Creative
wealth maximization strategies*

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Resolving Tribal Conflict in Retirement Planning

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From a consumer's perspective, it might appear that the only distinction among the many institutions that offer retirement planning services is their marketing slogans. But the carefully crafted phrases and slick brochures may obscure significant differences in retirement philosophies and processes. And the adherents of a particular view of retirement can be almost tribal; they are emotionally and professionally invested in their belief systems, and wary (even dismissive) of tribes with other views. In other words, they're sort of like the college football fans, where each game becomes a morality play between the forces of good (us) and evil (them).

Moshe Milevksy, a Canadian professor of Finance, and author of several books on retirement, identifies two dominant "tribes" in the retirement planning marketplace. He names one the Insurance Clan, the other the Investment Tribe. Here are thumbnail summaries of the beliefs and recommended strategies for each tribe.

The Insurance Clan

True to its name, Milevsky says the Insurance Clan sees financial security as the primary focus of their retirement philosophy: "They are well versed in the language of personal risk and…truly understand at a visceral level the importance of protecting a family against unexpected financial shocks." While acknowledging the mathematical aspects of personal finance, the insurance clan emphasizes the physical and psychological ramifications of one's financial decisions. As Van Mueller, a Wisconsin financial professional with more than 40 years of experience, puts it in a February 2016 commentary in *Retirement Advisor*, "Insurance and financial professionals do not make people rich. Our primary responsibility is to keep them from becoming poor."

One of the things the insurance tribe understands at a visceral level is the fear of running out of money. "(T)he insurance tribe is well aware of the benefits that life annuities can provide," says Milevksy. "They understand the value of risk pooling and diversification" to ensure financial security for a lifetime, no matter how long that may be.

The Investment Tribe

In contrast, Milevsky observes that most members of the investment tribe don't have a background focused on risk management. Instead, "They grew up imbibing the waters of capital markets, stocks, bonds, and security selection. (T)his second group tends to be more cerebral and intellectual," believing that every financial challenge can best be addressed through the pursuit of optimized returns based on statistical analysis. Where the insurance clan touts guarantees and security, the investment tribe makes performance its value-add.

It's why an investment management company's full-page ad in the March 21, 2016, *Wall Street Journal* boasts its offerings have "outperformed 95% of their peer indexes over a 20-year period." The implication: smart investing can be more rewarding than risk management.

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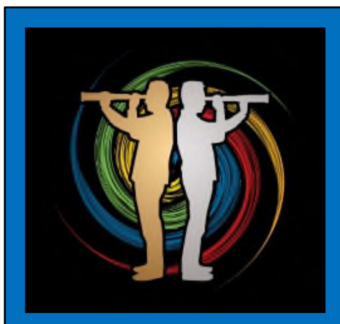

So, who's your tribe?

Thus, "When it comes time to deliver a retirement income, the investment tribe tends to shun insurance solutions in general, and annuities in particular, and takes a rather different approach to generating income in retirement. They have embraced something called the 4% rule, which is another way of saying: 'I can bake a better annuity at home.'" The 4% rule is the simplest version of a spend-down strategy which attempts to ensure, even though there are no contractual guarantees, that you will not outlive your money. In keeping with their analytical heritage, investment tribe retirement practitioners have developed ever-more-sophisticated variations of the 4% rule.

From these brief descriptions, it's reasonable to conclude each tribe has a plausible model for retirement. The insurance clan is correct to recognize that retirement is not simply a game in which the outcome is determined by mathematical formulas; your financial decisions affect your physical and emotional well-being. And while the certainty of guarantees may be hard to quantify numerically, they provide real value.

Yet decisions based solely on emotional responses to money (like the fear of losing some of it) can result in missed opportunities. Historical data from the investment tribe shows superior results can be possible with long-term commitments to dispassionate, data-driven strategies. For individuals to match these historic returns, they must temper the angst of short-term fluctuations and uncertainties.

So, who's your tribe?

If you attend the Iron Bowl, the annual Alabama-Auburn football game, it's sort of hard to be a neutral spectator; in the midst of two passionately devoted fan bases, there's a lot of pressure to choose a side. It's often the same when prospective retirees meet with representatives from the insurance or investment tribe. They want you to embrace their version of retirement planning. This is especially true among what Milevsky calls the "ultra-orthodox" members of each tribe, like the insurance agent who believes all financial issues (including retirement), can be addressed with a whole life insurance policy, or the investment rep that considers low-cost index funds the only "pure" financial instruments.

