THE RICH DAD POOR DAD LETTER

49 RETIREMENT INCOME SECRETS

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PARADIGM PRESS

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PARADIGM PRESS
AN IMPRINT OF AGORA FINANCIAL

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22 21 20 19 18 1 2 3 4 5 6 7
Published by Paradigm Press, 808 St. Paul Street, Baltimore, MD
Cover and Layout Design: Chad Clikeman

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Introduction

In this guide, you will learn 49 different secrets that will make you money, keep your money protected, and keep you wealthy for life. Pulling from different sources and some of our expert editors on these topics, plus my own personal viewpoints, I have put together this guidebook to teach you all the ways you never knew you could be building your assets column. Instead, I'm sure you've been racking up some serious numbers in your liabilities column, maybe without even realizing. But that changes today.

Read through this guidebook in its entirety, and keep it handy as a reference while you continue to build on your financial education. These will be lessons you can use for life.

*[**Editor's note:** As you read through this guide, you'll notice some bolded links I've included for reference. If you take a look at the **Links Index** at the very end of your digital book copy at **agorafinancialpp.com/49secrets**, you will be able to access all links I've provided.]*

8 Rich Dad Scams Making People Poor

There are all sorts of scam artists in the world. Most of the time we can spot them, like those emails that promise us millions if we'll just give away our bank account numbers. Sometimes we don't spot them until it's too late or the scammer makes a mistake (take Bernie Madoff).

But sometimes we don't know we're being scammed at all, never finding out because we've been conditioned to think from the cradle that something is the best way — the only way — to live a successful life. But it's not the case with these 8 myths we've been fed.

From my rich dad, I learned financial smarts, which taught me how to spot scams — and how to not be taken in. Without those financial smarts, it can be very easy to be taken in by scams, especially the scams that the rich use to keep the poor in their place.

So I want to break down the eight scams that most people never know about in the series I call "Rich Dad Scams." The first one is higher education.

CHAPTER 1:

Rich Dad Scam #1: "Higher Education Is Always the Answer"

The "School = Success" Scam

When I was young, my poor dad always told me the best path to success was to go to school. He felt that was the best way to get a good job. The problem was that my poor dad was one of the most educated people I knew, but he was always complaining about money and how unhappy he was with his work.

My rich dad, on the other hand, didn't have any degrees. Yet he was very rich and successful. Rich dad said, "School teaches you to be an employee. If you want to be rich, don't count on school."

From a very young age, I learned the promise of higher education meaning success was one of the biggest scams around.

That's why higher education is the first of the Rich Dad Scams.

Going to School Doesn't Make You (Financially) Smart

Because I'm outspoken against the school system, I'm often accused of being anti-education. Nothing could be further from the truth. But "go to college" is one of those things people point at as a way of being successful without ever stopping to think if it's true.

What will make you successful is not going to school, but rather financial education — learning how money works and how to make it work for you — is what will make you successful, and, unfortunately, you can't get that in our school system.

When it comes to money, going to school won't make you smart.

Understanding Value

This doesn't mean that education isn't important.

The basic education you get in your K-12 years is important to everything that comes after. And if you want to be a teacher, a lawyer, or a doctor, then obviously you're going to need to go to college.

But what you won't learn in school is how money works. Education, particularly in America, doesn't teach students how to live or be self-sufficient. Instead, it teaches us to be employees instead of our own bosses. It makes us workers instead of innovators.

In fact, the rich use school to keep poor people poor.

Different Types of Intelligence

One of the worst things about school is that it recognizes only one type of intelligence — book smarts.

If you aren't book smart, you are very quickly labeled stupid.

As a K-12 student, I was not book smart. But I wasn't stupid. I was just interested in different things. And I was bored. For instance, no one could tell me when I'd ever use calculus in my real life! Yet, I was told to comply and learn. I was being trained to be an employee.

My rich dad wasn't book smart either. He had street smarts, which he used to become very rich. I had to learn that from my rich dad because I didn't get it in school. My poor dad thought school was incredibly important, and he was very book smart. But what did it get him? He struggled financially most of his life.

That's another reason why we label higher education a Rich Dad Scam. The so-called experts tell you that you need it. They tell you it's important. But it doesn't actually do anything for you in terms of financial success.

"But I Studied Money in College!"

Tom Wheelwright, my Rich Dad Advisor on taxes, went to school to be an accountant and got straight A's. He will also gladly tell you that he got no practical financial education.

He learned what was needed to do a job but not how to successfully manage his own finances. And he went to school to learn about money!

People often say they learned about money in school. You may learn how to balance a checkbook, but you won't learn how money really works.

That's not an accident — it's a scam.

The rich use school to train us to be good employees. We start out being told what to do, and are rewarded for compliance.

It's very easy to transition from a school to a company; in both, you're given orders and rewarded for following them.

And that leads us to trust and hand things off to the government and the rich bankers who handle our 401(k).

The rich use education to make themselves richer and keep you poor.

Think for Yourself

The people who fall for scams are typically those who are conditioned not to think for themselves.

Unfortunately, this higher education scam robs us of the independence to think for ourselves, to think like an entrepreneur, an innovator, and an investor. It instead teaches us to be dependent.

You need to learn to speak the language of money to be successful. That takes financial education, which opens up a whole new world, a world where you can succeed on your own terms.

Our schools don't teach that language.

They teach you the basics, and then they either teach you a specific trade or skill, or they simply train you to be an employee.

Today, it's time to start thinking for yourself. Don't fall for this the scam of higher education. Instead, start your financial education today, and begin your journey to financial freedom.

Why Going to a Good School Doesn't Equal Success

When I was a child, my poor dad wanted me to get a good education.

"You need to go to a good school so that you can have a good job and be successful in life," he said. For him, successful meant a decent salary and job security.

My rich dad also believed in a good education.

"You need to learn how money works so that you can make it work for you," he said. For him, success was being an entrepreneur and a smart investor.

Most parents want their children to have a good education and a secure future. They want their child to make it to the top of the food chain. Most parents dread the thought of their children toiling at menial jobs, being underemployed, earning low wages, paying higher and higher taxes, and battling inflation all their lives.

Unfortunately, most parents think that a good school will help their kids avoid these things. The hope is that their kids will become doctors, lawyers, or CEO's. The problem is that none of those professions help them to be truly financially free.

The reality is that school does not make you successful because it does not teach you financial education. In fact, many of the most successful people in history were successful without finishing school.

To illustrate my point, here's a list of people who did not finish school but went on to be very successful.

R. Buckminster Fuller - Futurist and Inventor

Fuller, or Bucky as we called him, was brilliant. And what made him brilliant was his unique view of the world. Despite never getting a college degree, he received dozens of honorary degrees from top universities, like Harvard, earning him a Dr. in front of his name if you look him up online. Plus, without a formal education, he gained his acclaim in math and sciences: architecture, geometry, engineering, and became an educator himself. My time spent studying under Bucky shaped who I am today, mainly as an investor. His future-prediction methods taught me how to predict market behavior.

Ray Kroc - Founder of McDonald's

Kroc's journey to success started with his talent as a travelling milkshake machine salesman. When he got an order for eight machines from Richard and Maurice McDonald's drive through, he travelled to San Bernardino to learn why such a small venue would need so much production. Fast forward a little, Kroc has teamed up with the McDonald's brothers as franchise manager. He quickly realized that the "Speedee Service System" created by the McDonald's was going to be a cash cow in the burger industry. But he also understood — thanks to his businessman perspective — that the real money was in real estate. McDonald's is hugely profitable through its products, but the company's worth comes through the leasing of the property to anyone who wants to open a franchise. It's a business move that can't be taught in a textbook. It takes perspective.

Steve Jobs - Founder of Apple

He's everyone's go-to example for how you can drop out of school and become a millionaire. And I don't like using a cliché. But I give credit where it's due. The man wasn't a computer engineer. He didn't create the iPod. He was just an idea man with a businessman's outlook. And his ability to use what he did have — street smarts — made him an icon. He was a poor student all his life. Our education system has a way of hindering creativity and innovation.

These are just three examples of people who didn't need school to find success. My rich dad is another.

I could give you a list of thousands, each as impressive as the one before.

The point of all this is not to suggest that all kids should drop out of school, or that school is not important.

Education is extremely important. It's everything.

The question is: What kind of education? And where will your child's education take them? Will it prepare them for the future? Will it secure their financial future in a world with less and less security?

Those are the questions you want to answer.

CHAPTER 2:

Rich Dad Scam #2: "You Need a Job"

When I was young, my poor dad always told me that I needed to go to school so that I could get a good job. To my poor dad, getting a good job was the most important thing in life.

My poor dad worked very hard in any job he held. Yet, he never got ahead. His job was one of the things that actually kept him from succeeding.

He toiled away working for others, often getting raises only to keep up with the cost of living and paying a high percentage to the government in taxes.

My rich dad, on the other hand, never had a "real" job, and he was rich and successful. My rich dad understood the "Get a job" scam.

Rather than get a job, he made jobs. Rather than work for someone else, he worked for himself. Rather than pay high taxes, he used the tax code to get rich.

How the Scam Works

This such a massive scam because the trap it lays out makes you poorer, *especially* if you have a high paying job, because you pay the most in taxes.

And guess who isn't paying a lot of taxes? The owner of the business you work for. The scam gets even worse when you look at it long-term. If you do well at your job, if you claw your way up the ladder, what is your reward? A small increase in pay and a bigger increase in taxes.

It gets even worse if you work for yourself. You pay the highest taxes in the form of self-employment taxes.

The only way to avoid this is to be the owner of a big business or to be an investor, to put your money to work for you. That's where the rich work and live.

The system is set up to benefit the rich so they can keep their money while making sure YOU keep getting taxed.

The Tax Scam

When you realize that taxes are a way of keeping you in your place, you can see the “Get a job” scam is really just an extension of the “Higher education” scam. It’s in school that you learn to be a good employee, that if you work hard you can succeed. But really, you can’t, not on those terms.

The government gives tax breaks to people they identify as job creators: entrepreneurs and big business owners.

They want the private sector to develop real estate, start companies, and generate wealth. The government rewards citizens like that. In return, the government expects employees to pay taxes that cover things like Medicare and Social Security. The government loves low unemployment rates for a whole host of reasons, and “getting the country to work” helps *them* out a whole lot more than it helps the worker.

Some people argue that employers pay these taxes too, but really what they are doing is using money that would otherwise pay you to pay their share of the taxes.

False Security

The idea that a job is an important part of your personal security is a big part of the scam, too.

The reality is that having a job does not make you secure. Rewind the clock and look at life a decade ago: unemployment hovering around 10%, people getting laid off all over the country, living out what we now call the Great Recession.

In an economy where people are losing their jobs, the more secure position is to own, or at least have a stake in, the company that is firing people. And if history tells us anything, we’re always just X number of days away from the next crisis. Everyone can be fired. Except for the people who own the company doing the firing.

Stepping Away

My poor dad, just like most people, was conditioned and taught from the day he was born to be an employee.

My rich dad broke away from that thinking and was an entrepreneur. He put his money to work. He was on the side of the rich, the side protected by the government.

But how do you get there?

The first answer is simple. You do it by increasing your financial education and beginning to think like an entrepreneur instead of an employee.

When you do that, you break out of the rat race. You realize that everything you've been taught about getting a job and finding success is a lie, that there is another way, and it's a way that actually works while also giving you a better life.

And that's the secret the rich don't want you to know.

CHAPTER 3:

Rich Dad Scam #3: “If You Work Hard, You’ll Be Rewarded”

My poor dad worked hard all his life. He went to school because he was told to. He got a job because he was taught that was what you have to do.

He worked hard because that’s what he was supposed to do. Yet, he struggled financially his whole life, and it often made him unhappy.

Rich dad said, “Rather than work hard, I work smart. Smart work is getting others to not only do but also *want* to do hard work for you. And smart work is also getting money to work for you, not the other way around.”

Why Hard Work Doesn’t Work

It seems like a simple math equation: effort = reward.

You work hard, you earn more, you get more for your effort, and it seems like it should work. Once upon a time, it may have worked that way.

But now, there are two problems.

One — as I wrote about in Rich Dad Scam #2, “You Need a Job” — if you’re an employee, working harder may get you more money but it also means you’ll be taxed more. So working harder can actually result in your being punished financially. That’s why we created the Rich Dad Scams series, so that you can see these “truisms” for the manipulative lies they are.

The second problem is that you’re working hard for something in particular: Money. And that money is worth less and less every day.

Throughout the 21st century, average income after inflation has fallen. And continues to fall.

If you've been working hard at your job for 10 years, the money you're making now is actually worth less than it was when you earned it.

Practically speaking, that probably means you're either making the same amount now as a few years ago, or maybe even making less!

Rather than work hard for money, you should be working smart by having money work hard for you.

That's what the rich do.

Working Differently

There are two kinds of "work." **The first type is work you don't want to do.**

You only do this work because you know that if you don't, something bad will happen.

Examples of this type of work include:

- You go to work every day because if you don't then you'll lose your job and have no money for the necessities of life.
- You do the laundry because if you don't you'll have no clean clothes to wear and people will think you're uncivilized.
- You eat food you don't like because if you don't your health — and your waistline — will suffer.

I could go on and on with examples, but you get the idea. I'm sure you could list quite a few yourself. We all have at least some of this kind of work in our lives — yes, even when we become financially free.

The second type of work is **work you do want to do**. You do this kind of work because it is meaningful, fulfilling, interesting, etc. Work we enjoy gives us a sense of purpose, challenges us, and taps into our passion.

Here are some examples of work my wife Kim loves doing:

- Volunteering your time with a charity that you are passionate about.
- Spending hours on the weekends practicing your hobby.
- Volunteering your services as the family travel agent to make a special family reunion possible.

If you were to group all the work you do into one category or the other, which list would be longer?

Chances are, if you spend most of your time doing work you don't want to do, you feel trapped, resentful, and unhappy. If you spend a lot of your time doing work you do want to do, you likely feel energetic, fulfilled, and happy.

The goal of becoming financially independent is not to stop working, but to shift our efforts from work we don't like to work we do like.

Every week, most people just hold on until Friday because they hate their job. And when Sunday rolls around, they're miserable because they know they have five days of work to look forward to.

We all know this. Probably most of you reading *feel* this.

It's a lousy way to live, but it's not the only way! We've just been conditioned to think it's the only way.

I love my work, but I'm also never far from it.

Like most entrepreneurs, I'm at it almost 24/7, but it doesn't make me miserable — and it certainly doesn't feel like work. It's more like a game I love playing. It's challenging. It's fun. It's rewarding.

If that sounds attractive to you, the first step to get there is recognizing "work hard" for the Rich Dad Scam that it is.

Stop working hard for others and start working smart for yourself.

CHAPTER 4:

Rich Dad Scam #4: "To Be Rich, You Have to Live Below Your Means"

One of the most challenging things about these scams is how ingrained they are.

If you weren't lucky enough to have a rich dad to teach you about them like I did, these scams probably make up your ideas and attitudes toward money.

They feel built in.

Most people believe they must be true because they've heard them all their life.

So it can be difficult to remember that the Rich Dad Scams we've identified are lies, but it's vital to know that they are.

On the surface, "Live below you means," seems to make sense.

But really, the only people who live below their means are poor people.

The rich don't live below their means. Rather, they make better means.

A Poor Mindset

When it comes to money, what's your financial focus?

My poor dad spent his life working in the public school system — spent much of his energy working for others and saving as much money as he could. He was addicted to "safe" decisions with his money.

"If you want to be rich," my poor dad said, "Go to school, get a good job, and save your money."

The only problem is that my poor dad never became rich. He worked long hours, struggled financially and was never happy. If he wanted something nice, he denied himself. If we wanted to go on a trip, he'd say, "We can't afford it."

Yet, at the end of his life, my poor dad was penniless.

The costs of old age eroded his savings and he had no investments to fall back on. If it weren't for his pension and Social Security, he'd have been in real trouble — and people don't have those options now.

His financial decisions weren't "safe," in the end.

Again, my poor dad would always say, "We can't afford that."

My rich dad said, "Rather than live below my means, I make more money to get what I want. Rather than say, 'I can't afford that,' I ask, 'How can I afford that?'"

"Live below your means," is a poor mindset because it teaches you to think too narrowly.

Rather than teach you to be creative in making more money, it teaches you to be merciless in what you spend your money on. You balance the dollars you bring in from your job against your needs and wants. And no one likes finding things you can live without so you can afford something else. It's awful.

When my wife Kim and I want to splurge on something, we don't look at where to cut costs to afford it, we acquire an asset to offset the cost of what we want. So, instead of always looking for what we can cut to afford something, we're always looking to expand our wealth to cover the cost of what we want.

It's a completely different mindset, and it's the way my rich dad taught me to think.

For instance, some years ago I wanted to get a new Bentley. I could have easily paid cash for the car, but I didn't want to do that to buy a liability.

Instead, I invested in assets that would provide enough cash flow to cover my new toy. I took a little longer, but six months later my investments were creating enough cash flow to pay for my car — and then some. In the process, I got my fun car and also built my wealth.

This is the core of thinking like rich dad instead of poor dad. Think like an investor or an entrepreneur. Identify what you want and work out a plan to get there in a smart way through assets.

If you live within your means, you can never add assets, so you'll never break the chain of cutting costs and budgeting to afford something.

Change Your Thinking

If you want to think like rich dad instead of poor dad, begin asking, “How can I afford that?” rather than saying, “I can’t afford that.”

In the process you’ll go from a poor mindset to a rich one — and you’ll also break out of the pattern set by Rich Dad Scam #4, which tells you to live below your means if you want to be happy. It just isn’t true.

The Rich Dad Scams we’ve identified are, very simply, the things you are taught about money that are wrong. They keep you from becoming rich. They are the ideas the rich have built into society to keep you poor and them rich.

CHAPTER 5:

Rich Dad Scam #5: "Save Money"

"If you save money, you will have money."

"Save money for a rainy day."

"A dollar saved is a dollar earned."

These are common lessons parents teach their kids about money.

Unfortunately, there's one big problem with them: they're lies.

Time and Money Changes

The big problem with "Save Money" is that it used to be true.

A generation or two ago, saving money paid off. You could set aside a certain amount of money and retire on it.

Your parents or your grandparents might have done just that, and it worked. But what worked for them cannot work for you in today's economy. To understand this, you must understand the history of money.

In 1971, Richard Nixon took the United States off the gold standard, the system where every dollar in the US economy was based on a dollar's worth of gold that the country owned.

When Nixon did this, it destabilized the economy and kick-started inflation and a number of other factors that affect the power of your dollar. Before 1971, money was money, backed by the value of gold.

If you saved 10% of your income every year, it could turn into enough to retire on.

After 1971, money became a currency that could go up and down in worth with nothing of value backing it, other than the good faith and credit of the United States. That is why there have been so many fluctuations in the economy.

Real Money

Money is something that holds its value, which is a different concept from currency, which is a representation of that value and therefore fluctuates. When the US went off the gold standard, US dollars stopped being money and became a currency.

Today, savers are losers. Why? The bank pays you a lower interest rate on your savings than the inflation rate. In essence, this means that your money in the bank loses more value than it gains over time. It's a losing proposition to save. The dollar you save today will be worth less a year from now.

If, however, like an entrepreneur or an investor, you put that dollar to work for you, then you have a chance of a return that is much higher than inflation. You have an opportunity to make money instead of losing it.

Making Your Money Work

So, if you can't put your money in the bank, what can you do? The answer is to get aggressive. Putting money in the bank is passive. Putting your money out in the world is putting it to work. Why put your money in the bank where it will lose value when you can put it to work for you in assets where you can turn your money into more money? That sounds like a better idea to me.

Rather than saving, I encourage you to instead invest your money in cash-flowing assets or else in tangible commodities.

Protect yourself and keep your money moving at the same time. That is the true path to wealth.

CHAPTER 6:

Rich Dad Scam #6: "Your House Is an Asset"

It seems like every financial "expert" says, "Your house is your biggest asset."

When I wrote *Rich Dad Poor Dad*, I said that your house was a liability.

I emphasized they're expensive and don't always go up in value.

I wrote "I am not saying don't buy a house. What I am saying is that you should understand the difference between an asset and a liability… When I want a bigger house, I first buy assets that will generate the cash flow to pay for the house."

Saying that, I kicked the hornet's nest. The so-called experts lambasted me.

At the time, the real estate market was skyrocketing. Everyone called me a contrarian, out to sell books. Then 2008 hits, and after one of the worst housing crashes in US history, no one was laughing anymore.

So here's the biggest Rich Dad Scam of all — at least in physical size — "Your house is an asset."

Money In, Money Out

Your financial planner, real estate agent and accountant all call your house an asset.

But in reality, an asset is only something that puts money in your pocket.

If you have a house that you rent out to tenants, then it's an asset. If you have a house, paid for or not, that you live in, then it can't be an asset.

Instead of putting money in your pocket, it takes money out of your pocket.

That is the *definition* of a liability.

This is doubly true if you don't own your home yet. Then it's the bank's asset — it's working for them, but it's not earning you anything.

So What *Is* an Asset?

In business terms, assets are your pros and liabilities are your cons. You need assets to offset your liabilities.

Once you get away from the Rich Dad Scams, it's easier to think in those terms, to think like an entrepreneur.

But what exactly are assets?

The simple definition of an asset is something that puts money in your pocket.

This is accomplished through four different categories, one of which is real estate.

When I say real estate, I don't mean your personal residence, which, again, is a liability.

What I mean is investment real estate, which is a great investment because it puts money in your pocket each month in the form of rent.

There are three other primary assets:

- Business
- Paper
- And commodities.

If you are an entrepreneur or a business owner, your business is an asset.

Paper assets are stocks, bonds, mutual funds, and so on.

And commodities include gold, silver and any other physical resources like oil and gas.

My wife and I started out making our money in real estate, putting our money to work in properties that we could rent out to see ongoing returns. After that, we diversified, so now we have some money in all of four of these asset areas.

When your broker tells you to diversify in, say, mutual funds and stocks of varying scope…

That isn't really diversifying. Because if the market crashes, you get hit on any mutual fund or stock you have.

Invest for Cash Flow, Not Appreciation

The Rich Dad Scam that your home is an asset was prevalent when I first wrote *Rich Dad Poor Dad*.

That was in 1997, and everyone's home values were climbing.

It was easy to assume that your house was an asset because it was potentially making money for you in the long run through appreciation.

People bought into the scam hook, line, and sinker, taking out home equity loans to buy cars, vacations, TV's, and more.

Then in the Panic 10 years ago, those same people were so underwater that foreclosure rates rose to a peak of 10%. The foreclosure rate this year is 0.5%, to give you context.

When the panic struck and we saw the aftermath playing out in front of us, most people weren't saying their home was an asset if they were part of that staggering 10%. But now, we are back into a booming real estate market…

A lot of Americans got a fast, ugly financial education when the real estate market turned south. They realized very quickly that their homes were not assets.

Your House as a Retirement Plan?

Of course, there is also the notion that buying your own home is a cultural right of passage.

Many people dream of the day when they get the keys to their own front door, imagining the joy that will come with the monumental achievement of taking on hundreds of thousands of dollars in personal debt.

I'm only being slightly tongue in cheek.

The reality is that many people desire to buy a home because they think of it as a good investment. And in many cases, homeowners expect their house to be a big part of their retirement plan.

For instance, published just last year by Rob Carrick for the Canadian The Globe and Mail, "In a recent study commissioned by the Investor Office of the Ontario Securities Commission, retirement-related issues topped the list of financial concerns of Ontario residents who were 45 and older. Three-quarters of the 1,516 people in the survey own their own home. Within this group, 37 per cent said they are counting on increases in the value of their home to provide for their retirement."

The sentiment I'm sure is the same here in the US, and in many places throughout the world.

Lenders in ARMs

This is why I'm not surprised to read that now that housing prices are going up (6.9% year over year in August 2017), risky mortgages have come back into style.

As CNBC reported around the same time, "The number of adjustable-rate mortgage originations jumped just over 40% from the first quarter of this year to the second, according to analysis by Inside Mortgage Finance."

For those needing a refresher, an adjustable-rate mortgage, or ARM, allows potential homeowners to purchase more expensive houses by having lower interest rates than a traditional 30-year fixed-rate mortgage. ARMs are usually offered at one, three, or five years, meaning the interest rate will adjust to market rates after that period. In essence, it's betting that interest rates will be as low or lower down the road…and that you'll be in a better financial position to pay more, should the need arise.

You might not be surprised to hear that defaults on ARMs were a big part of why we faced the Great Recession from 2008 to 2011. And while there are new safeguards in place to ensure that ARMs aren't given to subprime borrowers, there is something of a frenzy that is building around buying homes in the U.S. again. This, again, is because people inherently think they are good investments. After all, don't housing prices always go up?

That's what you'd believe if you followed most conventional financial advice.

Many financial advisors will tell you that your house is an asset, but that is untrue. The fact is that when financial advisors say this, they are not really lying, but they aren't telling the whole truth either.

Your House Is Not *Your* Asset

If you look at a bank statement, it becomes easy to see just who gets cashflow from your home — the bank.

Most people do not own a home… they own a mortgage.

Those who are financially educated understand that a mortgage doesn't show up in the asset column on the financial statement. It shows up as a liability. But it does show up on your banker's balance sheet as an asset as you pay the bank interest every month.

Remember my rich dad's definition of an asset, "Anything that puts money in your pocket. A liability is anything that takes money out of your pocket."

Just look at your bank statement every month and you'll see that your home puts no money in your pocket and takes a heck of a lot of it out. This is true even if your house is paid off. Even after you pay off your mortgage, you still have to pay money every month in the form of maintenance costs, taxes, and utilities. And if you don't pay your property taxes, guess what can happen? The government can take your home. So, who owns your house really?

Don't Buy into a Lie

Am I saying don't buy a house? No. I own a home myself, but I didn't buy it as an asset or think of it as an investment. I bought it because I wanted to live in it and was willing to pay for the privilege of doing so.

Could it appreciate in value? Maybe. But it could also lose me money in the end. I don't really care. The money it takes out of my pocket is made up in my asset column. I always have positive cash flow despite any liabilities I own.

What I am saying is don't buy a home and think of it as an asset or investment.

I fear a booming market. I fear that what happened before will happen again sooner than everyone thinks.

So play it smart. You can make money in any market.

Rather than invest for appreciation, my rich dad taught me to invest for cash flow and to treat appreciation like icing on a cake.

I encourage you to do the same.

CHAPTER 7:

Rich Dad Scam #7: “All Debt Is Bad”

You may see some patterns in Rich Dad Scams. Several of them go together, and they all come from the same mindset.

Saving money, living below your means, and this Rich Dad Scam, “All Debt Is Bad,” all come from one place: **fear of money**.

Just like all the other scams, the idea that you have to eradicate debt from your life to be successful is a lie, and it gets repeated because people don’t have a financial education. They don’t understand what money actually is, how it works and how to put it to work.

There’s no doubt about it, from an early age we teach our children the value of saving money. “A penny saved; a penny earned,” we chime. And when they are a bit older, we spin tales of the magic of compounding interest. Save enough, children are told, and you’ll be a millionaire by the time you’re ready to retire!

That was Rich Dad Scam #5: “You Need to Save Money.”

But, we don’t tell them about interest rates, or the power of inflation to eat away at the value of money over time… we may not even be fully aware of these inconvenient financial truths ourselves. These realities cheapen millionaire status every single day.

It seems as if the “wisdom” to save your money is timeless, in that it won’t go away, even though it’s proven to be wrong. Even today you find “financial experts” who push the save to be a millionaire myth.

Playing with Numbers

Take for instance a video shared on Business Insider, “**How much money you need to save each day to become a millionaire by age 65.**” Breaking it down by age, it gives the following amounts:

- Age 55: $156.12 per day / $56,984 per year
- Age 50: $73.49 per day / $26, 824 per year
- Age 45: $38.02 per day / $13,879 per year
- Age 40: $20.55 per day / $7.500 per year
- Age 35: 11.35 per day / $4,144 per year
- Age 30: $6.35 per day / $2,317 per year
- Age 25: $3.57 per day / $1,304 per year
- Age 20: $2.00 per day / $730 per year

If you're in your 20s or 30s, you're probably feeling pretty good about these numbers. You might even be tempted to think it's worth it to start saving your money. After all, who doesn't want to be a millionaire by the time they're 65?

If you're in your forties or fifties, you're probably looking at those numbers and feeling a huge pain in your stomach. I don't know many middle class families with an extra $10K to $56K to save each year.

Now, here's the kicker, at the end of the video, the following assumptions (or should I say disclaimers?) are given:

"For simplicity sake, the calculations assume a 12% annual return and don't take taxes into account."

That indeed is some magical compounding interests — and mythical too. Let's break this down a bit.

What's a realistic return?

In the last 30 years or so, there has only been one time where interest rates on CD's reached 12%. That was for a 5-year CD in 1984. Over the last decade, the S&P has only returned 8.65% on average. In the same time period, the 3-month T-bill has returned 0.74% and the 10-year T. Bond has returned 5.03%. In fact, if you look at a **chart by Aswath Damodaran**, you'll see that since 1928, you'll be hard-pressed to find any standard investment or savings vehicle that returns 12% over a sustained period of time.

Perhaps you're ready to concede the point that 12% is lofty in terms of return assumptions, but maybe you're still pretty comfortable with the idea of a 10%, 8% or even a 6% return.

The problem is, not only does the video assume a high rate of return that most people will never achieve, but it also does not factor in taxes, which can eat up significant portions of your returns.

For instance, savings account interest is taxed at a marginal rate. This means it's taxed at your income bracket. So if you're taxed at a 25% rate for your income of say, $65,000 a year, you're savings interest earnings are also taxed at that rate.

You can begin to see how this pop financial advice quickly falls apart.

Savers Are Losers, but Who Is the Winner?

For years, I've preached that savers are losers. Hopefully the examples above will open your eyes as to why.

But the question becomes, why would financial advisers continue to push savings? As always, follow the money. The traditional vehicles by which most people save allow for financial institutions to charge fees. These fees can be especially devastating to a retirement account like a 401(k). Take this example from "USA Today":

> *Let's say, for instance, you save $10,000 a year for 30 years in your 401(k). If you average 7% returns annually and pay 0.5% in annual expenses, you'll finish with about $920,000 saved. However with 1.0% in annual fees, that total drops to a little less than $840,000 - and if you suffer 2.0% in annual fees, your finishing total is just under $700,000.*

Adding them all up together, lower returns that most models assume, losses to taxes, and payouts to financial institutions in the form of fees completely decimates the assumptions made by the Business Insider video, and frankly, most savings models out there. Savers truly are losers, and it's the financial institutions that win.

So, if savings isn't the way to become rich, what should you do?

The short answer is take out loans.

Isn't Debt Bad?

The Rich Dad Scams we identify are the ways the rich stay rich and make sure the poor stay poor.

That can be counterintuitive, especially when some of the scams — like living below your means and saving money—seem like they would help you get rich. But that's the scam.

The rich carry debt. They generally carry a lot of it. But they have assets that more than make up for the outstanding loans the carry.

In fact, the rich not only carry debt, they also use it to get richer.

The difference between the rich and poor when it comes to debt is understanding the difference between different reasons behind carrying it.

