an insurance company, or even a reinsurer, wondering how to get this product out to market. A reverse mortgage will be set up through a bank; banks are our lenders. And as Rosemarie said, people will just show up at the door. They come into the bank looking for a product. That distribution system is already set up. That's a great application.

Let me just mention fee income quickly. These are, as I said, similar to traditional mortgages. There is a closing; the closing costs are quite high. They can run upward of 7% of face value. That's a lot of money up front. But if an insurance company tried to sell that, you might run into some problem with regulators or consumer groups. The banks seem to be able to do that type of thing, and it's perfectly acceptable. That's something that they're more comfortable with.

And just to finish up, from an actuarial point of view, even though the product is nontraditional, even though the product has some things that are quite unusual, there are different risks that we would take on. It is easy to look at the product and see some things that are similar to other things we do. Assessing mortality, I don't think I'm uncomfortable using the type of mortality that CIGNA uses in its pension business. I know I want low mortality for this, similar to the long-term care. Because in many reverse mortgages, the idea of people leaving the home to go into a nursing home is an event that either might terminate a loan or perhaps make the loan do something else. Having some knowledge of nursing home stays, long-term-care products can be very useful, too. And lastly is annuities. Anytime you think about making payments of $500 every month for a lifetime, you can't help but think of annuities, immediate annuities. Perhaps there are some similarities there also.

MR. BRENNAN: You might think that would be a tough act to follow. But our next speaker is a frequent speaker on investments, particularly investments for retirement. He personally manages over $200 million in investments and is the author of *How to Retire Rich and Stay Rich: A Financial Road Map to Success* (Van A. Musso Enterprises, Ltd., 1994). From Dean Witter, Van Musso.

MR. VAN A. MUSSO: I speak all over the world, and I have found that one simple thing is true about my business. Whether I'm talking to people your age or the elderly, there is absolutely no difference between you and them except that the elderly might need a little more income than you do. But the fact is, if you don't get anything else from this session, stocks make more money than anything else. I'm not prejudiced toward anything. I sell them all. But if you can keep this with you for the day, I'll come back to it. Over the last 70 years, the average return in the stock market, common stock, blue chip stock was 12.5%. Show me something that has made that year in and year out. Real estate sometimes is better, sometimes worse, but real estate is not very liquid. Retirees are very concerned about liquidity.

Today we are retiring earlier. Every major company and major industry in the world is downsizing. I have 4,000 retirees with $200 million, and the average age of my retirees is 53. Males are living to 84; females are living to 88. If I'm retiring at 53, I'm going to live 30–35 years in retirement. And guess what folks? I didn't work as long as my father did and I don't have as much money, but I'm going to be retired longer than he was. I'd better have some bucks put away. I can't do it with bonds. I can't do it with CDs. I have to have some diversification.

But I can tell you this: I know that one of the worst things in the world is outliving your money. As far as I'm concerned, if you're retired and you run out of money at 70, and you live to 85, it's like dying and going to hell. You can't go anywhere, you can't go to the show, you can't go to a restaurant, and you can't travel. I'm trying to make sure that the money is still there. If you ask the average person on the street where he or she is going to put his money, it's the bank. If you don't get another thing from this session, when it comes to investing your money, the majority is always wrong. Everybody has their money in banks; it's the wrong place to have it. You are going to have to be different.

Now if you're 60 years old and you've been working 40 years, I will tell you this. If I was retiring I'd be elated, and I would also be scared, too. Will my money last long

enough? Have I got enough put away? What will I do with my time? I sit down with my retirees and I work with them for about two hours. I ask what they need and what their lifestyle is. I put it together in a 50-page booklet to explain to them what will happen to them emotionally, psychologically, and financially. As Tim Ruark just explained to you, they like detailed information. They want to see it in black and white. If you came to me and said, "Here's all my money, I don't know how much it is, but here it is, this is all I have," I would say to you, "Let's put it in a safe." A big huge safe from the floor to the ceiling with big thick walls will preserve your money. On each shelf you could put anything you want. You can start out and get one product, one investment. You know that is incorrect, because the number-one rule of financial planning is to diversify your assets, so I would never let you just buy one investment because that's wrong. What I talk to people about is concept selling. I will not talk about a specific product and get into the depths of that product. I'm trying to tell you that I know how to make money and plenty of it.

