

Creative

wealth maximization strategies*

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Blue water sailing refers to open-sea sailing, such as ocean crossings, where one is unable to put in at a sheltered harbor to avoid heavy weather. When storms bear down, a sailboat and its crew must be able to ride out the event, sometimes trimming all sails and simply absorbing the punishment of violent winds and heaving seas until the storm passes.

If you are a casual sailor just developing an interest in blue water sailing, you probably don't crave the experience of 24 hours below deck while 30-foot waves toss you around like a t-shirt in a washing machine. You're more likely thinking about how your boat will perform in fair weather with favorable breezes. But if you're heading into blue water, you want a vessel designed to survive the worst the ocean can throw at you, because in the words of an experienced sailor, "When you're in Blue Water, the only thing you have is your boat."

Blue Water and Life Insurance?

There is a blue-water parallel in the design philosophies underlying "permanent" or whole life insurance: fair-weather performance is a factor, but the most important design elements are the ones that will help you ride out financial storms and get you safely to your destination. From a blue-water perspective, it's the guaranteed¹ features, benefits and flexibility that make a permanent life insurance policy seaworthy.

Yet the prevailing financial culture that exalts rate of return and accumulation as performance measuring sticks often obscures the blue-water characteristics of permanent life insurance. Minimizing the protection features, permanent life policies are often assessed solely as "investments," with comparisons to various accumulation vehicles from CDs to mutual funds.

Life insurance companies inadvertently facilitate this myopic approach by producing ledger illustrations showing projected cash values for 20, 30, 40 years, or longer. For many prospective buyers of permanent life insurance, a ledger illustration is their primary reference point, not only relative to other accumulation options, but also in determining how to construct the policy. This is a flawed method for designing and selecting a life insurance policy. While cash values are certainly a valuable component in permanent life insurance, projected values are hardly the definitive issue.

The chart below shows 30 years of dividend interest rates² for six highly-rated issuers of permanent life policies.

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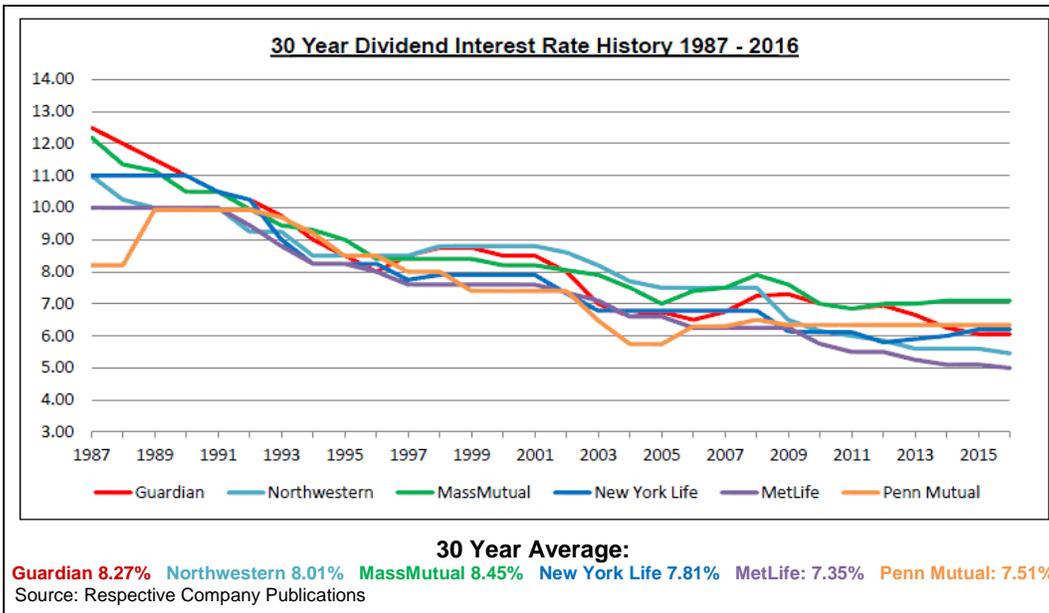
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- **Low, fixed loan rates**, particularly for policies more than 20 years old or for insureds over 65, provide financial certainty for those who may want to systematically withdraw cash values to supplement retirement income.
- One insurer (Guardian Life) even permits dividends and Paid-Up Additions (PUAs)⁴ to be **allocated to equities-linked indexes**, while maintaining the safety of the guarantees of a whole life contract.