Good Debt vs. Bad Debt

The bad debt is the one that makes you poorer, such as overdrawn credit cards, car loans, and so on.

This is the type of loans used to buy liabilities.

Good debt is the kind that makes you richer, such as a loan for investment property or to purchase equipment for your business that will make you a return.

This is the type of loan used to buy assets.

An easy example of good debt is my real estate holdings. By getting a loan from the bank, I can purchase a property with only a small percentage out of my pocket. I then rent that property and my tenant pays the cost of my loan while putting money in my pocket.

Business is the same as the real estate example.

You can take out loans that pay for themselves. The cash flow of your business covers the what you've borrowed and generates income. That income can be turned into more good debt to create more cash flow.

We've been taught to think of debt as a four-letter word, but it doesn't have to be. Especially once you have the financial education to see how it can work for you instead of against you.

How Money Works for You

Let me give you an example of how the good debt concept works…

Say I have $100,000. Maybe I inherited it, or sold something valuable. But I have this money. I can put it into a mutual fund, which is a little better than saving it — as long as I choose a good mutual fund that won't take a huge chunk of the profits while also sticking me with extra taxes on capital gains. The return on it would be a bit more than just putting it in savings, but it wouldn't be a lot.

However, if I use that $100,000 as a down payment on a $500,000 property, then I've actually bought $500,000 in value with just $100,000! The difference, that $400,000, is good debt.

This is exactly what my wife Kim did on a smaller scale with her first investment.

She bought a $45,000 house with a $5,000 down payment, acquiring $40,000 in good debt, and she put that property to work.

The tenants paid the mortgage and the taxes on it for her. She was profiting, or generating a positive cash flow of $25 a month. It wasn't a lot, but it was a start. She used the same practice over and over again, building her wealth up while putting the money she gained to work. Today, she invests in millions, but the concept is the same.

Today, rather than buy into the "All Debt Is Bad" scam, I encourage you to instead increase your education and begin learning how you can make loans work for you.

CHAPTER 8:

Rich Dad Scam #8: "You Need a Diverse Portfolio"

The reason so many people buy into these scams is because some of them, like working harder and saving money, used to be viable. If you followed them, there was a reward.

But not anymore.

As we've seen in other scams living below your means and saving your money, the Rich Dad Scams I've identified keep you from truly putting your money to work. They keep you from turning your money into more money.

In other words, they keep you poor.

So let's break down Rich Dad Scam #8, "You Need a Diverse Portfolio."

The Investment Illusion

Have you ever heard this advice: "Invest in a diverse portfolio of stocks, bonds and mutual funds"?

Seems like good advice, doesn't it? What could possibly be wrong with spreading your risk among a number of different investment vehicles?

If there's anything to be learned from the last few years of financial mess, it's that nothing is guaranteed. And that includes all the long-term investments that your financial planner will encourage you to buy.

It's worth noting that financial planners didn't exist until about forty years ago, when people were forced to take control of their own retirement funds through vehicles like the 401(k).

Financial planning is an industry created by the banks to make money off the financially illiterate.

It takes only *30 days of training* to become a financial planner.

To put that into perspective, to become a professional hairstylist, it takes two years of training. And even if you get a bad haircut, the hair will grow back. Money doesn't quite work that way.

Nearly every financial planner will tell you that in order to be financially secure, you must diversify. By this, they mean to invest in stocks, bonds, and mutual funds.

But this is *not* true diversification.

There are actually four asset classes: paper, real estate, commodities, and business. A truly diverse portfolio would have stakes in all or most of these.

It's diversification in only one asset class: paper assets — the class where banks make big money in the form of fees.

Virtually ignored are the other asset classes.

The Diversification Trap

But, you say, my financial planner helped me plan wisely. We invested in lots of different things, so that if one company's stock or one mutual fund takes a hit, there are others that will go up.

This is one of those scams that make sense on paper.

Of course, the more spread out you are, the more protected you are from losing money.

Except for the fact that everything you're invested in is still on paper…

It's based on the same fragile economy, and the same investment model. When the stock market goes down, it goes down everywhere, not just in certain places.

Investing in Microsoft and McDonald's won't make any difference if the market tanks and everything goes down across the board.

Widely investing in different mutual funds spreads that risk around even more, but the risk is still the same and the hit will be the same when things go south.

True diversification is investing across different asset classes, not different stocks.

This holds true with any of the asset classes. If I'm invested in condos, apartments, and houses, my portfolio looks diverse, but they're all still real estate assets. So I have real estate assets, commodities assets like gold and silver, business assets like my companies, and yes, I have some paper assets as well. But I know they're not going to make me rich.

Taking Control

The real issue here is that by buying paper assets at all, you're putting control of your money in someone else's hands.

A CEO makes a bad decision, and you're left holding the bag for his mistake when the stock drops.

The only control you have over paper assets is to sell them. Holding onto them, you're just playing a waiting game and crossing your fingers. And it's even worse if you put those paper assets into a 401(k), you have even less control, they're locked in, and you're penalized for taking those funds out or borrowing against them.

True diversification requires financial intelligence, which comes from financial education.

If you don't have the desire to increase your financial intelligence, then by all means continue using your financial planner and investing in only paper assets, as those investments are set up so that even a monkey could do them.

If, on the other hand, you want to be rich, I encourage you to ignore Rich Dad Scam #8, "Invest for the long term in a diversified portfolio of stocks, bonds, and mutual funds," and instead increase your financial education and begin working towards true diversification.

Safety comes from diversification of all four asset classes, but totally equal holdings in all four areas is not necessarily what I'm advising…

If you want to be rich, you must learn to focus.

Why Diversification Can Be Bad Advice

Again, what most people consider as diversification isn't really diversification. Rather it is spreading your money across one asset class.

Beyond that, diversification is a zero sum game. Gains in one class offset loses in another. Sure, it can be safe, but rarely does someone become wealthy by diversifying. As Warren Buffet says, "Wide diversification is only required when investors do not understand what they are doing."

The most successful investors don't diversify.

Rather, they focus and specialize. They get to know the investment category they invest in and how the business works better than anyone else.

For example, when investing in real estate, some investors focus on raw land while others focus on apartment buildings. While both are investing in real estate, they are doing so in different ways.

When Diversification Makes Sense

So why do financial advisors recommend diversification when the world's greatest investors choose not to diversify? I believe there are two answers to this question:

1. **Active vs. passive investing**. There are active and passive investors. Warren Buffett is an active investor. Most people are not. Active investors should focus. Passive investors should diversify.
2. **Risk**. Some investments are riskier than others. Stocks, bonds, mutual funds, and real estate investment trusts (REITs) are very risky investments; therefore, you should diversify if you invest in them. If you invest in businesses, as Warren Buffett does, or real estate, as I do, you should focus.

The real question is: Do you want to become a professional investor or remain an amateur?

If you choose to remain an amateur-a passive investor-then, by all means, diversify.

Diversification keeps you from "putting all your eggs into one basket," so if one industry collapses-as tech did famously in 2000-only a portion of your portfolio will be affected.

If, however, you decide to become a professional investor, the price of entry is focused dedication, time, and study.

Warren Buffett dedicated his life to becoming the best investor he could be. That is why he focuses and does not diversify. He does not need to protect himself from ignorance simply because he has invested time and money to understand what he is doing.

Intense Focus, Intense Rewards

In Hawaii, there is a great organization known as Winners Camp. It teaches teenagers the attitudes and skills required for success in life.

Winners Camp uses the word "focus" as an acronym, standing for "Follow One Course Until Successful."

I believe all children should be taught to focus, as should any investor who wants to be a rich investor.

If you look at anyone who has achieved great success and wealth, they have all focused intensely in order to win.

Rather than practice diversification, I encourage you to practice focus. In the process you will take control of your financial future in ways that amateurs simply cannot.

4 Ways to Buy Private Businesses

Over the last few decades, many individuals have placed their hard-earned money in the stock market with the hope of being able to enjoy an enhanced standard of living in the future.

Although some folks are able to protect and create wealth from stocks, there are a number of ways to accomplish this besides investing in public equities. One such way is to purchase existing businesses. This approach to investing may be extremely attractive to those investors who wish to have direct control over their investments.

Millennials who are interested in creating wealth but would like to escape the volatility of the stock market should consider acquiring small successful businesses. These firms include those that can be scaled as well as failing enterprises that can be bought at an undervalued price, turned around and then eventually resold for tremendous profit.

While it is often thought that investing in private equity is usually reserved for the ultra-wealthy, Millennials can build a portfolio of privately-held businesses by using one or more of the following methods.

CHAPTER 9:

Owner Financing

Buying a private business is an expensive endeavor. For the most part, Millennials will not have sufficient funds to purchase an enterprise on their own as an acquisition price can start anywhere from a couple hundred thousand dollars to well over a million dollars.

As a result, private equity transactions will typically require the use of external capital. In fact, wealthy people and large companies seldom use cash alone to finance the acquisition of another company. Millennials can take advantage of a financing method called owner financing in order to overcome this dilemma.

When a business is bought with owner financing, the seller plays the role of a bank and finances the acquisition. This method is often used when both the buyer and seller wish to expedite the transaction by avoiding the long process of applying for and receiving a loan.

Owner financing is also an alternative option for buyers who have not been successful getting a loan from a traditional lender.

In an owner-financed deal, the buyer makes a down payment for the business to the seller instead of paying the entire price all at once. The original owner would then receive a monthly payment from the new business owner until the outstanding balance is cleared. Owner financing might be attractive to entrepreneurs who have owned their business for years and are looking to cash out slowly over a period of time.

Here is a simple example. The local food court has been listed for sale at a purchase price of $500,000. Joe analyzes the listing and decides that he would like to purchase the business; however, he only has $150,000 in cash. After speaking with the owner, Joe is able to use his $150,000 as a down payment and agrees to pay the seller the remaining $350,000 in monthly installments over a three-year period at an 11% per annum interest rate.

CHAPTER 10:

Leveraged Buyout

A leveraged buyout is similar to owner financing in that the buyer pays for the business in the form of monthly payments. However, unlike owner financing, leveraged buyouts are financed by a traditional lender, such as a bank, rather than the actual seller.

As a result, the seller receives the entire acquisition price in a lump-sum, and the bank is repaid in installments, including interest, over a predetermined amount of time. In this arrangement, the assets of the company – for example, machinery and real estate – are used as collateral and will be seized by the lender in the event that the buyer defaults on the loan. (For more, see **Understanding Leveraged Buyouts**.)

CHAPTER 11:

Pooling Money with Family and Friends

Pooling money with family and family might be necessary if a person lacks the funds to even make the down payment. This can also be useful in increasing the size of a down payment and thus reducing the amount of debt. Additionally, this method can be used to purchase a business solely with cash and no debt.

With this financing arrangement, family and friends would contribute money into an entity that would become the holding company for the business to be purchased. In return, they will receive an equity stake in that entity based on how much they contribute. That entity would then purchase the business.

For example, four friends wish to pool their money together so that they can buy a small bookstore that is being sold for $200,000. The friends form a limited liability company and each put $50,000 into the newly formed entity. This will give each partner a 25% equity share of the LLC. Acting as a holding company for the friends, the LLC purchases the small bookstore with the pooled together $200,000.

CHAPTER 12:

Offering Equity in a Holding Company

Another option for financing with little to no debt is to offer the seller a portion of equity in a larger company. Actually, this is what publicly-traded companies do when they buy a smaller company. The shareholders are bought out with a combination of cash and equity. Pharmacyclics, for instance, was acquired for $21 billion by AbbVie Inc. (ABBV) in March 2015. Forty-two percent of the transaction was financed with shares in AbbVie.

If a buyer already has a holding company that owns a collection of other business, it can sometimes be wise to offer the seller equity in that holding company. This reduces the amount of cash that has to be paid out to the seller as a portion of the acquisition price will be covered by shares in another entity.

A simple example of a situation like this would be if a person who formed a holding company that owns four car rental agencies in one state and is interested in purchasing another that is selling for $750,000. Instead of acquiring this business through a leveraged buyout or by paying the seller all in cash, the buyer can offer the seller $400,000 in cash and $350,000 worth of ownership in the holding company.

Some sellers might find such an arrangement attractive because they are able cash out a portion of their equity in a business and convert the remaining equity into ownership in a much larger and more diverse company.

The Bottom Line

Investing in the stock market is certainly not the only way to create wealth. Buying private businesses is a good way to maintain greater control over your investments while increasing your income and avoiding the fluctuations of the stock market. The perceived high barriers to entry should not discourage millennials from investing in private equity. By using leverage as well as owner financing, pooling money together with friends and offering equity in a holding company, millennials can successfully build a portfolio of private businesses.

Source: **Investopedia.com**

CHAPTER 13:

Preferred Stocks

A preferred stock is a stake in a corporation that has a higher claim on its assets and earnings than common stock.

Preferred shares generally pay dividends before dividends are paid to common shareholders. The shares do not usually carry voting rights.

Preferred stock combines features of debt, in that it pays fixed dividends, and equity, in that it has the potential to appreciate in price.

The details of each preferred stock depend on the issue.

How Do Preferred Stocks Work?

As I mentioned above, if you are a preferred shareholder, you have priority over common stockholders when it comes to being paid your dividends.

The dividends paid to preferred stockholders generally yield more than common stock and can be paid monthly or quarterly.

These dividends can be fixed or set in terms of a benchmark interest rate.

If you are a preferred stockholder with adjustable-rate shares, there are certain factors that influence the dividend yield.

Also, participating shares can pay additional dividends that are reckoned in terms of common stock dividends or the company's profits.

Preferred Stock Shareholder Benefits For Companies in Distress

If a company has to suspend its dividend, preferred shareholders may have the right to receive payment in arrears before the dividend can be resumed for common shareholders.

Shares that have this arrangement are known as cumulative.

If a company has multiple simultaneous issues of preferred stock, these may in turn be ranked in terms of priority.

The highest ranking is called prior, followed by first preference, second preference, etc.

Preferred shareholders have a prior claim on a company's assets if it is liquidated, though they remain subordinate to bondholders.

Preferred shares are equity, but in many ways, they are hybrid assets that lie between stock and bonds.

They offer more predictable income than common stock and are rated by the major credit rating agencies.

Unlike with bondholders, failing to pay a dividend to preferred shareholders does not mean a company is in default.

Because preferred shareholders do not enjoy the same guarantees as creditors, the ratings on preferred shares are generally lower than the same issuer's bonds, with the yields being accordingly higher.

What About Voting Rights, Calling and Convertibility?

Preferred shares usually do not carry voting rights, although under some agreements these rights may revert to shareholders that have not received their dividend.

Preferred shares have less potential to appreciate in price than common stock, and they usually trade within a few dollars of their issue price, most commonly $25.

Whether they trade at a discount or premium to the issue price depends on the company's credit-worthiness and the specifics of the issue: for example, whether the shares are cumulative, their priority relative to other issues, and whether they are callable.

If shares are callable, the issuer can purchase them back at par value after a set date.

If interest rates fall, for example, and the dividend yield does not have to be as high to be attractive, the company may call its shares and issue another series with a lower yield. Shares can continue to trade past their call date if the company does not exercise this option.

Some preferred stock is convertible, meaning it can be exchanged for a given number of common shares under certain circumstances. The board of directors might vote to convert the stock, the investor might have the option to convert, or the stock might have a specified date at which it automatically converts. Whether this is advantageous to the investor depends on the market price of the common stock.

For more on this interesting hybrid security, read "**A Primer on Preferred Stocks**" and "**Valuation of Preferred Stocks**."

Source: **Investopedia.com**

CHAPTER 14:

Mining Stocks

Mining Stocks: A Beginner's Guide

If it isn't grown, it has to be mined. You've probably heard some variation of this saying. It is used by people concerned about the environmental effects of mineral depletion, as well as people bullish on mining stocks. Although these two groups have a very different emphasis when they speak it, they are both right – mining is big business. Almost every commercial product has elements that started off buried beneath the earth.

Here are a few things that you should know before adding mining stocks to your portfolio.

Two Groups, One Sector

Mining stocks are truly two distinct groups: majors and juniors.

The majors are well-capitalized companies with decades of history, world-spanning operations and a slow and steady cash flow. Major mining companies are no different from large oil companies, and many of the same metrics apply with a mining twist. Both have proven and probable reserves, except mining companies break down profit and cost on a given deposit by ton, instead of barrel. In short, a mining major is easy to evaluate and easy to invest in.

The junior mining stocks are very nearly the exact opposite of mining majors. They tend to have little capital, short histories and high hopes for huge returns in the future.

For the juniors, there are really three possible fates.

- Most common is failure, which leaves a hole in everyone's pocket, including that of the banks and investors.

- The second fate occurs when a junior has enough success to justify a major paying a decent premium to gobble it up, leading to decent returns all around.
- In the third and most rare fate, a junior finds a large deposit of a mineral that the market wants a lot of – it is a magical combination of the right deposit at the right time. When this happens, juniors can return more in a few days than a major will return in years.

Valuing Major and Junior Mining Stocks

Although majors and juniors are very different, they are united by the one fact that makes all mining stocks unique: their business model is based on using up all the assets they have in the ground. The catch is that mining companies don't know exactly how much is in a given deposit until it is all dug up. Therefore, the value of a mining stock roughly follows the market value of its reserves, with a premium paid to companies with long histories of successfully bringing those reserves to market.

Reserves are evaluated through feasibility studies. These studies independently verify the worth of a deposit. A feasibility study takes the estimated size and grade of the deposit and balances it against the costs and difficulties of extracting it all. If the deposit will fetch more money on the market than it costs to dig up, then it is feasible.

Different Risks, Different Rewards

If a mining major has hundreds of deposits staked and/or being mined, the contents of any single deposit aren't likely to shake the stock value too much. A major is the sum of all the deposits with the aforementioned goodwill tied to history.

A change in the market value of a mineral that makes up a larger percentage of the deposits will have a much larger effect than a new deposit or a failed deposit. A junior mining stock lives or dies on the results of its feasibility studies.

A junior mining stock typically sees the most action leading up to, and immediately after, a feasibility study. If the study is positive, then the value of the company may shoot up. The opposite, of course, is also true. Often, a junior miner won't mine a feasible deposit to the end. Instead, they sell the deposit (or themselves) to a larger miner and move on to search for another one. In this sense, junior mining stocks form an exploration pipeline that feeds the major miners in the end. In this view, the big risks and rewards mostly reside at the junior mining level.

Choosing How to Invest

As an aspiring mining investor, you're probably wondering whether you should invest in junior mining stocks or major mining stocks. The answer depends on what you are looking for. Juniors have the potential to offer a lot of appreciation in the right market. This makes them an ideal destination for risk capital, but hardly the best place to put your social security checks. If you are looking for a lower-risk stock with the potential for dividends and some decent appreciation, then major mining stocks may be for you.

The Bottom Line

This is a primer and as such, suffers from being overly broad and simplistic. Before you invest in the mining sector, you should probably know what greenfield exploration is, as well as how to estimate the impact of pricing risk and be able to hold forth on the dangers of buying on a single positive assay.

If you are interested enough in mining to do some research, then there is probably room in your portfolio for both mining majors and juniors. For those who would prefer to get investing exposure to the greater mining sector (rather than pick individual stocks), there are several mining-related ETFs and mutual funds available that could be added to your portfolio.

Source: **Investopedia.com**

CHAPTER 15:

Royalty Income Trusts

What is a Royalty Income Trust?

A royalty income trust is a type of special-purpose financing (similar to a Master Limited Partnership or MLP). The trust is created to hold investments or their cash flows in operating companies.

These trusts are neither stocks nor bonds but separate legal entities.

In general, royalty income trusts buy the rights to royalties on the production and sale of natural resource companies. They then pass on the profits on to trust unit-holders.

A Deeper Dive of Royalty Income Trusts

Royalty trusts are attractive to investors, because they promise high yields, compared with stocks and bonds.

They are also attractive to companies that wish to sell cash-flow producing assets, because they can provide a relatively high sale price.

For example, suppose that ABC oil company has maturing oil wells with well-known rates of production and reserves. The company estimates that it will produce and sell one million barrels per year for the next 20 years at a price of $20 per barrel (thus $20 million per year).

ABC wants to sell the wells, but an investment bank suggests that ABC use a royalty trust, so ABC sells all the oil wells to a trust, the XYZ Royalty Fund. ABC receives a payout from the investment bank and will still manage the company for a fee.

One of the largest U.S. royalty trusts, the San Juan Basin Royalty Trust (SJT), owns the royalties on Burlington Resources, an oil exploration and production company.

Additional Benefits of Royalty Income Trusts

Royalty income trusts also offer tax-advantaged yields. Because of the operations' depreciation and the depletion of natural resources over time, the IRS does not actually consider distributions from the majority of royalty income trusts income.

Instead, an investor can use the distributions to reduce their cost basis in the stock. When they liquidate the stock, the IRS taxes the proceeds at a lower capital gains rate and defers the taxes until after the owner sells the shares.

Since royalty income trusts are "pass-through" investment vehicles, they are not subject to double taxation. It is also possible for royalty trust unit-holders to qualify for certain tax credits for the production of fuels from nonconventional sources.

Risks Associated With Royalty Income Trusts

The cash flows from royalty income trusts are subject to volatility in commodities prices and production levels.

This inconsistency (in contrast with MLPs, which provide steady cash flows) poses significant risk for investors. Because these trusts are not standalone companies (i.e., they do not have independent operations, management, or employees), investors have less control and are more removed from their output.

Source: **Investopedia.com**

CHAPTER 16:

Introduction To Small Cap Stocks

Small cap stocks have a bad reputation. The media usually focuses on their negative side, saying they are risky, frequently fraudulent and lacking in quality that investors should demand in a company. Certainly these are all valid concerns for any company, but big, large-cap companies have also fallen prey to issues of internal fraud that virtually destroyed shareholder interest (think Enron and Worldcom).

Clearly, company size is by no means the only factor when it comes to investors getting scammed. In this article we'll lay out some of the most important factors comprising the good and the bad of the small-cap universe. Knowing these factors will help you decide whether investing in smaller-capitalized companies is right for you.

Background

Before we get into the pros and cons of small caps let's just recap (no pun intended) what exactly we mean. The term small cap refers to stocks with a small market capitalization, between US $250 million and $2 billion.

Stocks with a market cap below $250 million are referred to as micro caps, and those below $50 million are called nano caps. Small-cap stocks can trade on any exchange. although a majority of them are found on the Nasdaq or the OTCBB because of those exchanges' more lenient listing requirements.

It is important to make the distinction between small caps and penny stocks, which are a whole different ball game. It is possible for a stock to be a small cap and not a penny stock. In fact, there are plenty of small caps trading at more than $1 per share, and with more liquidity than the average penny stock.

Why Invest In Small Cap Stocks?

While small caps have their negative attributes – which we'll get into later on – they have a number of positive factors too. Below we have outlined three of the most compelling reasons why small caps deserve representation in many investors' portfolios.

1) Huge growth potential

Most successful large cap companies started at one time as small businesses. Small caps give the individual investor a chance to get in on the ground floor of younger firms that are bringing new products and services to market or entering new markets altogether.

Everyone talks about finding the next Microsoft, Wal-Mart or Home Depot, because at one point these companies were small caps – diamonds in the rough if you will. Had you possessed the foresight to invest in these companies from the beginning, even a modest commitment would have ballooned into a tidy sum.

Because small caps are just companies with small total values, they have the ability to grow in ways that are simply impossible for large companies. A large company, one with a market cap in the $1 billion to $2 billion range, doesn't have the same potential to double in size as a company with a $500 million market cap. At some point you just can't keep growing at such a fast rate or you'd be bigger than the entire economy!

Mature companies have limited organic growth rates because they already address a larger proportion of their target market. Any new product or service represents a smaller proportion of total revenue than the established product offering. For these reasons, earnings and cash flow growth in large-cap stocks can be limited, unless their corporations acquire other firms.If you're seeking high-growth companies, small caps are the place to look.

2) Most mutual funds don't invest in them

It isn't uncommon for mutual funds to invest hundreds of millions of dollars in one company. Most small caps don't have the market cap to support this size of investment. In order to buy a position large enough to make a difference to their fund's performance, a fund manager would have to buy 20% or more of the company.

The SEC places heavy regulations on mutual funds that make it difficult for the funds to establish positions of this size. This gives an advantage to individual investors who have the ability to spot promising companies and get in before the institutional investors do. When institutions do get in, they'll do so in a big way, buying many shares and pushing up the price.

3) They are often under-recognized

This third attribute of small caps is very important. What we are saying here is that small caps often have very little analyst coverage and garner little to no attention from Wall Street.

What this means to the individual investor is that, because the small cap universe is so under-reported or even undiscovered, there is a high probability that small cap stocks are improperly priced, offering an opportunity to profit from the inefficiencies caused by the lack of coverage devoted to a particular area of the market.

The Drawbacks to Small Cap Investing

Despite the fact that small caps demonstrate attractive characteristics, they are not without inherent drawbacks. These include:

1) Risk

In terms of equity categories based on market capitalization, small caps are the fourth riskiest group out of five. (The other categories from least to most risky are mega caps, large caps, mid caps, small caps and micro caps.)

Often much of a small cap's worth is based on its propensity to generate cash, but in order for this to happen it must be able to scale its business model. This is where much of the risk comes in.

Not many companies can replicate what U.S. retail giant Wal-Mart has done, expanding from essentially a mom-and-pop store in Arkansas to a nation-wide chain with thousands of locations.

Their smaller balance sheets are less insulated from changes in the economy and poor economic conditions.

Additionally, small-cap stocks tend to have much smaller customer bases, so their prospects are more uncertain and tied to a specific regional area. As a result, many small-cap stocks are unable to survive through the rough parts of the business cycle.

Small caps are also more susceptible to volatility, simply due to their size; it takes less volume to move prices. It's common for a small cap to fluctuate 5% or more in a single trading day, something some investors simply cannot stomach.

And since these stocks have less liquidity (the big institutional investors can't or won't traffic in them, remember), someone may not be able to exit a position at the market price, and this possibility is greater during a market panic.

So, the money you invest in small caps should be money you can expose to a much higher degree of risk than that of proven cash-generating machines like large caps and blue chips.

2) Time

Finding time to uncover that small cap is hard work – investors must be prepared to do some serious research, which can be a deterrent. Financial ratios and growth rates are widely published for large companies, but not for small ones.

You must do all the numbers-crunching yourself, which can be very tedious and time-consuming. This is the flip side to the lack of coverage that small caps get: There are few analyst reports on which you can start to construct a well-informed opinion of the company.

And because there is a lack of readily available information on the small-cap company, compared to large caps that are regularly covered by the media, you won't hear any news for weeks from many smaller firms. By law these companies must release their quarterly earnings, but investors looking for more information will be hard-pressed to find anything.

The Bottom Line

The primary advantage of investing in small-cap stocks is significant upside growth potential that is unmatched by mature companies with large market capitalizations.

Merger and acquisition activity also provides an opportunity for small-cap investors. Small caps are acquired more frequently than larger companies; large companies often can enter new markets or gain intellectual property by acquiring smaller businesses. Acquisitive companies usually pay a premium to market price to acquire growth firms, leading to share price appreciation as soon as a deal is announced publicly.

There is certainly something to be said for the growth opportunities that small cap stocks can provide investors. However, along with these growth opportunities come increased risk. Small-cap investors sacrifice stability for potential. If you are able to take on additional levels of risk, exploring the small cap universe is something you should look into. Alternatively, if you are extremely risk averse, the rollercoaster ride that is the stock price of a small cap company may not be appropriate for you.

In short, the money you invest in small caps should be money you can expose to a much higher degree of risk than that of proven cash-generating machines like large caps and blue chips.

Source: **Investopedia.com**

CHAPTER 17:

Invest in Defense Stocks

The Fifth Domain of War is About to Heat Up

By Byron King, Senior geologist, *Gold Speculator* and Peter Coyne

In this section, we're going to cover the Fifth Domain of War theme, why cyber warfare is important, how it's developed from infancy to maturity now that we have some headline stories like the so-called Russian hacking of the DNC in 2017.

As Senior geologist for Gold Speculator, I usually look at gold and silver prospects and other metals, and various things with Peter and Jim Rickards. But there was a time in my life when I served in the U.S. Navy. I was active for nine years and then I spent about 22 years in the Navy reserve. I spent a lot of time dealing with electronic issues, electronic warfare, cyber warfare and certainly the kinetic stuff.

I was a Naval flight officer. I flew an airplane called the S3 which was not one of those real sexy pointy-nosed fighters, it was a slightly shorter, a little bit stubby kind of airplane. We did anti-submarine warfare but one of the ways you do anti-submarine warfare is electronically. We had lots of radios, lots of signals processing, lots of capability.

I spent time in the Pentagon and then other things in the Navy over the years. I spent a lot of time in this arena. While I am the geologist and I love the geology and it is what I do, I have to say that the military technology, and cyber, and electronic warfare, those kinds of things are hobbies of mine, you might say.

What Is the Fifth Domain of War?

For thousands of years, human conflict has entailed one group, one tribe or whatever against another. People fought on the land, of course. They fought on the sea, the Navy. They fought in the air. For the last century, it's been aerial warfare. There's conflict in outer space, I don't mean Star Wars and Star Trekkie type stuff. We're talking about the orbital constellation above us that's filled with satellites that do everything from gather intelligence, take imagery, to do targeting, to do all sorts of signals, intelligence whether it's optical looking down or whether it's electronic looking down.

Now we go from land, sea, air, space into this electronic realm, this cyber realm. It includes just signals that fly through the air. It includes the wires and the cables that have circled the Earth, this signal generating or transmitting cables under the oceans. The fact that you are able to listen to this presentation, this is a tribute to the cyber capabilities of our society. But those things have been weaponized, which is where the defense sector comes in.

The first cyber war stories probably go back into the 1990s as the worldwide web began to develop outwards. We could go further back into the 1980s and even the 1970s into some programs that involved taking down other people's computers.

If you want to get really apocalyptic, you could go back to the 1960s when they first detonated nuclear weapons in high altitude bursts in outer space. The Starfish Prime nuclear blast was way, way, way in the far South Pacific just to see what would happen when they cooked off a nuke high in the upper atmosphere. It wound up taking down pretty much all the electronics for thousands of miles in any direction right there. That was a cyber attack although it was a very crude sledgehammer kind of attack with an electromagnetic pulse.

By the 1990s as the worldwide web started to come into existence. If you remember back the first time maybe 20 years ago when your office or your school or whatever first started hooking things up. You could send these things called e-mails to other people, and probably thought, "Wow this is really cool."

Instead of dropping mail into an envelope in the mailbox with a stamp on it, you can just type something and some guy in California can read what some guy in New York is saying within a fraction of a second. Well at any rate, back then people started fooling around with that and guess what? It was starting to be weaponized 20 years ago.

As far as where it is now today, the stories that you hear are just legion. It's everything from a criminal element or just cyber punks who are sitting in their mom's garage or mom's basement just trying to sneak into your bank account all the way to big, distributed denial of service attacks.

People trying to hack the electric grid or hack the water supply grid, or Saudi ARAMCO the world's largest oil-producing entity being hacked and having its computers go down. Imagine what would happen to the world's oil supply if somebody killed all the computers that run Saudi oil production.

