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COACHING & ADVISING

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Ever have this experience trying on new clothes? The "fashion consultant" raves over each new garment, saying things like:

"Ooh, I can't believe how good that looks on you!" or: ***"Wow, I can't decide which one I like better!"***

If you're like most of us, you probably appreciate the compliments and the personal attention. You also know some of the enthusiasm is because you're a potential customer. So you take the comments with a grain of salt.

But suppose a salesperson said:

"You know, that style just doesn't suit you. I think this one is a better fit." What would you think?

The Reasons Why, and the Reasons Why Not

When it comes to assessing your relationship with the professionals that provide input and products for your financial transactions, one of the things you might want to evaluate is how well these people can explain the reasons ***not*** to do something, especially the things that they most often recommend or support.

Some examples:

- A real estate professional who recommends buying an investment property probably knows all the benefits – the financial leverage of a down payment, potential for positive cash flow, market appreciation, deductible mortgage interest, etc. Since a lot of people have made a fortune in real estate, and this opportunity seems to fit the template for success, what's not to like?

  But is there ever a reason ***not*** to buy investment property? What if you don't have substantial savings set aside in an emergency fund? Is there a balance that should be kept between liquid and illiquid assets? Are there other market indicators that might caution against buying right now? Would any of those circumstances change your professional's recommendation?

- Similarly, a life insurance specialist may be very knowledgeable about whole life insurance as part of a program for individual financial protection and accumulation. Like the real estate agent who specializes in investment property, a good life insurance specialist knows all the ins and outs of working with a cash-value policy – the additional riders[1] (such as a disability waiver), the merits of loans[2] or withdrawals, amounts that can purchase paid-up additions[3], etc. And even though whole life insurance requires larger annual premiums, compared to term life, the specialist can effectively explain how the higher initial outlay delivers long-term benefits.

  But there may be another side to the story. Can this insurance professional offer a reason ***not*** to buy whole life insurance? What if there's an immediate need for more insurance protection than your budget can afford if the coverage is whole life? Why would someone buy term insurance instead?

From a consumer or client perspective, you want specialists and advisors who know

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* The title of this newsletter should in no way be construed that the strategies/information in these articles are guaranteed to be successful. The reader should discuss any financial strategies presented in this newsletter with a licensed financial professional.

both the reasons to buy, and the reasons not to. Because while common financial strategies and products have broad application and appeal, *they may not be the right fit for your unique situation.*

Ideally, competent financial professionals mention the reasons "not to" as part of their dialog with you. Either it comes in the course of "discovery" conversations about your objectives, current situation, and financial philosophies, or it is part of the education when making a recommendation. But if the professional doesn't bring up the "not to" reasons, be sure to ask. Getting an answer to the reasons "not to" is like getting a second opinion from the same doctor. It probably won't change the proposal, but it should give you an even clearer understanding as to why the proposal was made in the first place.

Two Cautionary Thoughts on the Reasons Not To

1. Beware the critic. Getting a second opinion regarding a financial strategy may have merit. But be careful about someone with a narrow perspective or an ax to grind. Some people make a living out of telling others what not to do, and provide very little substance on what *to do*.

If you've had any exposure to the concept of life insurance, you soon pick up on the philosophical conflict between those who advocate term insurance and those who espouse the values of whole life or similar cash-value policies. In their little corner of the universe, the divide can be as passionate as that between Yankee and Red Sox fans, or "dog" people vs. "cat" people, and the respective sides can be quite dogmatic (and cat-matic?) about their positions.

Historically, both policy formats have a long track record in the marketplace. Regardless what critics might say, it appears both types of life insurance have a legitimate place in individual programs. Someone with a one-sided perspective is obviously missing what many consumers find beneficial.

There may be specific reasons for you not to take on a real estate investment. But that doesn't make all real estate a bad idea. And while some may voice a strong opinion about single-family residential properties over office buildings (or vice versa), the continuing buying and selling of real estate – of all kinds – should be an indicator of its potential for wealth-building.

