

CREATIVE

Wealth Maximization Strategies



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"Without execution, vision is just another word for hallucination!"
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Retirement: Work longer. Spend more. Save less. Have fun. (*Really?*)

Math never lies, but sometimes its practical applications don't add up in real-life circumstances. And when you take a purely mathematical approach to retirement planning, these practical limitations can be a problem.

About 30 years ago, the advent of personal computing made it possible for anyone with a spreadsheet program to develop a Retirement Calculator. Suddenly, retirement planning became as simple as a mathematical formula. "Just plug in a few variables (personally tailored to your expectations), and voila! – you have 'your number.'" Or two numbers actually; the lump sum you'll need to retire, and the regular contributions that will be required to reach your lump sum target. It was almost too easy...

And it didn't work. Early retirement calculation programs were too simple. They couldn't account for fluctuations in annual returns or irregular increases or decreases to income, inflation, etc. But since math never lies, the problem must be with the inputs – garbage in, garbage out, right? So the math-driven strategy was to use more sophisticated models, ones that took into account historical trends, probabilities and worst-case scenarios. Instead of a one-page print-out with two numbers, the new retirement calculators could produce 20 pages of alternative numbers, all theoretically realistic. Every possibility was considered, unless a "black swan" showed up.

Black swans are what statisticians call those once-in-a-lifetime occurrences. Like a black swan, these unusual events could possibly occur, but almost no one has ever seen them. For example, who could ever imagine a housing bubble featuring massive defaults and fore-closures, with prices dropping 20 to 30% in two years? Or stock market investments that would show negative returns over 10-year periods? Or persistently high unemployment levels that would disrupt the ability to plan or save for the future? And who could imagine all of those things happening in the past five years? These events just weren't part of most people's retirement calculations.



Which is why a December 6, 2010 *Wall Street Journal Investing Report* begins with these less-than-cheery comments:

Imagine this scenario: You're only five or 10 years from when you hope to retire – but your portfolio looks like it needs another lifetime to bulk up...Most people, of course, don't need to imagine it. It's their reality – the result of watching their investments get clobbered in the two bear markets of the past decade. And many others will face this sad state of affairs in the years ahead.

What are appropriate responses to retirement in light of these current economic realities? First, the article recommends that you "take a deep breath and remind yourself that you're far from alone. Misery does love company." Then "you need to get serious about trimming your spending to save more money, or resign yourself to working more years." Oh, and one more thing:

"When your nest egg is small and time is short, you can make things worse for yourself by being either too conservative or too aggressive."

Wow.

Breathe deep, cut spending, work longer – and don't mess it up. (There's a slogan that's sure to motivate.)

But with a math-driven retirement program, there isn't much else to do. When you finally recognize that so many variables (rates of return, taxes, inflation, etc.) are beyond your control, the only numbers that you can change are the

size of the deposits and how long you plan to make them. Intended to be a predictive aid, most mathematical retirement calculators actually do a better job of explaining your past mistakes. “Oops! It looks like you should have saved more. And that investment was too risky, while this one was too conservative – if only you had made *this* decision instead!”

For some, the bottom line from a mathematical retirement calculator is even more depressing. According to the numbers, retirement is now impossible. There is not enough money to save and not enough time to save it. And since those are the only variables you can affect, math can’t help you. At a certain point, math says your financial future is beyond recovery.

Just on principle, there ought to be a better approach.

Change the Math – or Change the Path?



Some people in the financial services industry are beginning to acknowledge the limitations of math-driven retirement planning and are searching for alternative models. Like any concept that exists outside the box of what we see as conventional, the first exposure is likely to regard these ideas as unrealistic, provocative, even subversive to the known order of life. But even the most outrageous concepts often contain a kernel of truth that may lead to real-world solutions. One “out-there” retirement concept that seems to be gaining traction:

Adding a fourth leg to the retirement stool

The old retirement model that originated in the 1950s was often illustrated as a three-legged stool, because retirement was going to be funded by assets and/or income from Social Security, a company pension and personal savings. But given the financial uncertainty facing some or all of these legs today, a host of financial commentators are adding a fourth leg: continued earnings from employment. Yes, retirement now means continuing to work. This work is perhaps not as long or as hard, or for as much money – but is still steady employment. Continued employment can not only provide current income and essential insurance benefits, but it can also increase savings and shorten the period of “full” (i.e., non-working) retirement.

