CREATIVE Wealth Maximization Strategies

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The Perfect is the enemy of the Good.
– Voltaire.

Settling for Fixity

Q. When it comes to your finances, should you be willing to settle for anything less than the very best?

A. Maybe. Especially if pursuing the “very best” delays or disrupts steady progress.

The recently released book *On Settling* by social theorist Robert Goodin presents an idea that seems counter-intuitive to contemporary culture: sometimes the best approach to success and fulfillment comes from “settling.” Here’s an explanatory paragraph from the book jacket:

> ***On Settling* defends the positive value of settling, explaining why this disdained practice is not only more realistic but more useful than an excessive ideal of striving. In fact, the book makes the case that we'd all be lost without settling--and that even to strive, one must first settle.**

Once you read that brief description, it’s easy to think of instances where “excessive” pursuit of the best could be a hindrance to success.

– It’s the man or woman who winds up never marrying because they insist on holding out for Mr. or Ms. “Perfect” – when there were plenty of Mr. and Ms. “Rights” to choose from.

– It’s the designer who never completes a project because he is constantly re-evaluating the plans.

– It’s the relative who can’t get along with family members because an issue is “non-negotiable – now and forever!”

Goodin is careful to say that settling does not require compromising core principles or resigning oneself to accepting a bad situation. Instead, he defines settling as a way to achieve “good enough” results. In this format, settling keeps us from needlessly devoting too much time and attention in areas where the difference between “best” and “good enough” may be minimal, and where the extra time and energy required to achieve the best in one area means neglecting other equally important parts of life.

In addition, Goodin asserts that a higher degree of settling in a person’s life actually makes them better equipped to pursue excellence in areas that matter most. People with settled personal relationships can devote more time and energy to careers. People with both settled careers *and* personal relationships are free to concentrate their efforts toward achieving long-term financial and lifestyle aspirations.

Goodin defines this good form of settling as one that produces “**fixity**” in our lives. “People plan their lives on the assumption that the things they take to be settled in their own lives will remain fixed for some suitably protracted period.” Settling issues results in

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parameters defined, and provides a structure that allows people to plan – and succeed.

Economic Applications for Settling

The concept of settling has many applications in economic affairs, both large and small, because when things are unsettled, the uncertainty almost always means less-than-optimal choices and results. The current up-in-the-air status of several national economic issues – such as the "fiscal cliff" of looming tax changes, the legal challenges to the national healthcare provisions, the solvency of Social Security and Medicare, and the resolution of the federal debt – have ripple effects for businesses and consumers. Because these issues aren't settled, businesses are hesitant to expand and hire. Individuals, unsettled about their employment, are hesitant to spend.

Although the ultimate configuration of each of these external issues will have a great impact on everyone's financial life, the argument can be made that ***any*** resolution will be helpful – regardless of the details – simply because settling the issue will produce enough fixity for individuals and businesses to begin longer-term planning. If taxes are going to be higher, if health insurance is going to be costlier, if Social Security is going to establish a later age for full benefits, at least the certainty of it allows people to arrange their financial affairs accordingly.

The reality is, a commitment to steady (and perhaps slower) growth usually delivers better results.

Besides the benefits from settling macro financial issues like the ones mentioned above, there also appears to be a benefit for people who can stay settled in their personal financial actions. Research from Dalbar, a firm that studies individual investor behavior, has produced numerous reports that stock market investors who "chase returns," constantly re-allocating their portfolios to whatever segment of the market seems to be hot, end up with consistently *lower* performance. While hindsight might indicate that better results could be obtained from market timing, the reality is a commitment to steady (and perhaps slower) growth usually delivers better results.

Fixity in Personal Finance

Using Goodin's paradigm of settling some issues to provide the fixity necessary for good planning, it's worth considering which items in our financial lives should have a high degree of fixity. And putting this question into historical context, it's also quite possible to assert that financial fixity may be in the midst of a significant change.