I'll tell you a quick story. I don't know how many of you are sports fans, but there is a little product called Breathe Right. It's like a Band-Aid. You see football players wearing it at the Super Bowl. When I saw that product, I said that it would go. Every kid in America will want to follow their hero football players. The stock was at four, by the time I got to it, it was at eight. That was at Super Bowl time. It closed today at $25 a share. You can make money if you can see into the future, and you can see into the future. Five, six, or seven years ago I was talking to groups like yours when junk bonds were down 75%. I told people "I don't know if you should have junk bonds in your portfolio; it may not be right for you." When something is down 75% folks, it's either going out or it's going back up. The next year junk bonds went up 67%; the year following junk bonds went up 25%. Case in point. If I had to tell you where to go, I would tell you, if you had the guts, to buy Mexico. The average stock in Mexico is down 80%. If you were to have given me $10,000 five years ago and we had bought Telephon-ex to Mexico, the 16th largest telephone company in the world, you would have been a multimillionaire in December. You wouldn't be a multimillionaire now because it went down 80%. My point is, if Mexico is down 80%, is it a good buy? Probably. I can look into this crystal ball and tell you with absolute assurance that Mexico is not going to go under and disappear from the face of the earth. It's not going to happen. Sometimes you have to go in and suck it up and buy things that nobody else wants. Because the majority is always wrong. Three percent of the world gets wealthy. Two-thirds of all Americans over age 65 can't write a check for $1,000 after they have paid their monthly bills, after working for 20, 30, 40, or 50 years. Guess what? You had better have a balanced portfolio. Just as Rosemarie was saying, the average person does not start his or her life investment program until age 45. At age 45, he will wake up and say, "It's getting late. I am getting old. I'm going to look like my parents. I'm not going to have enough money, and I'm going to live 35 years." You have to get started.

What I do is sell this concept of owning a six pack of investments. You can't have 100; that is too many. You can't have one because there's no diversification. I try to blend some stocks, bonds, mutual funds, government national mortgage association investments (Ginnie Maes), federal home loan mortgage corporate investments (Freddie Macs), collateralized mortgage obligations (CMOs), or whatever that person might need. But coming back to what I started with, I already know from my crystal ball that I can make more money in stocks than I can in anything else and stay liquid. If I know that, and I believe that concept is true, I have to put more money in stocks. It doesn't matter if I'm

75 or 25 years old. The 75-year-old and the 60-year-old who come to retirement are so scared they will lose their money so they tend to put all their money in safety. That's fair because you first need to be comfortable. If I can show you how to make 35% per year, every year, but you can't sleep at night, is that a good deal? No. You have to live within your comfort zone or I'm not doing my job.

I have to teach you how to blend these things. I use what I call the turtle effect. The turtle effect is, within 18–36 months after they buy a too-conservative portfolio for their own good, they begin to stick their heads out. Van Musso did not go to Brazil with the money. The returns that we estimated probably were close. We hope we estimated low. We always try to estimate low. I try and blend this portfolio so they can live within their means and comfort zone, but I have to try and keep sticking the needle into them to buy more stocks for their portfolios because stocks work better than bonds.

Now if you don't know anything about the investment process, there are three basic concepts. When stocks are running, generally speaking interest rates are low. If prime rate is below 10% you're going to make money in the stock market almost every time. If prime rate is above 10%, it is going to kill the stock market slowly but surely. A businessman then can't afford to borrow the money, put the goods on the shelves, open a new unit, pay more bonuses to employees, and so he shuts down. As the interest rates begin to rise, I should put my money in the money market fund and just wait. Can anybody tell me what the interest rates were in 1981 in money market funds? Eighteen and a half percent. If I'm making 18.5% in the money market, I do not need to be in the stock market. I'll take the 18% all day long. All you have to know is that if interest rates are down, you will be better off in the stock market. When rates get up high, you will have to have the guts to buy as long as you can. When bond rates are way up there, buy the 30-year stuff. We need to mix our portfolios. We need to shift from stocks to bonds to cash. There are only three basic concepts. Either you're an owner in the stock market, in the bond market, or you're somewhere in neutral, which is money market funds.

Now the first thing my clients want to hear is how they will survive. "I'm scared to death. What's the safest thing in the world for my portfolio? "I'm retiring today, I'm 60, and I'm getting out." The first and the safest thing in the world is direct obligations to the U.S. government. That means the government literally has to pay you by printing money on the press to pay you back. I like that as a retiree, I want safety.

Number two is indirect obligations. Everybody thinks that if it says it's a government bond it has the full face credit of the United States government. That's not true. Only T-Bills, T-Notes, T-Bonds, and Ginnie Maes have it. Anything else is number two. They are indirect obligations, moral obligations. They are implied obligations. They do not have the full faith and credit of the U.S. government.

Number three is bonds. Even in the Depression less than 2% of bonds failed. Why? You're in New Orleans; suppose the water district said, OK, you lent us some money for a tax-free bond and we can't pay you back. Well, who would be stupid enough to give them money the next time they need repairs?

Number four is annuities issued by insurance companies. The safety of insurance companies, by and large, are just based on the strength of the company.

Fifth is stocks. There's absolutely no guarantee and no maturities on stocks. Well, if the majority of America is not buying stocks, you should, and so should my clients, regardless of what their age is.

Now in the 1980s interest rates went berserk. Once the 1980s went away, people said to me, "I'm going to wait until the interest rates go back to 13% or 14%." Well, guess what folks? It is not going to happen. If you look at the long-term history of interest rates, in the 220 years of United States history, 91% of the time the interest rate has been at 7% or below. It's been 8% or below 93% of the time. It has been 9% or below 97% of the time. This insanity in the 1980s was only for one time in 220 years, and it lasted for less than 5 years. You have to readjust your thinking and say that if 91% of the time 7% is a fair number, I have to start thinking in terms of 7%, 8%, or 9%. If I'm not in wishland, I have to tell my client that 8.5% is all he can get, and that's what I'm getting in bonds.

