

CREATIVE

Wealth Maximization Strategies

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WILL ROBOTS MAKE THE 401(k) A DINOSAUR?

It happened so fast, some people still don't recognize the shift that has taken place, but a technological trend four decades in the making has ushered in a new economic paradigm, seemingly overnight. And as a result, many financial ideas that were once seen as cutting-edge solutions may become economic dinosaurs, ill-prepared to survive the changing times.

Moore's Law = More work for machines, less for people

Marshall Brain, the founder of the "edutainment" company *How It Works*, recently posted a commentary on his website titled "Robotic Nation." In the article, he detailed the events of a recent Saturday morning with his kids:

- I got money in the morning from the ATM.
- I bought gas from an automated pump.
- I bought groceries at (a warehouse club) using an extremely well-designed self-service check out line.
- I bought some stuff for the house at (a do-it-yourself home maintenance store), using their not-as-well-designed-as-(the warehouse's) self-service check-out line.
- I bought my food at McDonald's at the kiosk.

**(The kiosk "as described above" allowed Brain and his children to place their order remotely from the McDonald's playspace.)*

In 1965, Intel co-founder Gordon Moore noted that the number of transistors that could be placed inexpensively on an integrated circuit had doubled approximately every two years since the invention of the first integrated circuit in 1958. Moore postulated that this pace would continue, for at least the next 10 years. This statement, which became known as **Moore's Law**, proved true, and not just through 1975, but for another 35 years. And while no one believes computing capacity will double forever, the latest projections are that Moore's Law will continue well into the next decade.

Moore's Law explains how digital technologies and devices have moved from science fiction fantasies to everyday necessities in every part of the world. It doesn't matter if it's agriculture, manufacturing, the retail and service industries, or various professional fields. The technologies that have come about as a result of Moore's Law – fax machines, personal computers, digital cameras, cell phones, bar scanners, GPS systems – have redefined employment in every sector of the economy.

In theory, these new technologies benefit the consumer. They are faster, easy-to-use, and lower the cost of doing business, which usually translates to lower prices. But Brain, a technology advocate, also sees a downside: **"The problem is that these systems will also eliminate jobs in massive numbers. In fact, we are about to see a seismic shift in the American workforce. As a nation, we have no way to understand or handle the**

In This Issue...

WILL ROBOTS MAKE THE 401(k) A DINOSAUR?

Page 1

CHECKING (and fixing) YOUR UNIVERSAL LIFE POLICIES... Before It's Too Late

Page 3

GURUS, NEWSLETTERS & "FINANCIAL ENLIGHTENMENT"

Page 4

PREPARING FOR YOUR "BASE INCOME YEAR"

Page 5

WHAT DOES IT MEAN WHEN 90% OF THE SMART PEOPLE ARE WRONG?

Page 6

level of unemployment that we will see in our economy over the next several decades.”

Mr. Brain’s observations have been echoed in a number of commentaries describing a “Jobless Recovery” from the recent recession. In a January 17, 2012, *Wall Street Journal* article, W. Brian Arthur, an economist at Xerox Corp.’s Palo Alto Research Center, says businesses are “increasingly using computers and software in the place of people in the nation’s vast service sector. Many companies, for instance, use automation to process orders or send bills.”

“It’s not just machines replacing people, though there’s some of that,” Mr. Arthur says. “It’s much more the digitization of the whole economy.”

The article goes on to note that the United States is second only to Japan in the use of industrial robots, and that “orders for new robots were up 41% through September from a year earlier, according to the Robotics Industries Association trade group.”

What Happens Next?

If the history of technology holds true, increased productivity from technology eventually creates new jobs and raises living standards, and those whose jobs are replaced by automation will move on to other fields. The current challenge is that the technological rate of change is occurring so much faster than the creation of new job opportunities, with the obvious consequence of higher unemployment. Another ripple effect is under-employment – many people with jobs aren’t working full-time.