Back then, the whole thing was very free ad-hoc. Just like 20, 25 years ago at the company where you worked or the school that you attended, if somebody needed some software, they'd stop at a store on the way home and they would buy a package of software then all of a sudden, people started saying, "Wait a minute, we can't have everybody running different systems. Let's all start to consolidate it."

For the military, it was the same thing in the Department of Defense whether it's U.S. or foreign. For decades what we called electronic warfare was a series of things, a series of items, "Oh, we need something that can process radar so we'll get this box. We need something that can process other signals, we'll get that box. We need something that can detect this signal or that signal, or emit something. We'll get these boxes and those boxes." We would bolt them onto platforms and we would train operators. You work on box A and you work on box B, and he works on box C or D.

One day some brilliant person said, "Wait a minute, we have all these boxes. We have all of these items. This is a thing. We need to bring this thing together. We can connect this box and that box and this box, and we can control them with software. We can have people sitting at workstations looking at screens, and we can bring all the signals to people's eyeballs who are going to make decisions and who need this kind of information. Let's bring it all together and let's start to put it together."

This really happened over the last 15 years. It is still in many respects a work in progress. There is money to be made and a lot of money to be spent yet to come in the Department of Defense in bringing all of these boxes and items in together into a big thing.

Is that good or bad? If you bring it all into one big thing and you take down that thing, you've just lost everything. That's a problem and that's where the cyber angle comes from. It is an evolutionary process. We are right smack in the middle of it and there's money to be spent and money to be made in this arena.

How Cyber Warfare Has Changed the Economics of Defense Spending

The traditional military outlook was you build up a big army, you have a lot of weapons, you have a lot of equipment, you have a lot of fighter jets or aircraft carriers. That is how force was measured and deployed and brought to their enemies or threats. It takes a lot of money. It takes a lot of manpower. It's kind of an industrial era type approach to things.

Whereas cyber warfare creates super empowered individuals. One man can do damage to an economy or a nation or a particular company or an agency of government that usually took millions and millions of dollars, maybe billions of dollars when you consider what it cost to fund an army or to have an espionage operation or something like that.

On the one hand at some point you need the kinetic devices if you're going to destroy something or break something. Much of warfare is deception, I think it was Sun Tzu who said this in his book on war, "All war is a form of deception."

To the extent that you can interrupt the flow of someone's kinetic efforts, you can interrupt the flow of their troops or their ships or their airplanes, you can confuse their missiles. You've defeated your enemy and you can do it at a relatively low cost.

The cost of building a new aircraft carrier right now for the United States is something like $12 or $13 billion. I was at a talk by the former Chief of Naval Operations, John Greenert who said that the next carrier was going to cost us $12, $13 billion and some people in the audience gasped. He said, "Hey, it's what it cost," and that's before he put the jets on the flight deck. All of those jets, like the ones on the F-35 are $120 million bucks each, they gasped at that. "Hey, that's what they cost."

The thing is if you could find a way to disrupt that one way or another, if you can disrupt just the food that goes to the aircraft carrier and the people can't eat, if you can disrupt the fuel that goes there and the jets can't fly, if you can disrupt the electronics that the jets need to do their job, you have defeated that entire multi multi-billion dollar system at what could be a relatively low cost.

Thus we see U.S. or western adversaries in the world investing asymmetrically. They may not be putting so much into shipyards to build ships because how would anybody ever really compete against a U.S. aircraft carrier or a U.S. submarine? It would be very, very difficult.

If you can train your cyber warriors, if you can put an army of thousands of computer hackers in a room all sitting at the screen coming up with ways of breaking down your front door instead of kicking in the front door kinetically like some army ranger jumping out of an airplane, take that hill or whatever.

If your cyber warriors can kick down the front door of the computer system and destroy just the basic background logistics of what supports the military effort, they've won.

There are some agencies of the defense department that are forward leaning and cutting edge, like DARPA. For the most part, bureaucracy (whether it's civilian government agencies or the defense department) are big entities that are very hard to turn around in a new direction.

The U.S. has been the global superpower. We have the best military fighting force in the world. But is the government reactionary in the sense that it needs to play catch-up relative to these other countries on cyber defense?

Well, I'd say that the U.S. is not behind certainly in specific capabilities. I think in terms of the political leadership and in terms of much of the management that is not actually in the weeds, the leadership needs to catch up with where the rest of the world is.

I think much of the rest of the world just thinks asymmetrically. They grow up reading Sun Tzu. They grow up in a culture that promotes the idea of asymmetrically defeating a big enemy like the United States.

In the U.S., I would say that our political leadership, our media, and much of the broad populace has read too many press releases, "Oh, we're great. We're wonderful. We have drones. We'll bomb you into the Stone Age and all this kind of stuff." That whole way of thinking has to change. Then you get into the issues of just governance and how you do it.

The Department of Defense is a great, big, huge bureaucracy that sucks down a lot of money. It spends a lot of money. There's an entire military complex, shipbuilders and airplane builders, and we get into this with the expensive aircraft carriers or the expensive jets, and the expense of everything.

What Does Donald Trump Mean for Cyber Warfare?

When we talk about Trump, you can't ignore his tweets. Right away this is cyber warfare with his little screen and his little handheld device, he is tweeting something out and he is tweeting it out quickly. It's pointed and it's fast, it's short and boom. First of all it goes to 25 or 30 million tweet followers that he has so this is his way of communicating with his masses.

He is bypassing the mainstream media which is why the mainstream media is apoplectic. Then he manages to control the narrative because he can react so quickly.

In 2017, the head of the National Intelligence Services, John Clapper made some comments that Trump has to be careful with what he's doing and all the things that he's said. Within probably two hours, Trump had answered that with a tweet and so instead of Clapper's comment becoming the news cycle, it was Trump's tweet becoming the new cycle.

He understands in a very Sun Tzu-ish kind of way how to use relatively basic electronic capability which is tweeting. It's just sending short little messages to devastate his enemies and control the news cycle. In that sense, that is an example of where things need to go and with that kind of leadership probably will go in war fighting and war preparation, war fighting, war deterrence.

But what if Twitter is hacked?

If you remember a couple of years ago, I think it was the AP the Associated Press' Twitter account, someone hacked it and wrote some kind of fake story that the White House had been bombed and President Obama was injured.

Say someone that hacks into there and says something as Donald Trump that doesn't surprise many people, because there a lot of things coming out of his mouth. But, what if they take that, keep it within the realm of possibility, but tweet something out that's inflammatory or suggest something really major is going to happen?

That's the danger and in fact that is one asymmetric way of influencing, of moving markets.

Whether it's true, whether it's partially true, an absolute bald-faced, pure line of garbage tweet or message might be seen quickly for what it is. But if you take a message and you insert enough grains of truth that it could be credible and you insert it, yes you could move markets.

You could create a political firestorm. You could cause great damage to that. As people have become used to Donald Trump tweeting, that is something that I hope his advisors explain to him that he has to be careful.

Meanwhile, the whole Twitter system is a commercial grade communication system and so it's eminently hackable. Any reasonably good intelligence service, electronic warfare type service ought to be able to break in there. All you need is someone who can insert an item that sounds true enough to cause problems.

Cyber Warfare and the Private Sector

There are obviously economic concerns and national security concerns that deal with cyber warfare that the government is concerned about. There's also the private sector concerns.

The U.S. Government is working to militarize the spectrum in so many respects. Much of civilian, normal, everyday life travels over the same literal wavelengths. It's the same spectrum, the same fiber optics the same cables and what have you.

In the sense that U.S. intelligence is sucking so much signal out of the air. They're not just sucking bad guys communicating with other bad guys about which building they're going to bomb or, which airplane they're going to hijack, they're sucking everything out of the air.

There are a lot of just personal privacy issues, fourth amendment type issues, search, and seizure type things. We get into issues where national military intelligence detects non-military intelligence but perhaps it's evidence of a crime.

The idea that, if a drone is flying down the highway and somebody is just practicing flying a drone so they can learn how to be a drone pilot and they're measuring the speed of automobiles on the interstate highway and they catch you speeding. Are they obliged to turn you over to the state troopers over that? It's a silly sort of question, but it is a legalistic concept that we get into that your daily life is becoming militarized as well. You are subject to so many things.

There are entire types of search software out there. Let's back up. Think of how much of America, the world anymore, is under a closed circuit television monitor and whether it's the gas station where you buy your gas or the grocery store where you check out to buy your food or the fast food place that you go to buy a sandwich for lunch. There's cameras everywhere. You can't walk down the street without being seen.

Now we have search software that can say "I want you to find me everybody who's walking down the street who is five foot eleven, wearing a green coat and glasses" and all of a sudden, boom, we're starting a search for that.

The next thing you know your entire day could be tracked from the moment you drive out of your driveway to you drive down the road, you park your car, you go to work. All of a sudden your life is an open book to anybody who really wants to track you down.

There are immense civil liberties issues with this militarization. We talk about the militarization of the police force and they're getting armored cars and they're getting body armor and these big heavy weapons and things like that, that you see. Even in your local police force.

Where I live our local police force in a municipality of maybe 15,000 people, we have an armored car, we have a SWAT team. Where does this come from? Well, it's coming down the pipe, well I guarantee you that my local police are better armed than anybody who lives there, that's for sure.

CHAPTER 18:

Invest in Art

The Investment Secrets of the Palazzo Colonna

By Jim Rickards, Editor, *Strategic Intelligence* and Ryan Cole

The Palazzo Colonna is a magnificent palace in Rome, right in the heart of Rome, at the base of the Quirinal Hill. It is named after the Colonna family. It's one of the most famous, prestigious, historic families in Rome, and it's their residence.

But also it is open to the public on a very limited basis, if you get to Rome, you should try to have a look.

I've been through it and it really is magnificent. But for investment purposes, I was once there with a group of high net worth investors.

I had dinner, we had a private guided tour of the palace and the important thing is this palace has been in the same family for 900 years.

Thirty-one generations of the Colonna family have lived in the same location. Now, the palace has been built up and parts were knocked down, it was restored and a lot of what you see today is actually 16th and 17th century construction, some even in the 18th century. But the family has been there since the 12th century, 900 years, and it has taken on different specifications since then.

Today what you see is really a magnificent really 16th or 17th century palace with everything that's inside.

While I was there, I was having a conversation with one of the wealthy European investors. I said, "You know, in the United States, we talk about the new money and the old money."

The new money would be first generation tech fortunes, so you started Google or you were an early investor in PayPal and you made a lot of money. The old money would be the Whitneys or the Vanderbilts or the Rockefellers or the Mellons or some of the very multigenerational wealthy families in the United States. Their money goes back 100 years or 150 years.

So what I said to this particular investor is "Look, here we are in a palace of a family that's been wealthy and powerful for 900 years, 31 generations. How the heck do you do that? There's gotta be something more going on than, you know, stock picking or, you know, speculating in tech startups or whatever."

And the person just looked at me and said, "A third, a third and a third." That's all he said. And what he meant, when asked to explain, he said, "One-third art, one-third gold, one-third land."

And now, obviously you need some cash to have a little something for whatever your expenditures are, but one-third art, one-third gold, one-third land.

And the idea is, because you have to recall these are families that have survived as wealthy families, not just physically surviving, but as powerful wealthy families through the Black Plague of the 15th century, the Thirty Years' War of the 17th century, the wars of Louis XIV of the 18th century, the Napoleonic wars of the 19th century and then you had to get through the 20th century, and if you were Italian, that means you had to survive the fascist of Mussolini, not to mention World War I and World War II, the Holocaust, the Great Depression, Cold War and everything else.

So that's a lot of survival. That's a lot of hanging onto your wealth and actually building your wealth over that period of time.

Let's say it's the 17th century and you're in Munich or Austria or France or anywhere throughout Europe or Rome, in this case, and you know there's some enemy at the gates. You know they're burning down everything in their path, they're conquering, they're looting, and you've got art, gold and land.

Well, you can take your gold and pack it up on your horse. You can take your art and actually remove it from the frames, roll it up and stick it in a backpack and get on your horse and ride away and get out of the way of trouble.

Then, maybe a year or two years later, after everything's burned to the ground, the fires are out and the enemy's been defeated, you ride back.

If you had good title to the land, it should still be good title. You should be able to re-establish the title.

So you go back to your house, put your gold on the table, you put your art on the wall, you're sitting on your own land and everyone else has been burned down.

Those are the ways to preserve wealth through thick and thin.

Now, in theory we live in a world where you don't have to worry about somebody in the next town coming along and burning everybody out but, you never know.

There are modern day equivalents of that, including, cyber warfare, cyber-attacks, closing down exchanges, financial panics, and that's in the United States.

If you do live abroad, maybe you do have to worry about somebody coming in and burning the place down.

So you probably shouldn't do a third, a third, a third 100%, but based on my experience at Palazzo Colonna and seeing the art around me, the palace, the galleries and the private apartments and knowing the history of the family and asking the question, "How do you survive for 900 years?"

Those three things do have a place in your portfolio.

But, let's focus specifically on art…

Just to be clear, we're talking about fine art. So these are not the posters you might have had in your college dorm room.

We're not talking about the kid next door with a little bit of talent.

We're talking about fine art, which really means museum quality. Museum quality just means that either some piece by that artist is in a museum or they're getting serious consideration. At some point, you can say, "Well, that guy's gonna make the Hall of Fame."

Appraisers, curators, experts and gallery owners can have a sense that somebody's museum quality, even if they're not hanging in a museum yet.

For some clarification, I do think of art differently from collectibles.

By collectibles, I mean something like wine.

There are wine funds out there. There are also people who buy baseball cards, others collect automobiles.

There's a whole universe of collectibles out there, it could be antiques of various kinds. There's nothing wrong with that and I'm not against that, but I do think of art differently.

To me, art is more like gold or land or some kind of money that has intrinsic value.

I do put art, as a store of wealth, it in a different category than collectibles because it's passed the test of time.

The automobile was only invented in the late-19th century, so they're only 140 years old approximately. That's fine and we all know what an antique 1951 Ferrari racing car might go for in mint condition. But my point being that's fun.

I'm not saying you can't make or lose money, but that's a thinner market. It's a less established market. It's a little bit more subject to trends. I'm not aware of any cars that are in museums except for I think there's a '62 Jaguar XKE that's in the Museum of Modern Art in New York.

There might be a couple examples like that, but very few cars are actually museum quality.

And then there's baseball cards. They were big in the '80s and there was too much forgery. Forgery is a big issue. That's another thing you have to look out for. It's a good way to lose a lot of money, even in art, if you don't know what you're doing. I think art has better benchmarks, specifically museums.

In terms of weight, if you do have to pack up and go, and you have $1 million in $100 bills, it weighs exactly 22 pounds.

So assume you're rocking $100s, you've got them in a briefcase, you know it's gonna be a 22-pound briefcase if you wanna move $1 million paper in $100 bills.

Gold actually weighs more than that. I like gold as an investment, obviously, but – as a store of wealth, it's heavy. That's one of the things about it, $1 million of gold is going to be more like 40 pounds, give or take. So it's going to weigh about twice as much as the $100s.

But the funny thing about art, if you think of it in terms of weight. If you have a $100 million painting and it weighs a couple pounds, you can take it out of the frame and roll it up and put it in a backpack. That could be $500,000 per ounce and it won't set off metal detectors.

So fine art is a very mobile form of wealth. You get very good weight for value, much more than cash, much more than gold, and it's easy to move around.

If for whatever reason the banking system shut down, there's a power grid outage, things get bad and you've got to get on the move, art is a good way to take, you know, literally tens of millions of dollars of wealth with you in the palm of your hand.

How to Invest in Fine Art

The first thing you want to do is to have a good idea of how devoted to this you want to be. If you are really interested in art and really want to dig in, then there are different things you can do as opposed to if you are just interested in the store of wealth, in which case, you're going to need to go with broader strokes.

So if you are just interested in this as a store of wealth, you don't really have that much intrinsic interest in art, then you wanna go with established names and that does generally mean museum pieces.

There are about 20 artists who are considered extremely bankable, their art just continues to go up. These are names that you would recognize easily like Monet, Bastiat and Andy Warhol.

The thing that scares a lot of people away is the actual price of these pieces of art. When you hear about a Warhol painting that sold for hundreds of millions of dollars, you figure that that's not really something you can get into.

That is true for the large pieces, but there also are usually good examples of much smaller pieces. Things that aren't necessarily considered official works of art, like sketches. If you're talking about sells, there are various different things that artists have done in preparation for their larger pieces.

There's a lot of those out there, and they can be had for a much more affordable price, so that makes it much more accessible for everyone.

You can get a Picasso sketch for a few thousand dollars. They tend to go up in lock step with the larger pieces. But that's one of the things you definitely want to look at.

If you are someone who really wants to get deep into the art scene, then you can be a little more experimental and you can try and find rising artists. If you think you have the talent to have that sort of an eye for art, then you can really make a lot of money by getting in on someone on the ground floor.

In terms of actually purchasing the art, there's a few different ways you can do it.

You can do it by a private sale. That's a set up with whoever actually owns the art at this point.

You can buy directly from the artist if it's someone who's still alive. Generally this is the case with someone who is a rising artist as opposed to someone who's already very firmly established.

You can purchase art through galleries. Galleries will take a cut, which is not so great, but on the other hand, they also will provide certificates of authenticity and things along those lines.

You're much less likely to get taken in by a hoax or a fake if you go through an established gallery. And if you were to be scammed, then the gallery is liable, so you will be able to have some protection.

The fourth way, which people are most familiar with and is really kind of the most fun, is to go to auctions.

There are auctions that are online.

There are also physical auctions and you can be present. Christie's and Sotheby's are the two biggest names in art auctions, and that is basically exactly what you would think it is. Usually art auctions are not quite as raucous as a farmyard auction, but they're very fun.

You'll have a wide range of pieces of art available at any particular auction. Oftentimes they'll have a theme. For instance, the auction house will decide they're going to go western renaissance and another one they might have is pop art of the New York 1960s.

But if you have an idea of what you want to do when you go into the auction, then that can be a very good way to purchase your art as well.

You just want to have a great idea of what you're aiming at before you get there, and you want to have a good idea of how much you're willing to spend, which means, doing the research behind it.

In the last couple of years, the Al Thani family from Qatar made big news when they bought Gauguin for about $300 million, which is a huge sum of money.

Most people think that they vastly overpaid, and in fact, Qatar has sort of been making a pattern of that. In 2011, they paid $274 million for a Cezanne in today's dollars. So they're way up above everyone else. One could argue that they're kind of being a little foolish. They're breaking the market. They're way outside the norm.

They should have done more research because they could have had some of those works of art for much less.

So if you know what you're doing going in, you can avoid making those sorts of mistakes, especially if you fall in love with something.

There's one other way that you can actually invest in fine art.

You can invest in an art fund. With that, you would be investing, say $500,000. These are not things you can invest in at a retail level like $10,000. But for $500,000 or something in that range, you can invest in an art fund.

Like any fund, the sponsors and the manager are going to pool the resources of different investors and they're going to go out and buy art. Then you're going to have a participation in that, so when they sell the art, you'll get your share.

But you've also got to do due diligence. You might not be diligent on individual pieces, but you are going to want to do the due diligence on the fund structure, the manager, what they're doing with your money, etc.

There are, of course, good funds and bad funds. Some funds are sponsored by dealers and there's a conflict of interest, because on the one hand, the dealer's managing the fund, but on the other hand, the dealer probably has artists that he sponsors or protégés or has an inventory. That puts you in a situation where the investible dollars they are using to finance the dealer's inventory and he's getting first dibs and you're getting the dregs.

There are also excellent funds where those conflicts don't exist. The sponsor is not a dealer, where they have their own money in the fund, where the interests are aligned, etc.

There are other things to look for. For example, is there a mark to market or fee back provision? Let's say it's a five-year fund and the art goes up in the first year, so the appraiser comes in at the end of the first year and says, “This art is now more valuable based on my appraisal,” and the manager takes a fee based on that and then year four, somehow the art is worth less, but they don’t give the fee back.

So that’s a conflict.

Therefore, you want to find a fund where the manager doesn’t take any fees until you get paid. That would be a fund where everyone puts their money in, four years go by, they sell the art, they get cash, then the manager gets his fee and you get your share.

That’s fair because obviously the manager deserves some fee for the performance, but you want the interests to be aligned so they don’t get paid until you get paid.

Well, there are funds out there that pass all those tests. One in particular is the 20th Century Master’s Collection.

So there are different ways to participate in fine art. There’s a direct buyer. There’s a fund buyer, fund investor.

CHAPTER 19:

Joining the Rich's "Secret Wealth Clubs"

Take Advantage Of This Special 'Income Multiplier'

Little known dividend plans can take your gains to the next level… automatically!

By Nilus Mattive, Editor, *Rich Life Letter*

Picking the right dividend stocks will set you up for dependable income no matter what happens next in the markets or even with the underlying investment's price itself.

That's the very cornerstone of steadily rising wealth.

But good dividend stocks are just the beginning.

If You Really Want yo See Your Future Income Skyrocket, You Also Need to Consider Dividend Reinvestment Plans (Drips).

Normally, when you hold a dividend-paying stock, the company sends you checks or deposits the dividends directly into your bank account.

But with DRIPs, you can use those dividends to buy additional shares directly from the company on the dividend payment date. Generally, the purchases are commission free and you often get a discount to the current market price of the stock. And some DRIPs even allow you to purchase extra shares under the same terms.

How great is that?

And the company benefits as well, especially since shareholders who participate in DRIPs are more likely to be long-term investors.

More than 5,000 stocks have their own DRIPs available.

If your stocks are held at a brokerage, many firms will also let you buy shares (or fractional shares) with your dividends… whether the company itself has a DRIP plan or not. Some brokers will even allow you to reinvest dividends paid by mutual funds and ETFs!

One of the great aspects of reinvesting your dividends is that you can accumulate more and more shares over time. But if/when the market ever starts sliding and your stock's price drops, your dividends will actually buy MORE shares during those times. That alone can increase your chance for bigger long-term gains down the line.

The Power of Compounding Is What Really Makes Dividend Reinvestment So Effective.

Compounding is that snowball effect of your earnings generating even more future earnings.

As a famous quote, which is widely-attributed to Albert Einstein, reminds us…

> *"Compound interest is the eighth wonder of the world. He who understands it, earns it… he who doesn't… pays it."*

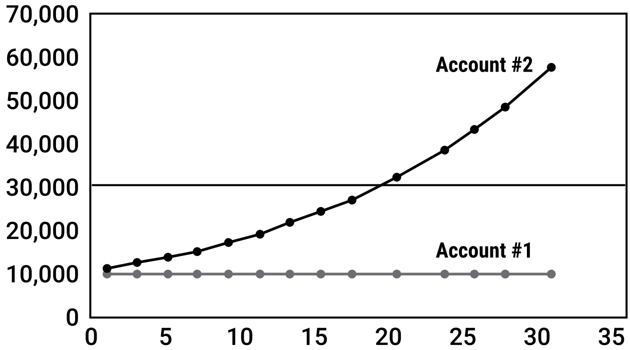
It's true, no matter who actually said it. In the case of dividend reinvestment, your reinvested dividends are buying more shares. Then, those shares are producing more dividends, which buy even more shares in the future. The cycle repeats and the numbers keep getting bigger.

Here's a Hypothetical Example:

Suppose you start with two separate $10,000 accounts. Both hold the same investments and earn 6%, or $600, a year.

Your plan is to withdraw the earnings from account #1 each year while reinvesting account #2's earnings. You can see in the chart on the next page that as you withdraw the earnings from account #1, its value stays at $10,000. However, in account #2 where the earnings are reinvested, the power of compounding becomes evident…

Compounding Turns $10,000 into $57,435



In 10 years, account #2 would be worth $17,908. In 20 years, its value will e $32,071. And in 30 years, a whopping $57,435! Now that's how wealth is really built!

And best of all, using DRIPs and the power of compounding can be used by anyone. The sooner you begin, the better!

CHAPTER 20:

Disney Dividends

The **Walt Disney Company (NYSE: DIS)** is one of the largest diversified international companies specializing in entertainment, media, parks, resorts and various consumer products.

Disney owns some of the most recognized TV channels in the United States, including Disney, ABC and ESPN. The company also operates highly popular amusement parks around the world, and it produces movies, cartoons and shows for kids and adults.

With its highly recognized brand and a very profitable sports channel, Walt Disney was able to grow its net income and operating cash flows into double digits from 2010 to 2015. As a result of its successful financial performance, the company has consistently paid, and increased, dividends year after year, making Walt Disney an attractive option for income-seeking investors.

Dividend Policy

The company has consistently paid dividends from 1995 to 2015, and it has one of the best track records of gradually increasing its dividends year after year. Disney raised its dividends per share from just over $0.23 in 2004 to $1.15 in 2014, which represents an average annual growth rate of 17%.

The company paid dividends once a year before 2015; however, in June 2015, Disney declared a cash dividend of 66 cents per share for the first six months of the fiscal year 2015, and announced the company will pay dividends on a semi-annual basis. The $0.66 dividend per share represents a 15% increase on an annualized basis when compared to 2014.

While Disney does not disclose how it determines its dividends, the payouts are likely contingent on the company's performance and especially its ability to generate sufficient operating cash flows to cover its investment and financing requirements.

As of June 2015, the company has a short- and long-term debt outstanding of $15.3 billion that is mostly due beyond 2020, giving it ample room for financial maneuvering with its cash on hand balance of $4.5 billion.

From 2004 to 2014, Disney's payout ratio ranged from 14.2% in 2007 to 22.8% in 2013, and its average payout ratio was 18.4%. In 2015, due to increasing operating cash flows and strong overall financial performance, Disney's payout ratio increased to 37.6% for the trailing 12-month period ending on June 27, 2015. Its current payout ratio of 37.6% is slightly above the media sector's average of 30.2%.

Dividend Yield

Disney's dividend yield is dependent on the dividend policy established by the company's board of directors and how the stock price changes.

From 2004 to 2014, the Disney's dividend yield ranged from 0.37% in January 2005 to 1.04% in February 2009. Its average dividend yield from 2004 to 2014 was approximately 0.5%.

In July 2015, the company's dividend yield jumped to 0.75% as a result of the 15% increase in the annual dividends per share. Also, since quarterly results as of June 27, 2015, did not meet analysts' estimates and there is growing concern over the TV industry, the company's stock price decreased by about 20%. As a result of its stock price decline, Disney's dividend yield went up further to 0.9%. At the end of September 2015, Disney's dividend yield stands at 1.3%.

Disney's dividend yield was 1.2% on average from 2010 to 2015, which is somewhat lower than the average of 1.9% for its peers within the media industry. As of September 2015, Disney's dividend yield of 1.3% is much lower than the media industry's average of 3.1%.

The industry's average is skewed, however, as there are a few movies and entertainment companies that do not directly compete with Disney but have higher dividends yields. Regal Entertainment Group and AMC Entertainment Holdings, Inc. have dividend yields of 4.9% and 3.3%, respectively.

Disney's closest competitors in the broadcasting and media business have dividend yields that range between 1 and 2%. Time Warner, Inc., which competes with Disney in the TV broadcasting space, has a dividend yield of 2.1%. Twenty-First Century Fox, Inc. a global programming entertainment company, has a dividend yield of 1.1%.

Comcast Corporation, a U.S. media conglomerate, has a dividend yield of 1.8%. While certain Disney competitors have higher dividend yields, none of them enjoy as high a degree of media products diversification as Disney does with its franchising, movies and TV channel offerings.

Disney's low dividend yield can be attributed primarily to its stock appreciation and the company's emphasis on stock buybacks rather than its dividends. From 2010 to 2015, the company bought back its own common shares worth $21.3 billion and is continuing its buyback program as of September 2015.

The company's spending on the share buyback program by far exceeds cash dividends. Some companies, such as Disney, prefer generating shareholders' returns through share buybacks rather than paying cash dividends since buybacks typically defer taxes for investors.

Dividend Safety

Disney's television and movies business lines coupled with its extensive franchising operations enabled the company to increase its operating cash flows from $6.6 billion in 2010 to $10.7 billion for the trailing 12-month period ending on June 27, 2015.

Disney prudently manages its capital by splitting its operating cash flows between its capital investments and financing needs so that at the end of the day, the company is left with a sufficient liquidity buffer. This is evidenced by Disney's cash balance, which grew from $2.7 billion in 2010 to $4.5 billion in 2015.

Despite recent challenges in its TV business, Disney remains in a financially solid position that enables the company to continue its dividend and share buyback program. The company's debt-to-equity (D/E) ratio of 33% remains far smaller than its peers in the media sector, which has an average D/E ratio of 68%.

In September 2015, Disney took advantage of rock-bottom interest rates by issuing bonds worth $2 billion that will mature within three, five and 10 years. Because of the company's superior financial position, its bonds have an investment-grade rating and are issued at very low spreads.

Disney has an interest rate coverage ratio of 49.7, and interest rate payments do not pose any risk to its payout policies. Disney's dividend coverage ratio stands at 549%, as the company spends most its funds on share buybacks instead of cash dividends.

Disney's Prospects

Disney enjoys a highly favorable position within media networks with its premier channels ESPN and ESPN2, which have exclusive deals with the National Football League.

The company's sports channels charge some of the highest fees among similar channels and generate some of the highest revenue streams from advertising. The Disney Channel is also one of the most trusted channels among parents who subscribe to media content for their kids.

Yet, Disney's broadcasting business is continuing to see some softness as consumers drop cable subscriptions and switch to Internet TV offerings. This development is likely to generate some headwinds for Disney and may slow down the company's growth in operating cash flows.

Disney is also generating an increasing amount of revenue from its characters by issuing franchising rights. As the company diversified its characters and franchises by purchasing cartoon and movie studios, such as Pixar, Lucasfilm Ltd., LLC. and Marvel, Disney has been able to expand its portfolio of characters and appeal to a much broader audience.

As the company continues creating movie hits and generating growing franchising sales, these revenue streams should offset any declines in Disney's broadcasting business and provide a sound foundation for a continued dividend policy.

Source: **Investopedia.com**

CHAPTER 21:

A Guide to Dividend-Paying Whole Life Insurance

The investment vehicle that allows you to earn tax-free and withdraw tax-free…

There are many different options when it comes to life insurance policies, ranging from comprehensive whole life to limited term policies. While term policies are usually the cheapest form of life insurance, whole life policies offer a number of benefits that policyholders may want to consider, including a guaranteed death benefit, predictable premiums over time, and even dividends that can provide cash or help offset the cost of insurance over time. In this article, we'll take a look at how whole life insurance policy dividends are handled and some important considerations for policyholders.

What are Dividends?

Many whole life insurance policies provide dividends representing a portion of the insurance company's profits that are paid to policyholders. In many ways, these dividends are similar to traditional investment dividends that represent a share of a public company's profit.

The dividend amount often depends on the amount of money paid into the policy. For instance, a policy worth $50,000 that offers a 3% dividend will pay a policyholder $1,500 for the year. If the policyholder contributes another $2,000 in value during the subsequent year, they will receive $60 more for a total of $1,560 next year.

These amounts can increase over time to sufficient levels to offset some costs associated with the premium payments.

Whole life insurance dividends may be guaranteed or non-guaranteed depending on the policy, which means it's important to carefully read through the details of the plan before purchasing a policy.