Now people tell me they want to be in bonds for two reasons: safety and income. That's why they buy bonds. But what they don't realize is that in the last 30 years bonds have been more volatile than stocks. Everybody says they don't want to be in stocks because it's too volatile. The truth is it is the safest thing in the world. U.S. government bonds were more volatile than U.S. stocks and were not paying more than about 8%. I can get 12.5% in stocks.

You need to understand what happens to bonds when interest rates start going up. Last year we had the worst bond crash in U.S. history. There were seven raises in twelve months. If you owned a two-year bond and interest rates went up 1%, the value of your bonds went down. A two-year bond went down 1%. If rates went up 2%, your portfolio went down 1.9%. Not too bad because the short bonds do not have the volatility. With a five-year bond, if interest rates went up 1% you were down 3.4%, and 6.7% if rates went up 2%. Now look at the 30-year bond. Up one point, I'm down 11% in my portfolio. If it went up 2% I'm down 20% in my portfolio. You need to understand that bonds are more volatile and will never return the same amounts of money as stocks. It's important that you understand that concept.

An article in *Money* magazine in September 1994 said, who needs bonds? Unless you're 1,100% income-invested, you'd be better off with just stocks and cash. The report went on to give three portfolios. For maximum growth, invest 80% in stocks and 20% in bonds. For conservative growth, invest 60% in stocks and 40% in bonds. For an income-only investor, put 60% in bonds, 20% in stocks, and 20% in cash because the reality is that bonds will not help you grow your portfolio. We must beat inflation in taxes, and we cannot do it with bonds.

I said earlier that sometimes all you have to do to be a visionary is to open your eyes. You truly can see into the future. But you have to do it; you have to look. You have to see what's out there. Now I'll tell a little story about myself. Suppose you knew the outcome of a football game in advance; how much money would you bet? Would you bet on the Super Bowl if you already knew the score? One day I was watching a ball game and my nine-year-old son's favorite team was playing. He woke up late, I was already into the game, and it was in the third quarter. And he said, "Oh gosh, my team is winning." I said, "No son, my team is going to win this ball game." He said, "No dad, my team is way ahead." Late in the game, I said, I'd bet him whatever he wanted to bet. "If you want to bet a nickel, I'll bet you a dollar." He said, "OK." We're into the fourth

quarter and his team is still ahead by 13 points. I asked if he wanted to up the bet. He said yes. He increased the bet as high as he could go with the money in his piggy bank. In the end my team scored two touchdowns and two extra points and won by one point. It was a taped delayed broadcast. I had already seen the game, I knew the score, and my son did not have the knowledge. If you can see something in advance, you can make a great deal of money.

Say a person has 40 years to go to retirement. He or she is right out of college or high school; he is 20 years old. Suppose you are going to retire at 60, and you are 20 today. You can earn 10% interest by only putting away $2,200 a year. In fact, it's $2,054 a year for 40 years. If you can earn 10%, you will have a million dollars. If you wait five years, you have to put in $3,300 a year. If you wait another five years, you have to put in $5,500 a year every year. Guess what? It's getting late. If you only have 20 years left, you're 45 now and will retire at 65, you have to start putting in $15,800 a year after taxes. Tough!

What interests me and makes me laugh is that piece in *Money* magazine, February 1992. The 20 great mutual funds to buy now. February 1993 lists the 12 best mutual funds to buy now. February 1994 lists the nine best mutual funds to buy now. August 1994 lists the ten best mutual funds to buy now. Guess what? Of all those that we talked about, only one of the best funds repeated in any other issue. All it does is sell magazines. Let me tell you about the best fund or the best stock last year. Unfortunately, it's too late. For example, the Pacific and Asian funds had fabulous years. In 1993, the Dean Witter fund was up 95%; that's unheard of in mutual funds. This year it was down 28%. Again, let's put the crystal ball in effect and just take a quick look. I can buy T-bills, T-bonds, Fortune 500, or small stocks. Look in this crystal ball. Which one will make you more money over the long term? Small stocks. If you know that in advance, you have to put more money in small stocks.

Show me a time in history when the stock or bond market has not recovered from a down year. This never happened and it will never happen. In the last 50 years, the stock market went down 11 times, and the average number of months that it stayed down was 11 months. If I look in the crystal ball, 1994 was poor, and I had some money, I'd go buy stocks. It does not take a crystal ball to figure that out. When you think about the stock market, if you think short term it will scare you to death. If you think long term it will be fantastic because the crystal ball says that if you can just stick with the program you will make 12.5% on average. That's just if you stick with the blue chips. If you buy the small-cap stocks, you'll make more money.

If you think U.S. stocks are great, foreign stocks are even better. There has not been a year in the last 15 years when foreign stocks haven't beaten American stocks. Not a year. In fact, in the last ten years, the U.S. only placed twice in the top five among the major countries in the world. Incidently, the common stocks we talked about average 12.5%. Small common stocks average about 15%, foreign stocks average about 18%, small foreign stocks average about 28%. If we know all that and it's been going that way for years and years, it is easy to look inside this ball and make some predictions: I'm going to make more money if I buy those things that have traditionally won. It works.