Ever since the end of World War II and the beginning of the Baby Boom, the bedrock item of financial fixity for most Americans has been **a steady income from employment**. An individual's access to credit – to buy a car, obtain a mortgage, use credit for personal purchases – has been connected to employment: *"Do you have the income to afford the payments?"* Through company pensions and Social Security, the employment factor has been critical: *"How many years have you worked? What is your five-year average annual income?"* Through payroll deductions, an employee could buy insurance, invest in the stock market, or save for holidays. Scheduled automatic payments made sure the bills were paid. Responsible adults could start retirement planning and college funding with their first paycheck, because every program was tied to the assumption of an ongoing (and usually increasing) income.

But what if you can no longer count on a steady and increasing income as being a point of fixity in your financial life?

In the past decade, many Americans have faced precisely this dilemma. They have seen their household income decrease through layoffs, lower wages, fewer hours worked. As a consequence, they have depleted their retirement savings, walked away from mortgages, filed for bankruptcy, delayed retirement. Because they no longer have fixity in their income, the rest of their finances have become unsettled.

The immediate response to this unsettled condition is predictable: Re-establishing a steady income. This approach is the basis for politicians promising to "create jobs," colleges encouraging workers to go back to school, and unions bargaining for guaranteed employment for their constituents. In a financial model where almost everything hinges on a steady income, creating more jobs and/or keeping them makes sense. However, this emphasis on a steady income may overlook a larger financial reality.

The Fixity of Liquidity

The strongest point of financial fixity has always been liquid financial accumulation – or "savings." As long as there has been money, those who have a sizable amount on hand have had the financial fixity to survive and thrive, regardless of whatever else might be unsettled.

Prior to the Industrial Age, very few people had a regular income. If they worked for someone else, their employment was often seasonal or intermittent. If they were farmers, their income was realized only at harvest. The irregularity of income gave purchasing, saving, or retiring a much different format.

One's ability to make financial progress was highly dependent on liquid financial resources, either real money or easily exchanged property (horses, land, machines, etc.). In general, less money passed through people's hands, but when they had it, they tended to save much more of it. Down payments as a percentage of purchase were higher, and periodic payments, if they existed, were typically annual instead of monthly or weekly.

And, even during the Industrial Age, liquidity as the central point of fixity in one's financial life has been a valid approach. It may not have been necessary, but there were advantages. Those with high liquidity tended to have lower transaction costs (they paid cash for their vehicles) and were able to act on financial opportunities (they bought distressed assets, capitalized businesses). While individuals operating from a high liquidity position may not have maximized their

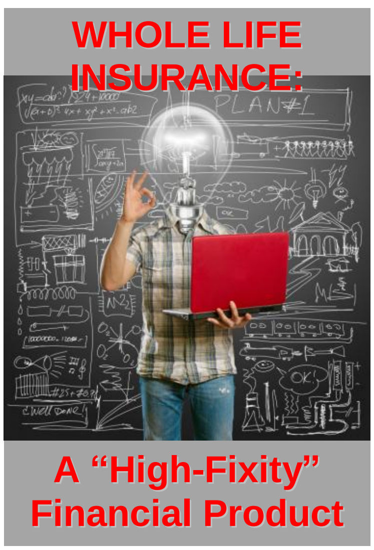
401(k) contributions or driven the newest automobile, the results have been at least "good enough."

Fixity in the Information Age?

There is a strong sense that the Industrial Age – and its employment model – may be fading. The Information Age poised to follow it gives many indications of operating from a different employment model, one that is less regular, uses contract workers as much as employees, and offers compensation packages that may include bonuses, stock options and other irregular-income items.

If these changes reflect new trends in employment, it can be hard to predict a new point of financial fixity. What is possible is to reference what has been good enough in the past: **a high level of liquidity**. In time, it may become evident that some other financial or demographic factor (home equity? life expectancy?) may emerge as a strong point of fixity on which financial plans can be made. But even if something else emerges, it's unlikely that liquidity will cease to have value. It has a long track record of being "good enough," and many personal financial programs would benefit from making sure liquidity has a central position in their priorities.

