MORE MONEY MOUNTAINEERING

3 TOOLS TO PUT IN YOUR BACKPACK

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AGENDA

-- Rethink what you need to thrive in retirement

-- Replace the 3- legged stool with 3 tools for your backpack

-- The 3 Tools

- -- Home Equity
- -- Insured Products
- -- Employer Provided retirement programs/Social Security

-- The Decumulation Problem

-- Final Thoughts/Q&A

RETHINKING WHAT YOU NEED TO THRIVE IN RETIREMENT

A DISCUSSION OF FINANCIAL WELLNESS IN THE CURRENT ENVIRONMENT

FINANCIAL WELLNESS IN THE NEW WORLD : WHY A NEW APPROACH IS NEEDED

- Beginning in the 1950's and continuing through the early part of this century, the metaphor of the "3 legged stool" was used to help individuals think about their financial security and how it could be provided during their retirement.

- The 3-legged stool consisted of

  --- Social Security (provided by the Government)

  --- A guaranteed Pension (provided by the employer)

  --- Personal Savings (provided by the individual)

FINANCIAL WELLNESS IN THE NEW WORLD : WHY A NEW APPROACH IS NEEDED

- Beginning in the 1990's and accelerating through today two of the three legs of the stool became unstable, and the third can't now make up the difference
- Social Security's future solvency is now uncertain
- Actuarial projections show that if nothing is done by 2033 **all** SS benefits including those in payment status will be automatically reduced by 25%
- Very few companies provide a guaranteed pension anymore as most employer sponsor retirement programs are now DC and more and more employment is "gig" work and not covered by **any** retirement plan
- The third leg (personal savings) is now overburdened and so **a new model is needed**

A NEW MODEL – 3 TOOLS FOR THE CURRENT WORLD

- One possible model is the financial wilderness model explained in *Money Mountaineering*. This model recognizes that individuals must rely on their own resources to achieve financial wellness and proposes 3 important financial tools to carry throughout your financial life.
- Each of these tools can be acquired by an individual on their own, though each requires an investment of time, money or both
- In no particular order, the 3 tools we suggest acquiring are

  -- **Home Equity**

  -- **Insured Products** (e.g. Life Insurance and annuities)

  -- **Employer provided Retirement Programs** (e.g. 401(k))

- Social Security will almost certainly survive in some form but could be radically redesigned and therefore should not be counted on unless you are approaching retirement age

ACQUIRING THE THREE TOOLS

-- The order in which you acquire each asset should be congruent with your goals, desires, family circumstances, earnings capacity etc., but there are many other factors that should determine which tool you acquire and when. This is an example of HFW Principle #1 (Everybody's Different) in action.

-- With the exception of annuities (longevity insurance), the earlier in your career you acquire the asset/product, the greater is the range and value you will get from it over a working career and through retirement

-- Depending on how early you acquire one of these assets you can expect to use each of these tools in different ways at different points in your life.

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ACQUIRING THE THREE TOOLS

Some more Principles :

-- Acquiring an employer provided retirement program should be a consideration in **every** career/job choice you make

-- The current "market value" of each of the assets/products listed is a poor measure of its true value **to you** which also is not the same as its **present value.** "Present Value" is an actuarial term discussed at length in *What's Your Future Worth*?

-- Taking on debt to acquire one or more of these assets **can** be a good idea, but same cautions about debt identified in HFW Principle #2 (Debt can enhance financial health, but also make you financially fragile) still apply

THE 3 TOOLS

TOOL #1

HOME EQUITY

HOME EQUITY

For over 100 years, young people starting out have sought to buy a home. Today it is more challenging than ever. Yet the benefits of home ownership are more varied and more important than ever and manifest themselves throughout one's entire adult life. For example, a home can be:

1. A place for you and your family to live
2. Temporary shelter for friends and family
3. A source of ready cash obtainable through a HELOC
4. A means of building debt capacity and improving your credit rating
5. A means to build wealth that can accumulate or be invested elsewhere through cash out refinancing
6. A source of income through renting out extra rooms
7. A place to work from by using a home office
8. An important source of retirement income and contingency funds by obtaining a HECM after turning 62
9. A legacy to leave your heirs

HOME EQUITY

Specific ways you can use your home throughout your adult life:

-- **At the beginning of your working life (25-40)**

-- Your new home is a place to live and represents an opportunity to accumulate wealth on a safe, leveraged, basis

-- **In the middle of your career (40-55)**

-- You can borrow against your home equity to expand your living space or to enhance your balance sheet by making other investments

HOME EQUITY

As you age and your home appreciates in value, more uses of the equity in your home become available to you

-- **As you approach retirement (55-70)**

-- Your home becomes a major component of your total assets to be used to plan for retirement

-- When you decide where you want to live in retirement you can consider getting a HECM line of credit (available beginning at age 62) to be used for future cash flow needs when you stop working

-- **In retirement (70- ?)**

-- Your house can be a configured so that you can “age in place” with extra space being available for rent or usable for live-in care providers

-- HECM credit lines can be an integral component of your retirement income strategy and a source of cash if unexpected contingencies arise

-- **As a legacy**

-- Your home (even encumbered by a HECM) can be left to your heirs or other beneficiaries after you die

THE 3 TOOLS

TOOL #2

INSURED PRODUCTS

INSURED PRODUCTS

Insured Products that we suggest come in two main forms:

-- Life Insurance (Permanent Cash Value Products.)