In this retirement model, the fourth leg is pretty important. So while you may want to adjust your investment portfolio or change your accumulation objectives, there are other “planning” issues to consider. In a November 8, 2010 article published on the Financial Planning Association website (www.fpanet.org), Jeanie Schwarz, a Virginia CFP® gives some “fourth-leg” advice:

Take classes to enhance your existing job skills or to learn new skills. Keep in touch with your professional network to improve your chance of finding a new job if your current circumstances change. Focus on maintaining a healthy lifestyle to reduce the risk that illness or injury will cause you to leave the workplace before you are ready.

Intended to be a predictive aid, most mathematical retirement calculators actually do a better job of explaining your past mistakes.

It’s a bit different when a financial professional sounds more a career guidance counselor isn’t it? That’s because this is almost a **no-math** approach to retirement planning. The basic idea is to make sure you keep working, stay healthy, and save what you can. Full retirement, whatever it looks like, will be what happens when you stop working.

Keep working, save less, enjoy today. Christine Fahlund, a senior financial planner and vice president from a global investment management firm (i.e., a mutual fund company), expands the fourth-leg idea with something almost counter-intuitive to the paradigms established by the mathematical retirement models. In a video interview accompanying the above-referenced *WSJ* article, Ms. Fahlund tells reporter Karen Damoto that since many Americans can’t meet the saving and accumulation requirements of a retirement calculator, it might be time to “stop knuckling under and start having fun.”

Where the almost universal hue and cry from the financial service industry is that Americans aren’t saving enough, Ms. Fahlund offers a strikingly different perspective. “Have fun while you’re working,” she says. Furthermore, if you are approaching 60 and haven’t accumulated enough to retire, she suggests that you may even want to stop contributions to a qualified retirement plan. In a February 2010 interview with *Morningstar*, she explained her logic:

“Well, what we found, as I said before, was the contributions really aren’t helping you that much at that point in time. And so our suggestion is delay the date but not the gratification. So instead of contributing each year while you are still working, start taking those trips. Start spending those contributions instead. So that way, it is more of a gradual transition. You are already starting your retirement while you are continuing to work. And the results will really pay off in the long run.”

Hold on. Instead of contributing to your 401(k), you might want to take a vacation? Is this a *Twilight Zone* episode?

Not at all. Ms. Fahlund recognizes one of the major motivations for saving in the present is to enjoy the money some time in the future. But *if an enjoyable future can’t be achieved by saving because you are starting too late or don’t have enough, saving becomes a negative strategy; it won’t work and it’s no fun.*

Is this approach realistic?

These comments represent a fairly significant departure from conventional retirement thinking. First, the new definition of retirement *includes working longer*. Second, “retirement” and “working” are not separate phases of your financial life; they overlap. Third, the enjoyment phase of retirement – travel, relaxation, indulging in personal projects,

etc. – is scheduled to begin earlier. It's an interesting trade-off. But can it work? And if so, how would it affect your financial decisions?

The idea of people working as long as they can is nothing new. It has been the default option for most of history; even today, true retirement (i.e., no working income) is quite rare on a global basis. In some ways, planning to keep working is a better hedge against economic volatility and financial uncertainty than a math-driven plan that hopes the numbers work out, because you can add another variable (generating new income) under your control.



Furthermore, none of these outside-the-box commentators are suggesting that continuing to work means you should stop saving. But this idea does suggest that some financial decisions should be different. In a scenario where the ability to generate ongoing income is a critical retirement resource, life, health and disability insurance benefits

have greater importance. People using a fourth-leg retirement approach need the income insurance.

