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Dumb and Dumber, Super Bowl XLIX, and the Improbable in Real Life

"So You're Telling Me There's a Chance…"

The *Internet Movie Database* describes the 1994 movie *Dumb and Dumber* as "the cross-country adventures of two good-hearted but incredibly stupid friends." If you've seen the movie, that summary doesn't begin to describe the idiocy. Among the outlandish plot elements is Lloyd Christmas' bumbling romantic pursuit of Mary Swanson. At one point, Lloyd, played by Jim Carrey, professes his love for Mary and wants to know if she feels a similar attraction.

Lloyd Christmas: Hit me with it! Just give it to me straight! I came a long way just to see you, Mary. The least you can do is level with me. What are my chances?
Mary Swanson: Not good.
Lloyd Christmas: You mean, "not good" like one out of a hundred?
Mary Swanson: I'd say more like one out of a million.
(pause)
Lloyd Christmas: So you're telling me there's a chance... YEAH!

Most movie-goers like happy endings, so Lloyd ends up winning Mary's affection; the one-out-of-a-million event comes to pass. Improbable? Of course. But the outcome is in line with the wackiness of the story. Part of the entertainment is imagining how things that are improbable might occur.

* * *

On February 1, 2015, more Americans watched Super Bowl XLIX than had watched any other telecast in U.S. history. Viewers were treated to a great contest, with the outcome not decided until the final 20 seconds of play. But unless you were a stat freak, you may not have realized the game featured some unprecedented instances of **improbable events**.

Advanced Football Analytics (AFA) is one of a number of statistics-driven websites that provides in-depth analyses for every play in an NFL game, a season, or multiple seasons. One of AFA's metrics is "Live Win Probability," a calculation which assigns a value to each team's chances of winning on a play-by-play basis as the game progresses. This number takes into account the score, down and distance and matches it against the historical outcomes of other games.

Trailing 28-24, with under a minute left in the game, the Seattle Seahawks had the ball on the New England Patriots' 1-yard line with three chances to score. At that moment, according to AFA, the Seahawks had a win probability of 88 percent; a touchdown would give Seattle the lead, with almost no time for New England to respond. Given Seattle had an All-Pro running back (with the nickname "Beast Mode") and New England's defense had limited success during the season in short-yardage situations, a Seahawks' victory seemed almost inevitable.

But, as most of us know, it didn't happen. Instead of running, Seattle chose to throw, and a backup New England defensive back made a superb interception at the goal-line. Facing almost certain defeat, New England miraculously escaped with the win.

In fact, this particular event was so improbable, *Grantland* sportswriter Bill Barnwell declared, "In terms of one play swinging a team's chances of winning the Super Bowl, the second-down interception was probably the most important in the history of the NFL." Barnwell supported his statement by noting that New England's win probability swung from 12% to 99% on the play, and "It's difficult for one play in any context to shift things that dramatically."

In This Issue…

DUMB AND DUMBER, SUPER BOWL XLIX, AND THE IMPROBABLE IN REAL LIFE — Page 1

COFFEE STAINS ON THE DISABILITY INSURANCE NAPKIN — Page 2

ULTIMATE SUCCESS IN SMALL BUSINESS REQUIRES A SUCCESSION PLAN — Page 4

DON'T IGNORE THE SAVING-INVESTING DISTINCTION — Page 5

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Culling other statistics, Barnwell noted that during the 2014 season, NFL teams had thrown the ball 108 times on the opposing team's 1-yard line. Those passes had produced 66 touchdowns and **zero interceptions**. While an interception is always a possibility any time a team throws the ball, the probability was infinitesimally remote. And yet, it happened.

This sudden, almost beyond-belief turn of events is one of the reasons sports are so compelling; you never know when the improbable will become possible.

The Improbable in Real Life

Movies and sporting events are amusements, so when an improbable event – fictitious or real – takes place on the screen or the field, we are merely spectators. We watch the show, we go home. The outcome might surprise us, but it doesn't have much impact on our material circumstances (unless you lose a lot of money betting on the game).

Real life requires a more sober approach, because when the improbable occurs, the impact can be far-reaching. **Failing to prepare for the improbable puts us at risk for losing things we value most.** Yet because these events are unlikely to occur, it also requires a balanced perspective. Time, energy and resources focused exclusively on improbable outcomes are inefficient and foolish.

One of the most practical balanced approaches to the improbable is insurance; i.e., any strategy in which a modicum of planning and money provides a degree of certainty should the improbable occur.

The real-life improbable events that usually come to mind are negative things like an accident, a job loss, a death. Imagining the difficulties that could arise from these improbable events, the "insurance solutions" are relatively easy: we buy life and health insurance, build emergency savings, and prepare wills.