--- Whole Life

--- Variable Universal Life

--- Indexed Universal Life

-- Longevity Insurance (Life Annuities)

---Immediate and Deferred annuities

---Fixed and Variable annuities

--- Annuities with a Term certain or cash refund feature

--- Annuities that are either Single Life or have joint and survivor options

---Commercial or Charitable Gift Annuities, (but NOT CRT’s)

LIFE INSURANCE

Permanent Life Insurance has been much maligned as inferior to "buy term and invest the difference", but while that may be more "efficient", it misses important aspects of Permanent Life Insurance products with a Cash Value feature that are designed to be flexible, versatile and useful over one's entire life. To our minds such products can act like a Swiss Army Knife – not the best at anything, but good enough to use for multiple purposes. For example:

1. Cash value of a Whole Life policy accumulates tax free at guaranteed fixed rates as good or better than the bond market provides
2. The death benefit is payable tax free and can be reduced at any time as insurance needs change
3. The cost basis (amount of premiums paid) can be withdrawn at any time without paying taxes
4. The cash surrender value can be borrowed against and most of the interest you pay goes back into the policy
5. Once the policy is "paid up" it can be used to provide retirement income or surrendered to provide a lump sum
6. After retirement, the policy can be used as an estate planning tool and/or used to provide survivors income to a spouse

LONGEVITY INSURANCE

Most people don't think of it that way. but Longevity Insurance is what you are getting when you buy or are given an annuity. Like Life Insurance, there are many many different kinds of annuities:

Each of the above types of annuities can serve to enhance your financial wellness as you prepare for the decumulation phase of life

For example:

1. Deferred annuities can provide for **future** income needs
2. Variable annuities can provide upside potential with downside guarantees
3. Term certain and cash refund annuities can protect against death early in retirement
4. J&S annuities can protect your spouse if he/she outlives you
5. CGA's can provide retirement income **and** a legacy to institutions and charities you care about

INSURED PRODUCTS

Insured Products can also be used over an entire working career

-- **at the beginning of your working life (25-40)**

--Buying Whole Life when premiums are low will let you begin accumulating a valuable asset that can be modified, enhanced or cut back throughout the rest of your life

-- **In the middle of your career (40-55)**

-- Maintaining and expanding your coverage to protect you when you need it most

-- Taking (and repaying) loans from the Cash Value of your policy can help you meet short term liquidity needs

INSURED PRODUCTS

Insured Products become even more valuable as you age

-- **As you approach retirement (55-70)**

-- You can withdraw cost basis or borrow against your policy's cash value for (un)planned needs and/or convert the policy to reduced paid up status for retirement planning purposes

-- If healthy, consider buying an annuity – commercially or as a Planned Gift

-- **In retirement (70- ?)**

-- To use for retirement income or to provide your spouse with a survivor annuity

-- If still healthy consider a QLAC

-- **As a legacy (???)**

-- Life Insurance beneficiaries can be either heirs or death benefits can be directed for charitable purposes

THE 3 TOOLS

TOOL #3

EMPLOYER PROVIDED RETIREMENT PROGRAMS/SOC SEC

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By far the most common retirement programs that employers offer to their full and part time W-2 employees is some sort of Defined Contribution account-based plan, usually a 401(k) or 403(b) savings Plan that

-- allows employee to make pre-tax contributions

-- gives participant investment options

-- is available for a tax-free rollover into an IRA

-- may allow after-tax/Roth contributions and/or loans

Note that Social Security Benefits will ultimately be based on your earnings history

EMPLOYER PROVIDED RETIREMENT PROGRAMS/SOC SEC

Most people will not work for one company for their entire career so it is important to consider what role accumulating a tax-sheltered investment portfolio will play over your entire working career. This is particularly important in the first half of your adult life

-- at the beginning of your working lifer (25-40)

-- Participating and contributing to a 401(k) can be a powerful way to accumulate assets on a tax deferred basis

-- **In the middle of your career (40-55)**

-- If you change companies, rolling over and aggregating account balances can enhance your accumulation of retirement assets.