- **HAS THE PURSUIT OF THE "BEST" ACCUMULATION RESULTS CAUSED YOU TO OVERLOOK THE BENEFITS OF SETTLING?**
- **HOW WELL-FIXED IS YOUR LIQUIDITY?** ❖



At least once a month, someone in the mainstream financial media will find time to cast disdain on Whole Life insurance – i.e., a life insurance policy designed to remain in place for one's entire (whole) life that includes cash value as well as a death benefit. The arguments against Whole Life insurance typically include a variation of the following:

- "Many people won't need life insurance in their old age, because the primary purpose of life insurance is to provide income for dependents."
- "Whole Life insurance is a poor investment because cash value accumulation returns are diminished by insurance costs."

Considering Whole Life insurance has been one of the two forms of life insurance (the other being term insurance) since the very beginning of modern life insurance history, it is perhaps odd that it continues to be a subject of continual criticism. Part of the problem may be that financial pundits, while perhaps experts at identifying the "best," overlook the practical, financial-fixity benefits that can be derived from the purchase of a Whole Life insurance policy.

While it may be perceived that some people won't "need" life insurance in their old age, there will always be a "want" rather than a "need" for the life insurance. The Life Insurance Company had you believe that you will not "NEED" life insurance when you are in your old age. Yet when you get there, you realize you "WANT" to maintain your life insurance coverage. However, if you pursued term (Universal/Variable Life) it is unlikely that type of life insurance will be in force upon your demise. A Whole Life policy is not only designed to provide a guaranteed financial benefit to a beneficiary but also provides living benefits to the insured/owner as well. These benefits include Guarantees, Tax-favored benefits, Liquidity, Law Suit protection (dictated by State Laws), Continued funding upon a Disability (Waiver of Premium Rider), income to dependents, funding an inheritance, resolve estate tax issues and charitable planning. Whatever the eventual application, a Whole Life insurance policy adds unique long-term **FIXITY** to a financial program.

Cash values are a source of secure, liquid cash.

As for the investment performance of a Whole Life insurance contract, the rate of return must be evaluated within an appropriate context (taking into account taxes, the alternative, Term Life costs and the associated "Lost Opportunity Costs"). Critics are often disposed to compare cash values with historical returns from the stock market rather than from "Bond" like rates of returns. But cash values are not equity instruments; they have a much lower investment risk…similar to "Fixed" interest rate type securities. While part of the actual accumulations in the form of dividends* will depend on the investment performance of the underlying insurance company, cash values also have stated guarantees. Coupled with the fact that many well-managed insurance companies have an impeccable track record for dividend distribution (Guardian has NEVER not paid a Dividend since its existence 1868) , it is apparent that cash values also have a high level of **FIXITY**. Cash values are a source of secure, liquid cash, and these are valuable attributes.

Even critics of permanent life insurance will admit as much. In an October 5, 2012 *Wall Street Journal* article, reporter Ellen Schultz uses the bulk of her article to broadly advise against owning life insurance in retirement, trotting out the usual reasons stated above. Then, tucked in the middle of her column is a disclaiming paragraph:

> **Granted, life insurance can be a critical tool in an estate-planning or charitable-giving strategy for wealthy investors. For example, death benefits can be used to pay estate taxes that otherwise would have to be paid by selling investments or illiquid assets at a discount. And if you already own a policy, it can be a very good fixed-income investment.**

If future events could be guaranteed, many scenarios could be imagined in which Whole Life insurance might be either unnecessary or less profitable. But since this foreknowledge is currently impossible, Whole Life insurance is an excellent application to increase financial fixity. The fixed benefits of Whole Life insurance represent a solid foundation for long-term wealth-building and financial security. ❖

*Dividends are not guaranteed, and are declared annually by the insurance company's board of directors.