In many math-driven retirement models, the approach to life insurance is to buy coverage in one's 30s and 40s to replace family income in the event of a premature death. Thinking the need for income replacement will be met by accumulated funds in retirement, many of those same people anticipate dropping the life insurance in their 60s. They may purchase a 20-year term insurance policy with low premiums, knowing that continuing the coverage beyond 20 years will be cost-prohibitive.

When the ability to generate ongoing income is a critical retirement resource, life, health and disability insurance benefits have greater importance.

But in a retirement scenario where working longer is the key ingredient, life insurance become a crucial piece of long-term financial protection. The financial relevance of replacing income may extend to age 60, or 70 – or until the end of life. Instead of needing life insurance for 20 or 30 years of prime earnings, life insurance may be required for 50 years – or longer. This requires a different approach to life insurance, with different plans and premiums.

As Ms. Fahlund mentions, there may be less incentive to use a qualified plan as a primary saving vehicle in a fourth-leg approach because one of the principal assumptions is that saving will be consumed, perhaps before retirement, and often in irregular amounts. These criteria may prompt you to consider other options for saving, perhaps with different risk levels and/or different tax treatment.

In consideration of all the uncontrolled variables in mathematical retirement scenarios, it is possible that a retirement strategy which emphasizes continuing to work, yet also allows for greater immediate enjoyment of the fruits of one's labor is not only realistic, but perhaps both desirable and practical – provided you adjust your financial allocations accordingly. As Ms. Fahlund says “you stay in the workforce longer, but you're having a lot of fun while you're doing it.”

IS YOUR RETIREMENT CALCULATOR RUNNING OUT OF OPTIONS? Adding a “fourth leg” to your retirement probably means a reassessment of how you are currently allocating your savings and insurance dollars. Why not contact us today?

Fourth-Leg Contrarian Indicator: Life Insurance Must Make Sense, Because Fewer People Have It.



A contrarian is someone who believes the herd is usually wrong; the herd is usually running just behind the curve, the herd buys high and sells low, and the herd

is always chasing the next big thing, but never catching it. For contrarians, their best bet is to figure out how to zig when everyone else is zagging, and vice versa. Intelligent contrarians often make very profitable financial decisions. But contrarians who make financial decisions just on the basis of being different usually end up with uneven results.

If you have a contrarian perspective, some information about life insurance released in August 2010 suggests the fourth-leg retirement ideas may have a significant place in shaping the financial futures of many Americans.

On August 31, 2010, The Life Insurance Marketing and Research Association (LIMRA) released a study that showed individual ownership of life insurance had hit a 50-year low. LIMRA determined that only 44% of U.S. households had individual life insurance and 30% had no life insurance coverage at all. Quoting the report, “Today, there are 11 million fewer American households covered by life insurance compared to six years ago.”

What does life insurance ownership have to do with the fourth-leg retirement idea? One of the questions asked in the study was why Americans didn't own life insurance. More than half of all households surveyed *said they needed more life insurance* – the highest level ever registered by LIMRA, which conducts the survey every six years. But 40 percent said the reason they didn't buy life insurance was because they had other financial priorities right now. The two highest priorities named were paying down debt and saving for retirement.

Here's the contrarian slant: These statistics indicate there is a herd of Americans that knows they are behind the curve on their retirement projections. In order to catch up, they believe they must make retirement saving a priority – even if it means going without life insurance. But if their financial situation is such that they have to sacrifice the immediate protection that life insurance provides, it means they probably are going to need a fourth-leg retirement approach in the future – and they won't have the life insurance to help them make it work.



IS “DO-OR-DIE” NECESSARY?

Deeply ingrained in American culture is the glorification of risk-taking. We immortalize those who risk it all, lay it all on the line, and make do-or-die decisions. We are told the way to maximize life is to “live each day as if it were our last.” In life or in finances, there is no doubt that success requires some risk-taking, but does it really call for such a reckless, off-the-cliff approach? The following quote offers a different perspective on what it takes to succeed.

In the playoffs, some coaches try to motivate their teams by telling them to play ‘as if this is the last game of your life,’ or to ‘play until you’re dead.’ We tell our kids ‘play like you want to keep playin’. A championship isn’t won by dying, it’s won by staying alive and continuing to play.