For those who appreciate the utility and long-term value of permanent life insurance, these are the blue water features that should influence a buying decision, not a ledger illustration. And excepting Guardian’s index feature, the six companies listed in the

The three-decade trend of declining interest rates is reflected in the results of each insurer. At various times over 30 years, each company has been “first,” but no company can claim they “beat the market,” or delivered returns superior to their peers. Whatever the projected illustration numbers might have been, actual performance has been markedly similar. In blue-water terms, there’s little to distinguish the fair-weather results posted by each company.

Blue Water Essentials Aren’t on a Ledger Illustration

Every ledger illustration is a fair-weather assumption: you will live a long time, have good health, and fully fund the policy. There is no accounting for a financial “storm,” like a market downturn, a disability, a loss of income, a legal entanglement, a premature death, or a terminal illness. But properly outfitted, a true “blue water” permanent life insurance policy can be invaluable in riding out these rough stretches.

If the fundamental guarantees regarding premiums, cash values and insurance benefits constitute the **hull** of a blue water life insurance plan, these pieces are the **rigging**, items essential to keeping your financial plans afloat under duress:

- **A Waiver of Premium for Disability**³ ensures the policy stays in force, and continues to accumulate cash value. This benefit often serves as “savings” insurance; while disability insurance may replace a portion of income, this waiver guarantees that some accumulation will continue as well. An “Own-occupation” waiver further enhances this benefit.
- **Flexible Paid-up Addition**⁴ (PUA) features allow for irregular additional premium payments. This option can accelerate cash values, allow for the deposit of lump-sums, or systematically increase the insurance benefit – without requiring additional evidence of insurability.
- **Guaranteed Increase Options** permit policyholders to add coverage at later dates without the need for additional underwriting. If your financial risks get bigger, your benefits can adjust to cover them.
- **Long-term Care riders**³ and accelerated benefits provisions for chronic illness and terminal conditions mean insurance benefits can be accessed prior to death on a contractually guaranteed and tax-favored basis.

dividend chart all offer these critical design elements.

But the particulars of these blue water life insurance features can vary significantly, particularly for PUA transactions and disbursements for long-term care and terminal illness. It is essential to know that each policy has the right combination of riders and contractual provisions (especially in cases where it seems desirable to divide the risk between two insurers).

Don’t See Blue Water in Your Future? You Never Know

Some people try to skirt the blue water design process. They say, “I’m not planning to go there. What I have should be good enough.” But just like a quickly rising storm can surprise a day sailor and carry him to deep water, your finances can be dragged out to sea, where the only financial asset that is still functioning is your permanent life insurance policy.

In order to reach your financial objectives, you may have to survive some storms along the way. With an insurance policy designed for blue water, your projected cash value accumulation may not finish first, but you can complete the voyage. ❖



¹ All whole life insurance policy guarantees are subject to the timely payment of all required premiums and the claim-paying ability of the issuing insurance company.

² Dividends are not guaranteed and are declared annually by the company’s board of directors.

³ Riders may incur an additional cost. Rider benefits may not be available in all states.

⁴ Paid-Up Additions (PUA) are purchases of additional insurance (death benefit) that have a cash value. These purchases are made with dividends and/or a rider that allows the policyholder to pay an additional premium over and above the base premium. This creates the growth of death benefit and cash values in a participating whole life policy.