But sometimes even "good" improbable events threaten our well-being. Think of the multiple stories of lottery winners who found that improbable wealth destroyed their lives. Or an inventor who sold his idea to someone else because he lacked the funds to bring it to market. In these instances, people were unprepared for unexpected good fortune. How do you "insure" for improbable opportunities? **With imagination and flexibility.**

Lottery winners are perhaps the extreme example of an improbable positive occurrence; the odds of winning the $485+ million jackpot in the February 2015 Powerball lottery were 1 in 175 million. But even though millions of people buy tickets each week, how many put serious thought into imagining how they would use their winnings? Oh, there may be a few discussions over beers about quitting a job or taking a long vacation. But almost no one calculates taxes, researches the experiences of previous winners, contemplates the payout options, or considers how it might change their estate plans. A lack of imagination leaves them unprepared for good fortune.

Less dramatic (and more likely) improbable events make a solid case for **flexibility** as a form of insurance. Ever heard someone say, "I had an unexpected opportunity to pursue my dream job, but I couldn't afford to…" followed by: "break my lease, go back to school for six months, pay the franchise fee, tap my retirement account, etc."? If this were something you wanted, however improbable, it might have been worth planning or saving, so that if the opportunity were available you would have a chance to make it possible.

Imaginative, flexible insurance concepts don't change the odds of the improbable occurring, but they are an efficient way to give you better options if it does.

The improbable is also *possible* – and when it happens, the ramifications can be enormous. Imaginative, flexible insurance concepts don't change the odds of the improbable occurring, but they are an efficient way to give you better options if it does.

Do you have insurance for improbable events – both good and bad?

Want some imagination and financial flexibility to survive an improbable opportunity? ❖

Coffee Stains on the Disability Insurance Napkin

Imagine that, after lengthy interview processes, two prospective employers offer you positions in their companies. Both companies are in the same industry, and your duties will be the same with either organization. The only real difference is the compensation package. Sitting at a local restaurant with your spouse, you summarize your options on a napkin:

	JOB A	JOB B
HEALTHY & WORKING	$100,000	$98,000
TOO SICK OR INJURED TO WORK	$0	$58,200 TAX FREE

The terms of employment for Job A are straightforward. You'll be paid $100,000 per year while you're healthy and working, but nothing if you get sick or hurt and can't work.

Job B's compensation package requires a bit of explanation. Your reportable income will be $100,000, just like Job A, but a portion of it will be used to maintain disability income insurance. This arrangement allows for any benefits to be received on a tax-free basis if you get sick or hurt and can't work.

So…which job do you choose?

Isn't this a no-brainer? The numbers in the second row of the napkin are stark: $0 or $58,200. That's a big difference in benefits for $2,000 less in take-home pay. Doesn't everyone want Job B's compensation package?

Think injuries are the main reason for a disability? Think again.

How a Clear Illustration Gets Cloudy

The essential concept of disability insurance really is as simple as the napkin diagram. Yet many Americans are either under-insured or without disability income protection. Why? Like a napkin that has coffee spilled on it, here are several misconceptions that make a clear idea harder to read.

COFFEE STAIN #1: DISABILITY IS ALL ABOUT INJURIES. A prevalent image of disability is an accident that results in a musculoskeletal injury – a fall, a car crash, or an on-the-job incident that leads to broken bones, a bad back, etc.

Is this an accurate perception?

In the Social Security Administration's (SSA) most recent annual report published December 2014, it found the largest single "diagnostic group" for disabled beneficiaries was a "mental disorder." *More than 35% of people receiving federal disability benefits were diagnosed with a mental disorder.* And "musculoskeletal system and connective tissue injuries" was the second largest category.

To be fair, the conditions that qualify someone to receive disability benefits vary. In an October 2012 *New York Times* article, a spokesman for a prominent insurance company said musculoskeletal injuries represented their greatest number of claims, but also mentioned that cancer was their second-highest claim category. Thus, while injuries figure prominently in disability and may correlate to occupations, other health issues that can affect everyone (i.e., cancer and mental illness) also play a prominent role. In reality, no age group, gender, occupation class or lifestyle is exempt.

COFFEE STAIN #2: PARTIAL PROTECTION FROM OTHER INSURANCE PROGRAMS IS ADEQUATE. Because other types of insurance often include some disability insurance, it may induce individuals to believe they already have coverage. Most employees can receive disability benefits for on-the-job accidents through Workers Compensation insurance provided by employers. Automobile insurance may offer protection if the insured is disabled in an auto accident. But these protections are situation-specific.