CURRENT FINANCIAL CHALLENGE:

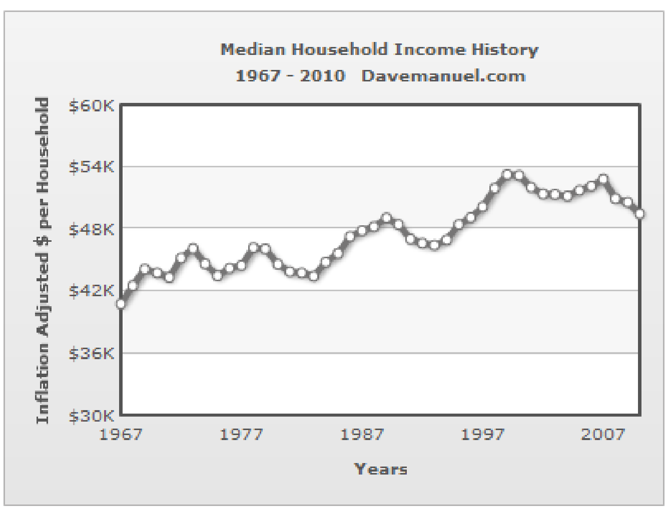
Doing More With Less

Achieving financial security has never been an easy task. But current circumstances have combined to make it even more challenging. Consider the following:

1. Real income is down. Quoting the *New York Times*, from September 12, 2012:

> The Census Bureau reported an overwhelming majority of Americans saw no gains from a weak economic recovery in its second full year. The numbers helped drive an overall decline in income for the typical American family. Median household income after inflation fell to $50,054, a level that was 8 percent lower than in 2007, the year before the recession took hold.

The following chart illustrates the trend:

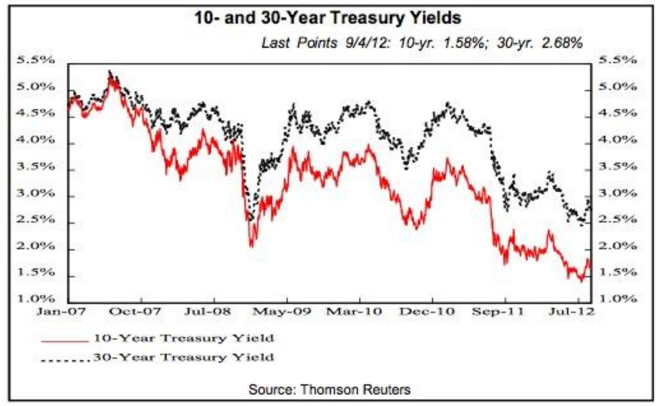


A few clarifying comments: The $50,054 number is for 2011. All values are expressed as "real" as opposed to "nominal." (In a somewhat ironic twist of logic, a "real" number is one adjusted for inflation.)

This decline cut across all levels of household income, but hit those nearest the median, i.e., the "middle class," the hardest.

2. Interest rates are down. In an attempt to jump-start a sluggish recovery, the Federal Reserve has continued to keep interest rates low, ideally to encourage borrowing. US Treasury yields are considered a benchmark for the interest rates on other financial vehicles from personal savings accounts to corporate bonds, and the recent numbers reflect all-time lows. Here's the chart:

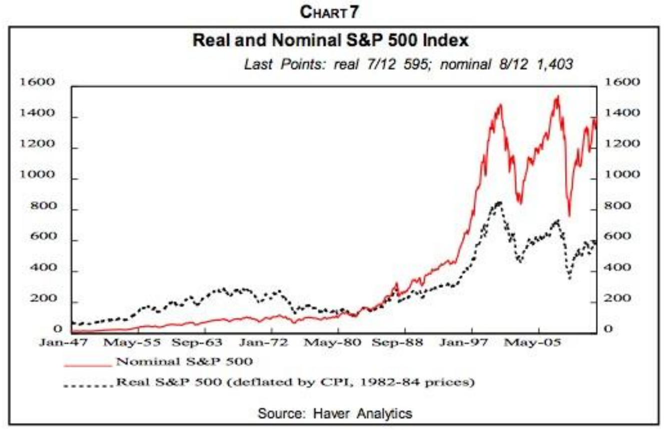
CHART 8



Low rates are attractive to borrowers. But for those seeking safe accumulation and income options that will keep pace with inflation, the current rates don't offer much reward. As low rates have persisted, more higher-yielding CDs and bonds have matured, leaving account holders with the challenge of accepting a lesser income stream or taking more risk to maintain it.