Charles Murray is the author of *Coming Apart*, a study of how income and employment has dramatically changed in America in the past 50 years. A key finding is a significant increase in what Murray calls “prime-age adults” (males ages 30-49) who work fewer than 40 hours a week. For men with only a high-school education (Murray’s “working class”), his research found that fully 20% of those working were not employed full-time.

Other studies focusing on this age 30-49 group show similar trends in income and employment instability. A January 2012 study from the Insured Retirement Institute (IRI) titled “Retirement Readiness of Generation X” reported that almost one in four of those surveyed had stopped contributing to retirement accounts, while another 15% had made early withdrawals. Most cited fallout from the recent recession, i.e., job loss, reduced wages, etc., as the reason for disrupted savings.

If the trend toward automation continues, particularly in large companies, where will these displaced employees find work? One likely answer is self-employment. In a paper presented to the Federal Reserve Bank of Atlanta in November 2011, New Mexico State University economics professor Anil Rupasingha found “self-employment has surged in the last decade and will continue.” Citing Bureau of Labor Statistics data that showed 31% of the labor force was self-employed in 2011 – and was projected to represent 40% of the work force in 2019 – Rupasingha concluded “For some, self-employment may be their best hope.”

Unemployment, Under-employment, Self-employment... “and the 401(k) fits where?”

The first 401(k) plans were established by congressional legislation in the 1980s to encourage workers to defer earnings for retirement. Deferred wages deposited into the plan, along with subsequent earnings, remained non-taxable until the time of distribution, which was ideally intended to occur after age 59 ½, and not later than age 70. The employer administered the plan, provided investment options, and often encouraged participation through the addition of matching deposits. Under certain circumstances, 401(k) account holders could also access funds prior to retirement, either as loans or pre-retirement distributions.

In a static employment situation, where steady paychecks and long-term employment are the norms, the 401(k) seems like a sound concept. Even today, generic financial advice from mainstream media still usually includes the phrase “max out your 401(k) contributions.” **But the viability of a 401(k) hinges on ongoing employment and a steady income.** Given the changing dynamics of employment, making 401(k) contributions a financial priority may be committing to an approach that is no longer well-suited for the current economic climate.

Suppose your household encounters a period of under-employment; overtime is eliminated, bonuses are cut, or a spouse loses a job. To bridge what is anticipated to be a temporary situation, many workers end up tapping their 401(k)s. Distributions from 401(k) accounts, either as loans or early distributions, may be limited by plan regulations and/or incur tax consequences, including penalties. Thus, when 401(k) funds are used as cash reserves, the cost of access could be significantly higher than the tax advantages that were given on the deposits – and the situation is exacerbated if the 401(k) participant terminates employment with an outstanding loan. In short, a 401(k) is not well-suited for use during periods of under- or unemployment.

Similar qualified retirement accounts for the self-employed and smaller businesses (such as IRAs or SEPs) face the same challenges regarding early distributions, albeit with slightly different regulations. But other factors work against using qualified retirement plans for the self-employed. Income from self-employment is often irregular, both during the year, and from year-to-year, which can make regular deposits problematic. Early on, cash flow may not even allow for deposits. If the business grows over time, a profitable self-employed individual may find deposits restricted by annual contribution limits – “Now that I’m making a lot of money, I can’t find a place to defer it for retirement!”



The viability of a 401(k) hinges on ongoing employment and a steady income.

Better Accumulation Plans for an Irregular Employment Future

Every year, Congress, in conjunction with economic policymakers, contemplates adjustments to existing qualified retirement plan regulations. But most of these changes are tweaks; they don’t change the fundamental structure of retirement accounts. Rather than trying to continue working within the confines of a model that may not be suited for

irregular employment, individuals might be better off considering alternatives. If so, what features should be part of an “Irregular Employment Accumulation Account”? (Some marketing guru needs to come up with a better name; an “IEA Account” just isn’t catchy.) Here is a partial list:

Flexible deposits and withdrawals. Liberal contribution regulations would provide the option of adding excess deposits in good years, or forgoing deposits in lean periods.