Social Security disability benefits are all-inclusive, but limited in other ways. An incident of disability must be at least six months in duration before an individual can make a claim. And, due to the stringent definition of disability, the Social Security Disability and SSI Resource Center reports that 65% of initial requests for benefits are denied. Further, the SSA reported the average monthly disability benefit payment in 2013 was $1,145 – and even multiplied by 12, this is not nearly enough to match the $58,200 in the napkin example.

COFFEE STAIN #3: THE BELIEF "IT WON'T HAPPEN TO ME." When the SSA says that a 20-year-old in 2011 has a 30% chance of being disabled for at least six months before retirement, we may see the number as too broad, and discount our personal odds because the number isn't adjusted for age, gender, health or occupation. In the absence of relevant statistics, we make up our own. But are our assessments accurate?

A better option might be to find your Personal Disability Quotient (PDQ) from a calculator on the Council for Disability Awareness website (www.whatsmypdq.org). The calculator matches age, height, weight, occupation and health to project the likelihood of disability for your demographic. A few examples:

- A 40-year-old male, 6 feet tall, 200 pounds, non-smoker with no adverse health history, working in an occupation that consists mostly of office work, and a healthy lifestyle that is "about average" has a PDQ of 16, meaning there is a 16% chance of his being injured or becoming ill and unable to work for a period of three months or longer before retirement.
- A 35-year-old female, 5'4" tall, 160-pound smoker with diabetes, living an about-average healthy lifestyle, and working in a job that is in-and-out of the office has a PDQ of 51; this person is almost as likely to be disabled as to continue working.

The reality: Most people underestimate their likelihood of disability.

COFFEE STAIN #4: FOCUSING ON COST INSTEAD OF BENEFITS. In the napkin example, the numbers reflect a quote from a leading disability insurance company for a healthy male, age 35, employed in a professional or executive occupation. The policy provides $4,850 in monthly benefits, beginning on the 90th day of disability, and is payable to age 65. Cost-of-living and residual/partial disability benefit riders were also included. The actual annual premium was $1,878, not $2,000. Premiums vary with age, health, gender, occupation and contract provisions, but a benchmark in the industry is that a solid individual disability plan can be secured at a cost of approximately 2% of gross income.

The napkin format emphasizes the benefits, and implies the cost (by showing the $98,000 instead of $100,000). But too often, a nuts-and-bolts discussion of whether to secure comprehensive disability protection ends up focusing on the premium. When cost becomes a predominant concern, benefits can easily be obscured. If you already believe you can avoid disability, and rely on other partial coverage, it's hard to forgo 2% of gross income over your lifetime for something you're sure you won't need.

BUT LOOK AGAIN AT THE $0 IN THE BOTTOM LEFT CORNER OF THE NAPKIN.

WHO CAN AFFORD A ZERO BENEFIT IF THEY ARE TOO SICK OR INJURED TO WORK?

> When the napkin isn't stained by misconceptions about disability, the picture is clear. The ability to earn an income – your greatest financial asset – is not only worth protecting, but can be accomplished at an affordable price. ❖

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Ultimate Success in Small Business Requires a Succession Plan

When you read the numbers, you can't help but admire small business owners. A March 2014 FAQ issued by the Small Business Administration (sba.gov) finds that almost one-half of private-sector employment and economic output comes from firms with 500 employees or less. Further, small businesses create almost two-thirds of new private-sector jobs.

Notwithstanding their robust contributions to the US economy, small businesses are risky ventures. For 2011, the US Bureau of Labor Statistics reported that 24% of businesses failed in their first year of operation, and 48% didn't make it past the second year. Small business ownership is not a fast track to guaranteed financial stability; success usually requires a lot of persistence and sacrifice. And anyone who has survived to thrive in a small business should certainly be well-compensated for their efforts.

Unfortunately, after devoting great time and energy to building a profitable enterprise, many small business owners neglect to prepare for their eventual departure from the company. After working so hard to succeed, the long-term rewards from their labors are diminished by the absence of a succession plan.

> Many small business owners fail to prepare for their eventual departure from the company.

The numbers suggest this is a very real issue for small business owners. A 2007 Family Business Institute report found that only about 30% of family-owned businesses survive into the second generation. And while some businesses may not transfer to the next generation because the owner simply decides to close the business when he/she stops working in it, there are plenty of others who want to transfer their businesses, but don't. In a business column for the January 11, 2015, *Arizona Republic*, management consultant Gary Miller writes: "Currently, 80% of business owners of small and middle market companies who put their businesses up for sale never close the transaction." Miller sees this dilemma growing: "With the impending Baby Boomer tsunami, more businesses will be for sale than at any other point in history, creating a buyer's market."

