Creative

wealth maximization strategies*

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Your Ultimate Financial Objective: Spend, Enjoy & Replace!

After sifting through all the jabber about money, empirical evidence suggests there are only three reasons to save:

1. To provide a measure of security against unforeseen events;
2. To spend/enjoy the accumulation at a later date; or
3. To make it easier for future generations to achieve #1 and #2.

These observations don't require extended analysis. Rational people know that life has daily costs and a degree of uncertainty about the future. Saving is a logical, prudent response.

But so much of the public discussion about money involves saving and accumulation, that we sometimes forget the ultimate goal of any accumulation program is to spend it! And not just a little, but as much as possible.

"Spending as much as possible" may come across as wasteful and hedonistic. But what is the purpose of saving, if not to eventually spend it? In a financial emergency, the reason you saved was to have some money to alleviate the crisis. In retirement, a large measure of your satisfaction will come from being able to spend money – for both necessities and pleasures. And even estate bequests are a sort of spending; you are providing the opportunity for loved ones or favored causes to increase their security or enjoyment.

At the most basic level, the money you've saved only manifests its worth when you spend it. **Your accumulation plans have no impact on your material world until you spend the money – or at least until you know you can spend it if you want to.** As long as the money is in a bank account, mutual fund, IRA, whatever, it doesn't have a tangible impact on your life. Food isn't more plentiful, the car you drive doesn't get bigger, and your home doesn't get redecorated.

Yet you might hear or read this advice: ***"Because of taxes, you'll want to delay distributions from this account as long as possible."*** This is your reward for 20 or 30 years of delayed gratification, to be advised to wait even longer? Sure, saving requires delayed gratification, but it shouldn't mean canceled gratification.

We have it on good authority that everyone dies. And so far, no one has been able to take the unspent portion with them to the Great Beyond. If those are the facts (and they are), it doesn't make sense to work and save all your life, and then not enjoy the fruits of your diligence and discipline. An accumulation plan is only half of a financial program. The other part is how to maximize spending.

How then shall we spend?

So once you've accumulated, how do you spend? Prompted by the disappearance of pensions, and the surge of Baby Boomer retirees (they impact everything!) the personal financial planning industry is just beginning to evolve beyond rudimentary lifetime spending plans. To understand why new ideas about spending are necessary, it might be helpful to critique the classic spending strategy summarized as **Live on Earnings, Conserve Principal.**

In This Issue…

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

The Classic Plan: Live on Earnings, Conserve Principal (LOECP)

The idea is simple: Build a large enough accumulation so that you can live on the earnings (interest, dividends, and capital gains) generated from the principal. You don't have to worry about "outliving your money," because the principal will always be there, generating income. Earnings may fluctuate with returns, but as long as you aren't touching the principal, your ability to continue spending remains intact. And when you are gone, the principal can be passed on.

Living on earnings also ensures there will be assets to inherit. Depending on the underlying investments, the principal may increase or decrease, but it will never disappear. Executed properly, the live-on-earnings-and-conserve-principal strategy accomplishes the three objectives of saving stated above: there is a sizable reserve for emergencies, an income to be spent, and the opportunity to pass the remainder to designated heirs.

The accumulation strategy prior to distribution for an LOECP approach is also pretty simple: accumulate the largest pile possible. Ideally, a well-funded LOECP provides growth that exceeds income needs. This "extra" can be added to the existing principal, generating ever-larger earnings.

LOECP works…but inefficiently

While LOECP is a workable spending strategy, it may not be the best way to maximize spending. In fact, using LOECP to provide security and inheritance almost guarantees that you will lessen your spending and enjoyment. Here's why:

1. The untouched principal is one very expensive "insurance policy." It's true that living on earnings provides security against outliving your assets, but it does so by assuming you will live forever, and that's not going to happen. The "insurance" you get from conserving principal comes at a steep price.

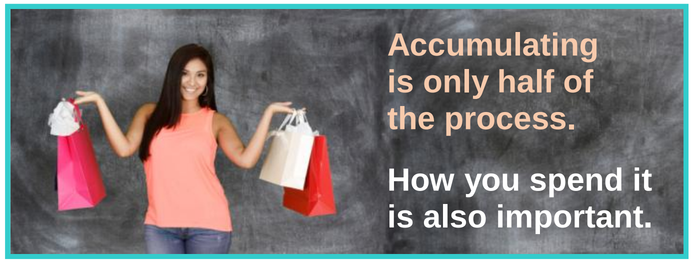
Essentially, not touching the principal each year is the premium required to provide "old age security." With most insurance you pay a small premium, relative to the principal amount, to get a large benefit when, or if, something unexpected occurs. But with LOECP, the principal ***is*** the premium ***and*** the benefit, and there's no financial leverage from sharing the risk with others.