2. If you aren't going to act on this idea, what are you going to do instead? Isaac Newton's first law of mechanical motion is the Law of Inertia: A body in a state of rest tends to remain in such a state unless acted upon by an external force. The Law of Inertia has application to human psychology as well. Most of us tend to prefer stability and resist change.

When a financial professional challenges you with a new idea, it can be an external force that upsets your status quo. The easiest way to restore your psychological equilibrium is to find a way to dismiss the new idea or strategy. If you're looking for a reason not to do something simply because you don't want to (because you're too busy, or bored, or want to spend the money on something more "fun"), you can always find a reason - a reason to wait, a reason to revisit the issue later, a reason to push the issue aside.

But before you lock in on your reason not to go forward, entertain one more thought: If a trusted advisor gave you the reasons **not** to, but still believes your situation is one where taking action would be the most beneficial, are you sure you want to blow it off?

Go back to the department store example. As you try on several outfits, the fashion consultant steers you away from several lesser choices. But after much review, there's a moment where they say,

"Hey, that's a perfect fit for you."

Are you going to ignore that input?

Asking financial professionals for the reasons not to do something is a way to make their input even more valuable. But getting better advice and better understanding doesn't mean much if you don't act on it. The purpose of getting the reasons **not** to do something is to get a better idea of what **to do**. Don't let *not doing* be your undoing. ❖

1 Riders may incur an additional premium or cost. Rider benefits may not be available in all states.

2 Policy benefits are reduced by any outstanding loan or loan interest and/or withdrawals. Dividends, if any, are affected by policy loans and loan interest. Withdrawals above the cost basis may result in taxable ordinary income. If the policy lapses, or is surrendered, any outstanding loans considered gain in the policy may be subject to ordinary income taxes. If the policy is a Modified Endowment Contract (MEC), loans are treated like withdrawals, but as gain first, subject to ordinary income taxes. If the policy owner is under 59 ½, any taxable withdrawal may also be subject to a 10% federal tax penalty

3 Paid-up Additions (PUA) are purchases of additional insurance (death benefit) that have a cash value. These purchases are made with dividends and/or a rider that allows the policyholder to pay an additional premium over and above the base premium. This creates the growth of death benefit and cash values in a participating whole life policy. Adding large amounts of paid-up additions may create a Modified Endowment Contract (MEC).

Over their financial lifetimes, almost every government, business, and household encounters a cash crunch – expenses exceed income. There are only two solutions to this financial dilemma: growth, so that income once again exceeds expenses, or austerity, so that expenses are adjusted downward to be less than income.

If you ask economists, the majority will say that, in the long run, growth is the only legitimate solution. Cutting expenses is a finite strategy; there's a limit to the expense that can be trimmed from the budget. On the other hand, growth is potentially infinite – who knows how great revenues, profits and income might be?

It's perhaps counter-intuitive, but a prevalent method for inducing growth is to increase expenses – by borrowing. Borrowing can be a catalyst to higher levels of growth, levels that not only pay back the debt, but produce additional profit.

Particularly for nations and large businesses, borrowing is an ongoing financial activity that never ends. Debts are rolled over, new bonds are issued, credit limits go up. For these entities, there may never be a time without debt.

But what about individuals or small businesses? Just like nations and corporations, these "personal economies" may face periods of lagging growth. Maybe a firm's overtime is reduced, a job is down-sized or moved offshore, technology disrupts the market for products and services, or personal circumstances change the financial dynamics of life and work. Borrowing, perhaps to pay for additional training or capitalize a new business venture, might seem like a solution.

In theory, borrowing as a first and best response seems sound. Except personal economies don't have some of the advantages of governments and big business if growth does not meet expectations. Governments can manipulate their money supplies to effectively reduce or eliminate debt. As corporations, businesses can limit or deflect the financial consequences of failing to meet their borrowing obligations. When the company goes broke, individuals – as shareholders, executives, or workers – aren't on the hook for unpaid loans.