3. The Stock Market is undecided and volatile. Regardless of which index is used as a reference, and whether the measurement in expressed in real or nominal numbers, the data show investing in equities has become a bit of a thrill ride in the past decade. Trends, both up and down, seem to come faster and steeper.

CHART 7



The 2012 year-to-date performance of the S & P 500 provides further evidence of the same volatility. The index began the year at 1,277.06 and rose 11% (to 1,419.04) in 3 months. By June 1, the index was back to 1,278.04, and those gains were wiped out. Another climb began, reaching 1,465.77 on September 14th – a 13% increase – but the following month chipped away almost 25% of those gains.

Commentators have pointed to technology as a cause of the volatility, in that it makes for speeded-up and intensified investor response to economic news. From a larger perspective, they say, the trends remain relatively the same. This may be a logical observation, but many individuals have yet to grasp this paradigm; instead they have decided they no longer want to ride the equity roller-coaster.

4. Oh yeah…taxes are probably going up, too.

Whatever the outcome of the November national elections, very few believe all of the higher income tax rates scheduled to be reinstated on January 1, 2013, will be enacted. But there is consensus that some increases are inevitable. For example, the 2% reduction in the employee-paid FICA tax is scheduled to return to 6.2% in 2013. And even if income tax rates don't increase, there is strong sentiment to reduce or eliminate some deductions, which will result in more taxable income.

These current financial realities have the potential to make it harder to realize plans for long-term accumulation and financial security, because one way or another, it means doing more with less, delivering higher returns from fewer dollars. Typical responses to these challenges – for businesses or individuals – might be to reduce expenses and increase investment risk in order to achieve a higher rate of return. These strategies are both rational and doable, but there may be other approaches that merit consideration. One of the best: **look for ways that one dollar can serve multiple purposes**.

This strategy has two facets. The first pertains to the purpose of the funds. Over the past few decades, the products and services of the financial planning industry have become excessively specialized and compartmentalized. There are accounts (with unique features and regulations) for retirement, college funding, medical expenses. The restrictions that accompany these specific plans may make it difficult – or expensive – to re-characterize the accounts or use the funds for purposes other than designated. In contrast to this "separate-bucket-for-each-objective" approach, there may be an advantage to increasing accumulation in formats that offer the option of deciding ***at a later date*** whether this money will be used for retirement, college funding, or some other purpose.

As an example, life insurance cash values accumulate on a tax-favored basis similar to some qualified retirement accounts, have some advantages when used for college funding (an exempt asset in financial-aid eligibility calculations), and can be accessed without penalty before age 59½. So instead of deciding how to allocate dollars among three categories (retirement, college funding, and emergency funds), some might find it advantageous to build a significant cash value accumulation – and decide later as to its use.

The second way to multi-task dollars is by deriving several benefits from the same transaction. Many financial instruments are one-dimensional; their purpose is to generate income, or offer the opportunity for growth, or provide insurance, etc. But some transactions may offer multiple benefits. The purchase of a profitable real estate rental property might provide long-term asset appreciation, rental income, and tax advantages. Some equity offerings combine both growth opportunities and regular dividend income.

If your financial circumstances require you to do more with less, tightening the budget and finding ways to prudently improve investment performance certainly need to be part of your assessment. But don't overlook the potential

gain from strategies that allow one dollar to deliver multiple benefits, or offer flexible access and distribution features.

IF YOU NEED TO DO MORE WITH LESS, ASK ABOUT WAYS YOUR CURRENT FINANCIAL ALLOCATIONS COULD SERVE MULTIPLE PURPOSES. ❖

WHAT'S "HOT" ON THE FINANCIAL RUNWAY (and may eventually catch on with "retail investors")

Each season, fashion designers present flashy, exaggerated "new styles" that eventually become a trendy look for retail clothing stores to market to the masses. What finally hangs on the rack at the mall is often a dramatically tamed-down version of what first appeared on the runway, but fashionistas in the know can see the connection.