Consequently, when you decide to live on the interest, a major beneficiary of your "insurance plan" is the financial institution that holds your assets. Consider:

If you have accumulated $2 million dollars, earning 6% annually, living on earnings produces a $120,000 annual income while preserving principal. Depending on how you evaluate your retirement future, $120,000 could sound like a nice number. But that's not the point.

The bank (or a pension plan, insurance company, or investment fund) gives you $120,000 while it uses the $2 million you've left in reserve. Year by year, you get $120,000 to spend, and they get $2 million to earn a profit. Who benefits most from your account? One might argue the financial institution has the advantage.

2. If you accept the spending limitations of LOECP because you want to leave an inheritance, there's another downside. **The untouched principal may not transfer directly to beneficiaries.** Any significant balances left for the next generation must first be filtered through the government, either by estate taxes or income taxes due on the unspent portions.*



Not only do you forfeit immediate spending and enjoyment, but so do your heirs. And the tax bite is progressive: the larger the principal that remains unspent, the greater the possibility of diminished inheritance.

In light of the previous paragraphs, one could argue that LOECP provides greater benefits for financial institutions and the U.S. Treasury, with you skimming the "extra" while alive, and your heirs getting the after-tax "leftovers" when you die.

3. And there's another problem with LOECP: **When the yields on guaranteed financial instruments are below one percent (like they are right now), spenders must either dramatically reduce spending or take on greater investment risk and volatility to produce the income they require.** Not only is the income less certain, but any loss of principal makes it harder to generate income in the future.

In summary, living on interest and conserving principal is a workable spending program, but it requires substantial capital to deliver arguably substandard spending benefits.

Looking for better ways to spend

In the past decade, financial professionals have taken a closer look at maximizing spending using a range of strategies, such as:

- Spend-down calculations to systematically liquidate assets according to longevity projections.
- Sequenced distributions from different asset categories to minimize taxes.*
- **Integration of Whole Life insurance to provide a guaranteed death benefit which gives you the ability to spend down principal and interest on your assets while guaranteeing full replacement of those assets upon death.**
- Blending guaranteed and fluctuating returns to achieve a greater stability in retirement income.

Saving is an essential ingredient for long-term financial satisfaction, but the endgame isn't accumulation. It's spending. And spending isn't just a retirement issue: There can be plenty of reasons to spend before retirement. A fully articulated financial program always has an eye on spending well. ❖

ARE YOU PREPARED TO SPEND?

OR ARE YOU LOCKED INTO A STRATEGY THAT FOCUSES ONLY ON ACCUMULATION?

* Tax, legal or accounting advice is not provided by the representative(s). Consult your tax, legal or accounting professional regarding your individual situation.

From the Levittown communities of the 1950s to no-doc lending in the 2000s, home ownership has been an essential element of the American dream for the past 70 years. And typically, it hasn’t been just one home, but a series of homes, with each new property standing as a milestone of financial progress. But today, demographics and changing financial realities are altering both the track to home ownership and its financial viability. Buying a series of homes may no longer be a default wealth-building transaction.

To understand this potential shift regarding home ownership, it helps to have a perspective on the established paradigm. In the years immediately following World War II, the Baby Boomer explosion dramatically increased the demand for housing, while widespread ownership of automobiles gave Americans greater mobility. Assisted by government programs that removed financing hurdles for many veterans, enterprising developers created…*The Suburbs*. And thus was born a housing boom that would last for almost seven decades.

Over time, a pattern emerged: One of the first financial objectives for young adults (usually a couple) was to save for a down payment and buy a “starter home.” Then, as children, promotions, and equity were accumulated, it was time to “trade up” to a larger home in a better neighborhood. In the best situations, the culmination of the process was another trade-up, this time to a “premium” property.