But personal economies don't have as many escape hatches when borrowing ends up putting them sideways. And if you spend a little time searching the personal finance blogosphere, you will find a significant segment who advocate austerity. In fact, some will argue that the downside of borrowing is so high it should be avoided at all costs. As an example, they point to student loans.

The Hazards of Borrowing While Broke

Student loans are a classic borrowing strategy for personal finance, theoretically justified by the increased earnings that will supposedly follow. The government (as an entity that borrows all the time) endorses this plan, offering subsidized loans and generous repayment terms.

A side effect of making more money available for higher education is rising costs; tuition increases have greatly exceeded inflation. As a consequence, more students have to borrow more money. A 2016 study by The Institute for College Access & Success found that in the 10 years from 2004 to 2014, the average student debt rose by 56%. Nearly 70% of students graduated with an average loan debt of $28,950.

Alas, the job market for many graduates is soft; there's not enough work, or high enough pay, to service their education obligations. A January 2017 report from the U.S. Education Department found that at least half of all student debtors had "defaulted or failed to pay down at least $1 on their debt within seven years." Unpaid loans (and the still-accumulating interest) become a drag on one's personal economy. Individuals may delay marriage, children, and buying a home because of student loan debt.

Worse than a delay in prosperity, a growing number of borrowers may never get free of this decision to borrow for growth. The Government Accountability Office published statistics showing that 156,000 Americans over the age of 50 in 2016 had reductions to Social Security disability and retirement benefits due to garnishments to repay outstanding student loans. Of that number, 38,000 were 64 or older.

A December 21, 2016, *Wall Street Journal* article provided a poignant example of a 63-year-old nursing home employee dealing with the fallout from student loans she took 20 years ago to earn an associate's degree in business administration. A better job didn't follow, but bankruptcy did. Her student loans were not dismissed, and kept accumulating interest. Along with $500 monthly payments, her income-tax refunds are garnished. If she retires, payments will be taken from her Social Security. Debt has unraveled her personal economy.

"I'm tired and I want to stop working," she said. "If I stop working, that little money they're going to give me, that goes toward student loans."

"Austerity" is Really "Robust Saving"

If you dig down into commentary that takes a hard line against debt in personal finance, you find that most of the "austerity advice," i.e., to move to a smaller home, buy a used car, stop eating out, terminate your cable service, etc., is really about adjusting the percentage of savings in relation to income – ***well before you encounter a cash crunch.*** As long as the percentage of savings to income is very high, expenses (including any borrowing costs) don't matter. It is the high level of savings which makes the difference, not austerity. Here's an excerpt from one blogger's commentary:

> If you can get by with only spending 50% of your income each month, then you only have to work half the time – or if you can get by with only spending 25% of your income, you only have to work three quarters of the time. It becomes easier to do things like take a leave of absence from your job to follow up on a dream (like writing a book). Or, in my case, it becomes easier to just walk away from a job to follow something you've dreamed about your whole life.

This version of austerity in personal finance is really a change in financial priorities. A high rate of personal saving is valued for the financial freedom it promises, both now and in the future. For those who embrace this approach, austerity. i.e., cutting expenses, becomes one way to make this transformation go faster.

But even austerity advocates have baseline expenses, which means they too require income. The challenge for many households is their baseline expenses exceed their income. When you can't go lower, borrowing may be the only solution for improving your personal economy.

The problem with borrowing is that many individuals see it as a first option when it most likely ought to be the last. Remember, the math of borrowing is that you are increasing expenses to eventually, hopefully, increase income. Those debts will usually stay on the books of your personal economy for a long time.

For many, student loans are a financial convenience, not a necessity. It might mean community college and a longer time frame, but it is possible to get a degree without borrowing. This holds true for mid-life income challenges as well: borrowing may seem like a way to adjust, improve or replace income with minimal lifestyle discomfort. The problem is debt injects additional expenses and opportunity costs into the future, to a degree that is often only understood long after the fact.

