CREATIVE Wealth Maximization Strategies

Certified Financial Services, LLC
600 Parsippany Road Suite 200
Parsippany, NJ 07054

Richard Aronwald
Financial Specialist

MARCH 2012

"The best way to predict the future is to create it yourself."
from *Abundance*, by Peter Diamandis and Steven Kotler

ANTICIPATING ABUNDANCE IN A CHANGING WORLD

Maybe it's the current political climate, including the national election process, which seems to emphasize how politicians have supposedly ruined the economy and oppressed all but the one percent. Or maybe it's the tendency of the news media to highlight stories about unemployment, foreclosures, European national economies on the brink, armed conflict and terrorism in the Middle East, and the nuclear threat from a destabilized Korea. If you pay attention to the headlines, you can't help but think the general trend is downward, and that the economic and social prospects for the future are decidedly bleak. In this context, the discussion isn't if the glass if half-full or half-empty; it's whether there's even a glass.

But all this pessimism may be obscuring a greater reality: Especially in the past 50 years, things have been ***getting better – for everyone*** – at a rapidly-increasing pace. Furthermore, considering the trajectory of past progress, as well as certain factors already in place, it is very likely that the next 10-20 years will be even better.

This is the message of *Abundance*, a new book by Peter Diamandis and Steven Kotler, who argue that "humanity is now entering a period of radical transformation in which technology has the potential to significantly raise the basic standards of living for every man, woman, and child on the planet." Diamandis, a self-described "serial entrepreneur" who is the chairman/CEO of the X PRIZE foundation, and Kotler, a prominent science writer, believe that the coming together of several technological and social factors has put humankind on the cusp of unprecedented peace, prosperity and well-being.

While Diamandis and Kotler may seem to be viewing the future through rose-colored glasses, their long view both of past history and future possibilities merits serious consideration. Writing a commentary for the *Huffington Post*, Diamandis makes the following observations:

We are richer than ever: Poverty has declined more in the past 50 years than in the previous 500. During that time, as the population of the Earth has doubled, the average per capita income (adjusted for inflation) has tripled.

We are healthier than ever: In the past century, the number of mothers dying in childbirth has decreased by 90 percent, infant mortality has dropped by 99 percent, and life expectancy has more than doubled.

We are safer than ever: Violence has been in decline since the Middle Ages; the homicide rates today are a hundred-fold less compared to their peak 500 years ago.

And it's not just the basic conditions of life that have improved. Diamandis declares:

In This Issue…

…even the poorest Americans today (those below the poverty line) have access to phones, toilets, running water, air conditioning and even a car. Go back 150 years and the wealthiest robber barons couldn't have hoped for such wealth.

He adds…

(R)ight now, a Masai warrior on a mobile phone has better mobile communications than the president did 25 years ago; and if they're on Google, they have access to more information than the president did just 15 years ago. We are effectively living in a world of communication and information abundance.

Citing several recent technological advances, Diamandis states that this communication and information abundance makes it possible for "small teams of dedicated individuals to take on the kinds of challenges that were once the sole province of governments." This means "Today, the average citizen is more empowered to change the world than ever before."

Are these guys nuts?

It would be easy to dismiss Diamandis and Kotler's sunny perspectives as either detached from reality, or at the very least, conveniently ignoring the troublesome and tragic challenges of life. In fact, some people get quite aggravated by the authors' optimism. As one respondent put it in the comments section of a blog touting the book, *Abundance* is just…

There will be bumps along the way. But history shows that the future, much like the present, is going to be a whole lot better than you think.

More utopian garbage. All that information doesn't amount to #@2!& when the world's financial system is collapsing into a black hole and we'll soon be forced to hunt animals to survive. Things are not getting better, they are getting worse.

Diamandis doesn't gloss over the challenges to peace, progress and prosperity. In an FAQ section of his website (diamandis.com/abundance), he says "We are not so naïve as to think that there won't be bumps along the way. Some of those will be big bumps: economic meltdowns; natural disasters; terrorist attacks. During these times, the concept of abundance will seem far-off, even nonsensical, but a quick look at history shows that progress continues through the good times and bad." This confidence in the pattern of history is why "I can say that the future, much like the present, is going to be a whole lot better than you think."

If "Abundance" is a correct long-term view, why don't most people see it?

Diamandis says "Human beings are designed to be local optimists and global pessimists." We are optimistic about handling many of the things that make up our everyday lives, because we believe we have some measure of control – we can affect the outcomes, we can make adjustments. On the other hand, when the issues get larger, and more beyond our control, we tend toward pessimism.

