

I recently read the book *The Great 401(k) Hoax* and it really got me thinking about how important it is for everyone to understand why the financial community is trying so hard to get your money – so they can benefit, not you. I wish my financial advisors would have enlightened me on this subject. Of course, they were a part of that community and they benefited as well, which is why they didn't necessarily want me to know. I decided that I wouldn't be that way. I would make every attempt to enlighten everyone coming through my office, whether they became clients or not, as to what was going on.

With that in mind I will attempt to summarize the key concepts of this book in the next few pages so that you don't have to read it for yourselves (*not that you shouldn't read it anyway*). I believe that this information could be critical to your financial future. As you can imagine, the title alone was enough to get me interested in its content.

The problem is that the 401(k) asks Americans to copy the investment behavior of the rich, even though they obviously do not have the resources to ride out bad markets of the kind we believe will prevail for the next decade (*note: this book was published in 2002 prior to what has happened in 2008, which I think it is very prophetic*).

The American public has been hoodwinked by political and corporate forces into relying on the 401(k) as the primary long-term investment mechanism. In doing so, the stock market has been put at center stage in providing for a comfortable retirement for the average American. The 401(k) represents an implicit promise to middle class Americans that they can live off the income that they receive from stock ownership, just like the rich do. It is a promise that is impossible to fulfill: thus *the great 401(k) hoax*.

The authors point out history which shows that stocks were driven to unsustainable highs three times in 1901, 1929 and 1966. Each of these flights into a valuable fantasy was followed by more than a decade in which stock prices stagnated or declined. That does not mean that there were no rallies in these periods but the fact is, the stock market could not, and did not go to new highs.

It looks like a fourth high has been reached at the end of the year 2000: and it is their opinion (*and I agree*) that we are now in for another decade (*or more*) where stock prices stay stagnant or decline.

The path to financial success must begin with a journey to escape from the thrall of Wall Street.

They point out that it is hardly a matter of rocket science to conclude that by far the greatest proportion of the 20th century stock market gains were comprised into 40 years. In the other 60 years of the hundred years of the 20th century, stocks languished. In those 60 years, the stock market was hardly a place where the average investor could compound for a comfortable retirement.

Wall Street tells the American family that it can rely on earning an inflation-adjusted rate of return of seven (7) percent on its money with a long-term stock savings plan. Reality, on the contrary, suggests that a return of fewer than two (2) percent is a far more realistic outlook for a person that extends well past the end of the first decade of the 21st century.

The difference between what Wall Street promises and what history suggests is the difference between comfort and virtual penury. They (the authors) believe the 2% scenario's is the most realistic benchmark for the next 20 years. This suggests that the dream of 7% returns on stock market investing is a hoax on the American public rather than a realistic appraisal of the future.

Understanding the true origin of the 401(k) plan is important for the American Family. It was the slow growth period in the American economy, the years from the beginning of the OPEC oil embargo in 1973, to the mid-1990's that undermined the old pension system. Not when things were good, but rather when the great corporations were having a tough time making money. Corporate America had a burning desire to get out from under its long-term commitments to its employees. Long-term pension liabilities were showing up as virtual black holes.

How to solve the problem? Simple, if the corporation could meet its obligations by allowing workers to voluntarily contribute part of their earnings into a 401(k), the dreaded unfunded liabilities would simply not exist. They were given tax incentives to "match" workers contributions with stock or cash. In effect, the corporation told its workers: 'you are now the owner of your retirement fund, but we are not responsible for whether it will be enough to provide a decent pension. That depends on you.' This is why the 401(k) was, in effect, the major tool used by Wall Street to capture family values (*as well as the family's money*).

The fundamental thesis of their book is that a long-term reaction to the stock market exuberance of the 1990's will set the tone for the current decade(s). The booms of 1901, 1929 and 1966 were followed by prolonged periods of market stagnation or decline that lasted for at least twenty years, and they have given their reason for believing that the early part of the current century will be no different (*as has happened and been reflected dramatically by what happened in 2008*).