Often times, policies that provide guaranteed dividends have higher premiums to make up for the added risk to the insurance company. Those that offer non-guaranteed dividends may have lower premiums, but there's a risk that there won't be any premiums in a given year.

Finally, policyholders should consider the credit rating of the insurance company itself when determining how sustainable dividends are moving forward. Most insurance companies are rated A or better by major credit agencies, but those below an A rating may warrant a closer investigation to determine whether the insurance is sufficient or not.

Using Policy Dividends

There are many different options when it comes to using whole life policy dividends, ranging from a check in the mail to acquiring additional insurance. The most common uses of dividends include:

- **Cash / Check** – A policyholder may request that the insurer send a check for the dividend amount, which may be subject to dividend taxes.
- **Premium Deductions** – A policyholder may request that the dividend be put towards their future premiums owed in order to offset the cost.
- **Additional Insurance** – A policyholder may use the dividend amount to purchase additional insurance or prepay on their policy.
- **Savings Account** – A policyholder may decide to keep the dividend with the insurance company in order to earn interest on the amount.

The good news is that dividend payments received from participating life insurance policies aren't subject to taxes by the Internal Revenue Service (IRS) since the insurance companies generated the gains off of their policyholders. In essence, the dividend payments are treated as refunds for overpayment of the premium. This means that the best option is usually taking the cash or check and reinvesting the proceeds in an investment vehicle that could earn more income.

The Bottom Line

Many whole life insurance policies pay dividends to their policyholders that can be used in a variety of different ways. When investigating insurance policies, individuals should investigate how dividends are calculated and whether or not they are guaranteed, as well as look at how they plan to handle the dividend income. The favorable tax treatment means that the best option is usually taking the cash and reinvesting it elsewhere at a better return.

Source: **Investopedia.com**

Dividend Aristocrats

Dividend aristocrats are defined as companies that have increased their dividend payouts to investors nonstop for the past 25 years.

The following comes from Jim Rickards' and Nomi Prins' market analyst at Paradigm Press, Dan Amoss…

Here's how I view the stocks in the Dividend Aristocrats Index…

There is a risk that some are ill-suited for the future economic environment, and were better suited for the past few decades (in which they delivered the earnings and dividend growth to be admitted to the index). Examples include some consumer staples that have struggled in recent years, as private label has taken market share, younger consumers are less brand-loyal, etc. Examples may include Proctor & Gamble, Hormel.

I ran a screen in Thomson Reuters Eikon to highlight the best three candidates (in my opinion!)…

Check your downloads folder to view the spreadsheet.

There are many columns, but the most telling in my view is column AT. Here's what it means:

Dividend Yield as % of FCF Yield – lower means the dividend is more sustainable and can more easily grow in the future…

Looking at the top of the list [of all Dividend Aristocrats], these three stand out as the ones I'd choose to buy out of the entire Aristocrats list:

CHAPTER 22:

Nucor (NUE)

The best-managed steel company in the world, in my opinion. And the Trump tariffs have made American steel producers much more sustainably profitable than they've been in the past… Specifically on NUE's dividend, I think management will soon announce an accelerated stock buyback. The more shares bought back, the more easily NUE's dividend per share can grow in the future (i.e., if NUE cuts its shares outstanding in half, its dividend per share would double even if the dollar amount it spent on dividends stayed the same).

CHAPTER 23:

Franklin Resources (BEN)

A mutual fund manager that's beat punished and is now cheap based on the indexing fad. I expect the indexing fad to fade as markets get more volatile.

Franklin Resources, Inc. (NYSE: BEN)

CHAPTER 24:

General Dynamics Corp. (GD)

A well-run aerospace and defense company. I recommended **General Dynamics Corp. (NYSE: GD)**… GD manufactures submarines, Abrams tanks, and Gulfstream private jets.

The thing I like about all three is that they should perform well if the market gets rockier from here. Nucor has structurally higher profitability in the Trump Administration, BEN has already been sold off to a cheap valuation, and GD is geared mostly to the DoD budget for major weapons programs, which is predictable and non-cyclical.

Also, as the Excel file above shows, each company has shrunk their share count via stock buybacks, and has plenty of capacity to raise dividends in the future.

CHAPTER 25:

AT&T Dividends

AT&T Stock History: A Dividend Dynamo That Stands the Test of Time

If you're looking for a great stock with a strong dividend history to buy now, then look no further.

Having existed in one form or another for over 130 years, **AT&T's (NYSE: T)** stock history is in many ways a history of the telephone itself. In the US the recent history of the telecoms industry has been a two horse race for some time, with AT&T and Verizon the leading ladies, and — as dependence on mobile technology increases — the outlook for the industry looks promising.

AT&T's history gives insight into this stock market stalwart, the value it has already returned to many investors, and how it may be an investment opportunity to buy now.

With dividend investing as a whole enjoying something of a resurgence lately, high-yielding stocks like AT&T are having something of a moment right now. In light of that, here's a quick overview of AT&T stock's historical performance and why its sizable dividend should continue to provide value for its shareholders.

AT&T stock history: From Graham Bell to Ma Bell to today

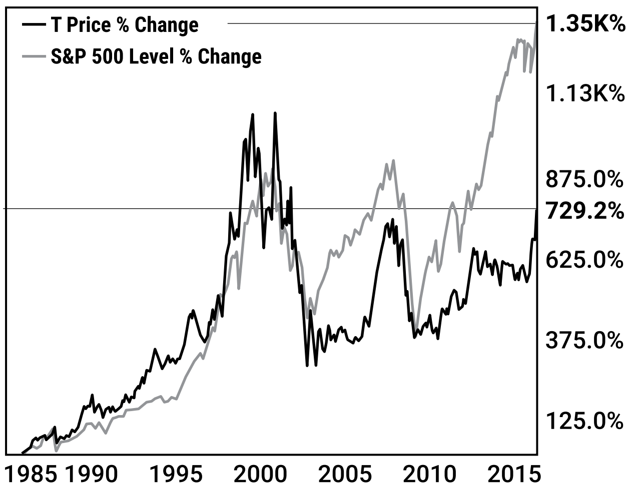
It isn't a stretch to regard AT&T's history as a reflection of American business as a whole in the more than a century since its founding by Alexander Graham Bell in 1876.

In its early years, the revolution in communication that AT&T and Bell helped spur gave birth to a business many grew to regard as a monopoly in the telecom industry for much the 20th century. Predictably, this culminated in the eventual break-up of

AT&T, or "Ma Bell" as many had come to call it, in 1984. However, the shattered remnants of AT&T's former glory also sowed the seeds for the company's more recent renaissance.

AT&T's 1980s breakup witnessed the creation of a number of smaller fragments of the former monopoly, which at least some readers will remember as the "Baby Bells." Of particular importance in terms of AT&T's corporate history today, the destruction of the original AT&T monopoly gave birth to the Southwestern Bell Corp, or SBC, which after a series of mergers and re-namings is the publicly security represented by AT&T stock today.

Here's how AT&T shares have fared against the broader market since their SBC days.



Source: YCharts.

It's an important caveat here that the above chart doesn't reflect the effect of dividends, of which AT&T and its myriad predecessors have all been prodigious payers.

Since it has engaged in so much merger activity in the past two decades, precisely calculating out how much dividends would change the equation becomes unwieldy. Just know, the above underperformance would be dramatically reduced or removed when counting dividends. As it also happens, AT&T's dividend prowess remains one of the core tenets of the current investment thesis in its stock today.

Outlook for AT&T Shares

Though it has other multibillion-dollar business units, AT&T's financial success largely rests on the strength of its massive U.S. wireless business; international sales account for less than 3% of total revenues.

Its massive consumer and business wireless segments together produce 50% of AT&T's total revenues and 80% of its operating income. Thankfully, these businesses are relatively stable — even growing slightly.

However, with the U.S. smartphone market quickly approaching maturity, AT&T's long-term revenue growth outlook appears moderately constrained. That's also where AT&T's history of outsized dividend payments helps create value for its shareholders.

AT&T Corp Dividend History	Current Divident Yield	No. Consecutive Years Increased	Total Dividends Paid LTM	5-Year Dividend CAGR
	4.7%	**31**	**$10.2 Bn**	**2.2%**

Source: S&P CAPIQ, AT&T Investor Relations, and Dividend.com.

Even given its relatively diminutive dividend growth, AT&T shares undoubtedly remains an income-generating machine. In an era in which the 10-year Treasury currently yields just 1.6% — roughly two-thirds below its historic average — those seeking income investments for whatever reason are increasingly, and rightly, shifting their attention toward dividend investing.

AT&T's stock is far from exciting. But in the context of helping meet savers' important needs, this U.S. telecom giant certainly appears to fit the bill. Relatively safe and sizable, AT&T shares should offer great value for dividend investors for years to come.

Source: **The Motley Fool**

CHAPTER 26:

Short Selling

How Does It Work and How to Properly Short a Stock

By Tim Sykes, Editor, *Tim Sykes' Weekly Fortunes*

Short sellers are often longs' best friends. They spike up stocks far above what they're worth! I thank them repeatedly for enriching me and several of my top trading challenge students.

If you're fairly new to trading, the notion of short selling may seem particularly daunting — or even downright scary. But short-selling is not something to be feared. It's a tool you can learn and use to help round out your trading activities and take advantage of situations when you're better off betting on a stock's decline in price.

However, I don't recommend shorting stock just because you can or because you think I'm telling you to short everything that comes your way. Far from it.

Instead, you need to master the concept of shorting stocks and learn to recognize repeating patterns that could help you forecast price movement. Otherwise, you're bound to lose money.

I'm getting ahead of myself, though. What is short selling? How does it work? And how can you potentially use it to your advantage? Let's take a deep dive into this sometimes confusing topic.

What Is Short Selling?

Short selling is the act of betting against a stock with the goal to generate a profit. When you go long, you bet on the stock's price rising until you sell it. That's a long position. A short position occurs when you believe a stock's price will move against what others assume.

Let's say that lots of people are buying up a stock we'll call XYZ, for example. There's a promotion going on that you've identified, so you predict a major crash once people start dumping their stock. By short selling that stock, you could possibly profit from the price's eventual decline.

This wouldn't work outside financial instruments. Imagine borrowing your buddy's car because you believe its market value will decline swiftly in the near future. You sell the car out from under him and pocket the cash. Later, when the market value falls, you buy an identical car and return it to him.

You probably wouldn't have a friend anymore.

It's all fair in the stock market, though, so you have to be willing to seek out patterns different from traditional longs.

How Does Short Selling Work?

Short selling is a four-step process:

Decide how many shares you want to short. You borrow those shares from your broker for a fee. There's no limit to the number of shares you can short as long as you have the cash available.

Sell the shares you borrowed. Ideally, you'll sell the shares close to the top of a spike. This often happens when unscrupulous promoters convince people to buy shares in a stock for no reason at all.

Buy back the stock. When the price declines, you want to buy back the shares at a lower stock price. Don't wait too long — take your profits early to avoid potential losses.

Return the shares. The shares you shorted go back to your broker. You pocket the difference.

Obviously, there's risk in short selling stock — I'll cover that later — but every stock market play contains some element of risk. You have to study and practice over months and years so the effective patterns become easy for you to spot.

Short Selling as a Daunting Task

Why does short selling seem so daunting?

Well, like most seemingly daunting tasks, short selling is not daunting in itself. To be honest, it's the idea of short selling that has become scary for many investors. People have it stuck in their head that short selling is something to avoid.

It's too complicated, too risky, too labor-intensive.

People have created this mental barrier, shielding themselves from something that could prove to be quite lucrative simply because they don't know enough about it, and they don't know where to start. And once someone has made their mind up about something, it can be difficult to change that perception.

Add to that the multitude of perhaps well-intentioned internet posts that spew gloom and doom with regard to short selling — "Why You Should Never Short-sell Stocks" or "How to Short Sell Stocks and Why You Shouldn't" — and you have a perfect storm that has effectively demonized this trading strategy.

But if used prudently, short-selling can indeed prove useful, particularly in a bear market and when betting against penny stock scams like these.

Benefits of Using Short Selling

If you only take long positions during your trading activities, you can only benefit when you're bullish on a stock. If you're bearish, you don't trade.

Short selling eliminates that conundrum. I'm not saying you should trade every day — you probably shouldn't unless there are tons of amazing plays — but what if there are no decent long positions?

You start looking for short selling opportunities.

Traders who avail themselves of short selling can potentially profit in both bear and bull markets. When you're bearish on a stock and you have good information behind your sentiment, shorting it allows you to trade even though there are no stocks you want to buy.

Short Selling Example

I provided the example of the car you shorted off your friend earlier, but let's look at a more direct analogy.

We'll start with a long position. Kim wants to buy five marbles. The going rate for marbles is $2 each, so she pays Sarah $10 for her five marbles.

A day later, marbles are selling for $3 each. Now Kim sells her five marbles to Jack for $15 — a profit of $5. That's an easy analogy for a regular purchase.

Now, let's look at a short sale (of marbles): Kim thinks the price of marbles is going to plummet because marble demand is expected to decrease tomorrow. The going rate is $2 each today, but she thinks that by tomorrow, marbles will be worth $1 or less.

Kim knows there is still a way to profit from the future price fall: she can short it. Kim goes to the bank and tells the bank of her plan.

The bank knows a customer — Mike — who has marbles. The bank borrows Mike's five marbles and sells the marbles on the market for $10 to Kim. The bank puts the $10 from the sale of the marbles in Kim's bank account.

The next day, marble prices halve. Kim calls the bank to "cover" her position — meaning she will now buy five marbles from the market (from her account of $10) at today's price of $1 each, or $5 total. The five marbles are then returned to their rightful owner, Mike.

In a tiny nutshell, short selling involves borrowing a stock and selling it, and then buying the stock (hopefully at a lower price) and returning it to the owner — pocketing the difference.

That's borrow it, sell it, buy it, return it: four steps.

Limitations of Short Selling Stocks

So, if short selling can prove so profitable, why is there so much trepidation among traders? As I mentioned above, short selling involves inherent risks. Let's look at the four most concerning risks and figure out how to overcome them.

#1 Endless Risk

Unlike regular trading, short selling comes with infinite risk. Yep: infinite. In theory, the price of marbles, after you borrowed them and sold what you didn't own, could go up — and up, and up, even to infinity. You could be left covering an infinite gap between what you sold it for and whatever price it reaches. And the bank (your broker) could demand that you cover that stock whenever it chooses.

All trading comes with risk, but with long positions, the lowest a price can go is zero, and since you bought it at a specific amount, the largest amount you can lose is the amount you paid for it.

Not that that's a good thing. Betting $1 million on a stock and having it plummet to $0 is still horrific and risky. So, I'm not sure the notion that short selling comes with some untenable risk is entirely fair. But, mathematically speaking, the risk is endless — and can even extend beyond what you have. You could lose way more money than you have.

At least with long positions, the complete risk is known up front. Even when faced with losing everything, which is possible in any long position, there is some comfort in knowing the absolute maximum that you could lose.

That's why you MUST follow rule #1 here on all short sells, no matter how much you hate the company/stock!

#2 Limited Returns

Normal stock trading comes with the possibility of infinite returns and limited risk. If you paid $5 for a stock, the most you can lose is $5 if the price falls to $0. In long positions, your profits are limitless — the price could theoretically go up and up into infinity, meaning that your profit-making opportunities are — at least in theory — limitless.

But in short selling, the inverse is true. The most you can make from shorting a stock is how much you put into it (or rather, how much you borrowed). So, for a $5 stock, the most you could possibly make is $5, and that's a best-case scenario that would only happen if the stock becomes completely worthless and falls to $0.

Because the risk is endless and the rewards are capped at a specific amount, traders don't always see short selling as a mouthwatering prospect, especially to the newer investor who is often looking for a small number of huge returns, rather than a large number of small gains over time.

#3 Not Every Stock Can Be Shorted

"No shares available." This is a common response to an inquiry to short a certain stock.

In the marble example above, notice that the bank borrowed Mike's marbles. Oddly enough, Mike is blissfully unaware of this five-finger lifting that would see his shares returned to him at a later date. Mike's account is never affected — just the actual marbles removed — so it doesn't actually show up on his statement.

But the only shares available for borrowing are held in margin accounts. Stock held in cash-only accounts are not available for borrowing, and therefore are not available to short sellers.

Also, penny stocks (stocks under $5) cannot always be shorted either, and will vary depending on your broker.

Sometimes, you will get the "no shares available" message even when it's possible to short the stock in question. You simply need to call your broker and ask whether any shares are available to short, and they will try to find them for you.

Also, note that some brokers will tell you — erroneously — that stocks under $5 cannot be shorted due to SEC rules. This is not so. You can read more about this here: Can You Short Sell Stocks Under $5?

The takeaway here is that the stock you are hoping to short will not always be available through your broker. You can likely have more opportunities if you work with multiple brokers.

#4 Covering May Not Be as Easy as You Think

Liquidity may be low, meaning that when you want to cover your position, you may not be able to find any shares to buy when you want to — let alone at the price you want.

Also, just because marbles were $2 each today doesn't mean that tomorrow, they'll be $3 before they hit $5, or $10. Tomorrow, they could be $20, and have skipped all the increments in between.

You may not be able to close out your position along the way because there may not be an "along the way." Prices do not necessarily hit every (or any) point in between.

But it's not all bad.

Important Metrics to Keep in Mind While Shorting a Stock

Short selling can prove profitable if you're willing to learn the intricacies of this trading practice and study hard. I always tell my students to hit the books every day and to bury themselves in spreadsheets. The harder you work, the better your prospects for success.

Let's look at a couple metrics you need to know before you consider shorting a stock.

Short Interest

Think of short interest as an expression of sentiment. It tells you whether other investors are bearish or bullish on a particular stock. It's communicated as a number or percentage.

Essentially, short interest conveys the number of existing shorted shares that have not yet been covered. In other words, how many shares have investors already shorted?

You can decide how to proceed based on how many outstanding shares have been shorted and whether that number has increased or decreased over days or weeks.

Short Interest Ratio (SIR)

You also want to track SIR, which tells you the ratio of shorted shares to trading volume. Let's say, for instance, that there are 10 million shorted shares and the average daily trading volume is 20 million shares. You have a ratio of 20 million to 10 million.

The reason this matters is that it tells you about how long it will take for all of those shorted shares to be covered. You just divide the first number by the second. In the example above, you divide 20 million by 10 million, which gives you two.

In this example, it would take two full trading days for all investors to cover their shorted shares.

How to Short a Stock

We've covered the basics, but how do you short a stock while reducing your exposure to the risks mentioned above? That's the big question.

Remember That Timing Is Everything

When you time a short sale right, it's possible to profit enormously. When you're off by just a few minutes — or even seconds — the profit potential declines swiftly.

This is particularly true when you're short selling based on panic. A promoter has gotten lots of ill-informed investors to buy shares in a given stock, but those investors start selling shares like crazy when they realize their positions aren't going to hold.

That's a great setup for short selling, but only if you're fast.

Stick to Your Trading Discipline

Just because you're changing up your trading strategy doesn't mean you should throw caution to the wind. That's how investors lose money in the stock market.

Remember my number-one rule: Cut losses early. If the price action moves against you, cover as quickly as you can to limit your losses.

It's true that there are situations in which you can't find shares to buy.

The way to avoid that as much as possible is to choose stocks with huge volume. When there's lots of volume, you'll cover your shares more easily.

Anticipate Declining Price Action

You need evidence before you try short selling.

In other words, why might a stock's price decline? You might have heard negative news about a company, seen a pump-and-dump scheme in action, or spotted a potentially lucrative pattern.

Whatever the case, there needs to be a catalyst. You shouldn't short a stock just because you don't like the company or because you're itching to trade. That's how you lose cash.

Best Broker for Short Selling

The best broker for short selling is the one that offers you the most flexibility.

You want a broker that will seek out shares for you to short when you can't find any on your own and one that will allow you to short penny stocks.

Robinhood, for example, is a free trading platform. Many people flock to it because they don't have to pay commissions. However, it's also severely limiting. You can't short at all.

I also recommend working with multiple brokers if you can.

That way, if you're unable to short a stock with one, you can switch gears and find shares through a different broker.

Never Stop Learning

I've emphasized several times in this article that you must, above all else, prioritize research. If you're not learning something new every day, you're doing yourself a serious disservice.

The Bottom Line

You don't have to be afraid of short selling. A little fear is good because it keeps you conservative, but you don't want to be overwhelmed by anxiety.

It starts with research. Reading this post was a good start. You're gaining a broader understanding of how short selling works and whether shorting is a good fit for you.

Once you've mastered the concept, try paper trading. It's a great way to get your feet wet. Many trading platforms offer paper trading where you don't have to risk real money. After a while, move on to actual trading. Once you're ready, take off the training wheels and dive in … because, after all, if you want to profit from the stock market, you have to invest real money.

Maybe you've already had some success with long positions, but you're ready to try your hand at shorting stocks. With lots of education and research, it could be a good fit for you.

If this all sounds appealing, it could be time to give shorting a shot!

CHAPTER 27:

Covered Calls

Covered Call Writing

By Nilus Mattive, Editor, *Rich Life ATM*

Before we get to covered calls, let's go over the basics on options.

An option is a contract between two parties that grants the owner the right — *but not the obligation* — to buy or sell shares of an underlying security at a specified price (the **strike price**) on or before a given date (the **expiration date**).

U.S.-listed options generally expire on the third Friday of the month. In the rare event that the Friday is a holiday, the options expire on the preceding Thursday instead.

There are two basic types of options:

- A **call option** gives its holder the right — but not the obligation — to *BUY* an underlying security.
- A **put option** gives its holder the right — but not the obligation — to *SELL* an underlying security.

Each options contract covers 100 shares of any given security, known as a **round lot**.

There are options actively trading on most major stocks and ETFs, and investors frequently use these investments as a way to hedge their portfolios or to speculate on a security's future moves.

One advantage of using options like this is that investors put less capital at risk — because buying a contract allows you to control 100 shares for a lot less money than it would take to buy the shares outright.

Plus, when buying options, they have strictly limited downside, which is not technically the case with other speculative activities like short selling.

Of course, in addition to buying options, you can also SELL options to generate additional investment income.

You see, most investors who use options to speculate never think about where the options actually come from.

Yet the reality is that options come from other investors willing to take on the specific obligation of the contract, in a process known as **option writing**:

So an investor who writes a call is willing to sell the security covered by the contract at the specified strike price up until the option's expiration day.

And an investor who writes a put is willing to buy the security covered by the contract at the specified price up until the option's expiration day.

In the next two chapters we will cover each of these options writing strategies in greater detail.

But first, let's talk a little bit more about how options are priced…

Options traders are most concerned with a few major aspects of any given contract.

The first major consideration is where the strike price is in relation to the underlying security's price…

There are three basic scenarios:

- "**In the money**" — For call options, this is when the strike price is lower than the price of the underlying security. For puts, it's when the strike price is higher than the price of the underlying security.

- "**At the money**"— This is when the strike price is essentially equal to the security's price regardless of what type of option you're talking about.

- "**Out of the money**"— This is when the strike price of a call option is higher than the price of the underlying security. Or, for puts, it's when the strike price is lower than the price of the underlying security.

So basically, the deeper an option moves "in the money," the more valuable it becomes… and the more likely the option holder is to exercise it before expiration.

The second major consideration is how much time is left before the option expires.

This one is pretty simple — all other things being equal, as an option moves closer to expiration, its value declines in a process known as "**time decay.**"

Of course, there are also other factors that help traders price options accurately…

For example, traders are very concerned with **volatility**… both how widely the underlying security tends to swing as well as how sharp the overall market's moves are at any given time.

Heck, it's just like other types of insurance: It costs more to write a policy for a crazy driver or to buy a homeowners policy as a hurricane approaches!

In addition, traders take into account things like dividend payments coming from the underlying security.

There is actually a basic formula for pricing any given option, created by two economists named Fischer Black and Myron Scholes. They first wrote about this in a 1973 paper entitled "The Pricing of Options and Corporate Liabilities," which was published in *The Journal of Political Economy*.

In 1997, Scholes and another economist named Robert C. Merton received a Nobel Prize related to their work related to option pricing. (Black was dead already though he was cited as a contributor.)

Of course, there are very few times that an option will trade below the price implied by the Black-Scholes model. This is because professional option traders (among others) constantly search for short-term price dislocations and buy the options as quickly as possible until they are fairly valued.

Now let's get to covered call writing…

Covered Call Writing

When you write a call, you are selling someone else the right to buy 100 shares of a particular security at a specific price during a specific timeframe.

For doing this you collect an upfront premium, or what we like to call an “instant dividend.”

IMPORTANT NOTE: I only ever recommend writing COVERED CALLS… and I strongly discourage you from ever considering selling a naked call.

That is because, although it is entirely possible to create and sell a call for a stock you don’t own, you are leaving yourself exposed to lots and lots of risk.

In contrast, with covered calls, you are engaging in what is considered to be the very safest type of options trading.

Reason: You are merely selling someone the right to buy a security that you *ALREADY own*.

Since each options contract covers a round lot, you will need 100 shares of any given security to write a call on it.

Determining which particular call to write is part art and part science, but the two basic ways to do it are:

A. Buying 100 shares of a given security and then immediately selling a call against the position (known as a “**buy-write**” or “**married**” order)

B. Writing a contract on a security that you already own in your portfolio.

IMPORTANT NOTE: If you want to write covered calls in the safest way possible, always make sure you’re selling a contract with a strike price higher than the price you paid for the shares. And also remember to factor in all commission costs — related to both the underlying investment as well as those paid to open and close the options trade.

There may be times when it makes sense to write an option very near the strike, or even when it’s already “in the money.”

Overall, though, the most conservative way to write covered calls is at prices above the price you paid for the underlying stock (and also factoring in all commissions for buying and selling). Doing it this way guarantees that you can only book a profit in the event that the option is exercised, and it adds no more downside risk than you had just by owning the shares.

In fact, the premium you collect actually lessens the overall downside risk!

To see why, let's walk through an example:

To keep things simple, we'll use 100 shares of a hypothetical stock that you just purchased for $30 a share.

Let's say you decide to write a contract that expires in September with a strike price of $35. You see that this contract is selling for $1.50.

Is that all you're going to get? A "cash on demand" payment worth $1.50???

No!

IMPORTANT NOTE: Because an options contract cover 100 shares you must multiply the price times 100 to reach the actual amount of premium you'll be collecting.

In this case, that means the actual premium you will collect is $150!

Now it's just a matter of placing your order, either online or with your broker over the phone. (We will talk about how these orders actually work in a later chapter.)

Once the contract is created and sold… you will receive the premium — minus commissions — in your account.

Although it will show as a "debit" until the contract is closed out, this money is actually yours to keep no matter what happens next!

In other words, with covered call writing, you always collect a nice little payment immediately. But your potential profits don't stop there. The rest of the story can play out in a few different ways.

Let's go through each scenario one at a time…

Scenario 1: *If the stock price fails to rise above the strike price of the contract*, the investor who bought your call option will let it expire worthless. You get to keep your stake in the company, plus the money you collected for the option.

End of story.

Scenario 2: *If the stock price rises temporarily above the strike price*, but the investor fails to exercise the contract… same result.

Scenario 3: *If the stock price goes nowhere during the life of the contract*… same result.

Scenario 4: *If the stock price only goes down during the life of the contract*… you keep your stake in the company and the money you collected. Your shares may be worth less on paper, but you've realized a gain from the option contract you sold.

And under any one of these four scenarios, you are now free to write a new call with a new strike price and a new timeframe!

You can continue doing this again and again for a continual second stream of income from your portfolio.

Okay, there has to be another scenario, right? Yes.

Here it is… the absolute "worst case"…

Scenario 5: *If the stock rises above the strike price and the investor exercises the option before it expires*… you will be forced to sell your shares to the options holder AT the strike price.

This is your only obligation.

You can never be forced to sell the shares at any price other than the strike price!

In other words, the worst thing that can happen with covered call writing is that you will be forced to part with your shares for the predetermined strike price.

But think about what that means… essentially, you can potentially collect THREE SEPARATE PROFITS:

Profit #1: You've collected the money from the sale of the option.

Profit #2: You've collected any dividends paid before the option was exercised.

Profit #3: As long as the strike price was higher than your original cost for the shares (factoring in commissions), you've booked a third profit!

Plus, you can always buy the stock back later if you want to!

Also, when you sell an option, you do *NOT* have to just sit there and wait for the contract to expire…

In some cases, it may make sense to close out the trade earlier — either to lock in profits or to protect against losses.

To do this, you can simply place an order that instructs your broker to "**buy to close**."

Basically, you're going out and purchasing the exact same contract you previously sold. And in doing so, you are cancelling out any future obligation you had.

If you're getting the idea that covered call writing is a great strategy when the stock market is trading within a range, you're absolutely right!

And as long as you want to continue holding your shares anyway, it's also a great strategy when the market is going down.

What about if the stock market goes up? You can still collect decent returns, it's just that your upside will be limited.

Pretty good deal, eh?

I sure think so!

CHAPTER 28:

Selling Puts

Selling Cash-Secured Puts

By Nilus Mattive, Editor, *Rich Life ATM*

Before we get to selling cash-secured puts, let's go over the basics on options.

An option is a contract between two parties that grants the owner the right — *but not the obligation* — to buy or sell shares of an underlying security at a specified price (the **strike price**) on or before a given date (the **expiration date**).

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There are options actively trading on most major stocks and ETFs, and investors frequently use these investments as a way to hedge their portfolios or to speculate on a security's future moves.

One advantage of using options like this is that investors put less capital at risk — because buying a contract allows you to control 100 shares for a lot less money than it would take to buy the shares outright.

Plus, when buying options, they have strictly limited downside, which is not technically the case with other speculative activities like short selling.

Of course, in addition to buying options, you can also SELL options to generate additional investment income.

You see, most investors who use options to speculate never think about where the options actually come from.

Yet the reality is that options come from other investors willing to take on the specific obligation of the contract, in a process known as option writing:

So an investor who writes a call is willing to sell the security covered by the contract at the specified strike price up until the option's expiration day.

And an investor who writes a put is willing to buy the security covered by the contract at the specified price up until the option's expiration day.

In the next two chapters we will cover each of these options writing strategies in greater detail.

But first, let's talk a little bit more about how options are priced…

Options traders are most concerned with a few major aspects of any given contract.

The first major consideration is where the strike price is in relation to the underlying security's price…

There are three basic scenarios:

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- "**At the money**"— This is when the strike price is essentially equal to the security's price regardless of what type of option you're talking about.

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So basically, the deeper an option moves "in the money," the more valuable it becomes… and the more likely the option holder is to exercise it before expiration.

The second major consideration is how much time is left before the option expires.

This one is pretty simple — all other things being equal, as an option moves closer to expiration, its value declines in a process known as "**time decay**."

Of course, there are also other factors that help traders price options accurately…

For example, traders are very concerned with **volatility**… both how widely the underlying security tends to swing as well as how sharp the overall market's moves are at any given time.

Heck, it's just like other types of insurance: It costs more to write a policy for a crazy driver or to buy a homeowners policy as a hurricane approaches!

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Of course, there are very few times that an option will trade below the price implied by the Black-Scholes model. This is because professional option traders (among others) constantly search for short-term price dislocations and buy the options as quickly as possible until they are fairly valued.

