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How to Reduce Your Top 5 Biggest Investment Expenses?

TAXES:

BECOMING THE IRS' FAVORITE CLIENT...

My goal for this guide is to highlight FIVE direct & indirect costs that main street must be aware of as investors. Regardless if you hire a financial advisor or are a do-it-yourselfer. I call this process the T.R.A.C.E True Cost system and the combined effects can wreak havoc with significant reduction on the total expected return.

Taxes are a big issue that often gets overlooked since it is buried in your tax returns and is reported in arrears. When reviewing a prospect's tax returns rarely do I come across a situation where proper tax planning couldn't have improved their outcome. I'm always amazed when I see penalties & interest for missed estimated payments, fully depreciated real estate, missed carryover items that can reduce their taxable income, and mutual funds that have high taxable distributions. Losing deductions and credits due to poor planning is akin to burning straight cash. If your advisor is not reviewing your tax return to score the efficiency of your investments, then you are by default overpaying and losing out on the opportunity to improve your Return on Investment.

Here are **TEN** reasons you may be making an unnecessary charitable donation to the IRS:

1

Asset Location:

This is a strategy that determines the proper account to place investments in to get the most favorable tax treatment overall. The key here is to reduce the amount of tax drag over decades by placing tax-efficient and tax-inefficient asset classes in the appropriate investment vehicles (including taxable accounts, tax-exempt accounts, tax-deferred accounts, trust accounts, variable life insurance policies, foundations, and onshore vs. offshore accounts).

2

Review Your Mutual Funds:

Is it possible to have a mutual fund that is negative for the calendar year and still have a tax bill? Yes! Make sure our funds are tax managed and have a low turnover ratio.

3

Ordinary Income vs. Tax-Preferential income:

There are three ways I normally see inefficiencies in this area. The first is trading too much in your taxable accounts and having a significant amount of short-term capital gains (held under a year). Short-term capital gains are treated as ordinary income. So, if you're in the combined tax bracket (State and Fed) of ~45%, you're practically 50/50 partners with the IRS on those trades. The second area of focus is being mindful of the characterization of your income investments. Qualified Dividends are taxed at the 15%/20% tax bracket. Lastly, cash management, holding too much money in cash. The tax on the interest could put you at a real return below inflation.

4

Review Rebalancing Methodology:

Is your software or investment manager automatically rebalancing your taxable accounts or is there a personalized approach to address the tax consequences?

5

Lost Deductions:

Capital gains and dividends stack on top of your earned income to determine your tax brackets for your ordinary income items. This could phase you out of certain deductions and credits. Also, don't ignore Net Operating Losses (NOL) due to selling a rental property or from a spouse's business. This could be used to do massive Roth conversions.

6

Tax Diversification:

Keeping your savings in different retirement account "buckets" will ensure you aren't hit with a tax bill that is larger than it needs to be. This is extremely important when you get to retirement and want to choose your tax bracket.

7

Tax-Loss Harvesting:

If you have multiple taxable accounts are you coordinating the tax loss harvesting to minimize the net capital gains? Are you working with your tax advisor at end year to reduce the amount of capital gains due that might push you into a higher tax bracket?

8

Real Estate Investing:

I see a lot of tax mistakes in this area. Some are related to poor tax planning such as: fully depreciated properties, not using cost segregation or qualifying a non-working spouse as a real estate professional, house hacking, and using a conservation easement donation. Check with your advisor to see if you can benefit from the new Section 199A deduction & new rules on bonus appreciation/section 179.

9

Tactical in Tax-Deferred Account:

I recommend having a bear market strategy for my clients. This means making sure there is liquidity during a crisis to pay living expenses or to take advantage of significant discounts across multiple asset classes. Some clients prefer having a money manager that takes action and moves to a cash position when markets are in the late stages of a bull market. Put those strategies in your tax-deferred accounts, so the trading activity doesn't come with late tax surprises.