This local-global contrast is often quite true in our financial thinking. When most of the financial input we receive is about falling housing values, rising gasoline prices, and overwhelming national debt, it's easy to become pessimistic. Faced with so many depressing factors, it is not surprising that some people believe "…we'll soon be forced to hunt animals to survive." In fact, there is a segment of the financial universe that seeks to profit from the gloom-and-doom by selling "financial survival" strategies.

Diamandis is arguing that technology is making it possible for many global problems to be seen as having local or small-scale solutions. Here is a modest example from the financial world:

As many large lending institutions have been forced to tighten their lending practices, some prospective borrowers have lamented their resulting lack of access to credit. These individuals and businesses find they cannot secure a loan for transportation, to start a business, or buy a piece of real estate. At the same time, many of these same institutions are offering minimal returns on savings account deposits. For both borrowers and savers, this seems like a global problem; there's nothing an individual can do to overcome this situation.

Yet with a quick Internet search using the phrase "micro loans" or "micro loan investing," it becomes apparent that technology is making it possible for small groups of individuals to associate for the purpose of providing funds for lending, or for obtaining loans. These arrangements are still in their infancy, and must be evaluated carefully because the terms – for both lenders and borrowers – are not the same as loans from large institutions. **But looking long-term**, it is possible to see that these peer-to-peer lending connections have the potential to radically reshape the process of saving and lending, giving individuals financial options which they can influence and control at a local, personal level. Who knows what other financial products and services can become "localized" by technology?

Does a static plan make sense in a rapidly-changing world?

Suppose you are willing to acknowledge that the future might be even better than we can imagine today. How might this optimistic perspective influence your financial decisions? Here are some thoughts:

First, **prepare for change.** "Progress is accelerating," according to Diamandis and Kotler. "We're poised to make greater gains in the next two decades than we have in the previous 200 years." If this prediction is even close to accurate, it is almost impossible to imagine how this will impact work and career. But for many, it will mean changing jobs, learning new skills, maybe relocating.

In this paradigm of change, some long-term financial vehicles and strategies may need to be re-evaluated. For example, depending on your personal situation, how wise is it to continue making maximum contributions to a qualified retirement plan? Does it make sense to continue extra principal payments on a mortgage for a home you may have to sell in the next five years because of a relocation? In general, is it prudent to commit to long-term financial formats when the next two decades could bring radical change? A better approach might be to select products and strategies that fit your immediate priorities, yet have the **flexibility** to adjust to changing circumstances.

Second, **control your benefits.** Since benefits became prevalent as a tax-favored workplace perk in lieu of additional compensation during World War II, the tax code has favored acquiring insurance (life, disability and medical) through employer-sponsored plans. Because they were subsidized (by employer contributions and tax breaks), these benefits were usually less expensive than similar coverage purchased individually.

This arrangement was fine when long-term employment with one employer was the norm. But in a workplace that is moving toward more independent contractors, project work, and self-employment, relying on employer-sponsored group benefits can become problematic; not all benefits will be portable, new employment may require waiting periods, new coverage may not be comparable to old, etc. A far better arrangement would be to "own" your benefits, to have personally owned life insurance, disability income replacement insurance, and if affordable, your own health insurance.

Third, **maintain liquidity.** Technological and societal changes have always presented great financial opportunities. Some of those opportunities will be available only to those who have money to invest in them.

Conversely, technological and societal change can also mean financial displacement. Old industries and professions will be supplanted by new ones. If you are part of a fading occupation, the transition to a new career can result in severe financial stress if there aren't extra funds available to bridge the change.

Finally, **clean up bad debt.** Looking at future possibilities can be tough when you are still paying for past financial decisions. Good debt helps you acquire appreciating assets and income streams (such as rental property or a business). Bad debt is usually unsecured, and, in the end, only adds an additional financial burden to your personal economy.

A better approach: select strategies to fit your immediate priorities, yet have the flexibility to adjust to changing circumstances.

You may not agree with the main premise of *Abundance*. But even if the authors' views of the future turn out to be off the mark, there is something worthwhile in their positive approach. On his website, Diamandis has a list of 30 maxims that he calls The Creed of the Persistent and Passionate Mind. Number 22 says:

"If you think it is impossible, then it is…for you."

Regardless of circumstances, who has the better chance for success, people who prepare and work toward a positive outcome, or those who are resigned to whatever fate and chance brings them?

In many ways, the basic financial ideas presented above are "local" decisions; they are things you can control. Because they are things you can do, you should be optimistic about the results that will follow. But if the paradigm of *Abundance* is correct, optimistic local financial actions could be the first step toward bigger financial opportunities, maybe even ones with a global reach. As Diamandis says in Statement #2 of his creed:

"When given a choice, take both!"