-- When considering a job change carefully evaluate employers that still sponsor Defined benefit or Hybrid pension plans. They tend to more valuable the older you are depending on the Plan specifics

EMPLOYER PROVIDED RETIREMENT PROGRAMS/SOC SEC

In the latter part of your working life it becomes even more important to stay cognizant of the Retirement Programs sponsored by your employer

-- **As you approach retirement (55-70)**

-- Once you are eligible for early retirement, Retirement Plans will often allow more flexibility for investment and distribution elections

-- On the other hand, changing jobs at these ages can reduce your ultimate retirement income as companies design their programs to encourage loyalty

-- Be attentive to voluntary severance programs that are offered as they can provide a significant supplement to your retirement income

-- **In retirement (70- ?)**

-- Even after ceasing full-time work, you are usually still considered a participant in your (former) employer's Plans and have rights and options to consider

-- **As a legacy (???)**

-- Most employer sponsored retirement plans provide for death benefits and/or survivor benefits for your spouse

APPROACHES TO DECUMULATION

THERE IS NO "CLOSED FORM" SOLUTION TO THE DECUMULATION PROBLEM

The only material risk in the accumulation phase (pre-retirement) is that investment returns will fall short of your target on a real basis (net of inflation).

The variety of risks facing a retiree managing a lump sum to last the rest of their life is substantially greater including

-- investment/inflation risk

-- investment liquidity risk

-- sequence of return risk

-- unpredictable life contingencies and expense risk

-- longevity risk

THE DECUMULATION PROBLEM

Our view is that in addressing the decumulation problem is best done piecemeal utilizing different strategies to overcome each of its unique risks:

-- **investment/inflation risk** can be addressed via effective portfolio management

-- **specific investment liquidity risk -** can also be addressed through effective portfolio management

-- **sequence of returns risk** can be addressed with a drawdown strategy that is utilizes a "coordinated strategy" which utilizes an asset whose return is uncorrelated with the invested portfolio (e.g. a HECM) and can be drawn on rather than the portfolio, when the portfolio is down

-- **unpredictable expense and life contingencies** can be addressed through Cash Value permanent Life Insurance including ones with a "disability rider"

-- longevity risk can be addressed directly through the purchase of annuities (e.g QLAC's)

Final Thoughts/Q&A

YOU MAY BE ASKING YOURSELF…

But what should I do now to plan for financially secure future?.

Again, there is no “general” answer to that, but there are ways of “putting it all together” that we have seen work, but each of those “success stories” is unique and I don’t know enough about YOU to suggest a specific set of tools best suited to your specific needs.

That being said, in addition to adhering to the 6 principles in *Money Mountaineering*, if you pack one or more of the 3 tools we have discussed today in your backpack, you should be well equipped to not only survive but to thrive in the financial wilderness.

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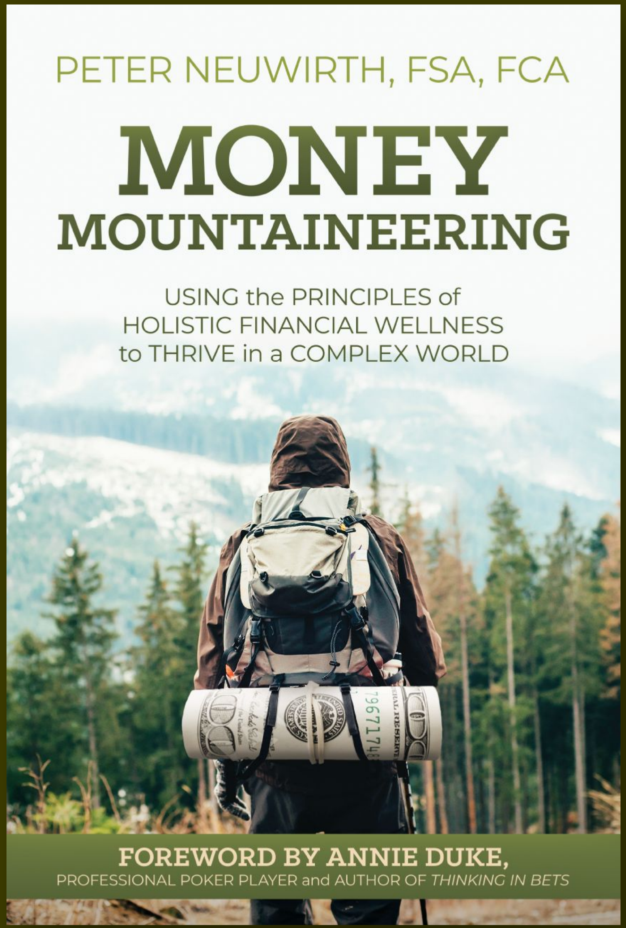

Notes

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