Tax advantages. If you aren’t using the money, it would be beneficial to eliminate or minimize carrying costs (such as the taxes on interest and capital gains).

Safety. Given the possibility that some funds may be required to replace income in the near future (such as between employment), these accounts should include conservative investment vehicles, preferably ones with guarantees.

Accessibility. Loan restrictions, surrender charges, and tax penalties in many financial products are practical deterrents to discourage the liquidation of long-term accumulation vehicles. But if the need or opportunity arises, access options should be possible with a minimum of restrictions.

Personal ownership and portability. Regardless of employment, and particularly in periods of unemployment, this account should be under individual control, and capable of fitting into future employment scenarios.

Adaptability and long-term value. A standard feature of personal planning for the past three decades has been to compartmentalize financial objectives and find a specific product for them, i.e., a separate account for cash reserves, retirement, college education, medical expenses, etc. Considering the ups-and-downs of irregular employment, a “multi-tool” accumulation account that can serve several purposes over one’s lifetime would be attractive.

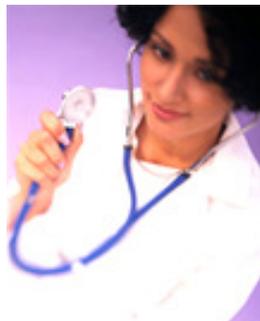
Does such a financial vehicle exist? The best answer is “yes and no.” Profitable self-employed individuals have been working with these ideas for awhile now. A competent financial professional can probably help you construct a financial program with many of these features, although they may not be combined in one product. And if the current trend in irregular employment continues, you can be sure the marketplace will develop new products. Is there a congressionally-authorized IEA account? Not yet.

Consider your current employment circumstances and your future prospects. How has technology changed your work in the past decade? Are more automation and fewer people a possibility? More to the point...

HAS THE 401(k) BECOME A DINOSAUR IN YOUR FINANCIAL WORLD? IS IT TIME TO CONSIDER ALTERNATIVES?

CHECKING (and fixing) YOUR UNIVERSAL LIFE POLICIES... Before It's Too Late

“The future ain’t what it
used to be.” – Yogi Berra



(This article is a bit on the technical side, but understanding the concepts could be important.)

Universal life (UL) is a type of permanent life insurance policy introduced in the early 1980s. Some of the features of UL were quite innovative, but because of the economic climate in which UL was introduced, the true long-term impact of these UL innovations is only now becoming understood. Since many long-term owners of UL policies are just now coming to grips with these issues, it is important to understand the concepts and factors that impact UL contracts, and how to address them.

First, a short (but necessary) explanation of the financial concepts that affect UL:

The Difference between Projections and Guarantees

In a traditional permanent insurance policy, such as Whole Life, both the annual premium and death benefit are fixed and guaranteed for one’s “whole life,” typically to age 100. As premiums are paid, a portion of the payment is designated as “cash value,” which is considered the owner’s equity in the insurance benefit. If the insured does not die before age 100, the policy “matures” and the insured receives what would have been the death benefit as a cash payment. (Every policy contains a schedule which defines the terms of these guarantees.)

Because life insurance companies have a contractual commitment to deliver an insurance benefit at any time, the determination of premiums and guarantees is based on extremely conservative risk assessments. Insurance companies overestimate how many policyholders will die, and overestimate how much it will cost to operate the company; they underestimate the rate of return they will achieve on the reserves they have accumulated to pay claims. If claims and operating costs are lower than anticipated and/or investment returns are higher, these savings are returned to policyholders in the form of dividends*. Often, these dividends are added to cash values, and may also be used to increase the insurance benefit.