Now let's get to cash-secured puts…

Cash-Secured Puts

Selling puts is like the mirror image of writing covered calls — instead of selling someone the right to buy an investment you already own, you're selling someone the right to sell *THEIR* investment to you.

This is precisely what Warren Buffett has done over the last decade. In his own words (from the 2008 Berkshire Hathaway letter to shareholders):

> *"We have added modestly to the 'equity put' portfolio I described in last year's report. Some of our contracts come due in 15 years, others in 20. We must make a payment to our counterparty at maturity if the reference index to which the put is tied is then below what it was at the inception of the contract…*
>
> *"Our put contracts total $37.1 billion (at current exchange rates) and are spread among four major indices: the S&P 500 in the U.S., the FTSE 100 in the U.K., the Euro Stoxx 50 in Europe, and the Nikkei 225 in Japan. Our first contract comes due on September 9, 2019 and our last on January 24, 2028. We have received premiums of $4.9 billion, money we have invested. We, meanwhile, have paid nothing, since all expiration dates are far in the future."*

Now, if you were to ask Buffett why he doesn't advocate that regular investors use this strategy, I'm sure he would say it's too advanced.

But that's just not true. In fact, it's so conservative many brokerages will also let you do put writing inside traditional IRA retirement accounts!

With put writing, you're simply selling insurance to other investors. And you get to control ALL the variables — the particular investment being covered by this insurance, how long the insurance contract is good for, and even how much you'll accept to issue the "policy."

Now, here's why writing puts is a great approach…

The Chicago Board Options Exchange, which is the biggest marketplace for these contracts, says a full third expire completely worthless… and that only 10% of them end up getting used!

That makes sense, right? I mean, how many times have you used your auto insurance policy during all the years you've had it? And who do you think has gotten the better side of the bargain during all those years?

The insurance company who sells you the policy… *exactly*!

Now to be sure, it IS also very possible to buy options for windfall profits… and I'm okay doing that for pure speculation.

But based on the numbers — and my personal experience — you stand a much better chance of CONSISTENTLY profiting from selling options.

The unfortunate part is that most investors simply have no idea that this is even possible.

In my opinion, the best way to sell puts is by collecting upfront income and targeting high-quality investments you'd want to own anyway…

Let's say you like XYZ dividend stock that's currently trading at $16 but you'd like to buy on a dip, when it hits $15.

Well, instead of just waiting around for a pullback — which is what most investors would do — you can sell a put option instead.

In this case, you'd be selling someone else the right to sell you 100 shares of their XYZ at $15.

And again, you could determine how long this right was good for — maybe a contract length of two months or so.

Once you've sorted out those details, you just place this order with your broker like you do any other trade. It really is just as easy, in fact.

Then, after someone agrees to buy this insurance from you, you'll immediately collect your premium — the money they paid to buy the insurance from you.

It could amount to hundreds — or even thousands of dollars — depending on a number of factors.

That cash is yours to keep no matter what happens next. So immediately, you've already collected an "instant dividend" without having to buy ANY investment upfront!

And in all but one scenario you end up keeping that money with no other obligation.

Better yet, you're free to do whatever you want next — including writing ANOTHER contract and collecting MORE cash upfront!

What about that other scenario — the one where you don't just keep your insurance premium and move on?

Well, let's stick with our example and say XYZ goes down to 15 (or below) and the other person decides to actually use the insurance you sold them.

That last part is a critical distinction because, again, only one out of ten people end up actually using their insurance.

Anyway, in this case, you will have to buy the shares of XYZ at 15 like you agreed to do.

Please note that with this example this is the only price you can be asked to pay — never a penny more or less!

And as long as you have the money in your brokerage account to pay for the shares — which is always what we recommend — then you've actually still essentially "won" with this strategy.

The reason is pretty obvious: You ended up owning an investment you wanted to buy at the price you wanted to pay.

More than that, you actually bought it at a LOWER price than you wanted to pay since you also collected that premium upfront.

So let's summarize. When done correctly, writing put options:

- Gives you immediate, non-refundable payments without having to buy any type of stock, bond, or other investment upfront…
- Can be done in your regular brokerage account and in practically the same way that you currently buy or sell other investments…
- Allows you to know, in advance, every possible scenario that could happen BEFORE you do anything…
- In all but one outcome, essentially hands you money for doing nothing…
- And in the worst case, gives you the chance to buy investments that you like at prices you predetermined were fair!

IMPORTANT NOTE: The only key here is that you must be ready to take ownership of the underlying stock or ETF, too!

The reason this is so important is because there is one major risk with selling puts — the possibility of getting stuck holding an investment that has declined in value.

For example, let's say you sell a put on XYZ stock with a strike price of $12 a share. In the process, you collected an upfront premium worth $100.

Although the shares were trading at $15 when you sold the contract, a bad piece of news came out right before your contract expired and the stock immediately fell to $10.

In all likelihood, you are now going to take possession of 100 shares of XYZ at $12 a share.

Not factoring in commissions, that means you are already sitting on a paper loss of $100 (you paid $1200 for the stock but it's now worth $1000 *plus* you collected the $100 in premium for writing the option).

Obviously, if you did this just to collect that premium, you may be unhappy.

However, if you like XYZ for the longer-term, you probably won't mind sitting on it with a paper loss for a little while.

Better yet, if it's a dividend-paying stock you can collect some income while you wait for the shares to rebound.

AND, you can also now consider writing a covered call against this new stock that you own!

This is exactly why I only recommend writing puts on quality stocks — so that you never end up with investments that aren't good long-term holdings… and so that you have plenty of ways to turn even worst-case scenarios into cash-gushing opportunities.

And again, just like with covered calls, you can also close out the trade earlier — either to lock in profits or to protect against losses by instructing your broker to "**buy to close**."

IMPORTANT NOTE: I only ever recommend selling CASH-SECURED puts!

You can actually sell a put using a couple different methods.

For example, some brokerages will allow you to sell puts without having enough money in your account to cover the potential assignment of the underlying investment.

And many investors choose to sell puts this way, maybe putting up only a fraction of the possible amount needed if the put is exercised.

The reason is simple: If the stock never gets assigned, the premium collected represents a far bigger return on their "investment."

But doing this amounts to using margin, or borrowed money, and that entails more risk.

After all, what happens if the stock *DOES* get put to you?

If you don't have the money to cover the purchase, you will either have to quickly come up with it or the brokerage might liquidate some of your other holdings to fund the trade.

This is what is referred to as a "margin call," and I don't ever want to see you deal with that.

Plus, if you are making the trade in an IRA or other account that you cannot easily fund, this can get very messy.

So I only ever recommend cash-secured put writing.

With this method, you must have enough money to cover the entire trade in your brokerage account before you write the put contract! (Many brokerages will keep the money in a separate fund for you so that it is always there until the contract expires.)

So basically…

As long as you write puts on stocks you wouldn't mind owning…

And as long as you always have enough money to cover the potential purchase if the contract is exercised…

Writing puts is far better than just hoping for a pullback or entering limit orders on investments you want to buy.

Reason: You'll happily start getting paid to wait — which is the very cornerstone of smart income investing!

By the way, you can also get the same basic benefits of selling cash-secured puts by writing in-the-money covered calls!

In the world of options, this is called "synthesizing" a trade.

While the outcomes may vary slightly depending on the specifics of a trade, and there can be slight differences in the end results, here's the basic deal:

Rather than selling a cash-secured put, you can simply *BUY* the underlying investment and *THEN* sell a covered call with the same strike price and expiration date as the put you want to synthesize.

The end result is going to be pretty similar:

In either case, *if the stock drops below the strike price* you're going to own it and you will have collected a premium for writing the option.

If the stock is above the strike price and you wrote a put, you will simply keep your premium.

And *if the stock is above the strike and you sold a covered call*, the option holder will likely exercise the option and take your stock away. So like above, you are only left with your premium!

Pretty neat, isn't it?

CHAPTER 29:

Use Put Options as a Hedge

There are two main reasons why an investor would use options: to speculate and to hedge.

Speculation

You can think of speculation as betting on the movement of a security. The advantage of options is that you aren't limited to making a profit only when the market goes up. Because of the versatility of options, you can also make money when the market goes down or even sideways.

Speculation is the territory in which the big money is made and lost. The use of options in this manner is the reason options have the reputation of being risky. This is because when you buy an option, you have to be correct in determining not only the direction of the stock's movement, but also the magnitude and the timing of this movement. To succeed, you must correctly predict whether a stock will go up or down, and how much the price will change as well as the time frame it will take for all this to happen. And don't forget commissions! The combinations of these factors means the odds are stacked against you.

So why do people speculate with options if the odds are so skewed? Aside from versatility, it's all about using leverage. When you are controlling 100 shares with one contract, it doesn't take much of a price movement to generate substantial profits.

Hedging

The other function of options is hedging. Think of this as an insurance policy; just as you insure your house or car, options can be used to insure your investments against a downturn. Critics of options say that if you are so unsure of your stock pick that you need a hedge, you shouldn't make the investment. On the other hand, there is no doubt that hedging strategies can be useful, especially for large institutions. Even the individual investor can benefit. Imagine that you wanted to take advantage of technology stocks and their upside, but you also wanted to limit any losses. By using options, you would be able to restrict your downside while enjoying the full upside in a cost-effective way.

Hedging is often considered an advanced investing strategy, but the principles of hedging are fairly simple. Read on for a basic grasp of how this strategy works and how it is used. (For more advanced coverage of this subject, read out **How Companies Use Derivatives To Hedge Risk**.)

Everyday Hedges

Most people have, whether they know it or not, engaged in hedging. For example, when you take out insurance to minimize the risk that an injury will erase your income or you buy life insurance to support your family in the case of your death, this is a hedge.

You pay money in monthly sums for the coverage provided by an insurance company. Although the textbook definition of hedging is an investment taken out to limit the risk of another investment, insurance is an example of a real-world hedge.

Hedging by the Book

Hedging, in the Wall Street sense of the word, is best illustrated by example. Imagine that you want to invest in the budding industry of bungee cord manufacturing. You know of a company called Plummet that is revolutionizing the materials and designs to make cords that are twice as good as its nearest competitor, Drop, so you think that Plummet's share value will rise over the next month.

Unfortunately, the bungee cord manufacturing industry is always susceptible to sudden changes in regulations and safety standards, meaning it is quite volatile. This is called industry risk. Despite this, you believe in this company - you just want to find a way to reduce the industry risk. In this case, you are going to hedge by going long on Plummet while shorting its competitor, Drop. The value of the shares involved will be $1,000 for each company.

If the industry as a whole goes up, you make a profit on Plummet, but lose on Drop – hopefully for a modest overall gain. If the industry takes a hit, for example if someone dies bungee jumping, you lose money on Plummet but make money on Drop.

Basically, your overall profit (the profit from going long on Plummet) is minimized in favor of less industry risk. This is sometimes called a pairs trade and it helps investors gain a foothold in volatile industries or find companies in sectors that have some kind of systematic risk. (To learn more, read the **Short Selling** tutorial and **When To Short A Stock**.)

Expansion

Hedging has grown to encompass all areas of finance and business. For example, a corporation may choose to build a factory in another country that it exports its product to in order to hedge against currency risk. An investor can hedge his or her long position with put options or a short seller can hedge a position though call options. Futures contracts and other derivatives can be hedged with synthetic instruments.

Basically, every investment has some form of a hedge. Besides protecting an investor from various types of risk, it is believed that hedging makes the market run more efficiently.

One clear example of this is when an investor purchases put options on a stock to minimize downside risk. Suppose that an investor has 100 shares in a company and that the company's stock has made a strong move from $25 to $50 over the last year. The investor still likes the stock and its prospects looking forward but is concerned about the correction that could accompany such a strong move.

Instead of selling the shares, the investor can buy a single put option, which gives him or her the right to sell 100 shares of the company at the exercise price before the expiry date. If the investor buys the put option with an exercise price of $50 and an expiry day three months in the future, he or she will be able to guarantee a sale price of $50 no matter what happens to the stock over the next three months. The investor simply pays the option premium, which essentially provides some insurance from downside risk.

Hedging, whether in your portfolio, your business or anywhere else, is about decreasing or transferring risk. It is a valid strategy that can help protect your portfolio, home and business from uncertainty. As with any risk/reward tradeoff, hedging results in lower returns than if you "bet the farm" on a volatile investment, but it lowers the risk of losing your shirt.

Source: **Investopedia.com**

Practical And Affordable Hedging Strategies

Hedging is the practice of purchasing and holding securities to reduce portfolio risk. These securities are intended to move in a different direction than the rest of the portfolio. They tend to appreciate when other investments decline. A put option on a stock or index is the classic hedging instrument.

When properly done, hedging significantly reduces the uncertainty and the amount of capital at risk in an investment, without significantly reducing the potential rate of return.

How It's Done

Hedging may sound like a cautious approach to investing, destined to provide sub-market returns. But this strategy is used often by the most aggressive investors. By reducing the risk in one part of a portfolio, an investor can often take on more risk elsewhere, increasing his or her absolute returns while putting less capital at risk in each individual investment.

Hedging is also used to help ensure that investors can meet future repayment obligations. For example, if an investment is made with borrowed money, a hedge should be in place to make sure that the debt can be repaid. Or, if a pension fund has future liabilities, then it is only responsible for hedging the portfolio against catastrophic loss. (See also: **A Beginner's Guide To Hedging**.)

Downside Risk

The pricing of hedging instruments is related to the potential downside risk in the underlying security. As a rule, the more downside risk the purchaser of the hedge seeks to transfer to the seller, the more expensive the hedge will be.

Downside risk, and consequently option pricing, is primarily a function of time and volatility. The reasoning is that if a security is capable of significant price movements on a daily basis, then an option on that security that expires weeks, months or years in the future will be highly risky, and therefore, costly.

On the other hand, if the security is relatively stable on a daily basis, there is less downside risk, and the option will be less expensive. This is why correlated securities are sometimes used for hedging. If an individual small cap stock is too volatile to hedge affordably, an investor could hedge with the Russell 2000, a small cap index, instead.

The strike price of a put option represents the amount of risk that the seller takes on. Options with higher strike prices are more expensive, but also provide more price protection. Of course, at some point, purchasing additional protection is no longer cost effective.

In theory, a perfectly priced hedge, such as a put option, would be a zero-sum transaction. The purchase price of the put option would be exactly equal to the expected downside risk of the underlying security. However, if this were the case, there would be little reason not to hedge any investment.

Pricing Theory and Practice

Of course, the market is nowhere near that efficient, precise or generous. Most of the time and for most securities, put options are depreciating securities with negative average payouts. There are three factors at work here:

- **Volatility Premium** - As a rule, implied volatility is usually higher than realized volatility for most securities, most of the time. Why this happens is still open to debate, but the result is that investors regularly overpay for downside protection.
- **Index Drift** - Equity indexes and associated stock prices have a tendency to move upward over time. This gradual increase in the value of the underlying security results in a decline in the value of the related put.
- **Time Decay** - Like all long option positions, every day that an option moves closer to expiry, it loses some of its value. The rate of decay increases as the time left on the option decreases.

Because the expected payout of a put option is less than the cost, the challenge for investors is to only buy as much protection as they need. This generally means purchasing puts at lower strike prices and assuming the security's initial downside risk.

Spread Hedging

Index investors are often more concerned with hedging against moderate price declines than severe declines, as these type of price drops are both very unpredictable and relatively common. For these investors, a bear put spread can be a cost-effective solution. (See also: **Option Spread Strategies**.)

In a bear put spread, the investor buys a put with a higher strike price and then sells one with a lower price with the same expiration date. Note that this only provides limited protection, as the maximum payout is the difference between the two strike prices. However, this is often enough protection to handle a mild-to-moderate downturn.

Another way to get the most value out of a hedge is to purchase the longest available put option. A six-month put option is generally not twice the price of a three-month option - the price difference is only about 50%. When purchasing any option, the marginal cost of each additional month is lower than the last.

Time Extension and Put Rolling

Example - Buying a Long-Term Put Option

- Available put options on IWM, trading at 78.20.
- IWM is the Russell 2000 tracker ETF

Strike ($)	Days to Expire	Cost ($)	Cost/Day ($)
78	57	3.10	0.054
78	157	4.85	0.031
78	248	5.80	0.023
78	540	8.00	0.015

In the above example, the most expensive option for a long-term investor also provides him or her with the least expensive protection per day.

This also means that put options can be extended very cost effectively. If an investor has a six-month put option on a security with a certain strike price, it can be sold and replaced with a 12-month option at the same strike. This can be done over and over again. The practice is called rolling a put option forward.

By rolling a put option forward and keeping the strike price close to, but still somewhat below, the market price, an investor can maintain a hedge for many years. This is very useful in conjunction with risky leveraged investments like index futures or synthetic stock positions.

Calendar Spreads

The diminishing cost of adding extra months to a put option also creates an opportunity to use calendar spreads to put a cheap hedge in place at a future date. Calendar spreads are created by purchasing a long-term put option and selling a shorter-term put option at the same strike price.

Example — Using Calendar Spread

- Purchase 100 shares of INTC on margin @ $24.50
- Sell one put option contract (100 shares) @ 25 expiring in 180 days for $1.90
- Buy one put option contract (100 shares) @ 25 expiring in 540 days for $3.20

In this example, the investor is hoping that Intel's stock price will appreciate, and that the short put option will expire worthless in 180 days, leaving the long put option in place as a hedge for the next 360 days.

The danger is that the investor's downside risk is unchanged for the moment, and if the stock price declines significantly in the next few months, the investor may face some difficult decisions. Should they exercise the long put and lose its remaining time value? Or should the investor buy back the short put and risk tying up even more money in a losing position?

In favorable circumstances, a calendar put spread can result in a cheap long-term hedge that can then be rolled forward indefinitely. However, investors need to think through the scenarios very carefully to ensure that they don't inadvertently introduce new risks into their investment portfolios.

The Bottom Line

Hedging can be viewed as the transfer of unacceptable risk from a portfolio manager to an insurer. This makes the process a two-step approach. First, determine what level of risk is acceptable. Then, identify the transactions that can cost effectively transfer this risk.

As a rule, longer term put options with a lower strike price provide the best hedging value. They are initially expensive, but their cost per market day can be very low, which makes them useful for long-term investments. These long-term put options can be rolled forward to later expiries and higher strike prices, ensuring that an appropriate hedge is always in place.

Some investments are much easier to hedge than others.

Usually, investments such as broad indexes are much cheaper to hedge than individual stocks. Lower volatility makes the put options less expensive, and a high liquidity makes spread transactions possible.

But while hedging can help eliminate the risk of a sudden price decline, it does nothing to prevent long-term underperformance. It should be considered a complement, rather than a substitute, to other portfolio management techniques such as diversification, rebalancing and disciplined security analysis and selection.

Source: **Investopedia.com**

CHAPTER 30:

Social Security Benefits

An Overview of How Social Security Benefits Work

By Dana Anspach, *The Balance*

For many Americans, Social Security benefits provide 50 percent or more of their income in retirement. By learning how you qualify for Social Security benefits, you can make decisions that help you get the most out of the program.

Social Security benefits are available to most people who work and earn income in the United States. There are three main types of benefits; retirement benefits, disability benefits, and survivor benefits.

How to Qualify for Social Security Retirement Benefits

While you work and earn income, you and your employer each pay 6.2 percent of your earnings into the Social Security system. If you are self-employed, you pay both the employer share and your employee share. Although you pay into the system while working, your benefit amount in retirement is not determined by how much you and your employer contribute. Instead, the following three factors determine how much you'll get:

- How long you work
- How much you earn
- What age you file for benefits

Let's take a look at how each of these factors impact how much you'll get.

1. How Long You Work

While you work and pay into the Social Security system you accumulate "credits." A credit is approximately equivalent to one calendar quarter of work. To qualify for Social Security retirement benefits, you must have 40 credits or 10 years of work where you paid into the Social Security system. You can earn up to four credits a year by earning $5,200 during the year (this is the 2017 amount and it adjusts up each year based on inflation).

Your highest 35 years of earnings are used in the calculation that determines your retirement benefit amount, so to get more benefits, make sure you have a full 35 years where you work and pay into the Social Security system.

Note: There are many government employers who have their own retirement system and when employed by these agencies you do not pay into Social Security, and thus your work for these agencies does not count toward accumulating Social Security benefits. This most commonly affects postal workers, teachers and others in the education system, firefighters, and law enforcement employees.

2. How Much You Earn

The higher your earnings, the higher your retirement benefit is likely to be, but there is a cap. Social Security is designed to replace more income for lower earner's than for higher earner's, so each year you pay into the system only up to the amount of earnings defined as the Social Security Wage Base, which is $127,200 in 2017. This amount is increased each based on inflation.

If you want to see how many years of earnings you have in the Social Security system, look at your Social Security statement, which you receive every five years from age 25 to age 60 (and each year after 60), or create a my Social Security Account online.

3. The Age You Claim Benefits

You can claim retirement benefits as early as age 62, but you get a higher benefit amount if you wait until age 70 to file.

Exactly how much you get at what age depends on your full retirement age (FRA) which varies by year of birth. For those born Jan. 2, 1943, or later your FRA will be in the age 66 to age 67 range.

If you file before you have attained FRA, and you continue to work, a portion of your benefits will be held back due to something called the earnings limit.

Once you attain FRA, the earnings limit no longer applies. If you are married and you have a higher potential Social Security benefit than your spouse, the age you claim will also impact your spouse's survivor benefits.

Putting all this together, you can get the highest benefit amount by working and paying into the system for 35 years, earning up to the Social Security Wage Base each year, and waiting until age 70 to begin your benefits.

Social Security Disability Benefits

The Social Security disability program is meant to cover long-term disability that is expected to last one year or more or expected to result in death. It is not a short-term disability program and so does not cover you if you are out of work for a few weeks or months due to illness or an accident.

To be eligible for disability benefits, you must also have worked and paid into the system and accumulated the minimum amount of credits needed based on your age, and you must meet Social Security's definition of disabled.

Minimum Credits Needed for Disability

The number of credits you need to be eligible for disability benefits depends on your age. If you become disabled at age 24 you need to have at least six credits earned in the three years prior to your disability, and if you become disabled at age 50 you must have at least 30 total credits, with 20 of them earned in the 10 years prior to your disability. The Social Security website provides a table that shows you exactly how many credits you need at each age.

Definition of Disability

Before you can receive a disability benefit, you must meet Social Security's definition of disabled. The Social Security Administration provides a comprehensive listing of impairments and explains how they evaluate whether an impairment meets the criteria for long-term disability. In general, your impairment must prevent you from doing the work you did before your disability, and it must prevent you from adapting to a different kind of work.

Social Security Survivor Benefits

For your survivors to be eligible for a benefit upon your death, as with other benefit types, you must have worked and paid into the Social Security system.

The number of credits required depends on your age at death. A special rule allows survivors of young workers to be eligible for benefits if the worker had at least six credits of work in the three years prior to death.

There are two main types of Social Security survivor benefits:

- Benefits paid to your spouse in retirement
- Benefits paid if you have minor children or other dependents such as a disabled adult child or dependent parent

1) Retirement Survivor Benefits for a Spouse

If you and your spouse are both already receiving retirement benefits, at death, your spouse (if married at least nine months) will continue to receive either the larger of your benefit or their own. For a spouse who didn't work, this survivor benefit is important.

To make sure a spouse receives the highest possible survivor benefit it usually makes sense for the higher-earning person to delay the start of their benefit to age 70.

If you have not started your benefits, the rules on how much a surviving spouse can receive are more complicated, but in general, if you have earned enough credits to qualify for a retirement benefit, then a surviving spouse would be eligible for a survivor benefit which they could start as early as age 60.

If you have a prior marriage that was at least ten years in length, an ex-spouse is also eligible for survivor benefits and when they file for this benefit it does not impact the benefits that a current spouse or other dependent may receive.

There are a few situations where a surviving spouse may receive a benefit before age 60; for example, a disabled spouse can be eligible for survivor benefits as early as age 50, and a surviving spouse of any age who is caring for your child who is under the age of 16 can be eligible.

2) Survivor Benefits for Dependents

Survivor benefits may be paid to three types of dependents; minor children (under the age of 18, or up to age 19 if attending elementary or high school), a child who was disabled before reaching age 22, or a dependent parent age 62 or older.

If you or someone you know think you may be eligible for a Social Security survivor benefit, it is best to contact the Social Security Administration either online or by visiting your local Social Security office.

CHAPTER 31:

Delaying Social Security Benefits

Tips on Delaying Social Security Benefits

Much has been written in the financial press about the merits of delaying the start of your Social Security benefits.

There is much to this, as the difference between commencing your benefits at 62 versus waiting until your full retirement age are significant, as is the difference in waiting until age 70.

Should you delay taking your Social Security benefits? As with most things in the financial planning world the answer is that 'it depends.' Here are some factors to consider.

Do You Need the Money Now?

Mathematically waiting until your full retirement age (66 for many of us, 67 if you were born in 1960 or later) to take your Social Security benefits results in a benefit amount that is about 30% higher than if you start taking benefits at age 62.

Waiting until age 70 results in a benefit that is about another 32% higher.

This is all well and good, but if you wait to take your benefit will you have enough income from other sources to tide you over from age 62 to age 66?

Are You Still Working?

If you are still working and take Social Security benefits before reaching your full retirement age (age 67 if you were born after 1959), you could easily exceed the annual earnings limit at which your benefits will be reduced.

For 2019, the annual earnings limit will be $17,640. If your earnings exceed this limit your benefits will be reduced. The amount will depend upon your age, but the reduction is a steep $1 in benefits for every $2 that your earnings exceed the limit. This may be a good reason to delay taking your benefits until at least your full retirement age. (For more, see: **Top 6 Myths About Social Security Benefits**.)

The annual earnings limit goes away once you reach your full retirement age, but your benefits may still be subject to taxation.

This means that up to 85% of your Social Security benefits could be subject to taxation, so if you are working while collecting benefits and in a high-income bracket, you may want to delay taking benefits until your earnings are lower or until age 70.

Cash Now or a Larger Benefit Later?

There is a significant (and permanent) reduction in your benefit if you commence taking Social Security at age 62. This reduction is reduced roughly proportionately for each year between 62 and your full retirement age.

Likewise, waiting until age 70 results in a permanent benefit that is about 32% higher than if you started benefits at your full retirement age. Again, this increase is proportional for every year between full retirement age and age 70.

The retirement planning question is whether the benefit of having the cash flow now outweighs the larger benefit gained by waiting. The answer will depend upon several factors.

- **Calculate the break-even point of waiting.** There is some point which the cost of waiting to take benefits is offset by the larger permanent benefit. This break-even point is expressed in terms of cumulative benefits.

- **What is your life expectancy?** While this is just an estimate, if longevity doesn't run in your family – or if you suffer from an illness that might shorten your life – then it might make sense to take your benefits sooner rather than waiting.

- **Do you have other retirement resources?** If you decide to wait in order to claim a larger benefit in a few years, do you have other resources to support yourself in the interim? This might include other retirement accounts such as a 401(k) plan or an IRA. Are you eligible for benefits from a pension plan? Do you have taxable investments or cash that you can tap into?

The Bottom Line

The decision when to take Social Security benefits is an important one and can be complex. There are a lot of factors to be considered including your other retirement resources, life expectancy and your need for the money.

If you're married, the decision can be even more complex. Take some time and seek help if you need it, as this is one of the most important decisions you will make regarding your retirement.

Source: **Investopedia.com**

CHAPTER 32:

Your Box 20a Trick

Taxes On Social Security Benefits

By Dana Anspach, *The Balance*

If you receive Social Security, you may pay income taxes on up to 85% of your Social Security benefits. This rule about the taxation of benefits is different than the earned income rule, which applies if you receive benefits before your full retirement age, continue to work and earn amounts in excess of the earnings limit. The formula that determines the taxation of benefits applies to everyone, regardless of age.

If you look at a 1040 tax form you will see two boxes; box 20a for total Social Security benefits, and box 20b, for the taxable amount. Here's how the taxable amount is determined.

Determine What Your Combined Income Will Be

Do you have income in addition to Social Security? Additional sources of income that would show up on your tax return include items such as:

- Wages (earnings or self-employment income)
- Investment income from interest, dividends and capital gains
- Pension or annuity income
- IRA/401(k)/403(b) withdrawals
- Rental property income

Social Security defines your "combined income" as the total of your adjusted gross income plus nontaxable interest, plus one-half of your Social Security benefits. Roth IRA withdrawals do not count as combined income, but municipal bond interest does. Your combined income is compared to the threshold amounts in the table below.

Combined Income Threshold Amounts

	First Threshold ($)	Second Threshold ($)
Sinlge Filers	25,000	34,000
Married Filers	32,000	44,000

If your combined income is less than $25,000 for single filers or less than $34,000 for married filers, then your Social Security benefits will not be taxable for that calendar year.

If your combined income exceeds the first threshold amount, then a more complex formula is used to determine what portion of your benefits will be taxable (up to a maximum of 85%).

Plug Your Combined Income into the IRS Social Security Worksheet

If your combined income exceeds the threshold amounts, an IRS formula is applied to determine how much of your benefits are taxable. The result of these calculations will be that you pay taxes on the lower of:

- 85% of your Social Security benefits
- 50% of the benefits plus 85% of the amount of combined income over the second threshold amount
- 50% of the amount of combined income over the first threshold amount, plus
- 35% of the amount of combined income over the second threshold amount

You can work through the numbers yourself using the **IRS Figuring Your Taxable benefits worksheet**. You can also use a free online calculator called **How Much of My Social Security Benefit May be Taxed** to come up with a rough estimate of the dollar amount of benefit that would need to go into box 20b (the taxable amount box) on your 1040 tax form.

Social Security Taxation for Married Couples

Let's look at an example for a couple, both age 67, who are married and file jointly. One is collecting a spousal Social Security benefit. They are both waiting until age 70 to claim their full retirement benefit amounts so they can get the most possible. While delaying, they are taking large IRA withdrawals.

Here's a snapshot of their income sources:

- $10,000 gross Social Security income
- $50,000 IRA withdrawal

Based on step number one above this makes their combined income $55,000 (which is in excess of the highest threshold amount for marrieds). Using the free Social Security taxation calculator in step two above, 85% of their Social Security will be taxed, or $8,500 that will be input to box 20b. They do not itemize deductions but instead use the standard deduction and exemptions.

- Their adjusted gross income (AGI) is $58,500
- Taxable income is $35,400
- Total tax due is $4,388
- After tax funds available to spend = $55,612

Now let's look at this same couple three years later. Both are age 70 and receiving their full Social Security amounts. On the next page is a snapshot of their income sources.

- $40,000 gross Social Security income
- $20,000 IRA withdrawal

Their combined income is $40,000 (which is between the threshold amounts for marrieds). Using the free online Social Security calculator, 10% of their Social Security will be taxed, or $4,000 to be input to box 20b. They do not itemize deductions but instead use the standard deduction and exemptions.

- Their AGI is $24,000
- Taxable income is $900
- Total tax due is $90
- After tax funds available to spend = $59,910

In both years the couple has $60,000 of gross income. However, after they are both 70, because a larger proportion of their income comes from Social Security their tax liability goes down, and they now have more funds to spend. Because of this taxation formula, a couple in the 15% bracket can find they pay tax at a much higher marginal rate.