Do you have to choose a tribe?

If you and a financial professional don't ascribe to the same views of retirement planning, it is going to be hard to have a good working relationship. But your tribal choice isn't necessarily binary, insurance or investment. In fact, the best decision might be an approach that blends both tribes. Because, more than some members of the Insurance Clan and Investment Tribe might want to admit, the two tribes sort of complement each other.

A base of guaranteed retirement benefits can make it easier – financially and psychologically – to persist with long-term investment strategies for the rest of your assets. And the opportunity for higher returns makes it palatable to allocate a percentage of assets to safer but often lower-yielding insurance products.

Even though the ultra-orthodox members of each tribe tend to get the most attention because of their passionate commitment to their ideals, most financial professionals who identify themselves with one tribe have respect for the other. For them – and for you – it's not either/or, but both. The practical application is deciding on the right mix of insurance and investment for your unique circumstances.

So when someone like Van Mueller asks, "If you had a choice, would you want to be rich or would you want an absolute and positive guarantee you will never be poor?"

Your answer can be "yes." There may be two tribes in retirement planning, but choosing one doesn't mean having nothing to do with the other. This is your retirement, not the Iron Bowl. ❖

Cars, Weddings, and Other $30,000 Projects

A "financial project" is an item whose cost is large enough that advance planning is required to pay for it. The baseline for what qualifies as a financial project is subjective. But if you have to save, borrow, liquidate assets, or in some other way plan to pay for it, that's a financial project.

For most Americans, their biggest financial project, both in duration and dollars, is funding their retirement. But prior to retirement, many Americans will also encounter other smaller, shorter term financial projects that also need funding. And the choices they make to address these smaller projects can significantly impact the outcome of their biggest one.

Consider two common "mid-size" financial projects: the purchase of a new car and paying for a wedding. Each has a price tag of around $30,000, and a range of funding options.

A New Car

According to an April 1, 2016, Kelley Blue Book update, the average price of a new car in March 2016 was $33,666. (The average purchase price of pickups is around $45,000, representing the greatest percentage of new-car sales.) And cars wear out; they aren't one-time financial projects. Studies indicate most American households will own between 6 and 8 cars in their lifetime.

How do most new car buyers pay for their transaction? In April 2015, Experian Automotive reported that approximately 15% of new car buyers paid cash. The rest opted to borrow, for increasingly longer periods. The above-mentioned Kelley press release found an increase in 72- and 84-month loans, with the average for all loans at 67 months.

A Wedding

The *Wedding Report's* annual survey found the average wedding in 2015 cost $26,601, not including the cost of the honeymoon. Wedding costs varied by geographic regions of the US, with the highest averages in the Northeast ($32,952) and West ($29,425), and the lowest in the Midwest ($24,614). When calculating averages, ultra-high-cost weddings can skew the numbers, but the Wedding Report found 16 % of all weddings were in excess of $30,000.

As a one-day event, weddings don't have monthly financing options comparable to automobiles. Besides the higher-interest options of credit cards or unsecured personal loans, the merits of using home equity versus retirement savings are the options that generate a lot of discussion. A 2014 TIAA-CREF report found that 15% of 401(k) loans were used for weddings and vacations.

The Impact of a $30,000 Project on Retirement

When money is diverted from your retirement (either as lump sum or reduced contributions) to pay for some other financial project, the cost isn't just $30,000. There are lost opportunity costs in the liquidation of long-term assets; what's spent today is not only gone, but so are the future earnings. There's also a diversion of future savings to debt service, which for many households means a decrease in monthly saving. (Example: If previous savings allocations were $500/mo., the new allocation is $350 to saving, $150 to loan repayments. The TIAA-CREF survey said more than half of 401(k) borrowers decrease their ***future*** retirement contributions to repay their loans.) If a 401(k) is the source of borrowed funds, repayments are made with after-tax dollars – *which will be taxed again when you take withdrawals at retirement*.