Since most insurance companies regularly surpass their conservative estimates, dividends can cause both cash values and life insurance benefits to dramatically increase beyond the guarantees specified in the contract over time. Thus, when illustrating their policies to potential buyers, insurance companies are permitted to present illustrations featuring both *guarantees* and *projections based on dividends*. While the planning rate in the illustration is not an exact determination of future performance, showing projections is a reasonable practice since most long-established insurance companies have paid dividends every year for over a century. In short, a good permanent life insurance policy is designed to exceed its guarantees, and will almost always do so.

*Dividends are not guaranteed and are declared annually by the company’s board if directors.

UL Tilts Toward Projections, Away from Guarantees

In several ways, UL policies capitalize on the spread between guaranteed and projected performance. Instead of establishing fixed premiums and guarantees, UL contracts

allow the policyholder flexibility in premium payments, based on the current performance of the insurance company. Within certain parameters, policyholders can make premium payments as large or small as they want, as often as they want, provided there is always enough cash value to cover the current cost of insurance and keep the policy in force. If there is ever an occasion where there is not enough premium and/or cash value to cover the cost of insurance, the policy is terminated.

Using the same format of illustrating both guaranteed and projected performance, a prospective UL policy owner can select a premium schedule that may not be guaranteed to age 100, but is *projected* to last until age 100. This decision, **to base the structure of the policy on projected performance instead of guaranteed performance**, results in lower premiums and cash values, but still offers the possibility of an insurance benefit being in force for one's entire life. The idea of paying less for a permanent insurance benefit has been (and is) a major UL selling point with some consumers.

Depending on the insured's age when a UL policy is purchased, the spread between the guarantee and projection can be significant. For example, a 40-year-old could select a premium schedule which guarantees the policy's benefits to age 70, while the projection shows coverage lasting to age 100. This leaves a lot of room for variation between the projections and actual performance. If any of the factors that figure into actual performance are below projections, the policy will either expire before age 100, or require additional premium to compensate for the under-performance.

Among the factors that affect policy performance, the rate of return on invested reserves is the hardest to predict and control. In the 1980s, interest rates were quite high, relative to today. Many UL policy illustrations used high interest rates, producing optimistic projections that haven't come close to reflecting actual performance. As a result, many long-time policyholders now find themselves in a dilemma: they must increase their premiums or forfeit their insurance. In some cases, the premium required to maintain the coverage at advanced ages is prohibitive. This is especially troublesome for individuals who intended the insurance benefit from a UL policy to facilitate estate plans, because the plan requires an insurance benefit to be paid at death.

UL Warning Signs and Remedies

If you own a UL policy, and want to assess its status, one of the steps you can take is to receive an updated projection of values and guarantees. Most UL policies can deliver the same guarantees as whole life policies if the premium is increased, and you'll want to know the numbers.

As you scan the illustration, see if there is a point where cash values begin to plateau or decline. This is an indication that the cost of insurance will begin out-pacing projected premiums and interest crediting rate, and the policy is moving toward termination. This decline in cash values may be quite gradual at first, but the shorter the time period to the plateau, the sooner you may need to consider corrective measures.

Many long-time policyholders now find themselves in a dilemma: they must increase their premiums or forfeit their insurance.

Even if the plateau is further out on the projection, it is particularly important for older policyholders to address adjustments as soon as possible. The cost of insurance climbs at an accelerated pace beginning around 60, and at later ages, adjustments may no longer be economically feasible.

Besides adding premium, UL policyholders may have the option of reducing the insurance benefit to enhance guarantees. While this option may not be ideal, it at least preserves some benefit for the premiums that have been paid, whereas a lapsed UL contract isn't any different than an expired term life insurance policy – a lot of premiums out-of-pocket, but no financial benefit if you are still living.

Some UL policy owners may not have intended to keep the insurance for their entire life. But owning a life insurance benefit is a valuable asset, and the appreciation of what life insurance can provide often increases with age. It is prudent to determine if there are ways to preserve your insurability and integrate it into your existing financial programs.

IF YOU (OR YOUR PARENTS) HAVE A UL POLICY, WHY NOT REVIEW IT TODAY?