Smart Idea - Use Tax Arbitrage to Your Advantage

Up to 85% of your Social Security benefits received can be taxed, but never 100%. It means that after taxes, a dollar of Social Security income is worth more than a dollar of IRA withdrawals.

If you design a retirement income plan that takes advantage of this tax arbitrage, it can make a big difference over the course of your retirement years. You can pay less in tax, and have more to spend.

There are many ways you can plan to reduce taxes when you begin withdrawing money. The most common strategy is to delay the start of your Social Security benefits to age 70 while taking IRA withdrawals or using Roth conversions in your 60's. It isn't the best option for everyone, but for many families, this approach results in less total taxes during their retirement years.

Much of this planning has to do with how other sources of income affect how much of your Social Security benefits will be taxable. By planning out the timing of those other sources of income, many can lower their tax bill.

CHAPTER 33:

Working While Receiving Retirement Benefits

What to Know About Working While Receiving Retirement Benefits

By Dana Anspach, *The Balance*

If you take Social Security benefits before your full retirement age and you earn income in excess of the annual earnings limit, your Social Security benefit will be reduced until you reach full retirement age.

Investment income does not count toward the annual earnings limit; the only income that counts is *earned income* — the income you earn by working, either for someone, or as a self-employed person.

How Much Can I Earn?

In 2018, the annual earnings limit is $17,040. That means in 2018 you can earn up to $17,040 and continue to receive all your Social Security benefits. This is an increase from the 2017 limit of $16,920.

If you earn over $17,040, there are a set of rules that determine how much your Social Security benefits will be reduced. There are 3 different earnings limit rules that apply, depending on whether you earn the income before, during, or after the year your reach full retirement age. Each option is covered below.

1) Income Earned Before the Year You Reach Full Retirement Age

If you are collecting Social Security benefits, and earn more than the annual earnings limit, Social Security will take back $1 of Social Security for every $2 over the limit. Ouch! This is a serious reduction.

This reduction applies to any year before you reach full retirement age, but it only applies to income earned after you start collecting Social Security benefits.

So if you work a partial year, the income you earn before the month you start collecting Social Security benefits does not count toward the annual earnings limit.

Note: Sometimes Social Security website pages use the term “normal retirement age”. It means the same thing as full retirement age (FRA).

2) Income Earned During the Year You Reach FRA

During the year you reach FRA, and up to the month you reach FRA, Social Security will deduct $1 for every $3 you earn that is over the annual earnings limit, but a different earnings limit applies the year you reach FRA.

In 2018, you can earn up to $45,360, a $480 increase from 2017, during the year you reach FRA.

During this year Social Security only counts earnings that you receive before the month you reach FRA.

Example 1: Let’s assume you were born in 1951, which means your FRA is age 66. You turn 66 in June 2018 and begin your Social Security benefits at that time, but you continue to work until the end of the year, and earn $44,000 for the year. Your benefits will not be reduced because you earned less than the $45,360 for the year.

The Social Security website provides additional examples of **how this deduction works**. You can also use the **earnings test calculator**, and plug in your date of birth and expected earnings to see if you think a reduction will apply to you.

3) Income Earned After You Reach FRA

Once you reach FRA, you are no longer subject to the annual earnings limit; you can earn as much as you like without incurring a reduction in your Social Security benefits!

Your benefits may, however, still be subject to income taxes.

Best Way to Avoid the Earnings Limit

The best way to avoid the earnings limit is to wait until you reach FRA to begin your benefits. Understandably, some people have no choice and must start benefits because they are laid off and they have no other income or assets. If this happens to you, but later your situation changes and you go back to work, you can **withdraw your application for Social Security** within 12 months of starting benefits.

Other people, however, do have a choice; perhaps they could use some of their savings or retirement money to tide them over until they reach FRA. This may be a better option than starting Social Security early.

What Counts as Earnings?

Unemployment income does not count as earnings toward the earnings test above.

If you are earning wages, income counts when it is earned, not when it is paid. The **IRS provides additional details** on what is and is not considered to be earned income.

Year	Limit ($)
2018	17,040
2017	16,920
2016	15,720
2015	15,720
2014	15,480
2013	15,120
2012	14,640
2011	14,160
2010	14,160
2009	13,560

Earnings Limit Is Indexed to Inflation

The earnings limit will adjust upward each year depending on the formal measure of inflation which is the Consumer Price Index. In the table below you see past year's limits. In the years where it did not change inflation was quite low or negative.

CHAPTER 34:

Taxes and Social Security Income

How to Avoid Paying Taxes on Social Security Income

Some people have to pay federal income taxes on the Social Security benefits they receive. Typically, this occurs only when individuals receive benefits and have other substantial sources of income from wages, self-employed earnings, interest, dividends, required minimum distributions from qualified retirement accounts, and other taxable income that must be reported on their tax returns.

Taxable Social Security Income

In accordance with Internal Revenue Service (IRS) rules, you won't pay federal income tax on more than 85% of your Social Security benefits. (At this time, there is no income level that creates a situation wherein Social Security benefits are 100% taxable for retirees.) The percentage of benefits for which you will owe income tax is dependent upon your filing status and combined income. If you:

- *File a federal tax return as an "individual"* and your combined income is
  - Between $25,000 and $34,000 – you may have to pay income tax on up to 50% of your benefits
  - More than $34,000 – up to 85% of your benefits may be taxable
- *File a joint return*, and you and your spouse have a combined income that is

    - Between $32,000 and $44,000 – you may have to pay income tax on up to 50% of your benefits
    - More than $44,000 – up to 85% of your benefits may be taxable
- *Are married and file a separate tax return*, you will probably owe taxes on your benefits.

The IRS defines combined income as your adjusted gross income, plus tax-exempt interest, plus half of your Social Security benefits. You will receive a Social Security Benefit Statement (Form SSA-1099) each January detailing the amount of benefits you received during the previous tax year.

You can use this when you complete your federal income tax return to determine if you owe income tax on your benefits. If you do owe taxes on your Social Security benefits, you can make quarterly estimated tax payments to the IRS or choose to have federal taxes withheld from your your payouts before you receive them.

When Social Security Is Not Taxable

For retirees who receive Social Security benefits with little to no supplemental influx of cash, either from retirement plan distributions or other earnings, their benefits are most likely not taxable. The average benefit received in tax year 2017 was $1,413.08 each month, totaling $16,956.96 annually; benefits are only taxable when overall income exceeds $25,000 for single retirees or $32,000 for couples filing joint tax returns.

Individuals who are able to sustain the type of lifestyle they need or want on that level of income do not pay taxes on their Social Security benefits.

Avoiding Tax on Benefits

The simplest way to keep Social Security income free from income tax is to keep total combined income low; however, most retirees are not able to live on the average monthly benefit of $1,413.08 ($16,956.96 annually) without supplementing it from investments or savings.

Individuals receiving Social Security benefits can get creative to avoid reaching or exceeding the relatively low combined income limits. Instead of taking distributions from a traditional IRA or other qualified retirement plan, such as an employer-sponsored 401(k) or 403(b), distributions from a Roth IRA may provide the supplemental income necessary to meet living expenses without affecting the combined income calculation.

Because Roth IRA distributions are made with post-tax dollars, withdrawals are tax-free in retirement and therefore do not increase total income for Social Security taxes. A similar effect can be achieved by withdrawing from conventional savings or money market accounts in lieu of tax-sheltered ones.

If Roth IRA or savings assets are not available, retirees may want to consider lowering living expenses to stay below the combined income limits. Paying off a mortgage balance or downsizing to a smaller home prior to receiving Social Security income may considerably reduce the need for supplemental income throughout retirement.

Although Social Security income is not fully taxable at any time, retirees need to be aware that benefits are subject to income tax under some circumstances and they must plan to reduce other sources of income if necessary.

Source: **Investopedia.com**

CHAPTER 35:

Income Sources That Are Not Taxed

8 Income Sources That Aren't Subject to Tax

By Beverly Bird, *The Balance*

To hear Benjamin Franklin tell it, nothing in this world is certain but death and taxes. He was almost right. Taxes are pretty much inevitable, at least on income, but there's a catch. Some revenue streams are not considered income under the U.S. tax code, and if they're not considered income, they're not taxed.

1) Certain Sick Pay and Injury Benefits

Unfortunately, the Internal Revenue Service (IRS) doesn't provide a nice, comprehensive list of what types of revenue fall into the category of not being income. Instead, tax law somewhat vaguely says that income includes everything that's not "specifically excluded" in the Code. A little digging is required to identify these income sources. There are actually quite a few of them, although most come with a whole host of intricate rules and conditions.

If you call in sick and your employer pays you for the day anyway, this is income. But if you become really sick or you're injured and you receive benefits from certain disability insurance policies, that revenue source is not income.

The catch here is that you have to be the one who has been paying the premiums on the policy. If your employer foots the bill on your behalf and you then receive benefits, that's taxable income to you.

The same applies if you receive benefits from any type of government program that's not a public welfare fund — they're income. But as long as you write the check every month using after-tax dollars, you're in the clear while you recuperate. This income is non-taxable.

An exception to this rule is workers' compensation benefits. It doesn't matter if your employer pays for workers' comp insurance or if the government kicks in with benefits. You can collect this source of income tax-free if you're injured on the job.

2) Employee Rewards

Maybe your boss just realized that you've been with the company longer than any other employee. He wants to do something nice for you so he gives you an engraved money clip. The value of tangible property is normally supposed to be included on your Form W-2 as compensation, but employee rewards dodge this rule as long as they're not given for job performance.

It all comes down to why you've received the gift. Because you're loyal and you come to work every day? That's not income. Because you work your tail off? That's taxable income.

There are other rules, too. You can't exclude from your income an amount that's more than what your employer paid for the gift, and his cost is capped at $1,600 for the year regardless of how much he actually paid for it. If he paid $2,000, you can exclude $1,600. If he gave you a money clip and another gift totaling $3,000, you can still only exclude $1,600. And if he paid $1,000, you can only exclude $1,000.

Your employer has to present you with the award in a meaningful way. Really. That's actually a tax rule. He can't just leave the clip on your desk for you to find when you arrive for work in the morning. If he does, you'll have to pay income tax on its value.

And this exclusion applies only to tangible property. You can't exclude money, gift certificates, or anything else that you can easily transform into cash, no matter how nicely your employer offers them to you.

3) Veterans' Benefits and Some Military Pay

Former members of the U.S. Armed Forces and even some active servicemen and servicewomen can collect certain forms of income tax-free. Any benefits you receive from the Department of Veterans Affairs are exempt from taxation as long as they're provided for by law.

If you're an active member of the military and you receive combat pay, this is tax-free income as well. You don't still have to be on the battlefield to qualify. This pay is tax-free even if you're hospitalized due to injuries sustained from your service.

But this exclusion doesn't apply to all income you receive. It's limited to hostile fire pay, the highest available rate of enlisted pay, and imminent danger pay. The key word here is "and." The total of these amounts is tax-free income unless you're a commissioned warrant officer.

4) Life Insurance Death Benefits

If you're Great Aunt Martha's favorite niece and she names you as the sole beneficiary of her life insurance policy, you can accept the money without worrying about setting any of it aside for income taxes. Death benefits aren't taxable income, at least not in and of themselves. Of course, there's a catch.

If Aunt Martha set up her policy so that you receive $1 million in benefits but they're paid out at the rate of $200,000 a year for five years, any amount that the insurance company holds onto for you over the course of that five-year period will produce interest. That interest is considered income that you have to report on your Form 1040.

If you invest the proceeds and they earn income for you… yes, that capital gain is taxable as well.

5) Child Support Payments

Child support is a tax-neutral event. If you have custody of little Johnny so the court has ordered your ex to pay you $150 a week, this is not taxable income to you. Of course, your ex has to pay taxes on the money when he earns it so the IRS isn't completely left out in the cold. Dad can't claim a tax deduction for paying it.

And this money is technically Johnny's, not yours. It represents what Dad would have contributed financially to his well-being if the two of you had stayed together. Johnny doesn't have to pay taxes on the money either, no more than he would have to if you were all a happy, intact family and Dad gave him an allowance.

6) Inherited Money and Gifts

Gifts can sometimes be taxable… but not as income to the recipient. The benefactor might have to pay a gift tax, but if Aunt Martha gives you $5,000 to pay off your credit card bills, the IRS does not consider that to be income to you.You don't have to report it.

In fact, Aunt Martha can give you up to $15,000 per year tax-free.

That's the amount of the federal gift tax exclusion per year per recipient as of 2018, so she can give you this much without the hassle of filing a gift tax return and handing a percentage of the gift over to Uncle Sam.

If she wants to be really generous, she can even give you $15,000 on December 31 and $15,000 on January 1 for a total of $30,000 because the gifts take place in different tax years. Of course, she'll have to wait until the following January to give you anything more.

The same applies if you inherit cash from anyone. That's still a gift — it just occurs after death. But this is by no means a blanket across-the-board exclusion. It applies to cash. Some other types of inheritances can have tax implications.

For example, if Aunt Martha leaves you a retirement account that's generating income, that revenue can be taxable to you as "income in respect of a decedent."

This would normally have been her tax responsibility but she's not here anymore and the account is now yours so you inherit the tax liability as well.

7) Compensatory Damages

Compensatory damages are money you receive from a lawsuit to compensate you for physical or emotional pain and suffering.

The IRS says this is tax-free income. But if the judge tacks on punitive damages, making the defendant pay you even more as punishment, this portion of your award is taxable.

Let's say you walk out to your mailbox at the curb one night to collect your mail. Your neighbor is driving intoxicated and he misjudges the distance to his own driveway and turns into you instead. You're grievously injured and you sue him.

The jury awards you $500,000 for your pain and suffering. That's tax-free income. The judge awards you another $500,000 to teach your neighbor a lesson — that he should never drive drunk again. This part is taxable income to you.

And if you're also awarded $125,000 for a year's lost wages because you couldn't work while you recovered, this is taxable income as well. If you hadn't been injured, you would have collected taxable earnings for the same amount.

8) Public Assistance

Most types of public assistance are non-taxable income. If you collect welfare, you don't have to pay taxes on that money. The same applies to SSI — Supplemental Security Income — and all other needs-based programs. You're receiving this money because your earning potential is such that you could not survive without it. This provision also includes Medicare Part A and Part B benefits.

It does not automatically apply to Social Security retirement benefits. Social Security is not a needs-based program. It's based on your work record over the years, and it's possible that some portion of these benefits could be taxable depending on how much other income you have.

The Rules Can Be Tricky

This list is by no means comprehensive is just a summary of the rules that apply to each of the exclusions mentioned. If you think you fall into one of these categories, check with a tax professional before you decide not to include the income on your tax return. Make sure you have a firm understanding of the rules, and if it turns out that your income source is indeed tax-free, enjoy it.

CHAPTER 36:

Debt & Financing

As you read through this section of your 49 Secrets, keep in mind Unit 2 of your **Retirement Masterclass video series**, "Investing for Infinite Returns."

Here, I'm going to give you an overview of how to procure financing for your investments. And of course, that starts with an understanding of good debt vs. bad debt. And it's very simple.

Good debt is debt taken on to buy cash flowing assets that put money in your pocket. Bad debt buys you liabilities that take cash out of your pocket.

When you procure financing, that just means a bank, company, government or person provides you funds to buy and control an investment. What the lender wants is to see a return on their money lent, which usually comes from interest. And, particularly with banks and company lenders, you will need to provide an exit plan for them to leave the investment with a larger return at a point in the future.

Financing in real estate is my favorite way to go for infinite returns.

You can get this from a bank if you provide a detailed plan. That means creating a proposal. Your proposal should cover *why* you want to buy this particular property, meaning you show your research into the area and the particular property itself, demonstrating why you believe the area is on the rise and what you plan to do to increase the property's worth. And you will need to provide them an exit plan to leave the deal with a positive return on investment.

You can also use the property owner as a means for financing. One way to do that is to offer them a competitive interest rate in paying back the money lent. This works especially well if the owner is eager to sell.

In any of these real estate investments, you will need to make sure you're creating positive cash flow for yourself by renting the property out for more than it's costing you in interest, taxes, and maintenance each month.

For even more options, take a look at this…

10 Ways to Finance Your Business

Financing a business is always a challenge. Here we've compiled 10 techniques, including factoring, from the tried-and-true to the experimental.

Finding financing in any economic climate can be challenging, whether you're looking for start-up funds, capital to expand or money to hold on through the tough times. But given our current state of affairs, securing funds is as tough as ever. To help you find the money you need, we've compiled a guide on 10 financing techniques and what you should know when pursuing them.

1) Consider Factoring

Factoring is a finance method where a company sells its receivables at a discount to get cash up-front. It's often used by companies with poor credit or by businesses such as apparel manufacturers, which have to fill orders long before they get paid. However, it's an expensive way to raise funds. Companies selling receivables generally pay a fee that's a percentage of the total amount. If you pay a 2 percent fee to get funds 30 days in advance, it's equivalent to an annual interest rate of about 24 percent. For that reason, the business has gotten a bad reputation over the years. That said, the economic downturn has forced companies to look to alternative financing methods and companies like The Receivables Exchange are trying to make factoring more competitive. The exchange allows companies to offer their receivables to dozens of factoring companies at once, along with hedge funds, banks, and other finance companies. These lenders will bid on the invoices, which can be sold in a bundle or one at a time.

Read more on **financing your business with factoring**.

2) Get a Bank Loan

Lending standards have gotten much stricter, but banks such as J.P. Morgan Chase and Bank of America have earmarked additional funds for small business lending. So why not apply?

Read more on what you need to know about **filling out a loan application**.

3) Use a Credit Card

Using a credit card to fund your business is some serious risky business. Fall behind on your payment and your credit score gets whacked. Pay just the minimum each month and you could create a hole you'll never get out of. However, used responsibly, a credit card can get you out of the occasional jam and even extend your accounts payable period to shore up your cash flow.

Read more on **financing your business with a credit card**.

4) Tap into Your 401(k)

If you're unemployed and thinking about starting your own business, those funds you've accumulated in your 401(k) over the years can look pretty tempting. And thanks to provisions in the tax code, you actually can tap into them without penalty if you follow the right steps. The steps are simple enough, but legally complex, so you'll need someone with experience setting up a C corporation and the appropriate retirement plan to roll your retirement assets into. Remember that you're investing your retirement funds, which means if things don't pan out, not only do you lose your business, but your nest egg, too.

Read more on **financing a business with your 401(k)**.

5) Try Crowdfunding

A crowdfunding site like Kickstarter.com can be a fun and effective way to raise money for a relatively low cost, creative project. You'll set a goal for how money you'd like to raise over a period of time, say, $1,500 over 40 days. Your friends, family, and strangers then use the site to pledge money. Kickstarter has funded roughly 1,000 projects, from rock albums to documentary films since its launch last year. But keep in mind, this isn't about long-term funding. Rather, it's supposed to facilitate the asking for and giving of support for single, one-off ideas. Usually, project-creators offer incentives for pledging, such as if you give a writer $15, you'll get a book in return. There's no long-term return on investment for supporters and not even the ability to write off donations for tax purposes. Still, that hasn't stopped close to 100,000 people from pledging to Kickstarter projects.

Read more on using **Kickstarter for business**.

6) Pledge Some of Your Future Earnings

Young, ambitious and willing to make a bet on your future earnings? Consider how Kjerstin Erickson, Saul Garlick and Jon Gosier are trying to raise money. Through an online marketplace called the Thrust Fund, the three have offered up a percentage of their future lifetime earnings in exchange for upfront, undesignated venture funding. Erickson is willing to swap 6% of her future lifetime earnings for $600,000. The other two entrepreneurs are each offering 3 percent of future earnings for $300,000. Beware: the legality and enforceability of these "personal investment contracts" have yet to be established.

Read more on **trading future earnings for funding now**.

7) Attract an Angel Investor

When pitching an angel investor, all the old rules still apply: be succinct, avoid jargon, have an exit strategy. But the economic turmoil of the last few years has made a complicated game even trickier. Here are some tips to win over angel interest:

- **Add experience:** Seeing some gray hair on your management team will help ease investors' fears about your company's ability to deal with a tough economy. Even an unpaid, but highly experienced adviser could add to your credibility.
- **Don't be a fad-follower:** Did you start your company because you are truly passionate about your idea or because you want to cash in on the latest trend? Angels can spot the difference and won't give much attention to those whose companies are essentially get-rich-quick schemes.
- **Know your stuff:** You'll need market assessments, competitive analysis and solid marketing and sales plans if you expect to get anywhere with an angel. Even young companies need to demonstrate an expert knowledge of the market they are about to enter as well as the discipline to follow through with their game plan.
- **Keep in touch:** An angel may not be interested in your business right away, especially if you don't have a track record as a successful entrepreneur. To combat that, you should formulate a way to keep them in the loop on big developments, like a major sale.

Read more on **finding an angel investor**.

8) Secure an SBA Loan

With banks reluctant to take any chances with their own money in the wake of the credit crisis, loans guaranteed by the U.S. Small Business Administration have become a hot commodity. Indeed, funds to support special breaks on fees and guarantees on SBA-backed loans have run out a number of times. And while SBA-backed loans are open to any small business, there are a number of qualifications, including:

- Under law, the SBA can't guarantee loans to businesses that can obtain the money they need on their own. So you have to apply for a loan on your own from a bank or other financial institution and be turned down.
- In order to qualify as a small business, your firm needs to meet the government's definition of a small business for your industry.
- Your business may need to meet other criteria depending on the type of loan.
- After determining that your business meets the qualifications, you need to apply for a commercial loan from a financial company that processes SBA loans since the SBA doesn't provide loans directly. The bank's qualifications can be more stringent.

Read more on **getting an SBA loan**.

9) Raise Money from Your Family and Friends

Hitting up family and friends is the most common way to finance a start-up. But when you turn loved ones into creditors, you're risking their financial future and jeopardizing important personal relationships. A classic mistake is approaching friends and family before a formal business plan is even in place. To avoid it, you should supply formal financial projections, as well as an evidence-based assessment of when your loved ones will see their money again. This should reduce the likelihood of unpleasant surprises. It also lets your investors know you take their money seriously. You also need to seriously consider how the arrangement will be structured. Are you offering equity? Or will this be a loan? Perhaps most importantly, you need to emphasize the risk involved. Offer up a strong business plan, but remind them there is a good chance their money will be lost. It's better to mention that upfront to Aunt Gladys rather than over Thanksgiving dinner.

Read more on **raising money from family and friends**.

10) Get a Microloan

The lack of a credit history, collateral or the inability to secure a loan through a bank doesn't mean no one will lend to you. One option would be to apply for a microloan, a small business loan ranging from $500 to $35,000. Microloans are often so small that commercial banks can't be bothered lending the funds. Instead of a bank, you need to turn to a microlender. a non-profit organization that works differently than banks. Microlenders offer smaller loan sizes, usually require less documentation than banks, and often apply more flexible underwriting criteria. There are a few hundred microlenders throughout the U.S. and they often charge slightly higher interest rates for loans than banks. "Microloans are really for that startup entrepreneur or an entrepreneur in an existing business facing a capital gap who needs to secure capital for new equipment or to service a contract," says Connie Evans, president and CEO of AEO, which represents 400 mostly non-profit microlenders and microenterprise organizations.

Read more on **getting a microloan**.

Source: **Inc.com**

CHAPTER 37:

Invest in Opportunity Zones

What is an Opportunity Zone?

An Opportunity Zone is an economically-distressed community where new investments, under certain conditions, may be eligible for preferential tax treatment. Localities qualify as Opportunity Zones if they have been nominated for that designation by the state and that nomination has been certified by the Secretary of the U.S. Treasury via his delegation of authority to the Internal Revenue Service.

How were Opportunity Zones Created?

Opportunity Zones were added to the tax code by the Tax Cuts and Jobs Act on Dec. 22, 2017.

Have Opportunity Zones Been Around a Long Time?

No, they are new. The first set of Opportunity Zones, covering parts of 18 states, were designated on April 9, 2018. Opportunity Zones have now been designated covering parts of all 50 states, the District of Columbia and five U.S. territories.

What is the Purpose of Opportunity Zones?

Opportunity Zones are an economic development tool — that is, they are designed to spur economic development and job creation in distressed communities.

How Do Opportunity Zones Spur Economic Development?

Opportunity Zones are designed to spur economic development by providing tax benefits to investors. First, investors can defer tax on any prior gains invested in a Qualified Opportunity Fund (QOF) until the earlier of the date on which the investment in a QOF is sold or exchanged, or Dec. 31, 2026. If the QOF investment is held for longer than five years, there is a 10% exclusion of the deferred gain. If held for more than seven years, the 10% becomes 15%. Second, if the investor holds the investment in the Opportunity Fund for at least ten years, the investor is eligible for an increase in basis of the QOF investment equal to its fair market value on the date that the QOF investment is sold or exchanged.

What is a Qualified Opportunity Fund?

A Qualified Opportunity Fund is an investment vehicle that is set up as either a partnership or corporation for investing in eligible property that is located in a Qualified Opportunity Zone.

Do I Need to Live in an Opportunity Zone to Take Advantage of the Tax Benefits?

No. You can get the tax benefits, even if you don't live, work or have a business in an Opportunity Zone. All you need to do is invest a recognized gain in a Qualified Opportunity Fund and elect to defer the tax on that gain.

I am Interested in Knowing Where the Opportunity Zones are Located. Is There a List of Opportunity Zones Available?

Yes. The list of designated Qualified Opportunity Zones can be found at Opportunity Zones Resources and in the Federal Register at IRB Notice 2018-48. Further a visual map of the census tracts designated as Qualified Opportunity Zones may also be found at Opportunity Zones Resources.

What Do the Numbers Mean on the Qualified Opportunity Zones List, Notice 2018-48?

The numbers are the population census tracts designated as Qualified Opportunity Zones.

How Can I Find the Census Tract Number for a Specific Address?

You can find 11-digit census tract numbers, also known as GEOIDs, using the U.S. Census Bureau's Geocoder. After entering the street address, select ACS2015_Current in the Vintage drop-down menu and click Find. In the Census Tracts section, you'll find the number after GEOID.

I am Interested in Forming a Qualified Opportunity Fund. Is There a List of Opportunity Zones Available in Which the Fund CanInvest?

Yes. The list of designated Qualified Opportunity Zones in which a Fund may invest to meet its investment requirements can be found at **Notice 2018-48**.

How Does a Corporation or Partnership Become Certified as a Qualified Opportunity Fund?

To become a Qualified Opportunity Fund, an eligible corporation or partnership self certifies. To self-certify, a corporation or partnership completes a form, due to be released in the summer of 2018, and attaches that form to its federal income tax return. The return with the attached form must be filed timely, taking extensions into account.

Can a Limited Liability Company (LLC) Be an Opportunity Fund?

Yes. A LLC that chooses to be treated either as a partnership or corporation for federal tax purposes can organize as a Qualified Opportunity Fund.

I Sold Some Stock for a Gain in 2018, and, During The 180-Day Period Beginning On the Date of the Sale, I Invested the Amount of the Gain in a Qualified Opportunity Fund. Can I Defer Paying Tax On That Gain?

Yes, you may elect to defer the tax on the amount of the gain invested in a Qualified Opportunity Fund. Therefore, if you only invest part of your gain in a Qualified Opportunity Fund(s), you can elect to defer tax on only the part of the gain which was invested.

How Do I Elect to Defer My Gain On the 2018 Sale of the Stock?

You may make an election to defer the gain, in whole or in part, when filing your 2018 Federal Income Tax return. That is, you may make the election on the return on which the tax on that gain would be due if you do not defer it.

I Sold Some Stock on December 15, 2017, and, During the Required 180-day period, I Invested the Amount of the Gain in a Qualified Opportunity Fund. Can I Elect to Defer Tax on that Gain?

Yes. You make the election on your 2017 return. Attach Form 8949, reporting Information about the sale of your stock. Precise instructions on how to use that form to elect deferral of the gain will be forthcoming shortly.

Can I Still Elect to Defer Tax On that Gain If I Have Already Filed My 2017 Tax Return?

Yes, but you will need to file an amended 2017 return, using Form 1040X and attaching Form 8949.

How Can I Get More Information About Opportunity Zones?

Over the next few months, the Treasury Department and the Internal Revenue Service will be providing further details, including additional legal guidance, on this new tax benefit. More information will be available at Treasury.gov and IRS.gov.

Source: **Irs.gov**

CHAPTER 38:

Focusing Your Opportunity Zones

The Treasury Department recently outlined rules for investors seeking to finance development in underserved regions in exchange for significant tax breaks.

The proposed guidance would govern investments in so-called "opportunity zones" across the country that were created under the sweeping new Republican tax law. Treasury Secretary Steven Mnuchin estimated as much as $100 billion in private capital could be funneled into those areas.

"We want all Americans to experience the dynamic opportunities being generated by President Trump's economic policies," Mnuchin said in a statement. "This incentive will foster economic revitalization and promote sustainable economic growth, which was a major goal of the Tax Cuts and Jobs Act."

For investors, the opportunity zones come with several tax advantages. Capital gains placed in a certified opportunity zone fund will not be taxed through the end of 2026 or when the investment is sold, whichever comes first. Any gains from the fund are permanently shielded from taxes if the investment has been held for 10 years. In addition, the initial investment will be discounted by up to 15 percent for tax purposes after seven years.

The guidance comes just weeks before the midterm elections. The GOP has struggled to sell its tax law to voters as the party tries to hold onto its House majority.

The proposed regulations clarify that only capital gains are eligible for preferred tax treatment. Investors who can participate include individuals, corporations, businesses, REITs, and estates and trusts. Treasury said additional guidance will be released before the end of the year, with final rules likely to come in the spring.

"We felt it was important to issue the core guidance now that's needed to get the funds up and operating and not wait until we have every question answered," said a senior Treasury official who declined to be named.

One key outstanding issue is how much flexibility the funds will have to buy and sell assets within an opportunity zone. The official said that will be part of the second round of guidance.

Still, some investors are already setting up funds amid early interest in the new program. Craig Bernstein of OPZ Capital said he has “soft-circled” $50 million in funding, and that demand has been high among families who have been reluctant to sell their businesses or significant shares of stock because of the tax implications.

“I think these regulations are going to free up and unlock a lot of capital that has been sitting on the sidelines waiting to get involved,” Bernstein said.

States have designated more than 8,700 Census tracts as opportunity zones, including nearly all of Puerto Rico. The average poverty rate in the zones is 32%, compared with the national average of 17%.

The American Investment Council, which represents private equity investors, said it is reviewing the regulations but has welcomed the idea.

“The private equity industry supports Opportunity Zones and looks forward to playing a role as this important program moves forward,” AIC President Drew Maloney said in a statement to CNBC. “Our members have a successful record of investing in communities across America, supporting millions of jobs, and strengthening local economies.”

Source: **Cnbc.com**

Tax Liens

Secrets #39 and #40 cover multiple understandings of the same larger idea. Tax liens.

Investing in tax liens is covered in great detail in your Retirement Masterclass video series, so make sure you go through Unit 4 again before acting on this lesser known method.