For governments and big businesses, borrowing is an essential component in their financial operations. And while borrowing

may be necessary for individuals, austerity measures that pre-emptively boost saving make borrowing a less attractive, and even unnecessary, option in personal finance. It's a radical idea, but if you implement austerity measures today when you don't need to, you won't be forced to implement them later if your personal economy experiences a down period.

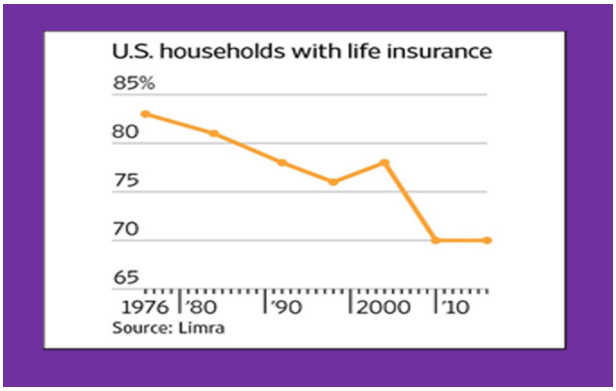
How close are you to becoming a world-class saver, someone who saves 25-50 percent of income? ❖

Imitation may be the sincerest form of flattery and often a template for those who aspire to achieve the same status. If you want to be an ultra-marathoner, you train like one. If you want to be wealthy, you consider how to emulate their behaviors and habits. You may decide to become an expert in your field, start a business, or copy their asset management strategies.

And you might want to own life insurance.

Owning life insurance does not guarantee wealthy status any more than simply starting a business does. But among the characteristics that appear to correlate with the thought processes and values of wealthier American households, life insurance ownership is prominent for its contrast, especially compared to previous generations.

A January 12, 2017, *Wall Street Journal* article, "The Latest Gamble in Life Insurance: Sell It Online," highlights a four-decade decline in life insurance ownership by American households, as well as a technology-driven attempt to reverse the trend. The graph here, provided by the Life Insurance Marketing



High net-worth individuals value the conservative, tax-favored savings and tax-free death benefits in life insurance.

and Research Association (LIMRA), shows that sales of individual life-insurance policies have declined more than 40% since the 1980s. Today, 30% of U.S. households have no life insurance at all – not even group coverage. This compares to 19% who were without life insurance in the earlier period.

Industry observers attribute the long-term slide in life insurance ownership to social and industry changes over the past 40 years, including two-income households, the proliferation of other saving/investing options, and the Internet. For almost one in three Americans, it appears life insurance is no longer a financial essential.

To address this decline, some insurers are moving the entire application process online. Instead of requiring blood samples, urine tests, and medical records, underwriters are relying on algorithms derived from answers to online applications, combined with data pulled (with the applicant's consent) from prescription-drug databases, motor-vehicle records and other sources. The goal is to deliver a quick underwriting decision – usually within one day, and sometimes as quick as 30 minutes.

Most of the policies currently offered through online channels are term insurance in amounts under $1 million, and are targeted to younger, less-affluent (at least right now) consumers. This strategy is prompted by several factors:

- The decline in individual life insurance protection is strongly correlated to a decrease in life insurance among the middle class. This is an under-served market.
- Term policies are the simplest to explain and understand in an online format, one that doesn't require the assistance of a financial professional. Life insurance can be a D-I-Y project.

Proponents of the process believe that this blend of technology and convenience "may transform the business." And it might. But a closer look at life insurance ownership suggests other factors are involved.

Different Values for the Same Product

The decline in life insurance ownership is sort of misleading, because other industry data indicate life insurance remains a viable and valuable financial instrument. In fact, many insurance companies have reported increasing and record sales in the past decade. It's more accurate to say more life insurance is in force, yet owned by fewer Americans.

