A FINANCIAL STRATEGY TO
REIGNITE THE AMERICAN DREAM

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TAILS YOU LOSE

PATRICK H. DONOHOE

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A Financial Strategy to Reignite the American Dream

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CONTENTS

CHAPTER 3

QUESTION EVERYTHING

"What we observe is not nature itself, but nature exposed to our method of questioning."

—WERNER HEISENBERG

The great American labyrinth begins while you're still in high school, where you're taught the following:

1. Go to college because college leads to a career with healthcare and retirement benefits. College is expensive, but there are student loans available that will pay for the whole thing.
2. After your 30-year career, you don't have to work anymore and should retire. To retire, you are told a 401(k) account with mutual funds as investments is the way to go and that the government will provide you with Social Security income during retirement on top of that.

3. When you have the means necessary, you should buy a house and put at least 20 percent toward the purchase. You are told to pay the mortgage loan from the bank off as soon as possible and even consider a 15-year loan to do it quicker. Your real estate agent has taught you well, and you firmly believe, as she does, that your home eventually becomes your most valuable asset.
4. A new vehicle must occupy the new garage of your new home, and because of your great credit score, you can qualify for a zero-percent automobile loan.
5. When your bank account gets a little thin from payments going to income taxes, health insurance, your 401(k) account, Social Security and Medicare taxes, and the bank who gave you a student loan, mortgage, and car loan, don't worry!
6. Credit cards will give you points and rewards!

This is the vicious cycle that most Americans find themselves in. The empirical data evidenced in the introduction tells a story that conventional wisdom isn't that wise and that this route may not be the best course of action for everyone.

These social beliefs and expectations are not as realistic as they seem.

WHO'S TEACHING YOU?

The people who are telling you that this is the way to use your money wisely are those who have the most to gain. They're looking out for themselves, not for you. Everything financial advisors are taught goes to confirm the standard narrative.

Look at the college loan industry. The higher education lobby is huge. If those government-backed college loans went away, what would happen? The college business model, especially the for-profit model, would be destroyed. Tuition would drop. All that investment in new buildings and other ways to attract students would be lost.

Look at banks. Banks control everything, and they spend vast sums on advertising and promotion and lobbying for their benefit. They work hard to convince you that you should borrow for everything and keep your savings with them.[19]

> *"Unburdened with the experience of the past, each generation of bankers believes that it knows best, and each generation produces some who have to learn the hard way."*
>
> —IRVINE SPRAGUE, FORMER CHAIRMAN OF THE FEDERAL DEPOSIT INSURANCE CORPORATION

Wall Street has taken over the massive amounts invested

19 https://hbr.org/2014/06/the-price-of-wall-streets-power

in 401(k) mutual funds. The amount spent on lobbying and advertising and promotion is enormous—the financial lobby alone is an $8 billion industry.[20] It all goes to convince you that this is the way financial planning is done, that your 401(k) is the best way to save for retirement, and that the best way to build that retirement fund is to invest it with them.

Look closer at consumer credit and lending. Huge amounts of money are spent to advertise and promote credit cards, car loans, and mortgages. Rationally, you should step back and think, "If they're spending so much on TV commercials and celebrity spokespeople, they must be making a lot of money off these products. Where is all the profit coming from?" It's coming from the high interest rates and fees that they never really tell you about until you're already signed up.

Everything in our economy today is leveraged. Let's say that mortgages were outlawed. You would have to significantly reduce the price of your house to sell it, because no one could afford the cash up front to buy it. But because mortgages do exist, you don't have to come up with the entire balance, which increases the price of homes. Same thing with cars. If you had to buy a car with cash, hardly anybody could. Everything in our economy is priced with leverage, even the stock market. At the same time, we're

20 http://www.opensecrets.org/lobby/top.php?indexType=c&showYear=a

all taught to pay off debt, to get out of debt, to be debt-free. In fact, that's not a good thing to do, because you're battling everything else that is priced with debt factored in. That's why people always find themselves in bad situations.