But an explanation of the tax lien and how you can invest in it is as follows…

CHAPTER 39:

How to Buy Properties for a Few Thousand Dollars

The increasing volatility of the stock market combined with historically low-interest rates has caused many investors to seek alternative avenues that can provide a decent rate of return. One investment niche that is often overlooked is property tax liens. This unique opportunity can provide knowledgeable investors with excellent rates of return in some cases, but it can also carry substantial risk, and novice buyers need to understand the rules and potential pitfalls that come with this type of asset.

What Is a Tax Lien?

When a landowner fails to pay the taxes on his or her property, then the city or county in which the property is located has the authority to place a lien on the property. A lien is a legal claim against the property for the unpaid owed amount. Property that has a lien attached to it cannot be sold or refinanced until the taxes are paid and the lien is removed.

Similar to how actual properties can be bought/sold at auctions, these property tax liens can be purchased as well. CNBC reported that approximately $14 billion in property taxes are not paid each year, and about a third of this amount is subsequently sold off to private investors, according to the National Tax Lien Association (NTLA). Local governments benefit from private sales because they immediately recoup the monies owed on the property in question.

How Can I Invest in Them?

When a lien is issued, a tax lien certificate is created by the municipality that reflects the amount that is owed on the property, plus any interest or penalties that are due. These certificates are then auctioned off and subsequently issued to the highest bidding investor. Tax liens can be purchased for as little as a few hundred dollars for very small properties, but the majority cost much more.

The auctions may be held in a physical setting or online, and investors may either bid down on the interest rate on the lien or bid up a premium that they will pay for it. The investor who is willing to accept the lowest rate of interest or pay the highest premium will be awarded the lien. It should be noted that buyers often get into bidding wars over a given property, which will drive down the rate of return that is reaped by the winning buyer.

CNBC's report also stated that while the national foreclosure rate on properties with tax liens is only about 6%, buyers need to be cognizant of the cost of repairs and other unknowns that they may need to pay if they assume ownership of the property. Those who then own these properties may have to deal with unpleasant tasks such as evicting the current occupants, which may require expensive assistance from a property manager or attorney.

Those who are interested in purchasing a tax lien can start by deciding what type of property they would like to hold a lien on, such as residential or commercial, or undeveloped land versus property with improvements. They can then contact their city or county treasurer to find out when, where and how the next auction will be held. The treasurer's office can tell the investor where to get a list of property liens that are scheduled to be auctioned, as well as the rules for how the sale will be conducted. These rules will outline any pre-registration requirements, accepted methods of payment and other pertinent details.

Buyers also need to do due diligence on properties that are available, because in some cases the current value of the property can be less than the amount of the lien. The NTLA advises dividing the face amount of the delinquent tax lien by the market value of the property. If the ratio is above 4%, potential buyers should stay away from that property. Furthermore, there could also be other liens on the property that will prevent the bidder from taking ownership of it.

Every piece of real estate in a given county with a tax lien is assigned a number within its respective parcel. Buyers can look for these liens by number in order to obtain information about them from the county (this can often be done online). For each number, the county has the property address, the name of the owner, the assessed value of the property, the legal description, and a breakdown of the condition of the property and any structures located on the premises.

CHAPTER 40:

How to Collect Up to 108% a Month

Reaping the Profit from the Lien

Investors who purchase property tax liens are typically required to immediately pay the amount of the lien in full back to the issuing municipality. In all but two states, the tax lien issuer collects the principal and interest (and any penalties), pays the lien certificate holder, and collects the lien certificate if it's not on file. The property owner must repay the investor the entire amount of the lien plus interest, which can range anywhere from 5% to 36% (the rate will vary from one state to another, and **one investor in Illinois even saw 108% after 18 months**). If the investor paid a premium for the lien, this may be added to the amount that is repaid in some instances.

The repayment schedule usually lasts anywhere from six months to three years. In most cases, the owner is able to pay the lien in full. If the owner cannot pay the lien by the deadline, the investor has the authority to foreclose on the property just as the municipality would have (although this is a fairly rare occurrence.)

Disadvantages of Investing in Property Tax Liens

Although property tax liens can yield substantial rates of interest, investors need to do their homework before wading into this arena. Tax liens are generally inappropriate for novice investors or those with little experience in or knowledge of real estate.

Investors also need to be familiar with the actual property upon which the lien has been placed to ensure that they can collect the money from the owner. A dilapidated property located in the heart of a slum neighborhood is probably not a good buy, regardless of the interest rate that is promised, because the property owner may be completely unable or unwilling to pay the tax that is owed. Properties that have suffered any kind of environmental damage, such as from chemicals or hazardous materials that were deposited there, are also generally undesirable.

Lien owners need to know what their responsibilities are after they receive their certificates. They must usually notify the property owner in writing of their purchase within a stated amount of time. Then, they must send a second letter of notification to them near the end of the redemption period if payment has not been made in full by that time.

Tax liens are also not everlasting instruments. Many have an expiration date after a certain period of time has elapsed after the end of the redemption period. Once the lien expires, the lienholder becomes unable to collect any unpaid balance. If the property goes into foreclosure, the lienholder may discover there are other liens on the property, which can make it impossible to obtain the title.

Many commercial institutions, such as banks and hedge funds, have been getting interested in property liens. They've been able to outbid the competition and drive down yields. This has made it harder for individual investors to find profitable liens, and some have given up as a result. However, there are also some funds now available that invest in liens, and this can be a good way for a novice investor to break into this arena with a lower degree of risk.

The Bottom Line

Property tax liens can be a viable investment alternative for experienced investors familiar with the real estate market. Those who know what they are doing and take the time to research the properties upon which they buy liens can generate substantial profits over time. However, the potential risks render this arena inappropriate for unsophisticated investors. For more information on property tax liens, consult your real estate agent or financial advisor.

Source: **Investopedia.com**

CHAPTER 41:

Wholesaling Real Estate for Beginners: Understanding The Pros And Cons

If you enjoy keeping up to date with market trends, following respected real estate blogs, or are addicted to HGTV, you might have more in common with a real estate investor than you think.

Perhaps you've been considering a career in real estate for quite some time now, but have yet to take the plunge. Maybe you've even come close to making an offer on a property, but the deal fell through because you were too afraid to take action. If the above statements ring true for you, wholesaling just might become your new best friend.

Real estate wholesaling is all about finding properties that are below market value, or being able to negotiate with the seller for a lower price. The most crucial aspect of wholesaling, however, is finding motivated sellers, or people who are looking to sell their properties quickly for whatever reason.

There's always the typical marketing strategies: direct mail marketing, email marketing, content marketing or bandit sign marketing. However, you can also go down to your local city hall and purchase pre-made lists with the contact information of homes that are nearing foreclosure or are distressed.

Once you find the right property and get it under contract, it is time to find a buyer. If you've invested in real estate before, you probably already have a solid buyers list. If not, you can find a buyer using the same techniques you employed to find your property. (Note to new investors: remember to keep track of all the information you receive from every potential buyer so that you can begin curating your own buyers list for future references.)

When you present the property to your buyer, make sure to keep in mind the after repair value (ARV) and ask for a reasonable price that will benefit both you and your buyer. Don't get confused; wholesaling is more about selling the contract than it is about selling the property.

Wholesaling is the perfect way to get your feet wet as a real estate investor. Do you know your real estate wholesaling goals? As with any new business opportunity, there are both benefits and disadvantages to the process; make sure to evaluate the pros and cons before getting started.

What Is Real Estate Wholesaling?

Real estate wholesaling is the process through which an individual, the 'wholesaler,' will acquire a contract from the seller of the property and then assign that same contract to an end buyer. Wholesaling is considered one of the best short term investment strategies, and is a great way for individuals to break into the real estate investing industry.

A wholesaler is able to make a profit by identifying properties being sold under market value, and then sell the contract to acquire the property to another buyer, along with a wholesaling fee. Ender buyers are often real estate rehabbers or other types of investors who prefer not to spend the time identifying discounted properties or negotiating with sellers.

5 Traits of A Successful Wholesale Real Estate Investor

A trained mindset: It can be argued that successful entrepreneurs do not have innate talents or abilities. Investors who are successful tend to have the right mindset, one that is cultivated over years, and attack each and every task with consistency and dedication.

Make use of technology: Those who incorporate technology into their workflow tend to be able to process more information with accuracy, while helping you stay organized. Examples of tools that can be a boon for your business include customer relationship management (CRM) software, Google Voice and mobile applications that allow you to store scan documents and store documents in the cloud.

Have an effective website: According to the National Association of Realtors, 51 percent of today's home buyers find their home on the internet, representing the large proportion of consumers who take to the web when searching for goods and services. Having a great website helps to establish your brand and authority, helping to drive more business your way.

Reliable access to neighborhood comps: A real estate investor's success largely depends on their ability to identify neighborhood comps, so that they can price their properties competitively. In addition, neighborhood comps allow investors to identify properties that are being sold for under market value. One way to access reliable market transaction data is to partner up with a real estate agent who has access to the MLS.

Know when to outsource or delegate: Savvy entrepreneurs know how much their own time is worth. Juggling daily tasks and projects is a constant balancing act, and investors who try to accomplish everything autonomously can end up hurting themselves in the long run. Cramming too many activities into your schedule can lead to errors, sloppiness, and even missing out on great opportunities. Knowing when to outsource or delegate tasks and projects can prove to be a worthy investment.

4 Benefits of Wholesaling Properties

Now that we have defined wholesale real estate, how wholesale real estate investing works, and some common traits of real estate wholesalers, you are probably wondering what some of the benefits might be. Read on to gain insights to three benefits of property wholesaling:

- **Make Money in Less Time:** If you've done your due diligence and educated yourself on the process, wholesaling can be a very lucrative business. Wholesaling is great for new investors because it requires little to no personal finances or experience. If you find a respectable deal, don't be afraid to offer a fairly low price, as there is a good chance they are desperate to sell. In the event your offer is accepted, it is entirely possible to close the deal and get your check in 30 to 45 days or less.

- **A potential scenario might go as follows:** You find a property that you know would be worth at least $125,000 after repairs. You offer $100,000 and put the property under contract. You find a buyer, ask for $115,000 – remember: buy low, sell low – and you close the deal using your own attorney or a title company. Voilà, you've just made $15,000 in a relatively short timeframe, and both you and your buyer benefit from the deal. Don't forget to add your buyer's information to your buyers list because he or she might want to do business with you in the future, assuming your initial transaction went well.

- **Learn About the Real Estate Market Quickly:** Wholesaling is great for beginners because it fully immerses them into the real estate industry in a short period of time. With the right instruction and education, you will learn the basics of marketing, negotiating, organizing, and acquiring the proper legal documentation. In a sense, a wholesale deal combines many of the aspects of other real estate transactions. With a few wholesale deals under your belt, you will know what to look for in deals and what to avoid.

- **No Credit Involved and No Cash Required:** If your low credit score or limited access to capital is what has been keeping you from investing in real estate, wholesaling is the route you need to take. Even with bad credit, you can participate in a wholesale agreement because you aren't actually the person purchasing the home. Your eventual buyer is the one who will have the go through the credit check. Another advantage of wholesaling is that you can put as little as $10 down on the property when putting it under contract, which mitigates the personal risk if the deal falls through.

The CONS of Wholesaling

Investors would be foolish to think that any type of exit strategy would come without any potential risks or downsides. The following includes some disadvantages of wholesale real estate investing that should be given careful consideration:

- **There Is No Guaranteed Income:** Keep in mind, wholesaling is not your typical nine to five job. Of course, there is the merit of being your own boss, but unfortunately you are not guaranteed that trusty paycheck every two weeks. There is also no health insurance or retirement benefits that come with wholesaling. Therefore, if you are considering making real estate investing – especially wholesaling – your full-time gig, it is essential that you are the type of person who knows how to manage their finances. The best thing you can do is set aside a "rainy day" fund in case a deal does not materialize as planned.

- **The Inability to Find a Buyer:** The key to being a successful wholesaler is having a solid buyers list. In the world of wholesaling, no buyer means no deal. Additionally, your personal risk is contingent on the way your contract is written. So depending on how much you put down in escrow – which, again, could have been as low as $10 – you might have to repay your seller if you are unable to find a buyer. It is best to have potential buyers lined up before even making an offer to the seller. That way, your risk of losing money is substantially lessened. While owing your seller a measly $10 doesn't sound like a lot, it has a bigger effect on your reputation. If word gets out that you are negatively affecting homeowners, future buyers will be less likely to want to do business with you.

- **Staying on Top of an Organized Buyers List:** Half the battle of maintaining a successful wholesale business is staying on top of your potential buyers. With the right marketing, and after completing a few deals, you should have a fairly solid list of contacts. However, it is not just about having those contacts. It is about knowing the different preferences of each individual buyer. If you know "Buyer A" prefers properties that he can use as rentals, you will only contact him when you find a property that can meet those needs – i.e. a property that will require less work and is in slightly better condition. If you know that "Buyer B" is a rehabber, you will only offer him properties that are in need of major construction. In Buyer B's case, the properties you offer to him should be a bit cheaper because they are in worse shape, but will yield a higher return after being repaired. Instead of offering every property you come across to every contact on your buyers list, only reach out to those you truly believe will find value in that particular property. Remember, it will benefit you in the future if both you and your buyer profit from a deal. The last thing you want is to earn a negative reputation. So be sure to stay on top of your list of contacts by taking note of personal tastes. This will ensure that you keep loyal clients.

Is Wholesaling Illegal?

The legality in wholesaling real estate can be a hotbed for debate. In general, those who like to argue that wholesale real estate investors are doing business illegally feel this way because they are not licensed brokers. However, wholesalers are not actually selling a property in of itself, but rather, are selling the ownership of the real estate contract associated with the property. Based on this argument, wholesaling is widely viewed as a legal activity. However, it cannot be stressed enough that real estate professionals should always be well-versed in their local rules and regulations and ensure that their business activities are wholly legal.

If after considering these pros and cons, and real estate wholesaling seems like a business that you can profit from, jump on the bandwagon that many successful investors are already on. If you are driven, disciplined, and organized, there is no limit to how much money you can make in your wholesaling career.

Source: **Fortunebuilders.com**

CHAPTER 42:

How to Be the Banker and Collect 10% Interest

Lease Purchase Agreement

Lease option sales first became popular financing instruments in the late 1970s and the early 1980s. They were used primarily used as a way to circumvent alienation clauses in mortgages, but they have some other advantages as well. Proponents claimed the sale was not really a sale because it was a lease but courts have argued otherwise.

Today, options to purchase, lease options, and lease purchase agreements are three separate financing documents. They're very similar, but they differ in the finer details.

The variances are state-specific and not all states have identical laws. Consult with a real estate lawyer before entering into one of these agreements with a seller so you're sure you understand its implications.

The Basics of an Option

The buyer pays the seller option money for the right to later purchase the property when he enters into an option arrangement. This option money can be substantial or it can be as little as $1.

The buyer and the seller might agree to a purchase price at that time, or the buyer can agree to pay market value at the time his option is exercised. It's negotiable, but many buyers want to lock in the future purchase price at the beginning.

The term of the option agreement is negotiable as well, but the most common duration is generally from one year to three years.

Option money is rarely refundable. Nobody else can buy the property during the option period, but the buyer can sell the option to somebody else.

The buyer isn't obligated to buy the property. If the buyer doesn't exercise the option and purchase the property at the end of the option, the option simply expires.

The Basics of a Lease Option

A lease option works much the same way. The buyer pays the seller option money for the right to later purchase the property. In this case, however, the lease option money can be substantial.

As with an option, the buyer and seller can agree to a purchase price at the inception of the agreement or the buyer might agree to pay market value at the time the option is exercised. It's negotiable but, again, most buyers want to lock in the future purchase price at the beginning of the lease option agreement.

The buyer agrees to lease the property from the seller for a predetermined rental amount during the term of the lease option agreement. The term is also negotiable, like an option, it's usually from one year to three years.

The option money generally does not apply toward the down payment, but a portion of the monthly rental payment can apply to the purchase price. Option money is rarely refundable.

Nobody else can buy the property during the lease option period and in this case, the buyer generally cannot assign the lease option without the seller's approval.

If the buyer doesn't exercise the lease option and purchase the property at the end of the term, the option expires. The buyer is not obligated to buy the property.

The Basics of a Lease Purchase

This is another variation on the same theme with some minor differences. The buyer pays the seller option money for the right to later purchase the property. The buyer and seller agree on a purchase price, often at or a bit higher than current market value.

During the term of the option, the buyer agrees to lease the property from the seller for a predetermined rental amount. The term of the lease-purchase agreement is negotiable, but again, the common duration is generally from one year to three years.

The buyer applies for bank financing and pays the seller in full at the end of the term.

The option money generally does not apply toward the down payment, but a portion of the monthly lease payment goes toward the purchase price.

The monthly lease amount is typically higher than fair market rental value for this reason.

Option money is nonrefundable. Nobody else can buy the property unless the buyer defaults. The buyer typically cannot assign the lease purchase agreement without the seller's approval.

Buyers are often responsible for maintaining the property and paying all expenses associated with its upkeep during the term, including taxes and insurance, and they're contractually obligated to buy the property.

Doing a Lease Option/Lease Purchase

Hire a real estate lawyer to draw up the documents and explain your rights, including those of possession and default consequences, if you decide to take one of these routes to home ownership or to sell your property.

The property might be encumbered by underlying loans that contain alienation clauses, giving the lender the right to accelerate the loan when the owner enters into such an agreement. You'll want to look into this.

Sometimes sellers give the option money to their real estate agent as full payment of commission.

Agents aren't always involved in the exercise of lease options or the fulfillment of lease purchase agreements and you'll probably still need a real estate lawyer even if you've retained real estate agent representation. Agents are not lawyers and they can't give you legal advice.

Obtain all the disclosures and do your due diligence just like you would with a regular sale. This means getting a home inspection, examining the title policy, getting an appraisal, and reading any and all seller disclosures.

Consider obtaining pest inspections, a roof certification, a home warranty plan, and hiring other qualified inspectors as well.

Lease Purchase Benefits for Both Sellers and Buyers

Lease purchase agreements are commonly offered by owners of hard-to-sell properties. Think about it — the owner would sell it to a conventional buyer who would pay the seller cash if the property was a plum and easy to sell.

Sellers generally get market value at today's prices and relief from coming out of pocket for the mortgage payment on a vacant property during the term.

Although the lease payments can exceed market rent, the buyer is building a down payment in some cases and she's banking that the property will appreciate beyond the agreed-upon purchase price.

Buyers generally make a small down payment with little or no qualifying and this makes a lease purchase an attractive way to ease into the benefits of home ownership.

Buyers enter into a forced savings plan when part of the lease payment is credited toward the purchase price at the end of the lease option agreement.

If the buyer defaults, the seller does not refund any portion of the lease payments or the option money and he can retain the right to sue for specific performance.

Tax Consequences

The Internal Revenue Service can and has classified these transactions as installment sales, not leases. Special rules can apply to them at tax time.

A portion of the buyer's rental payments can sometimes be categorized as interest and would therefore be tax deductible to her.

As for the seller, the option payment can be treated as a down payment or the initial payment of the transaction. The total amount of the payments can ultimately contribute to a capital gain or loss, both of which have tax implications. Rental income also contributes to capital gains.

The seller can no longer claim depreciation on the property if it's considered that he no longer owns it — he entered into an installment sale.

Several other potential tax rules apply as well so you might want to consult with an accountant prior to entering into such a deal.

Source: **Thebalance.com**

Invest in REITs

Become a Landlord Without the Land! Capture Big Income With Less Hassle and More Diversification Than Owning Rental Property…

By Nilus Mattive, Editor, *Rich Life Letter*

My wife and I recently bought a house right off the beach here in Santa Barbara, California.

Besides the ocean view, one of the biggest attributes of this house is that it has a two-car garage on a separate level.

For about $20,000 I figure I can convert that garage into a legal rental unit that will produce about $20,000 A YEAR in extra income. (Yes, Santa Barbara rents are outrageous!)

Now, perhaps you've thought about becoming a landlord, too. After all, owning a rental property comes with heaps of potential benefits.

You get steady cash flows that typically keep pace with inflation. You can enjoy various tax benefits.

Plus, you have another level of diversification on top of stocks, bonds, and other traditional investments.

Of course, there are also lots of downsides.

Here are just a few:

- **Money** — Even if you finance, you'll still need a lot of cash to get started. For example, a $100,000 property could require $20,000 down. Toss in another $5,000 for closing costs, and you'll have $25,000 tied up.
- **More Money** — There will also be ongoing maintenance and repairs both inside and out. Insurance costs. Taxes.

Maybe utilities. The list goes on and on.

- **Tenant Hassles** — You'll need to screen tenants, keep them happy, and evict them if they don't follow the terms of the lease. Of course, you can hire a property manager to take the day-to-day responsibilities off your hands. But then that eats further into your profit margins.

- **Lack of Liquidity** — Unlike stocks, bonds, and mutual funds, you don't have much liquidity. It can take months to unload a house even in a strong market. And if prices decline, you may lose a chunk of principal for good.

The point is that owning a rental isn't just a passive investment.

You can't expect to buy properties, sit back, and let the money flow in. Whether you have one property or ten, it's a business.

You're taking on a lot of responsibility, and it's a concentrated bet, just like any other business startup.

Don't want to deal with all those hassles?

No problem!

You can use Real Estate Investment Trusts (REITs) to get lots of income, an instant portfolio of properties and ongoing liquidity without the landlord hassles.

REITs are a special type of company that invests in different kinds of real estate or real estate related assets, including shopping centers, office buildings, hotels, self-storage facilities, and long-term care communities.

REITs do NOT pay corporate income tax.

But to qualify for this tax break, the Internal Revenue Code requires that the company must pay 90% of its taxable income to shareholders every year.

REITs must also invest at least 75% of total assets in real estate and generate at least 75% of its annual gross income from real estate-related income such as rents from real property and interest on obligations secured by mortgages on real property.

Some other benefits that REITs offer:

- **Liquidity** — You can buy and sell them just like regular stocks.
- **Retirement ready** — You can own them in your IRA.
- **Professionally managed** — You don't have to deal with upkeep or deadbeat tenants.
- **Diversified** — Rather than buying a single property on your own, shares of a REIT generally represent ownership in many properties throughout the country.
- **Income focus** — Dividends from a REIT can be easily re-invested to generate future returns or they can provide you with a steady income stream.

Examples of REITs

To give you an idea of the types of REITs available, here are three that invest in unique areas of the real estate world…

CHAPTER 43:

Sun Communities, Inc. (SUI)

Ratty trailer parks are being replaced with upscale, gated communities of manufactured homes. And REITs that specialize in manufactured homes get most of their income by leasing the space for those homes. They also own the utilities, such as street lighting, and take care of the community property. The homeowners maintain the spaces they rent, as well as their homes.

The manufactured housing sector is a small, often ignored one. However, the strong demand for affordable housing is attracting home buyers and investors.

Sun Communities, Inc. (NYSE: SUI) is a big player in this market. SUI owns and operates or has an interest in 348 manufactured housing and recreational vehicle communities located in 29 states throughout the U.S. and Ontario, Canada.

SUI pays an annual dividend of $2.84, which amounts to around a 3% annual yield at current prices.

Source: TD Ameritrade

CHAPTER 44:

Public Storage (PSA)

Self-storage facilities rent space to people whose garages are overflowing with junk they can't bear to part with it. But that's not all — they're also for law firms, accounting firms, and other businesses that need climate-controlled units to keep records secure and accessible.

Self-storage facilities have become more upscale over the years, with well-lit parking lots and attractive facades. It would be easy to mistake many of them for office buildings! **Public Storage (NYSE: PSA)** is a leader in this sector with thousands of locations in the U.S. and Europe.

PSA pays an annual dividend of $8, which amounts to a 4.03% annual yield at current prices.

Source: TD Ameritrade

CHAPTER 45:

LTC Properties, Inc. (LTC)

Based on simple demographics, demand for high-end senior housing is poised to take off. As Charles Bissell, an executive at commercial real estate services firm JLL, recently told National Real Estate Investor:

> *"It is a strong sector right now, and it really all goes back to the health of the economy and the health of the housing market. When seniors have the ability to sell their houses and generate significant proceeds from those sales, they are a lot more bullish about going into a luxury community."*

One of the REITs in this sector is **LTC Properties, Inc. (NYSE: LTC)**. The company operates more than 200 senior housing and health care properties across the U.S.

Based on the LTC pays an annual dividend of $2.28, which amounts to a 5.15% annual yield at current prices.

Source: TD Ameritrade

Now, am I saying it's the exact right time to buy any of these three particular REITs?

No.

But the overall point is that a well-diversified investment portfolio should always include some cash-gushing real estate and REITs can give you that without any of the headaches I might experience renting out my garage.

CHAPTER 46:

1031 Exchange

Before you read through this section, make sure you have watched Unit 3 of your Retirement Masterclass, 1031 Exchanges. In it, you will get an in-depth understanding of how and why to do a 1031 exchange. And with this post, any remaining questions should be answered…

How To Do a 1031 Exchange: Rules & Definitions for Investors 2018

FAQs answered by Benjamin Smith for ***Real Wealth Network***

Introduction:

A 1031 Exchange, also called a Starker Exchange or Like-Kind Exchange, is a powerful tax-deferment strategy used by some of the most financially successful investors. This is, perhaps, even more true as we head into 2018. Why? Because in many U.S. cities prices real estate have surpassed the "bubble levels" of a decade ago. Because of this, many investors think that today is the optimal time to exchange properties in expensive markets for cash flowing properties across the country.

FAQ 1: What is a 1031 Exchange?

The term 1031 Exchange is defined under section 1031 of the IRS Code.

(1) To put it simply, this strategy allows an investor to "defer" paying capital gains taxes on an investment property when it is sold, as long another "like-kind property" is purchased with the profit gained by the sale of the first property. We'll discuss like-

kind property in more detail in section four.

Brandon Turner from BiggerPockets explains that this strategy has more benefits than just saving yourself from taxes.

According to Brandon, a starker exchange can allow a real estate investor to shift the focus of their investing without incurring the tax liability.

For example, perhaps you are investing in properties that are low-income and thus high-maintenance.

You could exchange the high-maintenance investment for a low-maintenance investment without needing to pay a significant amount of taxes.

Or perhaps you want to move your investments from one location to another without the IRS knocking. The 1031 makes this possible.

Note: Traditionally, a 1031 exchange is where one property is literally swapped for another property of like-kind. However, the likelihood that the property you want is owned by someone who wants your property is really, really unlikely. According to Forbes, this is why “the vast majority of exchanges are delayed, three party, or ‘Starker’ exchanges (named for the first tax case that allowed them).

In a delayed exchange, you need a middleman who holds the cash after you “sell” your property and uses it to “buy” the replacement property for you. This three party exchange is treated as a swap.”

FAQ 2: When to Do a 1031 Exchange?

When you sell an investment property, even if you weren’t the one who initially purchased, you end up on the hook to pay capital gains tax.

If you’ve made some bad investments, or you just have bad luck, selling your investment can cost you more than you make.

But, if you own a rental property that is worth significantly more today than what you (or the original owner) purchased it for, you can make a killing using this powerful strategy.

The big question: how do you actually use this strategy? Continue reading the next section to learn some tips and strategies for success!

FAQ 3: How to Do a 1031 Exchange Right Now?

To use this strategy effectively, you must exchange one property for another property of similar value. In the process you avoid capital gains, at least for a while.

An investor will eventually cash out and pay taxes, but in the meantime, an investor can trade properties without incurring a sudden tax obligation. It's an important tool for real estate investors that has become a bulls-eye for tax reform evangelists.

However, the exchange rules require that both the purchase price and the new loan amount be the same or higher on the replacement property.

That means that if an investor were selling a $1 Million property in San Jose that had a $650,000 loan, they would have to buy $1 Million or more of replacement property with $650,000 or more leverage.

We'll talk more about section 1031 rules in section 5. First, you'll want to know about the four types of Starker Exchanges used by real estate investors.

FAQ 4: What Are the 4 Types of Exchanges for Real Estate?

There are four main types of like kind exchanges investors can choose from. The most common like-kind exchange types include the simultaneous, delayed, reverse, and construction/improvement exchange. Continue reading to learn more about each type of exchange.

1) Simultaneous Exchange

A simultaneous exchange occurs when the replacement property and relinquished property close on the same day. As the name suggests, these closings occur in a simultaneous fashion.

It is important to note that the exchange must occur simultaneously; any delay, even a short delay caused by wiring money to an excro company, can result in the disqualification of the exchange and the immediate application of full taxes.

There are three basic ways that a simultaneous exchange can occur.

Swap or complete a two-party trade, whereby the two parties exchange or “swap” deeds.

Three-party exchange where an “accommodating party” is used to facilitate the transaction in a simultaneous fashion for the exchanger.

Simultaneous exchange with a qualified intermediary who structures the entire exchange.

2) Delayed Exchange

The delayed like-kind exchange, which is by far the most common type of exchange chosen by investors today, occurs when the exchangor relinquishes the original property before he acquires replacement property.

In other words, the property the Exchangor owns (which is called the “relinquished” property) is transferred first and the property the Exchangor wishes to exchange it for (the “replacement” property) is acquired second.

The Exchangor is responsible for marketing his property, securing a buyer, and executing a sale and purchase agreement before the delayed exchange can be initiated. Once this has occurred, the Exchangor must hire a third-party Exchange Intermediary to initiate the sale of the relinquished property and hold the proceeds from the sale in a binding trust for up to 180 days while the seller acquires a like-kind property.

Using this strategy, an investor has a maximum of 45 days to identify the replacement property and 180 days to complete the sale of their property. In addition to the numerous tax benefits, this extended timeframe is one of the reasons that the delayed exchange is so popular.

Note: we’ll discuss the rules associated with a Delayed Starker Exchange in depth in the next section.

3) Reverse Exchange

A reverse exchange, also known as a forward exchange, occurs when you acquire a replacement property through an exchange accommodation titleholder before you identify the replacement property. In theory, this type of exchange is very simple: you buy first and you pay later.

What makes reverse exchanges tricky is that they require all cash. Additionally, many banks won't offer loans for reverse exchanges. Taxpayers must also decide which of their investment properties are going to be acquired and which will be "parked." A failure to close on the relinquished property during the established 180 day period that the acquired property is parked will result in a forfeit of the exchange.

The reverse exchange follows many of the same rules as the delayed exchange. However, there are a few key differences to note:

Taxpayers have 45 days to identify what property is going to be sold as "the relinquished property."

After the initial 45 days, taxpayers have 135 days to complete the sale of the identified property and close out the reverse 1031 exchange with the purchase of the replacement property

4) Construction/Improvement Exchange

The construction exchange allows taxpayers to make improvements on the replacement property by using the exchange equity. To put this into layman's terms, the taxpayer can use their tax-deferred dollars to enhance the replacement property while it is placed in the hands of a qualified intermediary for the remainder of the 180 day period.

It is important to note that the taxpayer must also meet three requirements if they want to defer all of the gain (from the sale of the relinquished property) and instead use it as part of the construction or improvement exchange.

The entire exchange equity must be spent on completed improvements or as down payment by the 180th day.

The taxpayer must receive "substantially the same property" that they identified by the 45th day.

The replacement property must be equal or greater in value when it is deeded back to the taxpayer. The improvements must be in place before the taxpayer can take the title back from the qualified intermediary.