Exit Plans should be Established at the Beginning (or Shortly Thereafter)

To maximize the lifetime value from building a successful business, owners should probably begin considering their departure from it as soon as it appears the business will be profitable. This is not to say owners should leave the business as soon as possible. But once it has been established as a going concern, the creator(s) should consider how to preserve its current value and maximize future benefits.

A succession plan will not be a one-time set-it-and-forget-it event. Rather, owners should see it as an ongoing project, one that will require regular adjustments and likely involve a variety of legal and financial arrangements, with ongoing reviews by legal, financial, and tax professionals. But for all the complexity, most succession issues fall into two categories: ownership and funding.

Ownership

The essential ownership question is: When the original owner departs, who will assume control of the business? This question usually spreads out into specific ownership issues. Some examples:

- **In the event of an early death, do surviving family members have an interest (or aptitude) to run the business?** Business owners reflexively think of the next generation, but the first family member to be considered is a spouse. This issue is particularly challenging for partnerships, because a surviving owner may not be excited about working with an ex-partner's spouse.
- **How many family members are interested in the business?** It is understandable that business owners would want to transfer ownership to interested heirs. But if some children have no desire to work in the business, the challenge is how to equitably pass on the company's wealth, given their unequal participation.
- **Can "outsiders" become owners**? If an owner wants to retire or leave the business, do the remaining owners or heirs have the right to restrict the sale? Or must a departing interest be purchased by surviving owners?

These ownership issues can be addressed in various ways. For example: Buy-sell agreements preemptively address an untimely death by designating a pattern for ownership succession. Issuance of voting and non-voting stock allows active heirs to manage the business, while permitting non-participating heirs to realize an appropriate percentage of future profits.

Transfer-of-ownership issues multiply if there are several owners with varying percentages of interest, or if there are several generations involved prior to the transfer of the business. Because ownership is a legal construct, getting the terms of ownership correct is a must. Improper titling not only risks court battles, but may cause estate and tax headaches as well.

Funding

In most business transfers, the transaction is effected with cash – the buyer/successor pays the departing owner. If the departure is an untimely death, a typical cash source is life insurance. For a retiring owner who wants to sell the business to provide a stream of income, sources for cashing out can vary. Some owners might be content with an agreement that has the successor send them (or their heirs) a monthly check for a specified period. But many sellers may not want to rely on a new owner's promises to keep paying them. They want the certainty of cashing out, and receiving their business's present value in full. In these instances, the sale of a business will often require financing. One of the keys to a successful succession plan is facilitating the funding.

Because small businesses are often a unique mix of an owner's sweat equity, hard assets and debt, they can be difficult

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to value and harder to sell, even to family members. Prospective investors or lenders will want credible documentation of the business's viability – particularly without the current owner – in order to participate. In the *Arizona Republic* article, consultant Miller says the two primary reasons small businesses aren't transferred are poor planning and overvaluation. Accurate assessments from good data give both buyers and sellers the best opportunity to complete the transaction.

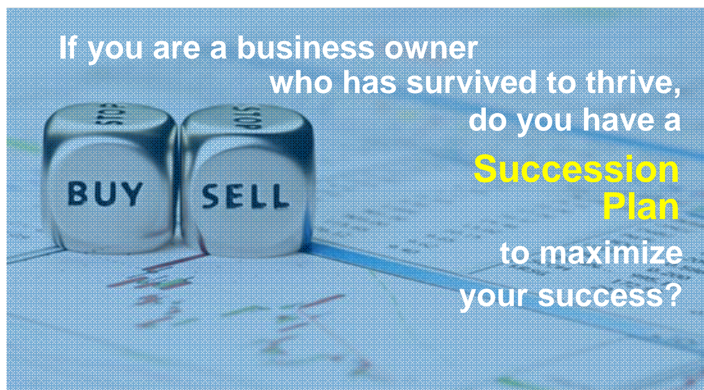
Life Insurance: A Succession Cornerstone

As a business's life progresses, things will change, and what once seemed like a viable succession plan will no longer fit. A future-oriented owner will constantly reassess the ownership and funding issues, and adjust. But in the midst of almost-certain change, **life insurance can be a constant succession plan asset**.

In fact, life insurance may be a critical business transition asset. Because of its unique now-and-later characteristics, attorney Andrew Sherman, in an article for entrepreneurship.org, says: "A life insurance policy is often the cornerstone of a business's succession plan." As circumstances change, life insurance can be repositioned to meet new financial objectives.