ZIRP, NIRP and Helicopter Money: What Do You See?



“When all you have is a hammer, everything looks like a nail.” – Abraham Maslow

If a group of people are asked to observe and evaluate the same situation, their responses will inevitably be influenced by many factors, both conscious and unconscious. One of the more intriguing elements in this evaluation process is how individual responses are affected by the opinions of others. The power of “groupthink” can sometimes make us accept perspectives that from our own experience seem contradictory or illogical. For example: The best way to jumpstart a sluggish economy burdened with heavy debt is to encourage *more* debt and spending.

This is just one of several seemingly counter-intuitive measures being promoted by some economic experts to improve the global economy. Starting from a belief that a healthy economy is primarily the result of robust consumer consumption, they steadfastly exhort governments and central banks to pursue strategies that will boost this activity, even if doing so appears to defy “conventional” financial principles, and cause damage to other aspects of the economy. As a result, according to *Wall Street Journal* writer Paul J. Davies, we have a financial environment where

“Banks and insurers don’t like it, borrowers are seeing little or no benefit from it and savers and pensioners fear their money is being eaten away by it...and yet no one really knows exactly how it is supposed to help.”

These economists might be the smartest people in the room, but most of us are having a hard time seeing what they see.

What Central Bankers See

The “it” Davies is talking about are the interest-rate and monetary policies enacted or proposed by central banks, such as the Federal Reserve, the European Central Bank (ECB) and the Bank of Japan (BOJ). As the entities responsible for overseeing the monetary system, central banks attempt to maintain stable currencies, manage inflation and encourage full employment by managing the commercial banks under their jurisdiction.

In the wake of the last recession, when so many mortgages defaulted and households filed for bankruptcy, banks were compelled to tighten their lending standards and increase their financial reserves. Decreased lending meant diminished economic activity and a slow recovery. For some national economies, this pivot to financial responsibility produced not recovery, but painful austerity, even fewer jobs, decreased government pensions, and no growth.

This expansion-contraction oscillation is a fundamental characteristic of a credit-driven economy; every so often bad debt needs to be cleared for new growth to occur. But until they are over, contractions are painful. Businesses close, jobs are lost, households go broke.

Recessions might seem like logical and inevitable consequences of too much debt, but it’s a central banker’s job to prevent their occurrence. So when a downturn looms, there are steps central banks can take to try to moderate or stop a contraction.

A central bank can change interest rates. Lower interest rates make borrowing more attractive, which should spur economic activity. But in the aftermath of the last recession, many commercial banks felt it was better for their bottom line to hold their reserves and earn interest from the central banks rather than make loans which might not be repaid. To discourage this “institutional hoarding,” central banks cut their interest rates to zero, hoping to force the commercial banks to lend instead.

But things haven’t unfolded as the central bankers hoped. Even at lower rates, a lot of people remain poor lending risks; they aren’t making enough money and still have too much debt. And many other consumers who have “recovered” from the recession are hesitant to borrow again.

There are ripple effects from this Zero Interest Rate Policy (ZIRP) to other areas. Savings and other guaranteed financial instruments are also yielding historically low returns. Retirees in need of income have fled to riskier investments, which has inflated stock values, but done little for the broader economies. And consumer spending remains depressed. In some cases, the lack of economic activity has triggered deflation – which means even at zero interest rates, there is less incentive for banks to lend or consumers to spend.

For central bankers, the next “logical” step has been a negative-interest-rate policy (NIRP). In early 2016, both the ECB and the BOJ instituted negative inter-bank interest rates, meaning commercial banks are now paying a fee to hold excess reserves. NIRP drives interest rates even lower; the interest paid on many savings accounts is effectively zero (.01 percent). And if account fees are assessed, real return is negative. NIRP means individuals and commercial banks are paying for the privilege of using the banking system to hold their money.

