IS LIFE INSURANCE A GOOD INVESTMENT RIGHT NOW?

PART 1 OF 2

BY ROBERT P. MURPHY

My business partner and co-author Carlos Lara and I have been warning since the financial crisis of 2008 that the Federal Reserve's response has merely set us up for another crash. In September 2016 we released a video entitled, "How to Weather the Coming Financial Storms" which outlined our prognosis, and gave strategies for business owners and households to protect themselves. (You can still view the video from our main landing page at: http://lara-murphy.com, or you can search that title on YouTube.) In this video, we recommended that Americans: (1) Acquire at least a month's worth of currency, (2) acquire 6 - 18 months' worth of gold (or silver), and (3) start funding a dividend-paying Whole Life insurance policy configured according to Nelson Nash's Infinite Banking Concept (IBC).

Doesn't elementary analysis say that if you expect the US dollar to fall, you don't want to be in dollar-denominated assets like life insurance?

In this context, readers of the *LMR* and/or listeners to our podcast ("The Lara-Murphy Show") often ask: How does it make sense to load up on life insurance, if the Fed is setting us up for an economic crisis, possibly coupled with a fall or even crash of the currency? Doesn't elementary analysis say that if you expect the US dollar to fall, you don't want to be in dollar-denominated assets like life insurance?

Over the course of two issues, I will answer this excellent question. In this first article, I will outline the theoretical considerations. In other words, I want to properly *frame* the reader's thinking, because many people misunderstand what Carlos and I are saying, and we need to adjust their thinking to properly weigh the issues. In the second article (which will run in the June 2017 *LMR*), I'll review the latest statistics on the assets of life insurers, to assess their relative health compared to other financial institutions.

Clarifying the Lara-Murphy Recommendation

In the first place, it's crucial to emphasize that Carlos and I are *not* merely saying, "You should get yourself a Nelson Nash-type policy." In *general* that would be good advice, applicable in any time period and for any economic landscape.

However, given the current realities—and

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in particular, the years of malinvestments fostered by artificially low interest rates, coupled with an explosion of federal government debt and a massive expansion of the Fed's balance sheet—Carlos and I are supplementing that timeless advice with the two additional recommendations of: (A) Acquire at least a month's worth of actual currency in case the banks suddenly close, and (B) Build up a stockpile of physical gold (or silver) in your possession in case the currency tanks.

So I ask that people keep the entire three-pronged strategy in mind. We are encouraging our readers and listeners to *play defense*, to make sure they don't get wiped out by a sudden catastrophe. It's not so much that we are saying, "This is likely the best thing for you to do," but rather, "If you do this, you will probably avoid disaster."

IBC Is NOT About "Investing in Life Insurance"

The second clarification is to reiterate that Nelson Nash is *not* telling his fans to invest in life insurance, the way a financial guru might advise people to invest in real estate, Asian stocks, Bitcoin, or some other asset class.

Rather, Nash is showing people how to "become your own banker" through the use of properly designed dividend-paying Whole Life insurance policies. Think of them as a cash-management vehicle. Consider an analogy in more conventional terms: Business owners have business checking accounts. This would be indispensable to modern affairs. Yet the owners are not "investing in a checking account." It just makes running the business so much easier than if they refrained from banking services.

Likewise, Nelson Nash discovered that given our current financial landscape and tax/regulatory environment, a dividend-paying Whole Life insurance policy is the perfect *platform* on which to implement the *process* of IBC.

Our Strategy Is NOT a Complete Plan

Let me issue another clarification: Carlos and I are not telling people to *merely* follow our three-pronged recommendation. Rather, we are saying that it is an excellent defensive measure to provide a minimum level of protection against the coming financial storms.

You should certainly be doing much more to get ready. We strongly recommend starting up multiple streams of income. In general, saving more is also a great idea.

But as far as *what* to do with your extra income and saving, we are going to remain agnostic. There are many idiosyncrasies with individuals and businesses. It can't possibly be right to say, "You should build and run middle-income apartments," because some people (such as me!) would be terrible landlords.

The beauty of IBC is that it gives flexibility to individuals. When they see a particular investment opportunity, they can take out a policy loan and pounce. In contrast, if they had dumped all of their spare income into a 401(k) or other tax-qualified plan, their money would be in prison and they'd have to watch that opportunity drift by…

HOW Inflation Can Hurt Life Insurance

Our concerned readers are right: Other things equal, life insurance is a "bad investment" if you're expecting large-scale price inflation. But it's important to think through exactly *why* there is a problem.