FAQ 5: What Real Estate 1031 Exchange Rules Must I Follow?

Rule 1: Like-Kind Property

To qualify as a 1031 exchange, the property being sold and the property being acquired must be "like-kind."

Like-Kind Property Definition: Like-Kind property is a very broad term which means that both the original and replacement properties must be of "the same nature or character, even if they differ in grade or quality." (4) In other words, you can't exchange farming equipment for an apartment building, because they're not the same asset. In terms of real estate, you can exchange almost any type of property, as long as it's not personal property.

For example:

Exchanging an apartment building for a duplex would be allowed.

Exchanging a single family rental property for a commercial office building would be allowed.

Exchanging a rental property or vacation rental for a restaurant space would be allowed.

EXCEPTION: It's important to note that the original and replacement property must be within the U.S. to qualify under section 1031.

**Another fun fact: Starker Exchanges can include more than two properties. For example, you can exchange one property for multiple replacement properties and vice versa: you can exchange multiple properties and for one larger property. As long as the new properties are like your original properties, you're good to go. Do yourself a favor and get a good qualified intermediary to assist you.

Rule 2: Investment or Business Property Only

A 1031 exchange is only applicable for Investment or business property, not personal property. In other words, you can't swap one primary residence for another.

For example:

If you moved from California to Georgia, you could not exchange your primary residence in California for another primary residence in Georgia.

If you were to get married, and move into the home of your partner, you could not exchange your current primary residence for a vacation property.

If you were to own a single-family rental property in Idaho, you could exchange it for a commercial rental property in Texas.

Rule 3: Greater or Equal Value

In order to completely avoid paying any taxes upon the sale of your property, the IRS requires the net market value and equity of the property purchased must be the same as, or greater than the property sold. Otherwise, you will not be able to defer 100% of the tax.

For example, let's say you have a property worth $2,000,000, and a mortgage of $500,000. To receive the full benefit of the 1031, the new property (or properties) you purchase need to have a net worth of at least 2 million dollars, and you'll have to carry over at least a $500,000 mortgage. It's important to note that the $2,000,000+ value, and $500,000 mortgage, can go towards one apartment building or three different properties with a total value of $2,000,000+. (FYI: Acquisition costs, such as inspections and broker fees also apply toward the total cost of the new property.)

Rule 4: Must Not Receive "Boot"

A Taxpayer Must Not Receive "Boot" in order for the exchange to be completely tax-free. Any boot received is taxable to the extent of gain realized on the exchange. In other words, you can carry out a partial 1031 exchange, in which the new property is of lesser value, but this will not be 100% tax free. The difference is called "Boot," which is the amount you will have to pay capital gains taxes on. This option is completely okay, and often used when a seller wants to make some cash, and is willing to pay some taxes to do so.

An example of this would be if your original property is sold for

$2,000,000 and the property you wish to exchange under section 1031 is worth $1,500,000, you would need to pay the normal capital gains tax on the $500,000 “boot.”

Rule 5: Same Tax Payer

The tax return, and name appearing on the title of the property being sold, must be the same as the tax return and title holder that buys the new property. However, an exception to this rule occurs in the case of a single member limited liability company (“smllc”), which is considered a pass-through to the member. Therefore, the smllc may sell the original property, and that sole member may purchase the new property in their individual name.

For example, the single member of “Sally Jones LLC” is Sally Jones. The LLC can sell the property owned by the LLC, and because Sally Jones is the sole member of the LLC, he can purchase property in his name, and be in compliance with the 1031 code.

Rule 6: 45 Day Identification Window

The property owner has 45 calendar days, post-closing of the first property, to identify up to three potential properties of like-kind. This can be really difficult because the deals still need to make sense from a cash perspective. This is true especially in today’s market because people tend to overprice their properties when there are low-interest rates, so finding all the properties you need can be a challenge.

An exception to this is known as the 200% rule. In this situation, you can identify four or more properties as long as the value of those four combined does not exceed 200% of the value of the property sold.

Rule 7: 180 Day Purchase Window

It’s necessary that the replacement property be received and the exchange completed no later than 180 days after the sale of the exchanged property OR the due date of the income tax return (with extensions) for the tax year in which the relinquished property was sold, whichever is earlier.

Recap

As you might realize, there are many rules and qualification requirements that you must comply with in order to perform a successful exchange. To sum things up, the biggest advantage of using this strategy is that you can avoid having to pay capital gains taxes on the sale of an investment property. This can be a huge benefit for real estate investors who know which markets are primed to grow next. It can also be a huge downfall for beginning investors, or those who don't understand the changing real estate landscape. If you don't, you risk falling victim to one the biggest disadvantages is the reduced basis for depreciation on the replacement property.

This means that if you were to sell your replacement property, even at a deficit, you would still be accountable for the capital gains on the initial property. In other words, if you want to maximize the benefits of your exchange, it's important that you choose your replacement property (or properties) wisely, investing in a market that has good potential for growth in the future.

CHAPTER 47:

Tax-Free Municipal Bonds

The Basics of Municipal Bonds

If your primary investing objective is to preserve capital while generating a tax-free income stream, municipal bonds are worth considering. Municipal bonds (munis) are debt obligations issued by government entities.

When you buy a municipal bond, you are loaning money to the issuer in exchange for a set number of interest payments over a predetermined period. At the end of that period, the bond reaches its maturity date, and the full amount of your original investment is returned to you.

Taxes

While municipal bonds are available in both taxable and tax-exempt formats, the tax-exempt bonds tend to get the most attention because the income they generate is, for most investors, exempt from federal and, in many cases, state and local income taxes.

Investors subject to the alternative minimum tax (AMT) must include interest income from certain munis when calculating the tax, and should consult a tax professional prior to investing.

Types of Municipal Bonds

Municipal bonds come in the following two varieties:

- General obligation bonds (GO)
- Revenue bonds

General obligation bonds, issued to raise immediate capital to cover expenses, are supported by the taxing power of the issuer.

Revenue bonds, which are issued to fund infrastructure projects, are supported by the income generated by those projects. Both types of bonds are tax exempt and particularly attractive to risk-averse investors due to the high likelihood that the issuers will repay their debts.

While buying municipals bonds is viewed as a conservative investment strategy, it is not risk-free.

Risk Factors of Municipal Bonds: Credit Risk

If the issuer is unable to meets its financial obligations, it may fail to make scheduled interest payments or be unable to repay the principal upon maturity.

To assist in the evaluation of an issuer's creditworthiness, ratings agencies (such as Moody's Investors Service and Standard & Poor's), analyze a bond issuer's ability to meet its debt obligations, and issue ratings from 'Aaa' or 'AAA' for the most creditworthy issuers to 'Ca', 'C', 'D', 'DDD', 'DD' or 'D' for those in default.

Bonds rated 'BBB', 'Baa' or better are generally considered appropriate investments when capital preservation is the primary objective. To reduce investor concern, many municipal bonds are backed by insurance policies guaranteeing repayment in the event of default.

Every year, Moody's releases a report on more than 10,000 municipal bond issuers, with all four Moody's-rated municipal defaults in 2016 related to the Commonwealth of Puerto Rico debt crisis. Overall, the total default volume for 2016 was $22.6 billion — the highest in the 47-year study period, according to Moody's.

The rating agency said that the U.S. municipal sector, while broadly stable and highly rated, is "fundamentally evolving" and that the dominant headwind in the sector is "the growth in general government leverage and increasing fixed cost burdens on operations."

According to the Moody's data, there continues to be a very clear delineation in default rates beginning in 2007. Between 1970 and 2007, Moody's reported an average of only 1.3 defaults per year in the muni bond sphere. That number quadrupled after 2007, highlighted by seven defaults in 2013.

Interest Rate Risk and Tax Bracket Changes

The interest rate of most municipal bonds is paid at a fixed rate. This rate doesn't change over the life of the bond. If interest rates in the marketplace rise, the bond you own will be paying a lower yield relative to the yield offered by newly issued bonds.

Municipal bonds generate tax-free income and thus pay lower interest rates than taxable bonds.

Investors who anticipate a significant drop in their marginal income-tax rate may be better served by the higher yield available from taxable bonds.

Call Risk and Market Risk

Many bonds allow the issuer to repay all or a portion of the bond prior to the maturity date. The investor's capital is returned with a premium added in exchange for the early debt retirement.

While you get your entire initial investment plus some back if the bond is called, your income stream ends earlier than expected.

The underlying price of a particular bond changes in response to market conditions. When interest rates fall, newly issued bonds will pay a lower yield than existing issues, which makes the older bonds more attractive. Investors who want the higher yield may be willing to pay a premium to get it.

Likewise, if interest rates rise, newly issued bonds will pay a higher yield than existing issues. Investors who buy the older issues are likely to do so only if they get them at a discount. If you buy a bond and hold it until maturity, market risk is not a factor because your principal investment will be returned in full at maturity.

Should you choose to sell prior to the maturity date, your gain or loss will be dictated by market conditions, and the appropriate tax consequences for capital gains or losses will apply.

Buying Strategies for Municipal Bonds

The most basic strategy for investing in municipal bonds is to purchase a bond with an attractive interest rate, or yield, and hold the bond until it matures. The next level of sophistication involves the creation of a municipal bond ladder.

A ladder consists of a series of bonds, each with a different interest rate and maturity date. As each rung on the ladder matures, the principal is reinvested into a new bond. Both of these strategies are categorized as passive strategies because the bonds are bought and held until maturity.

Investors seeking to generate both income and capital appreciation from their bond portfolio may choose an active portfolio management approach, whereby bonds are bought and sold instead of held to maturity. This approach seeks to generate income from yields and capital gains from selling at a premium.

Evaluating Municipal Bond Stability vs Fit

Stability is relative in the municipal bond market. Municipal bonds tend to be safer than many other types of investments, but they are less safe than U.S. Treasury bonds. You can also trade in multiple kinds of municipal bonds, such as assessment bonds, revenue bonds or general obligation bonds.

The issuer of the bond also matters; bonds issued from municipal authorities in a city with strong financials would be considered more stable than those from a city whose credit rating has been downgraded or has recently filed for bankruptcy.

Plenty of investors make an understandable mistake during tough or uncertain times and develop tunnel vision about stability and safety. In their flight from risk, however, they fail to consider how an investment fits in their financial plans.

Municipal bonds can be a tax haven, often generating higher returns than Treasuries. They can still lose to inflation and tie up large sums of money for much longer than a recession typically lasts.

Source: **Investopedia.com**

CHAPTER 48:

Invest in PMC Ounce

Introducing the PMC Ounce: The Best of Precious Metals With Less Volatility

By Jim Rickards, Editor, *Strategic Intelligence*

I'd like to introduce you to a little-known investment that helps you fight back against inflation's corrosive impact: the PMC Ounce. It's offered by precious metals dealer Neptune Global.

The PMC Ounce is a dynamic physical precious metals investment asset. It tracks the "PMC Index."

What is the PMC Index?

It's a fixed-weight index of the four primary precious metals expressed as a single ounce. It basically diversifies you across precious metals. Gold makes up roughly half of the PMC Ounce. The rest is split between silver, palladium and platinum.

The PMC Ounce is liquid and trades in real-time. Yet it also allows you to capture each metal's proven characteristics as a store of wealth, inflation hedge, currency hedge and industrial input.

Keep in mind that a PMC Ounce is not just a claim on physical metal; it's physical bullion stored in an insured, nonbank vault in Delaware. It's 100% bullion, it's not a fund, not a derivative and not "paper gold."

When you buy the PMC Ounce, there are no financial instruments between you and the bullion, thereby eliminating the counterparty risk associated with Wall Street-created financial instruments.

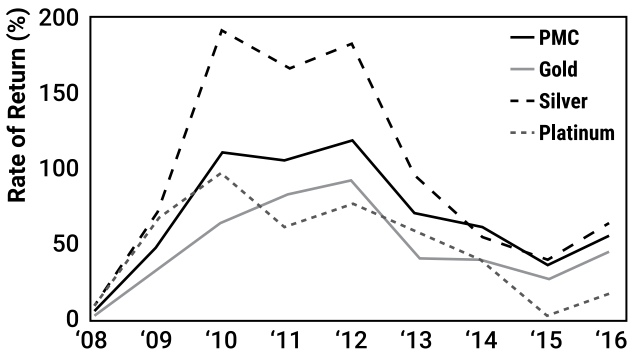
The metals are allocated in your name at a nonbank bullion depository and verified to you by them. With one day's notice, either the bullion or the bullion's cash equivalent can be delivered to you on demand. (The tax status for the PMC Ounce is the same as that for physical bullion.)

I like the PMC Ounce because it's a way to own four precious metals in a more diversified, stable manner.

For example, if gold is getting smashed, one of the other three metals may be rising. As the global monetary system experiences convulsions, the volatility of metals will spike. Most of the volatility will be to the upside, but there will be jarring corrections, too.

Over time, the PMC Ounce should yield a higher, smoother return than the return from each metal on its own.

Individual Bullion Metals vs. PMC Ounce



Source: PNC Ounce

How would the PMC Ounce perform in a deflationary environment? We experienced a mild deflation stress test from late 2014 to the present. And the results were good.

Oil prices and stocks were weak and investors bid up Treasury bonds. Yet these four precious metals held their value. On several occasions throughout this deflation stress test, these metals rose, making them great instruments to diversify your investment portfolio. As investors keep searching for hedges against both deflation and inflation, they will find their way to precious metals.

You don't need to worry about management fees, since the PMC Ounce is not a fund. There is a modest premium over the spot price, as with any bullion purchase. You can find the real-time PMC Ounce spot price easily through the PMC Index on Neptune Global's site.

You can also own the PMC Ounce within or outside your IRA. Visit **www.neptuneglobal.com/pmc-ounce/** for more information, or call Neptune Global at (302) 256-5080.

What I like best about this is that the index actually outperforms three of the four index components and has less volatility. That means a much higher Sharpe ratio — a measure of risk-adjusted performance — than either gold or silver.

The reason is that when gold is getting smashed, silver is not, and vice versa. The blended product dodges these bullets and reduces volatility, for a higher total return.

Of course, this product was beaten down in 2015, like the precious metals themselves, but with metals prices recovering, this could be your last chance to get in at such an attractive entry point.

CHAPTER 49:

Invest in Penny Stocks

Defining a 'Penny Stock'

A penny stock typically trades outside of the major market exchanges at a relatively low price and has a small market capitalization.

These stocks are generally considered highly speculative and high risk because of their lack of liquidity, large bid-ask spreads, small capitalization and limited following and disclosure.

They often trade over-the-counter through the OTC Bulletin Board (OTCBB) and pink sheets.

The term penny stock has evolved with the market. In the past, penny stocks were stocks that traded for less than a dollar per share. The SEC, however, has modified the definition to include all shares trading below $5.

Most penny stocks don't trade on the major market exchanges. However, there are some large companies, based on market capitalization, that trade below $5 per share on the main exchanges like the Nasdaq. An example of a penny stock listed on the Nasdaq is Curis Inc. (CRIS), a small biotechnology company.

That said, the typical penny stock is a small company with highly illiquid and speculative shares. The company is generally subject to limited listing requirements along with fewer filing and regulatory standards.

Things to Remember About Penny Stocks

Penny stocks are more suitable for investors with a high tolerance for risk. Typically, penny stocks have a higher level of volatility, resulting in a higher potential reward and a higher level of risk. Considering the heightened risk levels associated with investing in penny stocks, investors should take particular precautions. For example, an investor should have a stop-loss order predetermined before entering the trade, knowing where to exit if the market moves opposite of the intended direction. Investors may lose their entire investment on a penny stock, or more than their investment if they buy on margin.

Although penny stocks can have explosive moves, it is important to have realistic expectations. Typically, gains in the stock market take months and years to materialize. An investor who buys penny stocks with the intention of turning $100 into $50,000 over a week is likely to be deeply disappointed.

Penny stocks are often growing companies with limited cash and resources. In other words, most penny stocks are high-risk investments with low trading volumes.

To protect yourself, trade penny stocks that are listed on the American Stock Exchange (AMEX) or Nasdaq, as these exchanges are rigorously regulated. Avoid trading penny stocks that are not listed on a major exchange, such as a stock quoted on the pink sheet system in the over-the-counter (OTC) market.

What Makes Penny Stocks So Risky?

Four major factors make these securities riskier than blue chip stocks.

1) Lack of Information Available to the Public

The key to any successful investment strategy is acquiring enough tangible information to make informed decisions.

For micro-cap stocks, information is much more difficult to find. Companies listed on the pink sheets are not required to file with the Securities and Exchange Commission (SEC) and are thus not as publicly scrutinized or regulated as the stocks represented on the New York Stock Exchange and the Nasdaq. Furthermore, much of the information available about micro-cap stocks is not from credible sources.

2) No Minimum Standards

Stocks on the OTCBB and pink sheets do not have to fulfill minimum standard requirements to remain on the exchange. Sometimes, this is why the stock is on one of these exchanges. Once a company can no longer maintain its position on one of the major exchanges, the company moves to one of these smaller exchanges. While the OTCBB does require companies to file timely documents with the SEC, the pink sheets have no such requirement. Minimum standards act as a safety cushion for some investors and as a benchmark for some companies.

3) Lack of History

Many of the companies considered to be micro-cap stocks are either newly formed or approaching bankruptcy. These companies will generally have poor track records or none at all. As you can imagine, this lack of historical information makes it difficult to determine a stock's potential.

4) Liquidity

When stocks don't have much liquidity, two problems arise: first, there is the possibility that you won't be able to sell the stock. If there is a low level of liquidity, it may be hard to find a buyer for a particular stock, and you may be required to lower your price until it is considered attractive to another buyer. Second, low liquidity levels provide opportunities for some traders to manipulate stock prices, which is done in many different ways — the easiest is to buy large amounts of stock, hype it up and then sell it after other investors find it attractive (also known as pump and dump).

How Is a Penny Stock Created?

A penny stock, like any other publicly traded stock, is created through a process called an initial public offering, or IPO. First, a company must file a registration statement with the Securities and Exchange Commission or file stating the offering qualifies for an exemption from registration. It must also check state securities laws in the locations it plans to sell the stock. Then, upon approval, the company may begin the process of soliciting orders from investors. Finally, the company can apply to have the stock listed on an exchange, or it can trade on the over-the-counter market, or OTC.

Small companies and start-ups typically issue stock as a means of raising capital to grow the business. Though the process is lengthy, involves mountains of paperwork and can be quite costly, issuing stock is often one of the most efficient ways for a start-up company to obtain necessary capital. Penny stocks are often the result of such ventures and can make for profitable but precarious plays for investors.

As with other new offerings, the first step is hiring an underwriter, usually an attorney or investment bank specializing in securities offerings. The company's offering either needs to be registered with the SEC according to Regulation A of the Securities Act of 1933 or file under Regulation D if exempt.

If the company is required to register, Form 1-A, which is the registration statement, must be filed with the SEC and is accompanied by the company's financial statements and proposed sales materials. These financial statements need to remain available to the public for review, and timely reports must be filed with the SEC to maintain the public offering. Once approved by the SEC, orders for shares may be solicited from the public by accompanying sales materials and disclosures, such as a prospectus.

After initial orders are collected and stock is sold to investors, a registered offering can begin trading in the secondary market via listing on an exchange like NYSE or Nasdaq or trade over-the-counter. Many penny stocks end up trading in OTC markets due to the strict requirements for listing on the bigger exchanges.

The majority of penny stocks do not meet such requirements, and the companies cannot typically afford the hefty cost and regulations involved. Sometimes companies make an additional secondary market offering after the IPO. This dilutes the existing shares but gives the company access to more investors and increased capital. It is important that companies issuing penny stock keep this in mind and work to gain value in the shares as they trade in the open market. Furthermore, it is mandatory that the companies continue to publicly provide updated financial statements to keep investors informed and maintain the ability for quoting on the over-the-counter bulletin board, or OTCBB.

The SEC's Rules for Penny Stocks

Penny stocks are considered highly speculative investments. In order to protect the investor's interest, the SEC and the Financial Industry Regulatory Authority (FINRA) have specific rules to regulate the sale of penny stocks.

All broker-dealers need to comply with the requirements of Section 15(h) of the Securities Exchange Act of 1934 and the accompanying rules to be eligible to effect any transactions in penny stocks.

1) Sales Practice Requirements

Before effecting any transaction, a broker-dealer must approve the investor's transaction (of specific penny stocks); meanwhile, the customer must give a written agreement to the broker-dealer for the same transaction. This measure has been taken to prevent manipulative, fraudulent practices in such investments.

"Approving" the customer basically means checking his suitability for such investments. Approval should be given only after the broker-dealer has assessed the customer's investment experience and objectives along with his or her financial position.

2) Disclosure Document

A broker-dealer must provide a standardized disclosure document to the customer.

The documents explain the risk factor associated with investing in penny stocks, concepts related to the penny-stock market, customer rights, broker-dealers' duties towards the customers, remedies in case of fraud and other important information which can be handy for an investor.

The investor would be well-advised to go through this document so as to take informed decisions.

3) Bid-Offer Quotations Disclosure

It is mandatory for a broker-dealer to disclose and later confirm the current quotation prices and related information to the customer before effecting a transaction. If a broker-dealer doesn't follow the same, it is considered unlawful. This helps the investor to keep a track of the price movement in the marketplace.

4) Compensation Disclosure

This rule makes the investor aware of the money being earned by the broker-dealer from a certain transaction. This can help the customer to judge if the broker-dealer has a selfish motive in trying to push a certain transaction.

5) Monthly Accounts Statements

A broker-dealer must send to its clients a monthly account statement which discloses details such as: the number and identity of each penny stock in the customer's account; the dates of transaction; purchase price; and the estimated market value of the security (based on recent bids and purchase prices).

Such statements must also explain the limited market for the securities and the nature of an estimated price in such a limited market.

In cases where there have been no transactions effected in the customer's account for a period of six months, the broker-dealer shall not be required to provide monthly statements.

However, broker-dealers should send written statements on a quarterly basis.

Source: **Investpedia.com**

CHAPTER 50:

Modified Endowment Contracts — MECs

What is 'Modified Endowment Contract - MEC'

A modified endowment contract (MEC) is a tax qualification of a life insurance policy whose cumulative premiums exceed federal tax law limits. The taxation structure and IRS policy classification changes after becoming a modified endowment policy.

The taxation of withdrawals under the MEC is similar to the that of non-qualified annuity withdrawals. For withdrawals before the age of 59 1/2, a premature withdrawal penalty of 10% may apply. As with traditional life insurance policies, MEC death benefits are not subject to taxation. Modified endowment contracts are usually purchased by individuals who are interested in tax-sheltered, investment-rich policies, and do not intend to make pre-death policy withdrawals.

MEC Qualification Factors

Specifically, a life insurance policy is considered an MEC by the IRS if it meets three criteria. First, the policy is entered into on or after June 20, 1988. Second, it must meet the statutory definition of a life insurance policy. Third, the policy must fail to meet the Technical and Miscellaneous Revenue Act of 1988 (TAMRA) 7-pay test.

Life insurance policies entered into before June 20, 1988, are not subject to the payment of premiums over the money allowed under federal laws. However, the renewal of an older life insurance policy after this date, it is considered new and must be assessed with the 7-pay test.

The 7-pay test determines whether the total amount of premiums paid into a life insurance policy, within the first seven years, is more than what was required to have the policy considered paid up in seven years. Policies become an MEC when the premiums paid to the policy are more than what was needed to be paid within that 7-year time frame.

Tax Implications of an MEC

Unlike traditional life insurance policies, taxes on gains are regular income for MEC withdrawals under last-in, first-out (LIFO) accounting.

However, the cost basis within the MEC and withdrawals is not subject to taxation. The tax-free death benefit makes MECs useful for estate planning purposes. Furthermore, policy owners who do not take withdrawals can pass on a significant sum of money to their beneficiaries.

Source: **Investopedia.com**

CHAPTER 51:

Annuities

An annuity is a periodic or immediate payment to begin at a specific date for a fixed period or for the rest of the policyowner's life.

Simply put, an annuity is a vehicle for liquidating a sum of money. Annuities have received a bad reputation in the last few years because of advisors abusing them for high commission payouts. They can however, be a very useful tool in saving for retirement and accomplishing savings goals.

Structure

When individuals select an income option as a death benefit from a life insurance policy, they are actually purchasing an annuity and selecting an annuity payout option. We will look at the most common types of annuities and the premium options to fund these vehicles. The name of the annuity is usually very descriptive of the type and premium option available. For example, single premium immediate annuity (SPIA) is paid by the annuitant in one single premium up front and starts paying out benefits immediately.

Types

There are four common types of annuity's uses; refund, single life, joint and survivor, and period certain.

1. **Refund** — This payout is designed pay the beneficiary the difference between the purchase price of the annuity and the sum of monthly payments. The two types of refunds available are:
    - **Installment** — payments continue until full cost is recovered.
    - **Cash** — remaining lump sum is paid.

2. **Single life annuity** — Pays the annuitant a guaranteed income for his or her lifetime then ceases upon the annuitant's death.

3. **Joint and survivor** — If either insured dies the same income payments continue to the survivor for life. When the surviving annuitant dies, no further payments are made to anyone.

4. **Period certain** — Guarantees benefit payments for a certain period of time, such as 10, 15 or 20 years, whether the annuitants is living.

Final Note: The single life annuity will always have the highest income per dollar of outlay. It is not suitable for everyone.

Practice Question:

Which distribution option would be most appropriate for a retired married couple with no other source of income?

A. Joint-and-survivor annuity

B. Single life annuity

C. An interest-only option

D. Joint life annuity

Answer: **A**

Do not confuse the joint life annuity with the joint-and-survivor annuity. A joint life annuity ceases payments after the death of the first annuitant, whereas, the joint-and-survivor continues to pay benefits until the second annuitant dies.

Source: **Investopedia.com**

CHAPTER 52:

Treasury Inflation-Protected Securities (TIPS)

Treasury inflation protected securities (TIPS) refer to a treasury security that is indexed to inflation in order to protect investors from the negative effects of inflation. TIPS are considered an extremely low-risk investment because they are backed by the U.S. government and because the par value rises with inflation, as measured by the Consumer Price Index, while the interest rate remains fixed.

BREAKING DOWN ‘Treasury Inflation Protected Securities - TIPS’

Interest on Treasury inflation protected securities (TIPS) is paid semiannually. TIPS can be purchased directly from the government through the TreasuryDirect system, in $100 increments with a minimum investment of $100, and are available with 5-, 10-, and 30-year maturities.

Because the semiannual inflation adjustments of a TIPS bond are considered taxable income by the IRS, even though investors don’t see that money until they sell the bond or it reaches maturity, some investors prefer to get TIPS through a TIPS mutual fund or exchange traded fund (ETF), or to only hold them in tax-deferred retirement accounts to avoid tax complications. Purchasing TIPS directly, however, allows investors to avoid the management fees associated with mutual funds. TIPS are also valuable because they are exempt from state and local income taxes.

Example of Treasury Inflation Protected Securities Adjustments

Suppose an investor owns $1,000 in TIPS at the end of the year, with a coupon rate of 1%. If there is no inflation as measured by the CPI, the investor will receive $10 over the year in coupon payments. If inflation rises by 2%, however, the $1,000 principal will be adjusted upward by 2% to $1,020. The coupon rate will still be the same at 1% but it will be multiplied by the new principal amount of $1,020 to get an interest payment of $10.20. On the other hand, if inflation was negative, as in deflation, with prices as measured by the CPI falling 5%, the principal would be adjusted downward to $950. The resulting interest payment would be $9.50 over the year.

At maturity, the investor would receive the principal equal to either the original principal of $1,000 or an adjusted higher principal, if applicable. The interest payments during the life of the bond are subject to being calculated from a lower principal, but the investor is never at risk of losing the total principal of TIPS if held to maturity. The investor can sell TIPS for less than the initial principal in the secondary market, however, before maturity.

Risks of Treasury Inflation Protected Securities

TIPS usually carry interest rates lower than other government or corporate securities, so they are not necessarily optimal for income investors. Their advantage is mainly inflation protection, but if inflation is minimal or nonexistent, their utility decreases. Another risk associated with TIPS is a higher tax bill. The adjustments of principal are considered income for tax purposes, although investors do not receive the adjustments, but instead receive the coupons that result from them. Thus, investors may be subject to tax on "phantom income," with the gain in principal outweighing the coupons received.

Source: **Investopedia.com**

CHAPTER 53:

Understanding Smart Trend Following and Momentum

On a recent episode of the Rich Dad Radio Show, which you have in your videos section of the *Rich Dad Poor Dad Letter* site page, I had a long discussion with economist Richard Duncan that had a lot to do with this topic.

One of the big differences about the Rich Dad Radio Show, and your monthly newsletter, is that we see our job's focus to look over the horizon to see what's coming, but we have a unique viewpoint. We don't follow the mainstream wisdom.

This is my question to you. Why is it in 2008 when the economy crashed and I was on television warning everybody it was going to come, I was on Wolf Blitzer and CNN. I said Lehman was coming down, and then six months later Lehman came down.

Why is it so many people got wiped out? Asking this question another way, why do so many people get wiped out when economies change?

It's been about 10 years now from the crash of Lehman Brothers since 2018, and we said the highest bull market in world history, the world has gone nuts. People are throwing cash first at Bitcoin, that crashed. Then everybody's now into marijuana, and that keeps going up and up and up, and the people are crazy. They're chasing anything that might give them some kind of return. The question is why is it that so many people get wiped out when the signs are all there for them to, hey, maybe we should make some changes right now? All markets crash. All markets boom. That's why we have a very special program today. It's about why most people get wiped out is because most people are micro. They're watching micro.

Right now, I'm watching CNBC or Bubble Vision, and they're talking about, "Oh now, marijuana, marijuana." Everybody's chasing that sucker up, just like they chased Bitcoin up. There's nothing wrong with that, but you better know when to get out. That's the whole thing…

The reason most people get hammered is because they're micro. Very few people are macro…

I would say 90% of our guests on the Rich Dad Radio Show are macro. They're not talking about the ups and downs and the twists and the turns and "oh you better trade this for two cents of a gain and all that." That's not what we do at Rich Dad. We're basically a macro company, because if you're macro, you can see clearly now.

If you can see clearly now, it can be the best thing you can ever see. If you knew Bitcoin was going to crash, would you have gotten into it? Many people did. They chased it up. I was one of them. I watched it a little bit and I was watching it, but I knew that sucker was going to come down. Thank God that I lost nothing in the whole thing. When things are going up, that's when they're the most dangerous. That's why today's program is about micro and macro, and the reason most people get wiped out is some of them are not just micro, they're mini micro. They're just looking at the little one penny moves of a stock or something. They're trading on it.

That's what the stock market is right now. It's called HFT, high frequency trading. They can do 7,000 trades in a second right now. It's micro. Yet nobody's paying attention to the macro, and we had guys like Mohamed El-Erian. He's using the word collapse. James Rickards is using the word collapse. They're not talking about crash, they're talking about collapse. There's a big difference between a crash and a collapse.

The difference between a sophisticated investor and an average one is this point. Seeing the market's trends and following them is easy. But realizing when things are building too high and protecting yourself from the collapse is how you keep all the money you make in the markets. Follow trends, but always go in with an exit plan.

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