Both ZIRP and NIRP were envisioned as short-term stimuli. Once spending picks up, employment should follow, and interest rates can return to normal levels – which would be good for banks, savers, insurers, etc. When ZIRP started in 2009, no one thought it would last for seven years, or lead to NIRP. The US Federal Reserve made an attempt to unwind ZIRP with a small interest rate increase in 2015, but because of continuing slow growth, has suspended further increases.

These actions by central bankers have upended many long-held tenets of modern finance. As John Mauldin puts it, ZIRP and NIRP are “killing retirement as we know it...The Federal Reserve and other central banks have spent so many years subsidizing debt and punishing savings that it is now extremely difficult to guarantee future income streams at a reasonable present cost.”

What Individuals See

No matter what a central bank economist might see, it’s hard for individuals to get the negative-interest rate picture. In fact, NIRP causes some bizarre financial visions.

A general reaction is to hoard physical cash rather than paying

to keep it in a bank. In February 2016, several news outlets reported that Japanese stores were selling out of household safes (where the interest rate is zero, not negative), and that the demand for paper money had increased steadily for the past two years.

There are other upside-down financial possibilities. In a February 12, 2016, *New York Times* article, Neil Irwin wondered if prolonged negative rates could change consumer behavior in odd ways:

“Would people start prepaying years’ worth of cable bills to avoid having money tied up in a money-losing bank account? How about property taxes? Would companies and governments put in place new policies prohibiting people from paying their bills too early?”

Other Options to “Improve” Your Financial Eyesight

Money in a safe is money out of circulation, the very opposite of what central bankers believe the economy needs. To get individuals spending, some economists have called for limitations on cash holdings, primarily by eliminating higher-denominated bills. The Eurozone has proposed eliminating its €500 note, and former US Treasury Secretary Larry Summers recently advocated for an end to the \$100 bill – ostensibly to curtail criminal activity, but also to prevent money from circulating outside of banks. If all money is digital and transacted through banks, negative rates for keeping it idle might prompt spending.

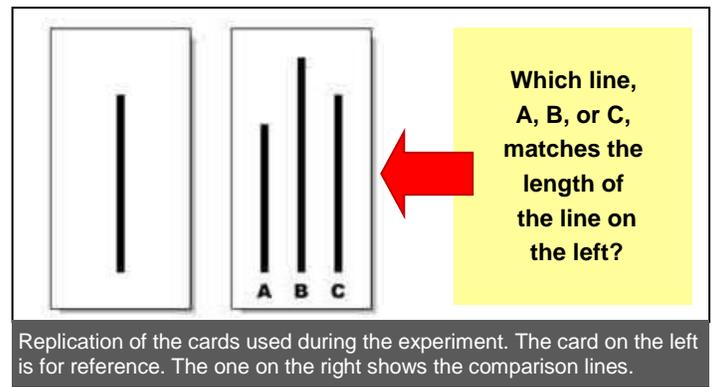
But the control implied by a cashless economy might not be politically palatable. And there’s another financial “Twilight Zone” idea: Helicopter money. If the banks can’t induce people to borrow and spend, why not skip the middleman and simply hand out money – or more accurately, make an electronic deposit to everyone’s account? This is what economist Milton Friedman in 1969 referred to as “helicopter money,” a one-time event in which money is “dropped from the sky, and hastily collected by members of the community.”

Why would a central bank do this? Here’s Mark Gilbert, in a March 5, 2016, *Chicago Tribune* article:

“The hope would be that putting more money directly into consumers’ pockets would send them scurrying to the shops to spend their windfalls...In practice, a central bank wishing to drop money on its constituents would probably either just add money to their bank accounts, or move in tandem with the government to fund a national tax cut. We’d all wake up a bit richer on a Monday morning.

What do you see?