10

Stop Panic Selling:

A lot of times I see investors buy what is hot only to see them sell weeks later when the trade goes against them. Mainly because they never had conviction in the investment but were just embolden by their FOMO. Remember short-term capital gains are taxed at your ordinary income. In California, that means up to ~50% when you combine both State and Fed. If you do panic sell in your taxable accounts, immediately meet with a fiduciary financial planner because you can have both the tax losses and the subsequent market rebound (this time with a more risk-appropriate portfolio).

RISK MANAGEMENT:

YOU CAN'T BUY PAST PERFORMANCE

Prospect: I'm giving you \$1,000,000 and another advisor \$1,000,000. Whoever performs better in 6 months will get the full \$2,000,000.

Me: Let me get this straight. You want to incentivize two separate financial advisors, with no skin in the game outside their fees nor any personal liability, to take on maximum risk with your hard-earned money to compete for the opportunity to gather more assets in an arbitrary?

Taking on too much risk is indirect cost. I see this all the time with prospects. They take a flier on a strategy or investment because of recency bias, herd mentality, or a friend recommended it then end up selling at the wrong time, which leads to a perpetual buy high, sell low mentality as you attempt to double down on losses. This Behavior Gap has caused a lot of retail investors to have a significantly lower return than the overall global market.

Don't fall in love with the rosy projections you see from investment advisors during sales pitches. It seems like every management company claims to outperform the market. This is particularly easy when they can data mine and cherry pick a period that looks favorable for their strategy. I say this all the time you can't buy past performance. Markets work in cycles and not all bull markets are the same.

Without conviction rarely is there commitment. There is no perfect investment strategy that will outperform in all market cycles. Every dog will have its day. It's important that you, as an investor, subject yourself to the expected underperformance that will not cause you to jump ship.

Have and fully understand your bear market strategy. Whether you are using hedged equity which puts a floor to your downside or holding enough fixed income (bonds) to cover all liquidity needs during a prolonged market downturn. Your fixed income portfolio should be designed to act as risk management & diversification, so that you tactically rebalance into depressed assets, and provide liquidity when equities are in a correction. I generally recommend 3-7 years of annually required cashflow in bonds. If you annually need \$120k from your portfolio to expense your lifestyle, you would want \$360k-\$840k in short-term fixed income that matches inflation.

Here are **FIVE** additional areas that tend to cause havoc for investors due to poor risk management:

1

High Yield Funds:

A Real Estate Investment Trust's (REITs) dividend is considered ordinary income. So a high-income earner at the top marginal bracket can see a significant reduction in return compared to the advertised yield. Also, REITs were down 37.3% in 2008, and Vanguard's High Dividend fund was down 34.7%. Both can be extremely volatile and should not be considered a conservative investment or a bond substitute.

2**Security-Based Borrowing:**

Typically, the variable interest rate is 2-5 percentage points above a 30 day LIBOR depending on the sum. Such non-purpose loans are being offered to millions of high-net-worth individuals via their accounts managed by broker-dealers eager to increase fees with the steady rise in equities and record-low interest rates. Such credit has become popular because it tends to be easier to obtain and requires far less documentation than a traditional loan. Borrowers can get cash within just a few days in most cases. These are best used for short periods of time in situations that demand a significant amount of cash quickly, such as an emergency or a bridge loan. As rates continue to increase and with the inherent volatility of stock collateral there is a greater risk of forced liquidation if the market falls and collateral value plunges.

3**Asset Protection for Rentals:**

I've seen too many rental properties without proper landlord insurance, umbrella policies, or setting up LLC when holding significant equity. There are tools to mitigate your liability. For a legal opponent planning to pursue your assets, you have placed multiple roadblocks. You have hidden (land trust), protected (LLC), and stripped the property (equity stripping) of its value.