THE DIFFERENCE BETWEEN A PROJECTION AND A GUARANTEE COULD BE HUGE!

GURUS, NEWSLETTERS & "FINANCIAL ENLIGHTENMENT"

Because everyone uses money, we all think we know something about it, and it's easy to have an opinion. We can tell our friends why it was smart to buy this house, how we figured out it was better to lease that car, and maybe offer a "special formula" for 401(k) allocations. But get a little beyond the specifics of our personal finances, and most of us are far from being experts, and we know it. So when someone else comes along and tells us they can make money "simple," and make us profitable, the attraction is strong. As long as there has been money, there have been gurus who offer "financial enlightenment" for the masses.

Today's financial gurus have TV shows, newsletters, DVDs and do-it-yourself money makeovers. They are smart enough to get your respect, entertaining enough to keep your attention, and down-to-earth enough to make you say, "hey, he/she is one of us! I can relate to this guy/gal!" Usually there's a hint of outsider to them, implying that they know the "inside scoop" and want to educate us so we can beat the big boys at their own game.

But while a guru might make personal finance simple and entertaining, their "objective advice" is sometimes a thinly-disguised reach for your wallet. Besides educational materials for sale, many gurus have business affiliations with select brokers and agents. Not surprisingly, the guru's "recommendations" often include investments with some of these same brokers and agents. Are these coincidences or conflicts of interest?

Every situation has to be evaluated on its own merits, but because of the nature of the financial guru business, skepticism is prudent. Consider the opening statement from Jason Zweig's January 21, 2012, "Intelligent Investor" column in the *Wall Street Journal*:

What business has an estimated one million clients, operates on the fringe of securities law and can say just anything without immediate consequence?

It is the investing-newsletter industry. And the public should approach newsletters with caution, even when they come with a celebrity endorsement.

It's all true. Except for "typos," and imaginary rankings.

Zweig goes on to delineate a tangled and somewhat sketchy relationship between a well-known money guru and the manager of a small mutual fund. In March 2011, the guru (who appears regularly on the cable TV business channels, has written several books, makes national speaking tours, and is described as a "personal-finance expert" by the *Journal*) and the fund manager launched a monthly newsletter featuring specific investment recommendations, typically adjusted for different age groups (20 years to retirement, 15 years to retirement, etc.). To jump-start this venture, the guru gave away 50,000 one-year subscriptions. On several occasions, the newsletter has recommended investing in the manager's funds.

The rationale for encouraging investors to use the fund manager is a supposedly stellar track record. **Except the outstanding results may have been inaccurately presented.** In a 10-year comparison of the manager's performance against the S & P 500 index, the *Journal* found that the newsletter understated the actual performance of the S & P in nine of ten years! In some instances, this meant the fund manager's underperformance compared to the S & P was *erroneously reported as beating the index*. When the *Journal* reporters confronted the manager about the anomalies, he responded, "I'm not perfect. We don't claim to be." A week later, the newsletter told readers the mistake was a "typographical error."

The fund manager has been associated with other newsletters in the past, and claims one of his publications had been "ranked #1 by Hulbert Financial Digest for five years through 2006," and that another was "ranked #1 and recommended by Hulbert Financial Digest!" When the *Journal* attempted to verify this claim, Hulbert, a publication that tracks investor newsletter performance, said it "doesn't make recommendations." Furthermore, the editor said that "No matter how I slice and dice the data, I cannot support the claim of being No. 1 for that five-year period." When confronted with this rebuttal, the fund manager insisted he was No. 1, adding "I'll say that to my grave."

When presented the same information, the money guru e-mailed her continued support: "(The fund manager) is ethical, honest and achieves stellar results that consistently outperform the market. I'm proud to be able to provide our newsletter to people who are looking for solid financial advice."

These types of interwoven business relationships create potential conflicts of interest and challenge the objectivity of the information presented in a newsletter. A newsletter's "solid financial advice" may be heavily influenced by the profit motives of the guru and other associated parties.