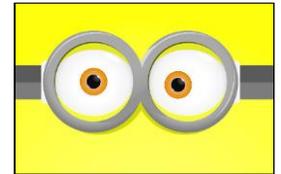
In the 1950s, psychologist Solomon Asch performed a series of experiments on social conformity involving a simple visual test. In a room of eight participants, each one was asked which line on the second card most closely matched the first. Seven of the respondents in each group were “plants,” instructed to occasionally give wrong answers. The one true test subject was asked either last or seventh, after hearing the responses of others. Even though the correct answer was obvious, 75 percent of the test subjects at least once gave a wrong answer because it conformed to the consensus. They succumbed to groupthink, and stopped believing their own perceptions. (Some even argued vigorously that their wrong choice was right!) Asch also noted that 25 percent of the test subjects were unfazed by the comments of their peers; even when everyone else chose the wrong line, they remained firm in their convictions.



From a central banker’s perspective, increased consumer spending is an imperative. ZIRP, NIRP and helicopter money are the tools at their disposal to make it happen. They all agree: To not use these tools would be irresponsible. While it may not have been done before, it’s what must be done.

Yet like the 25 percent who resisted conforming, there are those who continue to save, even if their “bank” is now a mattress or a safe. They just can’t see how negative rates and increased borrowing can lead to prosperity, for themselves or the economy at large.

What do you see? It’s an important question to answer, because these central bank decisions represent uncharted territory, and the consequences are hard to predict. And it’s a question you ought to ask the financial professionals that have been helping you save for the future. Sometimes groupthink is wrong, and you have to trust your perceptions and the perceptions of those you trust. ❖



When the topic is group disability insurance, master swordsman Inigo Montoya from the 1987 movie “Princess Bride,” might reply: *“You keep using that word ‘covered.’ I do not think it means what you think it means.”*

Montoya’s skepticism is justified. What is considered “covered” by an employer’s group disability plan may leave some employees far more exposed to financial hardship than they assume, when they are told the policy will replace 60 percent of income. It’s not until you get answers to the question **“60 percent of what?”** that you can be sure your income is protected.

A quick overview of disability insurance metrics:

- If disability insurance benefits fully replace one's income, there is a potential moral hazard: It may be more desirable to collect disability than work. Consequently, insurance to replace 60 percent of one's income is an industry benchmark for most group disability plans.
- Insurance companies assess premiums in keeping with the benefits they anticipate having to pay. To control costs, a group plan usually places limits on benefits, either by imposing a cap on monthly payments, or by limiting the definition of income to base salaries while excluding variable compensation like bonuses.
- If the premiums are paid by the employer, any benefits received by an employee are considered taxable. Conversely, when the employee pays the premiums (typically through payroll deduction), benefits are non-taxable.

From just these three factors, it's easy to see how critical it is to understand "60 percent of what?". Is it 60 percent of base salary? What items are included in the base? Is there a monthly benefit cap? Are benefits taxable or non-taxable?

Calculating benefits can be complex and confusing. Some employees with incomes on the lower end of the payroll might receive 60 percent of compensation in the event of disability, while others – in the same plan – could be covered for as little as 20–30 percent of their net take-home pay after taxes. Consider this example, provided by Gary Terry in an April 2013 trade publication article:

The vice president of sales for a consumer products company makes \$400,000 per year, which includes a base salary of \$250,000 and a bonus of \$150,000. He is suddenly hospitalized for complications from diabetes and he goes out on long-term disability. It's his belief that his monthly disability income will be \$20,000 per month ($\$400,000 \times 60\%$ divided by 12 months). Think of his surprise when a monthly check shows up in the amount of \$12,500 ($\$250,000 \times 60\%$ divided by 12).

For this vice president, his 60-percent-of-income benefit is actually 37.5 percent – and it might be lower. If the group plan has a monthly benefit cap of \$10,000, or these benefits are taxable because the employer paid the premium, the net benefit drops to around 25 percent. To repeat: "Covered" may not mean what you think it means.