So what do they suggest? The successful transition must begin with a stern determination to drown out the 'noise' that emanates from Wall Street's house gurus and their disciples. This means the cable financial channels, the personal investment magazines, and, above all, from the brokerage houses themselves. Some 'noise' is harder to ignore when it emanates from the great universities and research organizations. That is what makes a guide to 'noise suppression' an essential element of investment success.

Providing the best guide to the new investment terrain begins with answering the question: what is the likely rate of return of stock market investments over the coming couple of decades? They (the authors) believe the best answer lies in following the record during earlier periods of stagnations (like after 1901, 1929, 1966 & now 2000).

Three things they suggest will really matter: 1) Investors should buy stocks only when valuations fall to levels history suggests are safe (p/e ratio's below 15); 2) Investors must aim for income as well as capital gains; 3) They must seek ways of keeping the amount of money that they hand over to Wall Street for its services to an absolute minimum (fees).

Average investors must think of bonds, cash, cash value life insurance and some private real estate funds as the place to keep their money most of the time (*only bonds and cash can be kept inside a 401(k)*). Cash is not only king in very bad markets, but cash is king in stagnant markets. (*Cash normally means control but inside the 401(k) this control is mitigated because of the limited investment options.*) They should depart from these rules only when p/e's are really low. What is low? For the entire last 100 year period the average p/e ratio on the Dow Jones Industrial average was 15, they would suggest anything lower than this as a good cautious number. Here are some of their suggestions:

- Use index Funds (*or my suggestion - the new Exchange Traded Funds*)

- Never buy funds with a ‘load’ (*educate yourself as best you can on who manages the fund, what are their goals, who benefits and what value it creates*)
- Make sure that the management fees are very low
- Find out what the fees are in your own 401(k) – your company may not even know.
- Save enough to get the company match – don’t take the match in company stock if it can be avoided – if not sell it right away and put into cash (remember Enron & Lucent)
- Consider other alternatives if the company doesn’t give a match, or if you are contributing more than what they match
- Remember, there’s no evidence that any money manager can consistently beat the averages
- Look for mutual funds called ‘income funds’ – their goal is to produce a high current yield
- Do not even try to pick stocks, because you are likely to fail in the long run unless you get luckier than you have any right to expect

Most 401(k)’s almost always stress buying equities (noise – don’t listen). It is naïve to buy the argument that stocks are a good hedge against inflation. The late 1960’s and 1970’s were high inflation years, yet the stock market went absolutely nowhere.

The time has come for change. What you can’t do is throw your hands up and become passive about saving and investing. That would be a big mistake. I certainly don’t claim to have all of the answers, but I do have a passion for making sure that my clients understand what they are up against. Making sure they understand that there is another side (and maybe a solution) to all of the ‘noise’ put out by Wall Street and its proponents.

‘If what you thought was true turned out not to be true, when would you want to know, especially if it affected your financial future?’ I think you would agree, as soon as possible.

Reading this book, and the market events of 2008, made me realize that my recommendation and knowledge of how to set up your own ‘bank’ made even more sense now than ever before. You need to know your options and how alternatives might protect you if the markets do indeed remain stagnant over this period. If you don’t get returns in the 7% to 8% in your retirement accounts, a place where money is out of your control for as long as 30 years, what affect will this have on your ability to become financially independent when you need to be? What might you do to mitigate this situation?

Go to my website (www.americancollegefunding.net) and watch the short video on the ‘Infinite Banking’ concept. Then please read my white paper on ‘*how to become your own banker*’. If this peaks your interest then we should meet to determine how you can use this concept to improve your chances of reaching financial freedom.

Regards,

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You can go to any of the on-line book suppliers to get ‘The Great 401(k) Hoax’, by William Wolman & Anne Colamosca