- In the event of an owner's untimely death, a life insurance benefit can settle creditor claims and provide survivors with financial resources to either maintain the business or afford to liquidate it.
- Longer-term, cash value accumulations from the same policy, which may not be guaranteed, could be a supplemental source for retirement income.
- Life insurance can be the primary funding vehicle in a buy-sell agreement; the death benefit can purchase a deceased partner's share of the business from the estate, and cash values can facilitate a buy-out if one partner wants to leave.
- In one-way buy-sell agreements, such as a child succeeding a parent, cash values may be a source of funding or collateral for financing the purchase at the owner's eventual retirement.

Just like ownership stipulations in succession documents, the proper assignment of life insurance ownership and beneficiaries is critical to effective use in a succession plan. After a lengthy section detailing life insurance use in Volume 1 of Pepperdine University's 2014 *Graziadio Business Review*, author Otis Baskin concludes, "If this sounds complicated, it is." Succession planning is not a do-it-yourself project. Many business owners may be self-made, but it is almost impossible to self-succeed. Professional assistance is not only recommended, but necessary.



Don't Ignore the Saving-Investing Distinction

Enter the phrase "difference between saving and investing" in a search engine, and there will be no shortage of material. From blogs by personal finance hobbyists to formal statements (complete with disclaimers) by the Securities and Exchange Commission, a lot of parties have something to say about the topic. And most of it is essentially the same:

- **Savings** refers to money in low-risk (often guaranteed) accounts or products that are also easily accessible (liquid). Money allocated to savings has two primary functions: to serve as a short-term emergency fund in the event of a job loss, accident, or some other event that disrupts income, and to be a sinking fund for larger purchases anticipated to occur in the next few years.
- **Investments** are financial instruments with the potential to deliver greater cumulative returns than money held in savings, but typically also include the possibility of loss. Historically, investments perform best over longer time horizons, and may be less liquid than savings.

Both types of accumulation are important. Adequate savings protects households from financial turmoil and spares them the costs of financing, particularly with high-interest credit card debt. The stability and efficiency of adequate savings makes it possible over time to make larger allocations to investments.

Successful investing gives households a chance to "get ahead" by producing growth that exceeds inflation and multiplies personal wealth beyond what can be obtained through individual earnings.

Because savings are **foundational to financial stability**, the conventional approach is to first build an emergency fund, typically equal to three to six months of living expenses, then begin allocations to investment accounts.

What's so hard to understand?

In the world of personal finance, understanding the difference between saving and investing is kindergarten material. But as easy as it is to explain, and as much as financial experts of all stripes talk about it, many consumers fail to make the distinction between these two accumulation categories.

Because savings are **foundational to financial stability**, the conventional approach is to first build an emergency fund, typically equal to three to six months of living expenses, then begin allocations to investment accounts.

A June 2013 bankrate.com survey found that 76% of Americans “don’t have enough savings to cover at least six months of emergency expenses.” At the same time, retirement accounts primarily intended for investing, like 401(k)s, end up standing in for absent savings. Consider this excerpt from a June 19, 2014, *Money* article:

> Nearly one-third of Americans say they have taken a loan from their retirement plan, according to a study by TIAA-CREF, a retirement plan administrator. Many borrowed for urgent reasons: 46% used the money to pay off debt and 35% cited a financial emergency. But a significant percentage of 401(k) savers are using their nest eggs for non-emergencies: 25% report borrowing for a home purchase or renovations, while 15% use the money to pay for weddings and vacations.

Every reason listed for borrowing from their 401(k) investments is something that should have been addressed by savings. Adequate saving would have allowed existing investments to remain invested and eliminated both interest costs and monthly loan payments.

Why are Americans so confused about saving and investing? Some blame low interest rates, others focus on the taxable status of many savings vehicles. Another factor could be marketing: the potential to earn 10 percent has a lot more “sizzle” than a savings account that barely yields 1 percent.

What about you?

Statistics summarize the prevalent behaviors of large numbers of people. They may be informative, but they are not determinative. Just because “everyone else” under-saves and uses their 401(k) account as a messed-up substitute doesn’t mean you have to. You can choose to save, even if many of your peers do not. Don’t be a statistic. Undervaluing saving in your financial program isn’t a short-cut to financial stability; it’s a risk that can end up costing you a lot more than you think you’ll “save” by not saving.

- **Do you have 6 months or more of living expenses in an emergency fund?**
- **Have you saved for your next car, home appliance or vacation?**
- **Does your saving program need to be beefed up?**

If you couldn’t answer “yes” to the first two questions, the answer has to be “yes” to the last one.

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