If you're 50 when your daughter gets married, and you pay the $30,000 tab by liquidating an investment, there's likely 20 years of retirement opportunity cost attached to that decision. Compounded at a hypothetical 5% for 20 years, that's almost $80,000; at 8%, the number is $140,000.

The financial consequences of purchasing a new car are harder to calculate. Transportation expenses are part of a household's cost of living, whether buying or leasing, and so are the ancillary expenses of insurance and maintenance. So you really can't say that a monthly car payment is money that isn't going to retirement. But you can consider the long-term impact of financing. A $30,000 auto loan at 5% interest amortized over 6 years (72 payments), results in a monthly payment of $483, which includes $4,776 in interest. At 5%, the opportunity cost on the interest is $5,854 after six years. If you financed the car at 35, by age 70 the calculated opportunity cost on the interest from that one loan is $24,000. Opportunity costs for successive loans will be less because the time to retirement is shorter, but even with conservative opportunity cost assumptions, the cumulative effect of six to eight auto loans over a lifetime could easily exceed $100,000.

Throw in another $30,000 project during your working lifetime (like a small home improvement), and it's plausible that three mid-size projects have the potential to reduce your retirement accumulation by $300,000. That's no small number.

Obviously, the preferred approach to these mid-size financial projects is to save for them. For some, this means their saving focus has to expand beyond retirement (the big project). While some financial commentary has a "don't sweat the small stuff" approach – i.e., "just maximize allocations to your biggest financial project, and all of the others will somehow work out" – other projects, like cars and weddings, are not only likely, but costly. When the only project people intentionally save for is retirement, other intermediate projects will inevitably disrupt the big one.

Along with saving strategies and financial products, many financial professionals have programs to help assess the "true costs" of your mid-size financial products. When reviewing the status of your bigger financial projects, it might be worthwhile to include a cost analysis of your mid-size ones as well.

DO YOUR SAVINGS PLANS INCLUDE MID-SIZE FINANCIAL PROJECTS? ❖

Sidebar: An outside-the-box look on cars and weddings

Here's a sure-fire way to reduce or eliminate cars and weddings as financial projects: Don't pay for them. Or at the very least, don't pay $30,000 for them. Not to downplay their value, but some cutting-edge perspectives on both cars and weddings could be reasons to re-think their price-value equation.

You Should Rent an Autonomous Car

In the near future, new technologies may radically change the financial model for personal transportation. In 2013, the National Highway Traffic Safety Administration (NHTSA) defined five different levels of autonomous driving. Level 4 is "fully autonomous," which means vehicles can "perform all safety-critical driving functions and monitor roadway conditions for an entire trip." Some auto manufacturers believe they will have Level 4 vehicles available to the public by 2018.

In the December 2015 issue of *The Future of Everything*, Dan Neil opines that within a generation, self-driving cars "will not so much change the game as burn down the casino" when it comes to car ownership. Here's why:

"Autonomy will make it possible for unmanned automobiles to be summoned, via app, to your location...for as little or as long

as you need. When you're done – poof! – it will go away. You don't pay for the car. You pay for the miles. And only the miles."

Why would this eliminate car ownership? Because owning a car is financially inefficient. The utilization rate for automobiles in the U.S. is about 5% – for the other 95% of the time (23 hours), our cars sit dormant in a driveway, garage, or parking lot. Sharing autonomous vehicles will raise utilization and dramatically lower costs. "Twenty-five years from now," Neil says, "the only people still owning cars will be hobbyists, hot-rodders and flat-earth dissenters. Everyone else will be happy to share."

You Should Spend Less, and Add Guests

For weddings, it appears less is more, at least in terms of long-term happiness for the bride and groom. In a 2014 study, "'A Diamond is Forever' and Other Fairy Tales," two Emory University professors provided statistical evidence suggesting expensive weddings may actually be a detriment to marital bliss. Andrew Francis-Tan and Hugo Mialon found that "marriage duration is inversely associated with spending on the engagement ring and wedding ceremony," and that there is "little evidence to support the validity of the wedding industry's message connecting expensive weddings with positive marital outcomes."

Three of the factoids supporting these conclusions are sort of mind-bending:

- Spending ***$1,000 or less*** on the wedding is significantly associated with a decrease in the hazard of divorce.
- Women whose weddings had cost more than $20,000 (in 2014 dollars) ended up getting divorced ***60% more often*** than those whose weddings were cheaper.
- The types of weddings associated with lower likelihood of divorce are those that are relatively inexpensive but high in attendance.