Preparation today – from a positive perspective – offers a much better chance to "take both!" in the future.

- **ARE YOUR FINANCIAL STRATEGIES OPTIMISTIC?**
- **ARE THEY GEARED TOWARD AN ABUNDANT FUTURE?**
- **ARE YOU LOOKING FOR WAYS TO CHANGE YOUR FINANCIAL PERSPECTIVE?**

One of the critical factors in obtaining life insurance is the health of the proposed insured. One's current physical condition and past health history play a significant role in determining the cost of life insurance. In some instances, a poor health report may result in the insurance company declining to offer coverage, as the company's underwriters deem the applicant a risk not worth taking.

Underwriting issues concerning the health of an applicant can result in a tragic irony: By the time someone recognizes the value of life insurance, his/her poor health may preclude them from getting it. For this reason, many financial experts recommend obtaining some form of life insurance (as term, whole life, or a blend of the two) simply to secure insurability for the future.

In the life insurance industry, certain conditions or incidents in one's medical history have historically been considered by actuaries as "death markers," i.e., these were preexisting conditions that typically made applicants uninsurable. Some of the more prominent death markers have been issues relating to heart disease, several forms of cancer, or some psychological afflictions, such as severe depression or schizophrenia.

However, as modern medical treatments for these conditions have evolved, the growing track record of success is changing the underwriting paradigm. As Charles Passy reports in a February 12, 2012, *Wall Street Journal Sunday* article:

> **Ever so quietly, insurance industry number crunchers are tossing aside the old statistical models and life tables.**
>
> **They're recasting tired stereotypes about the 'fatal' diseases of yesteryear. They're rethinking that most ancient of questions: How long will we live? And they're coming up with what many would say is a radical answer: much longer than we think.**

Passy leads off the article with the example of a 78-year-old woman applying for life insurance, with the following health history: She is a breast cancer survivor, and on medication for a bipolar disorder. Her father died of a heart attack in his 60s. In the past this applicant's combination of advanced age, cancer, family history of heart disease and the bipolar condition would have resulted in a highly-rated policy (one with a premium much higher than standard guidelines) or an outright decline. Instead, it took the underwriting team at the insurance company a "mere 30 minutes" to review the file and issue a policy.

Many of the metrics in personal financial planning have changed.

Why? According to one of the company's assistant vice-presidents, the woman's bout with cancer happened in her late 50s, and after two decades, current evidence shows there is a slim chance of a recurrence. As for the family history of heart disease, "The woman has already outlived the danger marker." In fact, the company estimated the woman's life expectancy to be 92½!

These underwriting adjustments, while just beginning to move through the industry, are significant. Passy noted that "As recently as 1995, for instance, a man with advanced coronary disease was uninsurable. Now it's expected that an arterial blockage can be repaired relatively simply and new plaque buildups can often be controlled with medication." In several companies where underwriting guidelines have changed, Passy reports the results "have been immediate – with hundreds of formerly uninsurable applicants now getting coverage (or better classes of coverage) each year."

The Flip Side to Disappearing Death Markers

The phasing out of old death markers is without question a positive development for both individuals and life insurance companies. But the advances in medical treatments are also effecting changes in other areas where finances and longevity are connected.

Brian Anderson, the Editor-in-Chief of *Life Insurance Selling* magazine, wrote a February 20, 2012, commentary online at www.lifehealthpro.com regarding Passy's *WSJ* article. While applauding the adjustment in underwriting practices, Anderson also remarked:

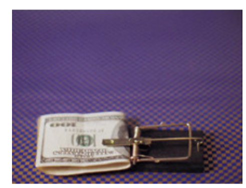
> **On the flip side, many people are now living much longer than they would have before advances in modern medicine, but they are not necessarily saving the additional money that will allow them to live out these extended years in the lifestyle to which they are accustomed.**

The essence of Anderson's comments is that many of the metrics in personal financial planning have changed. Longer life expectancy and better health care not only affect life insurance decisions, but these factors also change the variables in retirement accumulation, long-term care decisions, and estate planning.

The Census Bureau reports that 7,671 Americans turned 65 years old on average each day during calendar year 2011. That's almost 2.8 million people who will probably be living longer – and healthier – than their ancestors. And surprisingly, a lot of those people may still be eligible for life insurance.