THE TYPICAL MINDSET

The result of following the typical mindset about your finances is that Wall Street and the banking industry get bigger and bigger. Any gains you might have made on your investments are wiped out during the inevitable downturns in their cycles, fees and commissions, and inflation. People continue to follow the typical approach to their money because of the sheer number of those doing the exact same thing and thinking that any alternative is too risky. People are naturally trusting, and they trust the crowd's opinion of financial markets and the conventional wisdom of investment, debt, and retirement. The typical models don't work.

Banks and Wall Street are collecting your money for retirement savings in one hand and lending you back the same money at higher interest rates with the other hand. All the money you're investing in mutual funds earns some money, but the earnings are offset by the interest and fees you pay when you borrow the same money at higher interest rates.

The numbers are staggering. Mortgage debt is more than $15 trillion,[21] consumer credit is almost $4 trillion,[22] auto loan debt is $1.1 trillion,[23] and student loan debt is $1.5 trillion.[24] That much money in debt is hard to fathom.

What will it take for people to wake up to this?

CONTROL = FREEDOM

When you control your money and financial potential, you are truly free. The biggest step to financial freedom is to consider yourself your most valuable asset, not your 401(k), home, an investment property, or your bank account. When you adopt this mindset, you start to think differently about how you dress and groom yourself, how well you maintain your body, how you treat other people, and how you look for opportunities—how to be more valuable to your employer, your colleagues, your children, and yourself.

If you don't have control of your money right now, that means the control is with someone else. Who is that someone else? It's someone who didn't earn the money that you're investing with them. It's someone who is managing

21 https://www.federalreserve.gov/data/mortoutstand/current.htm

22 https://www.federalreserve.gov/releases/g19/current/default.htm

23 https://www.federalreserve.gov/releases/g19/current/default.htm

24 https://www.federalreserve.gov/releases/g19/current/default.htm

a lot of other money from other people as well. Do you really think that the mutual fund manager who's taking care of your 401(k) account is thinking, "What can I do with [insert your name]'s money that's in their personal best interest?" No. That person is thinking, "How can I make the most money for me? How can I hit my bonus this quarter?"

At the banks and financial firms, collectively they think, "We're a public company. We need to hit our quarterly projections. If that means individual account holders suffer, too bad." Everybody's pressured to grow, grow, grow, grow—at your expense.

You're putting control of your financial future in the hands of people who don't have your best interests in mind. You're relinquishing control to big institutions that serve their own needs first and yours a distant second. You're increasing your risk while minimizing the earnings on your money. The typical financial mindset benefits institutions, not you.

When your money is tied up in funds managed by big institutions, you're not prepared for large expenses, lay-offs, emergencies, or market downturns. A 401(k)-based investment and retirement plan was never intended to be the "American Way to Financial Freedom." Today, the deck is stacked against most Americans, and it will be too late to make the course corrections necessary. When you consider fund manager performance over time, fund and administrator fees, and back-end taxes upon withdrawal, the 401(k) looks like the best retirement plan *only* for Uncle Sam and the financial institutions. Then you take into consideration the increases in life expectancies, caps on contributions, and falling retirement account distribution rates. The 401(k) makes no sense.

Most people still consider a million dollars a lot of money. Let's say that you amassed this sum in your portfolio and were ready to retire. According to renowned financial analyst Dr. Wade Pfau, columnist for the *Wall Street Journal* and *Forbes,* the maximum rate of distribution today, based on low interest rates and volatility, is 3.5 percent per year for 20 years.[25] That means that you can withdraw $35,000 per year for 20 years and be certain that you won't run out of money. That $35,000 is before taxes. Depending on your tax bracket—let's assume a blended rate of 20 percent—that ends up as $28,000 in spendable income. How is anyone supposed to live off that? If you go to headsortailsiwin.com/StudyGuide, I recorded a tutorial that takes you step by step through the math and actual fund performance. You will see more clearly how unlikely the feat of a million dollars is when considering taxes, fees, and inflation. If you have the typical mindset,

25 https://www.forbes.com/sites/wadepfau/2015/05/13/improving-retirement-outcomes-with-investments-life-insurance-and-income-annuities/#5305c35737ab

you're handing over pretty much everything to others. You're obligating yourself to debt, because when all your money is in your investment account or retirement savings, you're not able to spend it. You're pushed into using expensive consumer credit.