This paradoxical growth and decline of life insurance ownership among American households is more likely connected to diverging financial philosophies; different segments of the population see life insurance differently.

The primary appeal of many, if not most, financial products marketed to the middle class for long-term accumulation is the potential for higher returns. This emphasis tends to obscure or ignore the conservative, multi-faceted, and integrative benefits of life insurance. In the higher-return paradigm, life insurance has a very narrow application: savers will "need" it for limited time, and only for the specific purpose of replacing income. The goal is to own as little life insurance as possible, for the shortest period, at the lowest premium.

Contrast this perspective with the reasons wealthier individuals choose to own life insurance. In a September 2014 article in the *Insurance Innovation Reporter*, Ken Hittel, a former insurance executive with more than two decades of experience in the industry, notes that life insurance "turns out to be an especially attractive product to (affluent clients), one they are eager to buy for its 1) tax free death benefits and 2) tax free "inside" (investment) "build-up." Hittel bolsters this claim with the following statistics regarding ownership of the tax-deferred inside build-up, i.e., life insurance cash values:

6.5% of life insurance cash values…are held by American households with a net worth in the bottom 50 percent of the population.

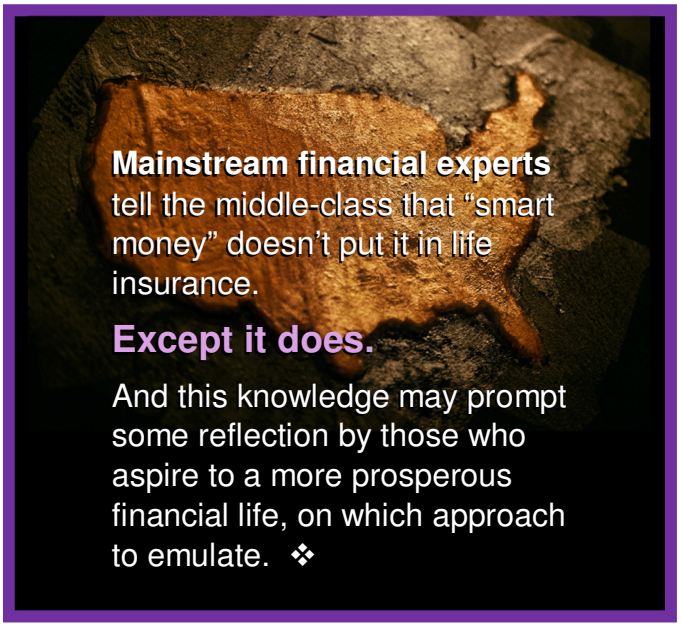
38.5% of life insurance cash values…are held by those in the 51st - 90th percentile.

55.1% of life insurance cash values…are held by the top 10 percent of net worth individuals.

(Note: Because of rounding, the total is slightly more than 100%.)

These numbers mirror other financial metrics where a high percentage of assets or income are controlled by smaller, wealthier segments of the population. They suggest high net-worth individuals value the conservative, tax-favored savings in life insurance, and the tax-free death benefits that will eventually be distributed to their beneficiaries. This perspective is a sharp contrast to the "middle-class" life insurance mantra of little, brief and cheap. And the difference prompts some additional observations:

- If life insurance is purely a "need" product, ownership statistics say the wealthy need life insurance more than the middle class. Yet by the very nature of their higher incomes and greater wealth, the top percentiles would seem to be much better equipped to withstand financial loss, with or without life insurance.
- If pursuing higher returns is a superior strategy, the wealthy – while having more money – must be financially "dumber" than their middle-class counterparts by electing to own, and intending to keep, life insurance.



Better Than Conserving Principal

Lifespan has increased substantially in the past century, causing sea changes in social and financial norms. Longer lifespans skew the demographics between workers and retirees, affect the viability of government benefits, alter the time frames for work and retirement, and present a different set of health and lifestyle challenges compared to previous eras.