4**Stock Compensation and Concentration:**

Employees who receive stock compensation should reduce concentrated company stock positions to help achieve their long-term goals. An optimal sale amount can be quantified based on the investor's time horizon and risk tolerance, the tax cost of selling, the volatility of the single stock, and the level of portfolio concentration. This means a comprehensive analysis of key issues, such as: the tax cost of selling versus the benefit of diversification, How much to divest?, immediate versus staged selling, and alternatives to sale (including hedging with options).

5**Underfunding a Universal Life Insurance Policy:**

You need to be vigilant with their Universal Life (UL) policies and get a second opinion from a fee-only fiduciary because UL policies contractually allow insurers to adjust insurance costs up to a maximum rate (sometimes an increase into the double and triple digits on a percentage basis) based on certain factors. Time after time, I encounter investors who were unaware that fees and expenses in a universal life or variable universal life policy could skyrocket. With universal life, that means understanding that a contract could go "sideways" if insurers credit the minimum interest rate to a policy and impose the highest contractual cost of insurance.

6**If it Doesn't Make Sense, Don't Buy it:**

One of the newer ways Wall Street is getting people to lose money is inventing products using what's called Exchange Traded Notes. These bank products offer

no principal protections and can wreak havoc on a portfolio. In February 2018, the VelocityShares Daily Inverse VIX Short-Term ETN (ticker symbol: XIV) plunged more than 94% in a week. Inverse and leveraged ETFs that will track 4x or -4x the DAILY performance of the S&P 500 or a sector. I see investors making foolishly long-term bets with short-term trading vehicles. You can lose over 50% of your investment in ONE DAY. If you see an ad in the paper for a 5% CD when you're getting 1% at your household bank, you need to think how is that possible. You will be presented with a well-crafted sales pitch that will say all the right things, but when you're not working with a financial planner, it's hard to separate the wheat from the chaff.

ADVISOR FEES:

STOP PAYING FOR THEIR PRESIDENT'S CLUB

Today, there is no logical justification for basing your fee on percentage of assets under management (AUM). The typical 1% of AUM fee is exorbitant. One percent of \$2 million amounts to \$20,000 a year!! The only logical fee arrangement is one based upon flat fees similar to the arrangement used by attorneys and CPAs.

The AUM fee is likely to be used for some time to come by many advisors, but its usefulness is coming increasingly into question by both consumers and industry observers for potential conflicts-of-interest issues. I often see advisers who are paid primarily for managing assets with little incentive to offer advice in areas that could reduce AUM, such as using assets to pay off a mortgage or invest in a business. Investing in an income annuity might be the right strategy if you want to ensure lifetime income sufficiency, but an AUM-fee-only adviser would not be compensated for the investment. Most adviser-fiduciaries strive to be conflict-free in dispensing advice, but the method of compensation may at times influence that advice. It is hard to imagine a system that is as egregious as the AUM-based model, since most of those advisors charge from 1% to 1.5% of AUM for stocks, but they have a reduced rate of .25% or less for cash and bonds they are managing. The natural proclivity of the advisors with this arrangement is of course to invest most of their clients' money in the stock market, since the advisor's compensation is 10- to 15-times greater for stocks than on cash and bonds.

With a flat-fee model, you simply pay for unbiased advice, rather than an investment product. It provides the most complete transparency and fairness in that it aligns the pricing of services directly with the cost of delivering those services. More importantly, an annual flat retainer completely changes the client-advisory relationship, with the emphasis placed on the holistic nature of financial planning. Although portfolio management should remain an integral part of the relationship, it is more aligned with all the elements of your financial life, including retirement planning, estate planning, income tax planning, risk management and cash flow planning, as well any investments the adviser is not managing. Under a flat-fee arrangement, all elements receive the appropriate attention based on their priority at any given time.

There are very few scenarios where it's more cost effective to use the assets under management type of financial advisor, and in almost every case, you won't have enough capital to get the attention of one of these advisors. That's why sophisticated advisors are turning to monthly subscription and fixed annual retainers to provide comprehensive financial planning. One day, we will be asking, "Why would anyone pay 1% on AUM knowing they can pay a simple flat fee for advice?"