- Jerry VanHavel
high school football coach

Success requires effort, planning and perseverance. If you’ve reached the point where everything rides on one play, one investment, one decision, it means your chances for success are down to one. Better to prepare to keep playing than to let yourself be caught with only one option.

Saving: A logical response to uncertainty

A July 29, 2010 *USA Today* article noted that “Rather than investing in their future, companies are piling up cash and collecting practically zero interest on the money.” The December 9, 2010 issue of the *Wall Street Journal* reported the trend continued in the third quarter of 2010, and that US companies were holding more cash than at any time in the past 40 years. The 3rd quarter report from the Federal Reserve said that individual Americans are also increasing their savings, as well as reducing their credit card debt. This begs the question:

Why would anyone keep putting money in accounts that pay almost no interest?

Answer: Because it’s the logical thing to do. Having cash reserves, even at no interest, is a prudent, rational response to economic uncertainty. And right now, there are some major economic uncertainties.

Even as Congress settles the tax rates for 2011, most observers see the potential for more change in the future – and some of the change could be dramatic. In the aftermath of the financial crisis, banks have tightened their lending standards, making it harder to borrow. The national unemployment rate has remained high, affecting both personal income and consumer spending. Real estate values, both residential and commercial, continue to be buffeted by defaults and foreclosures.



How will these issues play out? Right now, it’s hard to say. And that’s why people are stashing cash. Georgetown economics professor Lee Pinkowitz told *USA Today*, “Companies want cash for a rainy day. People didn’t realize how rainy it could get.” Peter Crane, founder of a money-fund research firm, fully supports the idea. In a November 24, 2010 *CNBC.com* article, Crane told correspondence John Carney: “Levels of cash should always set records. After what we’ve seen in the last few years, you’d be crazy not to hold a higher liquidity buffer.”

Eventually, the increase in cash reserves will resolve some of the uncertainties in the economy. In times of financial uncertainty, one of the best long-term responses, both for businesses and individuals, is to **save**. Some commentators argue that saving is detrimental to the current economy because it results in decreased spending, decreased output, and increased unemployment. Short-term, this may be true. But long-term, saving restores financial equilibrium, and this stability makes growth possible.

As companies and individuals accumulate more cash, they become better equipped to take on new risks, such as buying additional properties, introducing new products and hiring more people. Several news stories reporting on the increase in cash reserves also noted that higher cash positions were prompting some companies to contemplate mergers or acquisitions. Even if some other issues remain unclear (such as taxes), there will come a point where the opportunity to prosper will be more attractive than simply accumulating more savings. While tax breaks, subsidies, and monetary policies can definitely influence economic growth, the foundation for long-term financial prosperity and stability, both individually and nationally, is built on a solid base of saving.

**NOT SURE WHAT TO DO RIGHT NOW? BUILD THOSE CASH RESERVES!
WANT TO EARN MORE THAN ZERO PERCENT?
SEE US!**

Uncertainty Example: The Boss Of The Yankees And His Estate

On December 13, 2010, BTN Research, referencing information from *Forbes*, published the following news item:

“George Steinbrenner, the principal owner of the New York Yankees baseball team, died on July 13, 2010. His net worth at death was an estimated \$1.15 billion. Since he died in 2010, his estate will pay zero



federal estate tax (under current law). Under the estate tax plan proposed by President Obama on December 6, 2010, if Steinbrenner had died in 2011, his estate would have owed \$401 million in federal estate taxes.”

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By itself, this information provides an illustration of the uncertainties regarding tax law changes. But wait, there's more...