But this is a newsletter, too...

Yeah, it is. However, there are several important distinctions between what you read here and something that comes from the money gurus.

- First, unlike newsletters distributed by non-credentialed "experts" **the content of this publication is regulated.** Because the providers are licensed brokers and insurance professionals, every article is reviewed by a compliance department and edited for accuracy and proper attribution.
- Because every personal finance situation is unique, there **are no specific recommendations.** The articles may be thought-provoking, opinionated (and hopefully worth reading), but any recommendations will be the result of your meeting with the financial professional and crafting a strategy or solution that matches your personal circumstances.
- Following in the same vein, **products or companies are not mentioned by name.** This publication is not a marketing vehicle for an insurance company or an investment firm.

Listening to a money guru may give you a fundamental understanding of many financial issues. But when it comes to completing a transaction or executing a particular financial strategy, it should be obvious that personal communication and expert assistance offer substantial advantages for individuals who want to improve their financial performance and realize their long-term goals. Financial professionals may earn commissions or charge fees, but the compensation arrangement is usually transparent.

PREPARING FOR YOUR "BASE INCOME YEAR"

For parents who anticipate their child/children will attend college, part of the process will usually include compiling personal financial documentation to apply for grants, loans and scholarships. While much merit-based financial assistance exists to help students pay for college, the greater percentage of aid is needs-based; in general, those with lower incomes and fewer eligible assets will receive more funds.

However, there are several determining factors in the financial aid application process which can be preemptively adjusted to improve your household's financial eligibility. For example, home equity, retirement accounts and life insurance cash values are not counted as family assets when calculating eligibility. This means some households may benefit from repositioning existing funds by making extra principal payments on a mortgage, increasing contributions to retirement accounts, or adding to cash values. Another big

planning opportunity is preparing for your household's base income year.

Beginning on January 1 of a student's junior year in high school, this base income year is the one that counts most in determining a family's eligibility for aid. Since income and assets acquired during this year set a baseline for subsequent years, there is strong incentive (from a financial aid standpoint) to depress income. This can be accomplished through several avenues, including:

- Postponing retirement distributions to the next year
- Avoiding the sale of any assets (such as real estate, stocks or bonds) that would trigger capital gains
- Incurring as many deductible expenses as possible (applicable primarily to self-employed or business owners)
- Pre-paying property taxes
- Properly titling accounts (20% of the balance in an account with the student's name is considered available for college expenses, while only 5.64% is considered from parents' accounts)

A bit of prudent asset re-positioning might pay dividends in increased financial aid.

IF COLLEGE IS IN THE FUTURE FOR YOUR CHILD, YOUR FINANCIAL PROFESSIONALS SHOULD KNOW ABOUT YOUR PLANS.

HAVE YOU PREPPED FOR YOUR BASE INCOME YEAR?

WHAT DOES IT MEAN WHEN...

90% OF THE SMART PEOPLE ARE WRONG?

The following information was compiled by Michael A. Higley for his January 9, 2012, issue of *By the Numbers*:

In the December 20, 2010, issue of Barron's, 10 Wall Street equity strategists forecasted where the S&P 500 would finish 2011. **9 of the 10 prognosticators** predicted the S&P 500 would end the year at 1,325 or higher (note that the index ended 2010 at 1,258). Douglas Cliggott (Credit Suisse) was the lone dissenter from the majority belief, forecasting a 1,250 year-end value for the S&P 500. The stock index finished 2011 at 1,258. The S&P 500 is an unmanaged index of 500 widely held stocks that is generally considered representative of the US stock market.

So what does it mean when 90% of the smart people are wrong? It just means that predicting the future is impossible, even for smart people. And Mr. Cliggott, the one analyst who was "right," probably just got lucky. As Peter Drucker (another smart person) put it:

"Trying to predict the future is like driving down a country road at night with no headlights on and looking out the back window."

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