COMMISSIONS:

I LOVE MY SALES JOB, IT'S THE WORK I HATE.

Over the past few years, the financial services industry has come under criticism regarding fees charged, hidden fees, commissions, 12b-1 fees, and a host of other reductions in the value of their client investments. Much of this criticism is warranted, in my opinion.

A huge topic of conversation in recent years has been around the up-front commission charged by broker/dealers (B/D), who are not held to the fiduciary standard when they place clients into front-end load mutual funds. Many savvy investors have discovered how these commissions can take a huge chunk out of their portfolios and have turned to advisers covered by the fiduciary standard, such as Registered Investment Advisers (RIA), or have decided to self-manage accounts to avoid these up-front commissions.

Thankfully, the cost of trading has fallen by more than 80%, without adjusting for inflation, since the regulators abolished fixed-rate commissions. Until then, a broker who tried to charge customers less than the fixed rate to trade shares ran the risk of being expelled from the stock exchange.

Today, there is a race to get this fee to zero. You see Charles Schwab, E-Trade and TD Ameritrade using expensive marketing to tout their lower commission fees. There is even a company called Robinhood, a mobile app, that doesn't charge any commission and only takes a fee on the amount you hold in cash.

One of Wall Street's major revenue sources is trading fees. Therefore, it has an existential prerogative to create & sell esoteric products. The major financial media outlets need ratings to increase their ad revenue; thus, most continue to trigger fear and greed with their audience to get you churning your portfolio. Here are **FIVE** ways to make sure you are not diluting your returns due to commissions.

1

Reduce the conflict of interest:

American investors lose about \$17 billion a year to conflicted advice in their retirement accounts, according to a study by the White House Council of Economic Advisers. A broker's job is to produce revenue for the firm. The two main ways to do that is to sell you products and generate trading fees. What happens when there are two investments that are perfect for you, but one of them is the proprietary fund that pays the broker more or gets him closer to his quarterly minimums to keep his job?

2

Insurance is sold. Not Bought:

Commissions vary by policy and company, but life insurance agents often receive 80% to 100% of the first year's policy premium as a commission. Those commissions and other costs are why most permanent life insurance policies, such as whole life insurance, build no cash value in the first year and don't even until after a decade. This also disincentives some agents from creating the most cost-effective insurance contract for you since they would lose the higher upfront commission.

3

If it sounds too good to be true..

“Chris, I went to a seminar and the speaker was offering a 7% guaranteed compound return if we invested in his annuity.” I get this all the time. Remember there are two buckets at play. The actual money that you put into the contract and the actual returns of those investments. Then there is a separate bucket (benefit base) that you don’t own and can’t take with you into which the insurance company applies those roll-ups, bonuses, and guaranteed growth. The benefit base can only be taken when you annuitize decades into the future. So, your investment is not going 7%. The benefit base is growing 7%. Also, check to see if it’s simple interest or compound interest.

4

Watch out for non-traded Real Estate Investment Trust (REITs)?

Investors often pay commissions and fees of 15% for nontraded REITs, according to the SEC. The average cost for those 89 REITs in the new study was 13.2%. A new and broad analysis of 89 nontraded REIT found that they generated average annual returns of 4% for investors, compared with 11.3% for their publicly traded counterparts.

5

Take the 100% discount:

There are several Exchange-Traded Funds (ETFs), which is a fund holding a large number of securities, that can be bought with no commissions at many discount brokerages. Recently, in August 2018, Vanguard Group’s online brokerage platform will be offering commission-free trading on more than 1,800 ETFs.