A search of stories released shortly after Steinbrenner's death noted that the federal estate tax was not the only up-in-the-air tax issue facing Steinbrenner's heirs. Several sources speculated on the possibility and/or constitutionality of a *retroactive* estate tax assessment for 2010 becoming part of new estate tax law in 2011. Another mentioned that the state of New York has an estate tax that might apply, even if federal estate taxes do not. In a July 15, 2010 online article, Attorneys Andrew and Danielle Mayoras, co-authors of *Trial and Heirs: Famous Fortune Fights!*, referenced a potential capital gains tax that might be assessed if the family sold the Yankees, concluding “the Steinbrenner family will have no choice but to hold onto the New York Yankees' stock and not sell it, unless they want to pay this large tax. Instead, they'll likely pass down the stock from generation to generation, **unless of course a new tax law gets passed which changes their situation.**”

Your financial situation may not involve \$1.15 billion estate and a possible \$400 million tax bill. But consider the proportions. How could anyone effectively prepare for a tax assessment that could fall anywhere between zero and 40 percent? Besides consulting your tax specialist, contact our office. An overview of your entire financial situation can provide clarity and options to help you deal with the moving target of changing tax laws.



Knock, knock.

“IT'S HOUSEKEEPING...We're Here To Clean Up Your Beneficiaries”



The essentials of everyday life require ongoing maintenance. Your car needs regular maintenance, your family needs attention, your lawn needs to be mowed – and the dishes don't get clean by themselves. On a regular basis, the essentials of your financial life should receive a little housekeeping as well. You should balance your checkbook, review the quarterly statements on your investments, prepare a net worth statement. And you should review your beneficiaries.

Beneficiaries are a major component on life insurance policies, pension plan accounts, retirement plans (like IRAs and 401s) and estate planning. Invalid or improper beneficiary designations may lead to legal disputes or delay distributions, and cause unexpected tax complications. But because beneficiary designations are usually only considered at the time when a life insurance policy is issued or a retirement plan is initiated, it's easy for them to be neglected even as the circumstances of your life have changed.

Beneficiary considerations: whether declaring a beneficiary for the first time or reviewing previous designations, there are fundamental points to consider.

> **Ages of beneficiaries.** Many policies and plans will not directly transfer assets to minors until a trustee or guardian is approved by a court. This often precludes naming children as beneficiaries. But if you have children who have reached adulthood, you may want to make a change.

> **Ability of beneficiaries to manage assets.** Some beneficiaries may not have the character or competence to handle an insurance settlement or retirement distribution responsibly. This can be an issue not only for immature adult children, but also a spouse or relative afflicted with dementia. Perhaps a trust set up in the person's name would be better than a direct transfer.

> **Contingent beneficiaries.** Should something happen to your primary beneficiary, a contingent beneficiary will receive your assets or insurance proceeds. When beneficiaries are first named, determining a primary beneficiary is usually easy. Because most financial instruments with beneficiary designations require only a primary recipient, contingent beneficiaries are sometimes overlooked (“we can take care of that later”), then forgotten.

> **Change in status of beneficiaries.** As the circumstances of life change, so may the desired beneficiary. These changes could be personal (the additional of a grandchild), contractual (the termination of a buy-sell agreement) or a combination (a marriage or divorce). When these changes occur, a reassessment of beneficiaries may be desirable.

> **Unique circumstances.** While most beneficiary designations are straightforward, special circumstances may result in unique beneficiary arrangements. For married individuals, the law requires that a spouse be the primary beneficiary of an employer-sponsored retirement plan unless he or she waives that right in writing. (A waiver may make sense in the case of a second marriage if a current spouse is financially independent or if family members from a first marriage are more likely to need the money.) A divorce decree may require an ex-spouse to remain as beneficiary on a life insurance policy, retirement plan or other inheritable asset. Tax advantages may result from naming grandchildren as beneficiaries in some trusts.

How often should you review your beneficiary designations? The most accurate answer is every time you need to, every time there is an event in your life that requires updating beneficiaries. That could be once in six months, or six years, or maybe never. But how likely is it that you will recognize every event that might lead to a beneficiary change, and how likely is it that you will remember every document that needs to be reviewed? A more practical approach is to review beneficiary designations at least once a year, or perhaps every time you meet with your financial professional to discuss your financial objectives.

Beneficiaries are a small financial detail, and can be easily adjusted to reflect your current financial status. Neglecting to keep them current can risk financial loss or distress. So why not plan for a little financial housekeeping to make sure everything is the way you want it?

WHEN IS THE LAST TIME YOU REVIEWED YOUR BENEFICIARIES?

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