Interesting ideas, right? But even if you end up just paying for miles, and don't have a big wedding, there are going to be other financial projects in your life.

Now or in the future, saving should be for more than just retirement. ❖

Inheritance Equalization Strategies for Business Owners

A unique challenge and/or opportunity for small business owners is what happens when one or more of their children are brought into the business. The combination of family dynamics and day-to-day business can be explosive, both positively and negatively, and long-lasting.

One of the more sensitive aspects of involving children in a business is the terms of inheritance when the business owner passes, especially if the children's participation in the business has been unequal. For example, if one child has become the company CEO, while the others have pursued careers in other fields, how should the business' value be distributed?

Most owners/parents say, "I love my kids equally, so I want to share my assets equally," writes Steve Parrish, a regular *Forbes* contributor, in a January 16, 2013, blog post. But a simple division of the business ignores both the past contributions made by children who have been part of the business, and the incentives they may have to either sell or continue operating it. As Parrish writes, the estate plan should result in "not only an equal transfer, but an *equitable* transfer."

For many small business owners, the task of equalizing inheritance is complicated because the types of assets that comprise the business are illiquid. Land, buildings, and equipment may represent much of the business' value, but forced, piecemeal sales will probably mean a discounted inheritance. Further, even a partial sale (one of three trucks, or a third of the farm's acreage) to satisfy non-involved heirs may result in unemployment for the child who's stayed in the business and helped build its value.

Although these issues can apply to a wide range of small businesses, family farms are particularly susceptible to these inheritance dilemmas. The May 2014 issue of *Progressive Cattleman* provides an example of the challenge of equalizing inheritance, along with some possible solutions.

Dividing the Ranch

John and Mary, both 65, own a central Montana ranch valued at $8 million, along with cash assets of $200,000. They have three adult children, Steve, Mark and Sue. Steve, who has lived and worked on the ranch for his entire life, earns a modest $30,000 salary. Mark and Sue have established careers off the farm, and have no interest in returning, even in a management capacity.

John and Mary want Steve to have the ranch, but also want to provide a "fair" inheritance to Mark and Sue. They decide a fair inheritance would be giving half the farm to Steve (reflecting his long-term involvement) while dividing the remaining $4 million between Mark and Sue. But with only $200,000 in liquid assets, how can this be accomplished? John and Mary have three plausible options.

Option 1: Accumulate liquid assets. With a life expectancy of 20 years (to 85), John and Mary could save and invest approximately $110,000 for 20 years at 6% to produce approximately $4 million to leave to Mark and Sue. As the *Progressive Cattleman* says tersely: "Option 1 won't work."

Option 2: Borrow. John and Mary inquire about the cost of a $4 million loan, initiated at their death, and to be repaid by Steve. At 6% for 20 years, the monthly payments are $26,398, for a total cost of $6.3 million. That's an unequal burden on Steve's inheritance; he pays interest while his siblings get a lump sum.

Option 3: Use life insurance. John and Mary obtain a survivorship life insurance policy. When John and Mary have both passed, the insurance benefit will be paid. This scenario provides an immediate inheritance payment to Mark and Sue,

without further encumbering Steve for inheriting the ranch. This solution is not only more effective than saving, but also ensures the estate plan will be workable regardless of when John and Mary die.

How Could This Work for You?

The type of life insurance used for equalizing inheritance will vary depending on the age(s) and circumstances of the owner(s), and the format of the estate plan. The insurance benefit is the funding mechanism, while the legal arrangement determines the method of inheritance distribution. Common arrangements include a policy owned by:

- an irrevocable life insurance trust (ILIT)
- the children
- the business owner

Similar inheritance equalization strategies using life insurance can be applied to any situation where it is deemed desirable for one heir to inherit a unique asset (like a home, or a work of art), yet still treat all heirs equally in terms of total value received. ❖

> Estate plans involving life insurance and specific distribution instructions require a coordination between several financial and legal professionals. If you have a business or other assets that you wish to share unequally but equitably, advance planning is a must.