Today, real estate analysts still keep track of home sales using the three designations of starter, trade-up and premium properties. Although prices can vary significantly depending on location, the nationwide median prices reported by Trulia, a real estate tracking firm, for February 2016 were:

Starter -	**$154,156**
Trade-Up -	**$267,845**
Premium -	**$542,805**

The progression from Starter to Premium homes hinged on two factors: a robust demand for entry-level homes, and appreciating property values. A steady influx of prospective homeowners meant those already in starter properties could quickly sell their existing home to buy another. Market appreciation added substantial equity for these trade-up buyers, and made it possible for them to afford a more expensive home, even if their incomes had not increased proportionally.

As the trade-up market grew, home ownership offered more than steady equity appreciation and the psychological benefit of having your own castle. Trading up became a leveraging strategy to multiply net worth, which could then be monetized with home equity lines of credit.

The maturation of the Baby Boomers signaled a possible change in this housing model; the oldsters were down-sizing, and there weren’t as many young buyers looking for starter homes. But this change was masked by loosened lending standards that opened home-ownership to more people. And then the market unraveled: the fallout was foreclosures, falling prices, and empty subdivisions.

After the Fall

Two prominent shifts have been observed in the aftermath of the real estate crash:

1. It is harder for young households to become starter-level homeowners. Prudence dictates tighter lending standards, which has made it harder for aspiring buyers: they don’t have the credit scores and/or the down payment. Myles Udland of *Business Insider*, in a March 21, 2016, article says “Mortgage lenders, despite record-low rates, are still reluctant to extend credit to less-than-superb borrowers.”

2. People can’t trade up, so fewer homes are on the market. Kerry Close, in a March 21, 2016, *CNNMoney* article says “There’s a smaller supply of starter homes because they’re owned either by investors or underwater homeowners who are effectively unable to sell.” Meanwhile, the number of trade-up homes on the market has declined by 41 percent since 2012, in part because the price gap between trade-up and premium homes is growing. Per Close: “Mid-tier homeowners are becoming less likely to sell because buying a better home is becoming increasingly unrealistic.”

Chris Kirkham, in an April 9, 2016, *Wall Street Journal* article, summarizes the upheaval:

> “The housing market can be viewed as a progression through time: Younger people start out renting, save enough to buy houses, build equity and then trade up to more desirable homes. Now that trajectory has been interrupted, with fewer middle-aged buyers trading up, which would open up the inventory of smaller homes for younger buyers.”

Even before this year, some people have articulated problems with the trade-up strategy. Leon Yang, in an August 2013 article titled *“Why ‘Trading Up’ Your House Might Just Be Killing Your Financial Future”* gives an example from Orange County, California (where home prices are above the national average). A couple is looking to trade up from a $350,000 home to one that costs about $800,000. With each transaction comprised of 20 percent down and a 30-year mortgage, their monthly payment increases from $1,337 to $3,055, and “That’s a lot of change no matter what you do [for a living].” Besides the steep increase in monthly overhead, Yang also sees the risk of not being able to sell, and transaction costs that run 8 to 10 percent of the purchase price as deterrents to trading up.

This new reality of tighter finances, fewer homes on the market, and a greater price gap between trade-up and premium homes has moved some buyers off the trade-up track. Such as:

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Save longer, enter at the mid-level, and don't plan to trade-up. An April 2013 *USA Today* article declared "It's a shift in the housing market that arrived with this millennial generation…

Today's young buyers often vault right past their parents' traditional first house – the tiny bungalow or mini-ranch – and grab the house they really want."

USA Today credits this shift to people marrying later, having kids later and couples being more likely to have two incomes. "The acronym for well-off couples – 'DINK' for 'Double Income No Kids' – has become 'DINKY' for 'Double Income No Kids Yet.' These buyers can afford a substantial house, so they shop for the size they think they'll need later."

Pivot to multi-generational residential properties. Aging parents living with their children and/or boomerang children living at home is another demographic phenomenon impacting housing. A 2014 Pew Foundation report said "The growing number of Americans living in multi-generational households reflects more than the overall increase in the U.S. population."

Besides meeting family needs, multi-generational properties may allow extended families to pool financial resources for a larger home with some trade-up advantages built in. A property reconfigured to a multi-unit dwelling, such as a "mother-in-law" apartment or garage converted to an on-site cottage, can serve several generations as they transition through life stages.

Instead of trading up, send your children to private school. A common rationale for trading up is that better neighborhoods usually have better schools. But increasing prices for premium properties challenge this assumption. An August 2014 *CNN Money* article notes that "Homes in districts where rich families send their children to public school can cost more than twice the national average per square foot. That means in certain cases, private school can actually be a bargain."