Some people ask us, "Won't the life insurance companies fail if the dollar crashes?" Well, given a bad enough calamity, *every* financial institution could go under. After all, we could have a Mad Max environment if things got really hairy.

However, in terms of merely economic crises (as opposed to civil war, foreign invasion, massive flu outbreak, etc.), a crashing dollar wouldn't directly strike life insurance as an asset per se. Ironically, it could arguably make the life insurers *stronger*, as it might become much easier for people to make their premium payments.

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Consider: If prices in general go up by, say, 100 percent over a five-year period, then wages and salaries would go up too, perhaps after a lag. Perhaps at the end of the five years, the average person's salary has gone up 90 percent.

So yes, this person is feeling the crunch from price inflation; his paycheck has gone up 90 percent in dollar terms, but gasoline, groceries, and other goods are now twice as expensive.

However, one of the things that *won't* go up is the dollar amount he has to pay the life insurance company to keep his policy in force. If he had opened up and signed a contract for a Whole Life policy with a level premium of (say) $800 per month before the massive inflation hit, then he would still only need to write checks for $800 per month. And now it would be easier to do that, because his salary was 90 percent higher.

Admittedly, if the mismatch between general price inflation and the (lagged) jump in wages and salaries were too large, then perhaps households would be so far behind the 8-Ball that they had to drop their life policies, even though the policies were becoming "cheaper" by the year to keep in force. But here again, the issue wouldn't be the price inflation per se, but rather the *lag* in wages and salaries to catch up. Higher price inflation per se makes it easier for policyholders to make their premium payments on already-issued policies.

Rather than worrying about the life insurance companies going under, the *true* danger of large-scale price inflation is that the "real" value of your Cash Surrender Value (and hence the amount you can borrow against your policy) would go down sharply. For example, if you have taken out a policy that promises to have at least $600,000 available in the year 2030, but between now and then large-scale price inflation occurs, then the life insurance company will still probably be able to deliver on its promise to have $600,000 available for you in 2030. The problem is that $600,000 at that time might not buy as much as you currently predict.

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In this context, the reader can appreciate why Carlos and I included the hedge with gold (or silver) in our three-pronged strategy. In the event of a large-scale price inflation, the precious metals component of your overall portfolio will rise to help offset the loss in purchasing power of your dollar-denominated assets.

On the other hand, we don't *merely* recommend bulking up on "inflation hedges." Absent the abandonment of the currency, Americans will still be using dollars for their everyday transactions in the coming decades. That's why it's still a great idea to get a cash-flow management system—in other words, a Nelson Nash-type policy—up and running.

How Rising Interest Rates Affect Life Insurer Balance Sheets

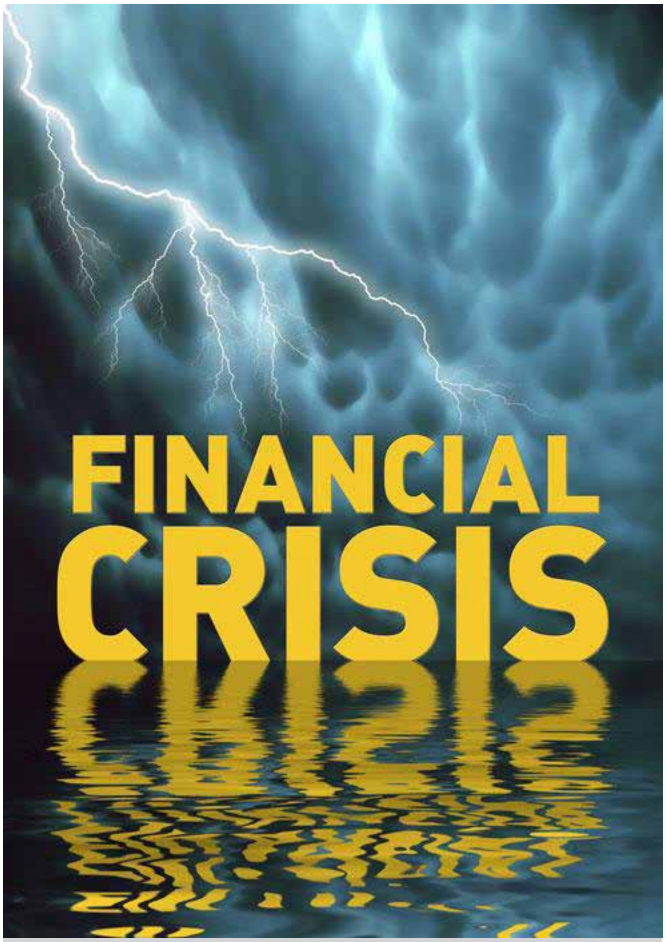
Sophisticated readers sometimes ask, "If interest rates rise sharply—as you and Carlos warn that they might—then won't this destroy the life insurers? After all, they hold a bunch of bonds on their balance sheets, and rising interest rates reduce the market value of bonds. So won't the major life insurers go bankrupt if interest rates spike?"