You're also obligating yourself to a tax code that can change. The widely held assumption of typical retirement specialists is that you'll be in a lower income tax bracket when you retire. That's risky. You're basically wagering that your tax rate is either going to be the same or better than the tax rate when you put the money in today.

You're tying up money until you're of retirement age. But what if you need the money before then? What if you have an emergency, medical expense, or you get laid off and you can't find a job for a year? If you need to tap that retirement money, you have to pay taxes and get slapped with a penalty.

What if you want to tap your 401(k) to pay a child's college tuition? You don't want your child to have to go into debt, but tapping your own money could wipe out well over a million dollars of retirement money because of opportunity costs and lost interest.

All the retirement models assume you'll be willing and able to work until you're 65. But in today's economy, you might find yourself pushed out of the workforce at 55. You might never find another job as good. That affects your retirement—and because the likelihood of living into our 80s is now higher, that means even less.

At the same time, Social Security funds are steadily depleting. According to a study by the Social Security Administration, the disability fund is going to run out in 2028,[26] and Social Security by 2034.[27] Social Security and Medicare have huge unfunded liabilities coming up. If you're betting on Social Security to provide for or supplement your retirement, you're in for a rude awakening.

RESISTING THE PRESSURE

People feel powerful pressure to put their retirement funds into 401(k) plans and take the employer match. That advice can be misleading. You're not really getting a 100 percent match from your employer. The maximum amount you can contribute to a 401(k) is determined by the government; match programs are typically based on a percentage of your earned income. Most employers only match, up to a point, what you put in—and your employer doesn't have to match your contribution at all. An employer can choose not to contribute, and you have no recourse.

26 https://www.ssa.gov/policy/trust-funds-summary.html

27 http://time.com/money/4213065/will-social-security-run-out-money/

Most people don't really think about this. They contribute as much as they can and trust that it will all work out. They prefer the payroll deduction approach, so they don't have to think about it. That's what they've been taught: you're not disciplined or educated enough to save and invest money.

There's a problem with that approach. The majority of the $100 trillion[28] in American wealth is in Wall Street's hands. According to Dalbar Research—which analyzes investor *actual* returns—over the last 15 years, the average asset allocation fund investor has earned 2.58 percent; equity fund investors have earned 5.29 percent.[29] This is before fees and taxes.

If returns are so poor for 401(k) plans, why do people continue to participate in them?

It's human nature. Everybody else is doing it, right? You don't want to be the odd person out. Doing something different isn't natural. It makes you feel unsafe. It's the status quo, and change in the status quo comes only with severe pain. The pain of changing is less than the pain of staying the same.

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28 https://www.wsj.com/articles/u-s-household-net-worth-rises-in-4th-quarter-on-higher-stock-home-values-1520528423

29 2018 Dalbar QAIB Research Report, www.headsortailsiwin.com/StudyGuide

We're also all just busy. We work hard, we need time for our families, and we don't want to take on more tasks and responsibilities. We don't want to take the time and mental energy to learn something, especially if it's not pressing to our well-being. It's just easier to sign up for the 401(k) automatic payroll deductions. Looking at alternatives that might be better is just too much work.

A DIFFERENT WAY

It takes a certain type of person to realize the problems with American personal finance, dominated by the 401(k) mutual fund and banking industry. These problems are real and need to be challenged. Not everyone is ready to believe me, but as George Washington said,

> "Truth will ultimately prevail where there are pains to bring it to light."

Those pains are on the foreseeable horizon. You can take steps and find solutions now. If you are the sort of person who wants to regain control of their future, achieve financial freedom, and live a life you love, keep reading. I'm going to tell you about a different way. It's simpler, it's safer, and it's historically proven. It will reduce your anxieties about money once and for all and allow you to be more productive. It's the route taken by far fewer people, but isn't success normally that way?

> *"Two roads diverged in a wood, and I—I took the one less traveled by, and that has made all the difference."*
>
> —ROBERT FROST

KEY TAKEAWAYS

- You are truly free when you take control of your money and financial potential.
- When you take the biggest step to financial freedom and consider yourself your most valuable asset, it changes how you think about everything.
- Resist the pressure to rely on conventional financial advice and educate yourself.
- You are the source of financial freedom, not a college degree, secure job, or 401(k).