View real estate as a legacy asset, instead of part of your retirement. An exit strategy for the trade-up track has been selling the premium property, downsizing to a condo, and using the excess equity to supplement retirement. This approach heavily depends on being able to sell the home, at market value, at retirement. But what if there aren't any buyers?

An outside-the-box alternative: When parenting respons-ibilities are done, sell the personal residence, and buy a vacation property. If work or other commitments keep you from living there right away, rent in the interim. The vacation property is a potential retirement home, and something your children will want to keep in the family.

Real estate values and market conditions vary greatly by location. None of this discussion is meant to say there are no opportunities for starter properties or trading up. But like many other aspects of life, the outsized impact of the Baby Boomer demographic is passing, and new conventions of living are emerging.

If there is a new home on your financial horizon, it may be wise to check other options besides the trade-up track. ❖

You Don't Get to Define Your

In 2011, the US Census Bureau reported that about 12% of the total population was classified as disabled. More than 50% of those disabled Americans were in their working years, from 18-64. And the Social Security Administration's February 2013 Fact Sheet projects that about 1 in 4 of today's 20 year-olds will become disabled before they retire. If roughly 1 in 8 Americans are currently disabled and the odds are 1 in 4 that a disability will occur, it seems like an issue that merits serious attention, right? Well…sort of.

- A 2015 study by Insurance Barometer found that "61 percent of Americans say most people need disability insurance, yet only 26 percent have it."
- A May 2014 report from the Council for Disability Awareness found that "57% of working adults report having no private disability insurance."

Why doesn't the threat of disability, and the financial havoc it causes, register for many Americans? Where is the disconnect?

First, there is the idea that while death may be inevitable, disability is avoidable. And in a way, that's sort of (partially) true. Good drivers have fewer accidents. Employees that observe workplace safety rules are less likely to be hurt on the job. Except…most disabilities are not the result of automobile collisions or workplace accidents. The *JHA Disability Fact Book* states 90 percent of disabilities are caused by illnesses. And the National Safety Council finds that 85 percent of disabling accidents and illnesses are not work-related.

Then there is the variety. Because there are so many ways in which a disability can occur, there is perhaps the tendency for us to define disability as something that will happen to someone else. Which leads to these confounding statements:

- "Well you know, Ed always had a bad back. It's not a surprise he had to stop working. But I'm careful about exercise and watch my weight, so I'll never have that problem."
- "I heard Jane was taking maternity leave, but I never thought the complications from pregnancy would keep her from returning. It's a good thing I'm a man."
- "Sure, work can be stressful, and I can understand how it might have knocked Fred for a loop; he has a tough job. But if I were disabled, I'd still work. That's just the kind of person I am."

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If I were disabled, I'd still work. That statement (an actual quote from a business owner), has to be the ultimate example of defining disability so it can be ignored.

A Dose of Disability Reality

An internet search of "disability case studies" sheds light on what real disabilities are like, and how many are not workplace-related. Even from this small sample, the breadth of conditions and occupations is sobering.

– A warehouse manager with severe cardiac artery disease
– A pharmacist with a degenerative hip condition
– A nurse with a rare visual disorder causing loss of vision, and extreme light sensitivity
– A senior project manager with degenerative lumbar and cervical disk disease
– An investment banker with clinical depression and attention deficit disorder
– A court reporter with cubital tunnel syndrome and related wrist injuries
– A CPA with sleep apnea and clinical depression
– A dentist with a severed clavicle from a bicycle accident
– A doctor with a variety of psychiatric conditions
– An insurance agent with phobias, depression and other psychiatric conditions
– An orthopedic surgeon with numbness in fingers caused by diabetes
– A printer who suffered a heart attack while hiking
– A periodontist with a broken wrist, which surgeries failed to repair

Those who insist on their own definition of disability may not be swayed by this list. But notice how several of the disabilities were the result of conditions that were not immediately traumatic; they were degenerative conditions that got worse, or mental issues that became unmanageable.

Note also that these conditions might not be disabling for everyone; sleep apnea, diabetes, and depression do not always result in disability. But for these people, they did. Conclusion: They didn't get to define their disability out of existence. And you don't either.

When is the last time you took a realistic look at the risk of a disability, and your options for dealing with it? ❖

The random returns from non-guaranteed investments can be compared to playing cards drawn from a shuffled deck**.** You know that a regular deck of playing cards consists of 52 cards, but the order in which you receive them will be random. Likewise, historical returns from different investments may suggest a range of possible outcomes, but future returns will be impossible to predict.