Completing your coverage with individual disability insurance

Employees, especially those with high and fluctuating incomes, should consider addressing potential group plan shortfalls by securing additional coverage through a individual disability income replacement policy. This can not only fill the gaps in a group plan, but may allow the total disability benefit to exceed the 60 percent group threshold. Better still, in many cases, a single individual policy can provide a lifetime of valuable income protection.

- Most individual disability policies are non-cancelable and guaranteed renewable; as long as you pay the premiums, the benefits can't be changed or eliminated.
- Individual disability insurance is portable; if you change employers, you can take the policy with you.

- Benefits from a individual policy usually are not diminished or coordinated with benefits that may be paid by worker's compensation or Social Security.

Adding individual disability protection is a personal project, not an employer-sponsored benefit. Most individual policies involve underwriting; an application will be submitted, a medical exam and income documentation may be required. And premiums will typically be paid by the insured, not the employer.

But the extra work (and cost) might be worth it. Because when you have individual disability insurance, 'covered' can really mean what you think it means. ❖



In classical economic theory, people make rational decisions in their best interests. In real life, people make dumb decisions all the time.

The gap between ideal and actual behavior guarantees employment for financial behaviorists. They study human decision-making and develop methods to guide us toward better outcomes, using things like default options, framing devices, mandatory disclosures, consumer education, or tax incentives. But some research indicates a most effective way to improve our decision-making is lot simpler: make your important decisions in the morning, on a full stomach. Specifically, the optimal time for decision-making is between 10:00 – 11:00 am, after a breakfast that features high-quality protein.

The science behind these conclusions is quite interesting. Professor Baba Shiv, from the Stanford Graduate School of Business, says serotonin, a hormone which has a calming effect on the brain, is at its cyclical high in the morning after awaking from sleep. In this serotonin-rich state we are better equipped to contemplate difficult or complex issues, and more likely to make good decisions.

Shiv says a breakfast featuring high-quality protein prolongs serotonin levels, typically to midday. But as serotonin levels decline later in the day, "we gravitate toward the status quo," and resist making decisions. Indecision becomes our default preference.

Besides sustaining serotonin levels, a full stomach seems to encourage impulse control. A 2007 Dutch study found that fasted (hungry) individuals made riskier bets on a financial decision-making task involving lottery choices, while those who were full made the safer choice.

Another factor in favor of morning decision making: most people haven't yet encountered "decision fatigue" by 11:00 am. Repeated decision-making exacts a cumulative physiological toll. John Tierney, co-author of "Willpower: Rediscovering the Greatest Human Strength" put it thusly in an August 2011 *New York Times* article:

No matter how rational and high-minded you try to be, you can't make decision after decision without paying a biological price. It's different from ordinary physical fatigue — you're not consciously aware of being tired — but you're low on mental energy.

In light of both the chemical and physical factors at play, Dr. Amantha Imber, an Australian organizational psychologist, recommends scheduling major decisions and meetings before 11:00 am whenever possible. If important decisions must be made later in the day, Dr. Imber says it is beneficial to schedule a rest period immediately before the meeting.



Seriously...This is a Good Idea

In most households, money has a major role; even if it's not front and center, money is always on the stage. There are car payments, mortgages, groceries, and taxes to pay. There are retirement plans, college savings accounts, and vacations to save for. For most of us, our money management isn't on auto-pilot; we face dozens of financial decisions each day. Do you remember how many of these financial decisions, especially the really big ones, were made before 11:00 am? Probably not. Our awareness regarding big decisions gets lost in the volume of decisions made every day.

But going forward, it's worth asking: If you're meeting with a financial professional after work to discuss your retirement allocation, an estate planning strategy, or a long-term care policy, have you already compromised your ability to make a good decision?

It's probably not necessary or practical to insist that all important financial decisions be made before 11:00 am. And there is no guarantee that just because a decision was made in the morning it will be the right one. But if you can meet with your financial professionals in the morning, why not plan on it? And have a good breakfast. ❖

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