

1ST EDITION

# FINANCIAL FREEDOM BLUEPRINT

A STEP-BY-STEP GUIDE  
TO INVEST FOR  
FINANCIAL  
INDEPENDENCE



LOUIS B. LLANES, CFA CMT  
FOUNDER OF  
MACROTREND STRATEGIES, LLC AND  
WEALTHNET INVESTMENTS

# CONTENTS

Introduction 1

1 Make Smart Choices and Avoid Mistakes 7

2 Build Wealth Faster: Avoid, Reduce, or Eliminate Taxes 25

3 Evidence-Based Investing 35

4 Practical Advice on Managing Risk 51

5 Should I Pay Off My Mortgage? 63

6 How to Select an Investment Advisor 71

7 Common Questions 83

8 Putting It All Together 101

Disclaimer 103

Appendix 105

Resources 109

## SEVEN-STEP PROCESS FOR PLANNING

I recommend a seven-step planning process to guide your investing. It's important to do the steps in sequence so you get the best results. Otherwise, you will find yourself spending more time to get them done. Reduce the hassle and do them in order.

*Step 1: Identify and Prioritize Objectives*

The first step is to create an ideal vision for your future and to **identify** your important goals. I've found that there are five types of questions we can ask ourselves to identify our real goals. They are questions of

1. Purpose and values
2. Dangers, opportunities, and threats
3. Visualizing your future
4. Goal transformation
5. The wider impact of your goals

Being rich is empty without a purpose in life. Take time to reflect on your own personal values and what they mean to you; discuss them with your partner and your advisors. Huge rewards can be reaped from this alone because the hardest part of planning is getting clear on what you want. These two questions will address your long-term values:

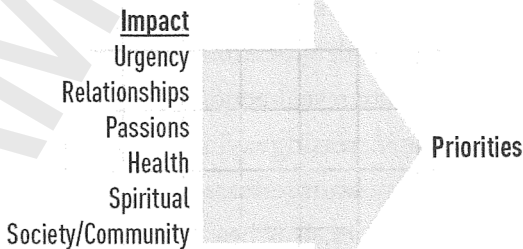
- What is the single focus and activity that would keep you absolutely fascinated and motivated for the rest of your life?
- What is important about money to you? Why is that important?

Sometimes short-term obstacles can stifle your progress toward your long-term goals. Overcoming them is the key to breaking

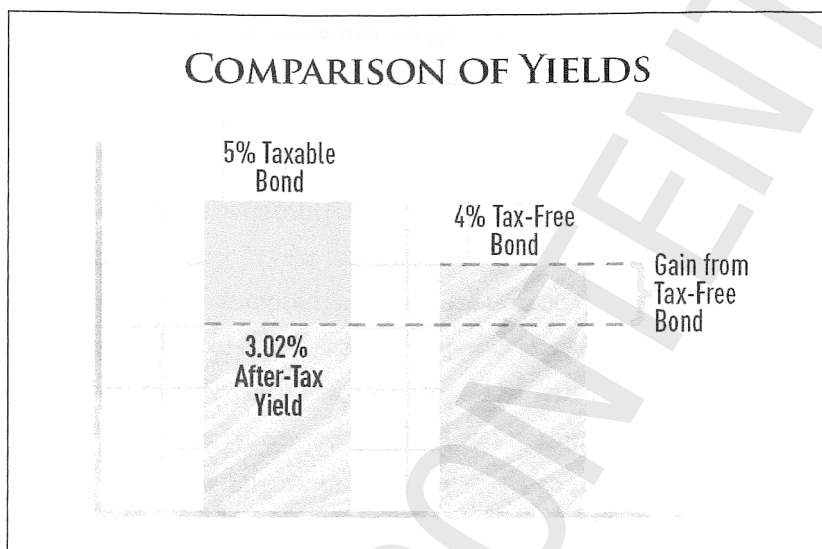
know which goals should take precedence over the others. Your priorities will then be used when it comes time to determine how to allocate your investments and future savings.

1. *Urgency.* How urgent is the goal? Does any goal need to be reached sooner rather than later? (1 = not urgent, 5 = very urgent)
2. *Relationships.* How does this goal affect the people who are important to me? Is the impact good or bad for my family, friends, and colleagues? (1 = bad for relationships, 5 = good for relationships)
3. *Passions.* Does this goal move me toward my passions in life? (1 = away from passions, 5 = toward my passions)
4. *Health.* How does this goal affect my health and happiness? (1 = bad for health, 5 = good for health)
5. *Spiritual.* Does the goal help me actualize my higher purpose? (1 = no, 5 = yes)
6. *Society and Community.* Does this goal move me toward the societal or community goals that I would like to achieve during my lifetime? (1 = away from, 5 = toward)

## GOAL GRADING







higher after-tax yield is a better buy, all else being equal. Evaluate the yield-to-maturity of bonds that have a similar credit quality and maturities to make an apples-to-apples comparison.

Let's say you have a taxable bond that's paying 5% and your current marginal tax bracket is 39.6%. After taxes, your yield is only 3.02% [ $5\% \times (100\% - 39.6\%)$ ]. That's almost two full percentage points knocked off your yield because of taxes. If you can buy a bond paying 4% tax free, then you will earn almost a full percentage point higher than with the taxable bond. In this case you would go with the tax-free bonds.