But even as life expectancies keep inching up, it is also accurate to say people are not living longer.

Maximum Age: Stuck at 115

Sampling from large groups of people born at the same time, demographers record (or estimate) the ages at which each person dies. Apart from irregular catastrophic events, like a war or a pandemic, the shape of the distribution is essentially the same for all age groups: A long period of low mortality, followed by a period when the majority of the population passes, then a trickle of deaths each year until the last of the cohort is gone. (see Fig. 1)

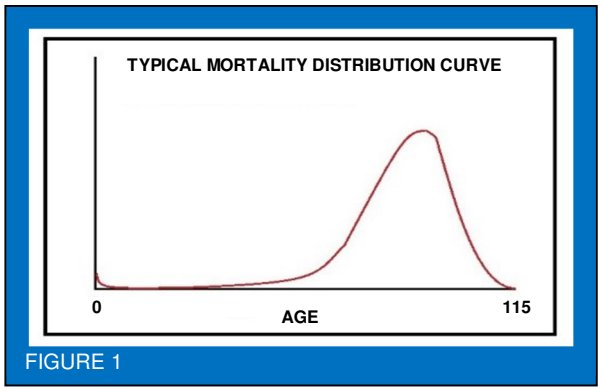


FIGURE 1

In every group born at the same time, there will be one person who is the last to die. Theoretically, this person, due to their good health and good luck, represents the "maximum age" for their group. If everyone in the group was as healthy and fortunate, they would live to maximum age. In Fig. 1, the last person in the group dies at 115.

There's an interesting thing about maximum age: Regardless of the shape of the distribution curve for a particular group, every distribution ends at 115; **maximum age hasn't changed in the past century** (and perhaps not much in the last two millennia).

> Uncertainty about life expectancy causes many retirees to revert to distribution strategies that conserve principal.

Based on verifiable records going back to the late 1800s, the oldest person from every age group has lived to about 115. Wikipedia maintains lists of "Verified Oldest People" and "Verified Oldest Living Person." Overwhelmingly, their lives ended at 114 or 115. The few individuals who lived beyond 115 are so rare as to be statistically insignificant.

Age 115 as a Planning Benchmark

Increasing life expectancies are primarily the result of medical advances; ailments that were once fatal can often be cured or managed to extend life. But thus far, these advancements have not been shown to push the maximum age for healthy people beyond 115. This is relevant to retirement planning.

Some retirement scenarios project a systematic draw-down of accumulated assets, calibrated to an estimated life expectancy. The goal is maximum distributions, while ensuring there will be enough to last a lifetime, however long that may be.

Knowing that life expectancies are inching upward, and that future medical breakthroughs might bring additional jumps in lifespan, selecting a distribution plan at 60 or 65 for the rest of your life can be a daunting task. A draw-down plan projected to last to age 95 might seem overly conservative – unless you end up living past 100 because of some yet-to-be discovered procedure or medication.

Surveys show this uncertainty about life expectancy causes many retirees to revert to distribution strategies that conserve principal. This approach ensures money will be available no matter how long they live, but also dramatically reduces income. Conserving principal is a distribution plan for eternity, one that is extremely inefficient if retirees don't live forever. And they don't.

For at least the past 150 years, 115 is a hard ceiling for life expectancy. For retirees, this means a draw-down plan that lasts to 115 is arguably just as safe as conserving principal for ensuring retirement income will last as long as you do. The only difference: the distributions are higher. And this certainty holds true whether retirement starts at 60 and might last 55 years, or at 80, and you die the next day. A projection that ends at 115 is safe at all ages and every health condition.

Once you have a draw-down calculation based on living to 115, use the same lump-sum accumulation in a quote for an annuity that promises a guaranteed lifetime income. If nothing else, the comparison will help you quantify the benefits of using an insurance company to spread your longevity risk, as opposed to taking responsibility for the same guarantees using just your assets and personal money management acumen. ❖

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