Regardless of the order in which these fluctuating returns occur, and even if there are occasional negative numbers, consistent savers will generally achieve results that approach the long-term averages. But the same cannot be said when it comes time to draw income from the same account. The specific *sequence of returns* can have a huge – and detrimental – impact on the longevity and stability of your retirement, even when the long-term averages are positive.

To illustrate how critical this difference can be, an insurance company produced the following hypothetical scenario:

- Two retirees (Person A and Person B) each have an investment account worth $621,155 at age 65.
- At age 66, both individuals take annual withdrawals of $31,055, which is equal to 5 percent of the $621,155.
- To account for inflation, each person increases their annual withdrawal by 3 percent for the next 25 years (to age 90).
- During this withdrawal period, each retiree reports identical year-by-year returns, resulting in an average annual return of 8 percent over the 25-year period.
- **The only difference:** the order of the annual returns is reversed. Person A begins with three years of negative returns. Person B experiences the same losses, but not until years 23-25.

	PERSON A		PERSON B	
Age	Annual Return	Year-End Value	Annual Return	Year-End Value
65		$621,115		$621,115
66	-9%	$533,511	19%	$706,040
67	-12%	$438,111	18%	$800,716
68	-22%	$308,339	22%	$945,192
69	14%	$318,498	-8%	$837,437
70	19%	$344,042	15%	$929,104
71	5%	$326,105	8%	$971,239
72	17%	$343,183	23%	$1,157,156
73	1%	$309,520	-3%	$1,083,638
74	-3%	$260,571	16%	$1,215,450
75	22%	$276,193	19%	$1,401,794
76	19%	$285,856	30%	$1,787,126
77	6%	$260,801	10%	$1,924,257
78	-15%	$178,214	-15%	$1,597,329
79	10%	$150,570	6%	$1,651,935
80	30%	$149,467	19%	$1,912,379
81	19%	$128,982	22%	$2,276,041
82	16%	$99,518	-3%	$2,155,552
83	-3%	$45,150	1%	$2,132,685
84	23%	$2,646	17%	$2,434,017
85	8%	$0	5%	$2,507,361
86	15%	$0	19%	$2,927,542
87	-8%	$0	14%	$3,288,418
88	22%	$0	-22%	$2,502,155
89	18%	$0	-12%	$2,143,462
90	19%	$0	-9%	$1,885,183

Person A runs out of money shortly past age 84, while Person B's account not only lasts to age 90, but has tripled in value. How can the same average annual rate of return deliver such disparate results? The difference is the sequencing.

At the start of retirement, the three years of negative returns combined with increasing withdrawals drive Person A's account balance so low it never recovers; the positive returns that follow simply don't have enough principal to work with. Conversely, the prevalence of positive returns for Person B during the early years of retirement result in growth that outstrips the inflation-adjusted withdrawals.

Is this illustration accurate? The range of annual returns, and their sequencing, doesn't appear to match historical returns from any specific investment or index. Since the example was produced by an insurance company, a cynic might assume there is some manipulation of the return sequence to produce a more dramatic contrast in results.

However, the three-year stretch showing -9, -12 and -22 percent returns for years 1-3 for Person A happens to be the exact results for the S&P 500 Index for years 2000-2002. So what occurs to Person A has historical precedent. (It's also worth noting that the S&P 500 reported a -37 percent return in 2008 – a result that is not included in the illustration.)

You can Stack the Deck

Seeing how a random sequence of returns can impact retirement security is unsettling, especially since retirees consistently report their greatest financial concern is outliving their savings. And it makes a credible argument for considering the place of annuities** in a retirement plan.

Annuities can deliver guaranteed incomes that last a lifetime, however long that may be, and provide a base of financial certainty – regardless of how the return cards are shuffled. Card players accept they have to play the hands they are dealt. But retirement doesn't have to be a game of chance; you can decide how many random cards you want in your retirement deck. ❖

IF YOU DON'T HAVE A LIFETIME GUARANTEED INCOME PLAN, NOW MIGHT BE AN OPPORTUNE TIME TO SEE IF AN ANNUITY CAN BE AN ACE IN YOUR RETIREMENT.

** Annuity guarantees are backed by the strength and claims paying ability of the issuing insurance company.

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