Why You Want Others to Become World-Class Savers

The Federal Reserve's *Report on the Economic Well-Being of U.S. Households in 2015*, released May 2016, included a summary comment that garnered quite a bit of media attention:

> **47 percent of adults say they either could not cover an emergency expense costing $400, or would cover it by selling something or borrowing money.**

This is a sobering statistic. It says almost half of American households are living financially precarious lives, where a small misfortune can push them to the brink.

Perhaps even more startling: ***almost one in five households earning incomes greater than $100,000 said they would not be able to cover a $400 emergency expense***, meaning it's not just "poor people" who are broke.

In a May 2016 *Atlantic* article titled "The Secret Shame of Middle-Class Americans," Neil Gabler, a screenwriter, author, and visiting professor, admits to being one of those high earners who would have trouble finding $400 to pay for an emergency:

> "(Y)ou certainly wouldn't know it to talk to me, because the last thing I would ever do—until now—is admit to financial insecurity or, as I think of it, 'financial impotence,' because it has many of the characteristics of sexual impotence, not least of which is the desperate need to mask it and pretend everything is going swimmingly. In truth, it may be more embarrassing than sexual impotence."

In an April 23, 2016, NPR interview, Gabler added: "I am in a situation that tens of millions of Americans share. I'm not poor. We're talking about middle-class Americans, even upper-middle-class Americans, who live paycheck to paycheck."

And…why does this matter to me?

If you are reading this newsletter, there's a good chance your saving habits and accumulation achievements exceed those of the average American. You may not have as much money as you'd like, but you can comfortably handle a $400 emergency. ***So why care about a statistic that doesn't apply to you?***

Here's why: You are in a daily financial competition with other households for scarce goods and services. And how well you do is in part connected to how well others are doing. This awareness spurs two seemingly paradoxical urges: to stifle competition or encourage it. To illustrate:

If more people can afford 50-inch flat-screen televisions, the demand for a limited number of TVs will either raise prices or result in shortages. In this instance, there seems to be a case for thinking you are better off if your neighbor can't afford a TV. Better you have money and he doesn't, right?

This is a zero-sum view of economics that in order for one person to take a step up, another must take a step down. In a zero-sum world, it is in your best interests to allow, *even encourage*, others to make poor financial decisions, because less for them means more for you. Except…

If more people can afford 50-inch flat-screen TVs, new manufacturers have an incentive to enter the TV market. The competition among manufacturers often results in better products and lower prices – for everyone. And in fact, this is what has happened: adjusted for inflation, large flat-screen TVs are cheaper today than five years ago.

In this classic free-market example, increased competition benefits everyone. Your neighbors' success is ultimately beneficial to you. In this view, you want more people to be able to afford a home like yours because the increased demand will increase your property values, and the chance you'll be able to sell at a later date. You want more people to operate profitable businesses because it means more job opportunities and potential customers in your community.

(Continued...)

The belief that your neighbor's success is beneficial to you is one of the reasons economists and policymakers want to diminish the income inequality gap in the United States. When the economy's prosperity is concentrated in too few hands, even the wealthy experience negative social and financial consequences.

Unfortunately, most of income inequality "solutions" from the government are legislative, a mix of tax incentives and penalties to "nudge" people toward better choices or redistribute income. And the financial impotence that Gabler talks about can't be solved by law. These are households with incomes, cars, homes, debt. They have resources, but they are mismanaged. They need education and guidance, primarily in the area of cash flow management. And since they haven't been able to do it on their own, they probably need individualized attention and professional assistance.

"There's a fundamental flaw with lots of financial advice: it assumes you have money." – Eric Ravenscraft

There is perhaps the idea that consulting with a financial professional is something you do after you've established a positive cash flow and can start saving. But if you ask most insurance agents, registered representatives, investment advisors, even accountants, they will tell you one of their primary functions is helping their clients "find the money," i.e., to come up with ways to rearrange or restructure a budget to make saving possible. Cash flow management is an essential service that underlies the other products and advice these professionals provide.

Getting back to the question of minimizing competition or encouraging it: There may be zero-sum scenarios, such as real estate (recall the classic line "they're not making any more land"), where your having something means someone else doesn't. But improving the cash flow management of others is not a zero-sum economic event for you. When more households become world-class savers, the positive effects ripple through the economy. ❖

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