This is a great question, and it's a legitimate worry for some types of institutions that invest in bonds. Indeed, we have warned that the Federal Reserve itself could become technically insolvent if Treasury yields rise quickly.

However, with life insurers we must also consider the *liability* side of their balance sheets. These consist of the present value of the actuarially expected death benefit payments they will make on their outstanding policies.

Now the crucial point here is that the death benefit claims are themselves "fixed income" by their nature; the life insurance contracts promise a certain dollar amount. Because of that, when interest rates rise, the present value of those looming future liabilities *goes down.*

Therefore, so long as the life insurers have engaged in a reasonable degree of maturity matching, movements in interest rates do not have a first-order effect on their solvency. Yes, a spike in the 10-year Treasury yield will cause the market value of the life insurers' bond assets to drop, but at the same time it will cause the market value of their death benefit liabilities to drop by a similar amount.



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To make sure the reader understands this crucial point, consider a simplified scenario: Suppose a life insurance company knows that Joe Smith is going to die in exactly 10 years, at which time the insurer will have to pay Smith's beneficiary $1 million. Further suppose that the yield on a zero-coupon ("STRIPS") 10-year Treasury bond is 2 percent. So in order to ensure that it has the ability to pay Smith's beneficiary, the insurance company right now spends about $820,000 on zero-coupon 10-year Treasuries, because the U.S. federal government will then have to redeem them for $1 million in 10 years.

Now a year after making this purchase, suppose that the yield curve on all Treasuries shifts up by 4 percentage points. This will affect the market value of the bonds and the liability. But if the life insurer just forgets market value and looks at the ultimate redemption value of the bond itself, it will still have just enough coming in the door to pay Joe Smith's beneficiary the required $1 million upon his death. In other words, the U.S. Treasury owes the life insurance company $1 million when the bonds mature, regardless of what happens to interest rates in the meantime. The fact that the market's valuation of this approaching cash payment fluctuates over time can be ignored so long as the life insurer has enough cash to finance its operations otherwise.

In next month's issue, we'll look more carefully at actual statistics of life insurers to see how well (or poorly) they live up to this ideal of perfect maturity matching. But I wanted to set out the theory first, to make sure the reader understands the real issue at stake.

Banks and Policy Loans

Finally, an excellent objection runs like this: "You and Carlos are warning that the commercial banks could collapse. In that scenario, how am I supposed to access my policy loans?"

Yes, a spike in the 10-year Treasury yield will cause the market value of the life insurers' bond assets to drop, but at the same time it will cause the market value of their death benefit liabilities to drop by a similar amount.

Here it's important to consider that the life insurance companies themselves, though they of course have checking accounts like other businesses, don't keep a large portion of their wealth in the form of commercial bank deposits. (They wouldn't earn much interest on such an asset.)

So if the commercial banks experience a crisis, the assets "backing up"

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your life insurance policy won't be caught up in the problem, at least not directly.

Now then, when you request a policy loan, the only requirement is that *some* commercial bank is still open for business. You can open an account with them, and have the life insurer deposit your policy loan in that account.

Notice that this is entirely different from you keeping a large portion of cash inside a particular checking account—as many gurus are currently recommending. In the event of a big crash where FDIC goes under, and the government has to declare a "bank holiday," you could find that the (say) $30,000 in your particular checking account is inaccessible, until the government moves things around or possibly forever, depending on how big a "bail-in" is needed.

But to repeat, if instead of keeping your "cash" inside a commercial bank, you keep it "inside" a properly structured Whole Life policy, then you are much more likely to be able to access it in the event of another financial crisis.

Conclusion

In this article I explained the three-pronged strategy that Carlos and I recommended in our video, "How to Weather the Coming Financial Storms." If you haven't yet watched it, I strongly encourage you to find it at: http://lara-murphy.com.

Furthermore, I addressed several common objections to our approach. People understandably think life insurance is a "bad investment" if one worries that the economy might crash and the dollar plummet. However, in the context of IBC and our other defensive recommendations, we saw that these fears are misplaced. ◆◆◆