IF YOU (OR SOMEONE YOU KNOW) HAS EITHER BEEN DECLINED LIFE INSURANCE COVERAGE, OR BEEN CHARGED A HIGHER PREMIUM, NOW MIGHT BE A GOOD TIME TO RE-EVALUATE INSURABILITY.

A PROPOSED TAX CHANGE TO INHERITED IRAs IS DROPPED, BUT IS IT A SIGN OF THINGS TO COME?



One of the unknowns that lurks in the shadows of many qualified retirement plans (such as IRAs, TSAs, and 401(k)s) is future taxation. Deposits that have received tax deductions and earnings that have accumulated on a tax-deferred basis will become taxable at distribution. But what will the tax cost be in the future? It's hard to say, not only because it is difficult to project how much money will be withdrawn in retirement, but also because it is almost impossible to predict how taxes might change in the future.

Especially in tough economic times, there is a strong tendency for governments to discover untapped sources of "revenue." Since undistributed retirement accounts represent a large pool of unrealized tax revenue, legislators frequently contemplate ways to "improve" government access to these funds.

In February, Montana Senator Max Baucus, the chairman of the Senate Finance Committee, floated a proposal as part of a highway funding bill that inherited IRA accounts should be required to make a full distribution within five years after the death of the IRA owner.

Currently, heirs who inherit undistributed balances from IRAs have the option of spreading the distributions over their projected life expectancies, using Internal Revenue Service tables. For younger recipients, this approach, known as a "stretch IRA," typically results in modest payments (and modest taxation) over potentially long time frames. For individuals who have accumulated significant amounts in IRAs, this option maximizes the amount that can be passed to heirs in the event the owner doesn't live long enough to liquidate the account according to the IRS's Required Minimum Distribution guidelines.

Forcing heirs to make full distributions in five years will not only result in larger distributions, but these larger amounts will most likely incur higher marginal rates of taxation. This is precisely the intent of the proposal, according to Baucus, because he contends that IRAs "are being used by some taxpayers to give tax-free benefits to second, third, maybe even fourth generations."

Baucus' proposal met with immediate criticism, and not only because of the upheaval such a change would cause in estate planning. Besides the potentially increased tax costs, some financial experts also noted that assets distributed from an IRA are no longer sheltered from creditors in bankruptcy. After some public discussion, *Bloomberg News* reported on February 13, 2012, that Baucus removed the provision from the proposed legislation, although he added "perhaps this provision and the subject can be taken up in tax reform" at a later date.

One of the features of all qualified retirement plans is that the terms of the plan are subject to legislative adjustment. Since IRAs came into existence four decades ago, these provisions have frequently been tweaked: Contribution limits have changed, catch-up provisions have been added, loan arrangements have been restricted, excess distribution penalties have been abated, types of investments have been allowed and prohibited, etc.

For the moment, the stretch IRA concept is still alive as legacy planning strategy. But as Ed Slott, an IRA adviser from Rockville Centre, New York, told the *Wall Street Journal* in a February 12, 2012, article, "Congress sees gold in these IRAs, and they're looking to corral some of that money."

While some of these plan changes for IRAs may have been advantageous for individuals, there is little that can be done to anticipate future changes. And just the possibility of change may make some long-term planning strategies dicey propositions. For example, if an individual already has significant assets, does it make sense to continue funding qualified retirement plans considering the possibility of unfavorable tax treatment that may be incurred by heirs?

One of the features of a well-designed retirement distribution plan is a thoughtful consideration of which assets should be spent, and which should be preserved for heirs. While the stretch IRA concept remains a viable strategy under current tax law, the greater concern for many individuals is not current regulations, but what the terms of taxation will be in the future.

IF YOU HAVE QUALIFIED RETIREMENT PLAN ASSETS IN YOUR ESTATE, YOU MIGHT PROFIT FROM A REVIEW OF YOUR DISTRIBUTION AND INHERITANCE STRATEGIES

ESTATE PLANNING #101: PREPARING A WILL

A will is written statement made by an individual that directs the distribution of his/her property at death. A legal will is a fundamental financial document that is relevant for almost every adult, and for most people it is relatively easy to complete. Yet a December 2009 survey by Harris Interactive found that only 35% of adult Americans have a will.

The primary reason given for not executing a will by the survey respondents was the tyranny of the urgent – immediate financial concerns were a higher priority than taking the time to address an unpleasant event that is hopefully far into the future. Others commented on their uncertainty about the legal language, and the perceived expense of obtaining a lawyer to prepare the document.