A similar migration of product often occurs in the financial services industry. Strategies and products once designed by creative financial professionals working for large institutions, after some alteration, may eventually become available to "retail investors," the industry name for individuals and small groups. If you skim the financial press, one of the current hot topics for new financial products is "Alternative Asset Classes."

Alternative Asset Classes: What are they?

The number of items that might qualify as alternative asset classes is head-spinning. But all alternative assets have one feature in common: their investment performance tends to have "a low level of correlation to fixed-income and equity markets" (from an *investopedia.com* definition). This means that if the stock market zigs, alternative asset classes might zag. When interest rates go up, income from alternative asset classes might go down – and vice versa. The rationale for alternative assets is fairly simple: since fixed-income and equity markets occasionally go down, it makes sense to find profitable alternatives. Again quoting investopedia.com:

> "Combining different types of alternative assets into a portfolio can produce a more optimal asset allocation, and resulting performance benefits that are particularly visible during sustained periods of weak equity market performance."

There are many investments which might qualify as alternative assets. Some, like real estate, art, collectibles, or precious metals, fit the bill because they are ***not*** equities, bonds or other paper assets. Other items qualify as alternative assets because they act as "hedges"; they are structured to provide positive returns when regular paper assets decline. Hedge funds get their name because they typically consist of devices (such as options) or investments (like private equity, or currency futures) chosen for their non-correlation to whatever is happening in the larger stock and bond markets.

Alternative assets tend to be illiquid in comparison to traditional assets, and the minimum purchase price is typically steep – you can't build an art portfolio with monthly withdrawals from your checking account. In the past, many of these alternative asset classes have been available only to institutions or other "sophisticated investors," i.e., those who theoretically have either enough money and/or experience to afford the high price points and accept the liquidity and investment risks.

But just as high-end fashions are repackaged for mass consumption, it appears alternative asset products are showing up on the radar screens of retail investors. A July 2012 survey commissioned by a prominent broker of life insurance and investment products found that

> "The trend toward alternative asset classes among retail investors has been growing steadily for the past several years…Over the last decade, markets have experienced record volatility. We're entering a new era of diversification and alternative asset classes are becoming a significant part of that development."

Part of the repackaging of alternative assets for retail investors is finding ways to lower the price of entry. One of the easier ways to make alternative assets retail-friendly is to package them as *funds*, which allows for the sales of shares to individual investors. An October 27, 2012, *Wall Street Journal* article highlighted how some mutual fund companies are changing their tax status to qualify as real-estate investment trusts (REITs). While a typical REIT fund portfolio might own office, industrial and residential properties, some of these new REITs consist of "cloud-computing data centers, cell phone towers, prisons, billboards and document-storage facilities" – all chosen because their financial performance is not connected to traditional financial markets.

In a similar way, insurance companies use hedging devices in their indexed annuity products. This combination of opportunity for growth with a guarantee against loss within the format of an annuity allows retail investors to indirectly receive the benefits of alternative asset classes.

Alternative Asset Classes: A Passing Fad or Here to Stay?

No matter how complex they may seem, most financial products are simply different configurations of fundamental economic concepts. At first, their arrangements may seem impossibly difficult to comprehend, but with repeated exposures they make sense. So, as retail investors gain a better understanding of financial products and their applications, it follows that interest in alternative asset classes will increase.

This proliferation of alternative asset classes at the retail level doesn't mean everyone should own some. There are times when what's trendy just doesn't fit. That's why a team of good financial professionals is helpful. Not only can competent financial professionals be a great resource for explaining alternative assets, they also might be just the right people to say "that doesn't look good on you."

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LOOKING FOR THE RIGHT FIT WITH ALTERNATIVE ASSET CLASSES?

FOR A PLAN THAT'S TAILOR-MADE FOR YOUR SITUATION, CONSULT YOUR FINANCIAL PROFESSIONALS. ❖