EXPENSE RATIOS:

If you or your advisor is using Mutual Funds or Exchange Traded Funds (ETF) as the primary investment vehicle, then that is an additional cost that needs to be added to your total all-in cost. It is important that your advisor is using low-cost, no-load, institutional-class funds if they are using mutual funds. These remove unnecessary sales commissions and various additional fees.

Nowadays, expenses don't even have to be paid. Fidelity recently launched their free index funds. But Vanguard's Total Return Index Fund cost 0.04%, and Schwab's Total Return Index Fund cost 0.03%.

Review your current fund holdings. What do they cost? How have they performed relative to its benchmark? Is it tax-efficient? Most importantly, are you paying too much to simply mirror the market or even underperform the market? Closet indexing can hurt investors because they are paying higher fees for mediocre performance and should use (3) metrics – R-squared, tracking error, and active share – to tell you if an actively managed fund is simply charging more to mimic an index.

Since a lot of investors have money tied up in their company's 401k, it's important to know what the underlying cost is for your mutual funds. Knowing how to determine which share classes to use if your plan doesn't offer no-load funds. For example, Class B and C shares have higher annual expenses than the A shares, so the total return from paying the maximum front load or going with a back-end load is about the same after six or seven years. An investor who is investing enough to reach a class A breakpoint will be better off with the front-loaded shares.

For those solo-practitioners or small practices, review your 401k plan to make sure you're not paying revenue sharing or ongoing trails. Many providers may tuck or hide 401(k) costs within insurance or mutual fund expenses making it difficult to determine what services you are paying for and at what cost. These amounts may even vary by fund. So look for an investment roster that is trail-free. Cutting out revenue sharing is a great way to lower costs for you too.

Lastly, be careful with variable annuities. These products are often touted as a "swiss army knife" of investing. Sales people will say this product can accomplish all your goals and is pitched to high-income professionals who have maxed out their retirement account and want another tax-deferred vehicle. But variable annuity fees can be as high as 3.00% or more per year. Higher fees mean less of the investment returns come back into your account. These fees can make this one of the most expensive products that you can purchase. Take the time to understand all the following fees and charges before you buy. Even better, before you purchase anything from a financial salesperson who will receive a commission, you may want to talk to a fee-only financial advisor.

SO WHAT'S NEXT?

If you're considering working with a financial professional, or if you currently have one, it's important to know the entire cost of doing business.

This is particularly important if you're in the accumulation phase because reducing your total cost by 1% can amount to tens of thousands and sometimes of hundreds of thousands of additional wealth at retirement (or even the option to retire earlier).

For those of you who are living off your investments, this means potentially being able to take less risk or have a higher net draw on your portfolio.

Anyways, if you're worried about all the money you've lost over the years, don't be! You did not know about these savings hiding right under your nose, but now you do.

Even better? You can do something about it. Right now.

All you have to do is click this link and schedule your free (no obligation) expense-slashing, return-enhancing session.

During this 20-minute call you get personalized advice that helps you:

- Understand if you're using the right tax strategy for your investments (this one thing can save you hundreds of thousands over the life of your accumulation phase...and it's EASY to get wrong)
- Audit your Investment's Expense. Budgeting from zero helps to remove unnecessary cost & can save huge amounts of money in the long-term. This means auditing the management company for your rental properties, reviewing the cost of investment vehicles with lower cost comparable options and cost-benefit analysis on insurance contracts.
- Reduce behavioral & cognitive bias with zero cost thinking. People tend to ascribe more value to things merely because they own them. In psychology and behavioral economics, this hypothesis is called the endowment effect. This is common with people holding cash-drain real estate properties, significantly underperforming stocks, and even unhealthy relationships. It's important to constantly ask yourself this question, "If I knew what I know now, would I commit to this investment, project, person today?"

All you need to do is click here to schedule your call right now. You work hard for your money, and I want to show you how to keep as much as you can. But you must take the first step and make the call. I look forward to getting to know you (oh, and helping you save money :)).

Sincerely,

Chris Jackson, MBA, CFP, EA