If an individual does not have a will in place at death, he/she are considered to have died "intestate," or without an estate plan. If this occurs, the state government will administer the distribution of assets and settlement with creditors according to its own regulations and judgment. For individuals who have little or no assets, no spouse, no children or family connections, dying intestate and letting the state settle one's affairs may be inconsequential. But once assets and family become significant, the few hours of thoughtful planning and organization required to produce a legal, signed document can go a long way toward ensuring the appropriate distribution to the people that matter most.

While there is a great deal of flexibility as to what can be specified in a will, much of the language used in all wills is quite standardized. There are certain provisions that need to be part of the document for it to be a valid and legal will. The following is a list of necessary will provisions:

Exordium (Beginning) Clause. This is the basic identifying statement clause at the beginning of each will, which typically reads something like, "I, John Doe, being of sound mind and body,.." Besides usually giving your current address, this beginning statement also explicitly revokes all previously written wills and codicils (amendments).

Survival Clauses. This section provides instructions for secondary beneficiaries in the event one of your named beneficiaries dies before you. If you don't specify secondary beneficiaries, then whatever would have been distributed to the beneficiary will be distributed to the beneficiary's heirs.

Simultaneous Death Clause. This section is important when you and one of your beneficiaries (typically a spouse or child) die at the same time, such as in a car accident. When this happens, the standard language usually stipulates the beneficiary died first. The wording of this clause may be particularly important in the context of determining if and how federal estate taxes will be applied to the remaining assets.

Tangible Personal Property. Tangible personal property is distinct from financial assets. These are personal items such as clothing, keepsakes, firearms, etc., that you want to leave to someone specifically.

Executor Appointment. The executor is the person you appoint to supervise the distribution of your property according to the provisions in the will. The executor is subject to court approval, depending on whether anyone objects to your choice. It is prudent to select a contingent executor in case your first choice is not able to serve.

Powers of the Executor. In most wills, the executor is authorized with a default list of powers needed to carry out the provisions of your will. However, in creating your will, you may define fewer or more extensive powers. These stipulations can be particularly important in the probating of larger estates. Additionally, some executive powers need to be specifically mentioned in the will, such as the authority to continue operating a business or to sell your real estate if necessary. If one of the provisions of the will is to create a trust, it is also necessary to establish the powers of the trustees.

Guardian Appointment. If you have minor children (under 18), you'll want to appoint a guardian to oversee the care of your children until they reach adulthood. As with other designees, it is prudent to consider alternate guardians, in case your first choices cannot carry out this responsibility.

Bond. In most states, executors, administrators, trustees and guardians must give a bond when appointed. The bond is a promise to reimburse the estate for any losses created as a result of negligence or wrongdoing on the part of the estate representatives. It is also possible to waive the requirement for a bond to be posted.

Tax Apportionment Clause. This provision specifies how inheritance and estate taxes will be paid from the remainder of the estate after your property and money are distributed to named beneficiaries. This is an important clause that should be carefully reviewed, because without it, beneficiaries will likely pay a share of taxes based on the amount they receive from your estate.

Handwritten wills, handwritten amendments.

While about half of the 50 states currently accept a handwritten will (called a "holographic will"), it is usually considered valid only if all material provisions and clauses are entirely handwritten. However, because most handwritten wills are not as in-depth as a professionally drafted will and because they are oftentimes not properly written, holographic wills are not recommended. Given the non-standard nature of handwritten documents, courts can be unusually strict in determining whether a holographic will is authentic, and thus it is also not recommended that people *revise* their wills by hand.

Probate

Probate is the legal procedure for validating a will. Once determined to be valid, the property owned by the person who died is distributed to the heirs according to the provisions of the will. At one time, the probate process was extremely slow and occasionally susceptible to fraud and thievery by unscrupulous lawyers and judges. While the process can still be lengthy and costly in some situations, many states have streamlined the probate process and reduced the costs, thus repairing the reputation of the process and removing some of the fear. However, as estate assets and family connections get more complex, it may be desirable to move beyond a simple will, and consider the use of other legal arrangements (such as a trust) to facilitate the transfer of assets at death. But creating a will remains the starting point for personal estate planning.

DO YOU HAVE A VALID WILL?

ARE SPECIAL ASSETS PROPERLY DESIGNATED TO BENEFICIARIES?

DOES THE WILL REFLECT YOUR CURRENT CIRCUMSTANCES, OR IS IT TIME FOR AN UPDATE?

CREATIVE
Wealth Maximization Strategies

Certified Financial Services, LLC
Richard Aronwald
Financial Specialist
raronwald@cfsllc.com

600 Parsippany Road Suite 200
Parsippany, NJ 07054
973 263-0622
Richardaronwald.com