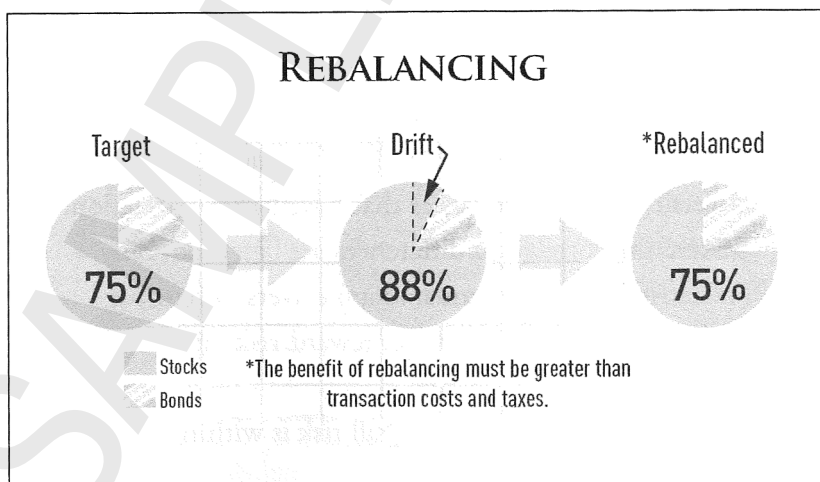
#### AVOID PAYING TAXES ON OTHER PEOPLE'S GAINS!

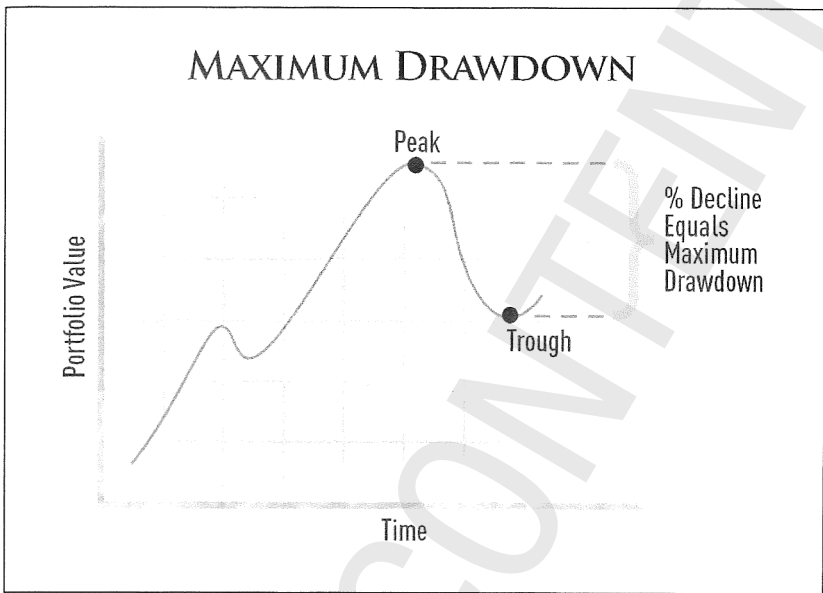
You may not be aware of the *phantom tax*, a relatively unknown nuisance that causes people to pay taxes on capital gains they never actually earned. What you don't know **can** hurt you. Mutual funds have potential capital gains the moment you buy them, and if you are

## BENEFITS OF REBALANCING ASSET CLASSES

Rebalancing is a process of establishing target percentages for investments, then buying or selling when the investments stray too far away. When the allocation is out of line, rebalancing will bring them back closer to their targets. These targets are specific percentages of the portfolio. For example, you may want to have 35% of your portfolio in US stocks. If this percentage increases to 45%, you might consider selling enough stocks to take their share of your portfolio back down to 35%. Target percentages can be applied in a broad or narrow fashion to individual securities, styles, or asset classes.

Numerous studies find that rebalancing is an effective tool to improve portfolio performance (Dichtl, Drobetz, and Wambach, February 2014). Strong evidence suggests that rebalancing outperforms buy and hold in terms of risk/reward ratios. Most of the benefit is derived from better risk control resulting in higher *Sharpe ratios* and *Sortino ratios*. One study estimated that rebalancing adds





drop in value I can bear while I'm pursuing higher returns?" Is it 10%, 15%, 25%, or 50%?

Another excellent measure is the standard deviation of returns. This measures the amount of variation around the average of returns. If there is a large amount of variation in the returns, the standard deviation will be higher. Conversely, investments that are less volatile will have a smaller standard deviation. Standard deviation is different from drawdown because standard deviation measures **both** up and down returns, whereas drawdown only deals with negative outcomes. Combining these two numbers can help you and your advisors construct a portfolio in your comfort zone.

### *Step 3: Simulate Your Portfolio's Performance*

How do we develop a portfolio within your risk tolerance? One good way is through portfolio simulation. This is a type of statistical analysis that performs thousands of what-if scenarios given