

Creative

wealth maximization strategies*

 **John Driscoll & Company, Inc.**

5080 N. 40th Street, Suite 400
Phoenix, AZ 85018

Phone 602.957.7155 • Fax 602.956.7711

www.JDriscollCo.com

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Financial Ideas That Have



“Jumped
the
Shark”

In September 1977, the hit TV show “Happy Days” started its fifth season. Since its debut, the situation comedy about 1950s-era high schoolers had seen a once-minor character, Arthur Fonzarelli – “the Fonz” – become a pop-culture icon for his leather jacket and cool demeanor. The season-opening episode began with the central characters visiting Los Angeles, where, in response to a dare, the Fonz was about to jump a shark – wearing water skis *and* his leather jacket.

For many fans and critics, this ludicrous plot development marked a turning point. While “Happy Days” would continue for another seven years, they felt the show was different – and not as good – compared to the first five seasons.

In 1985, radio personality Jon Hein coined the term “jumping the shark” for the moment a once-popular TV show starts to lose its way. Today, the phrase has expanded to any event or idea “that is believed to be past its peak in quality or relevance.” Just because something has jumped the shark doesn’t mean it’s gone,

or that some people don’t see benefit in it. But as Hein put it, “You know from now on, it’s all downhill...it will never be the same.”

Hmm... “ideas that are believed to be past their peak in quality or relevance.” That sounds like a provocative starting point for some personal finance commentary. For your consideration: Two candidates from the realm of personal finance that may have jumped the shark.

Pre-tax qualified retirement plans

Pre-tax qualified retirement plans are those in which contributions from earnings are deductible from current income, accumulate tax-free, and are taxed when distributed. This format started with the authorization of Individual Retirement Accounts in the 1970s, then evolved in the 1980s to the employer-sponsored 401(k)s and 403(b)s that predominate today.

These plans were formulated on two intriguing premises: First, employees would have control over their investment choices, with the accompanying opportunity for higher returns. Second, the expectation of lower tax rates during the distribution phase in retirement meant the tax-deferral would be a long-term economic gain for participants.

Three decades later, even though these pre-tax plans represent the bulk of employer-sponsored retirement options, there is rising dissatisfaction with the format, the premises, and the results.

First, there is ample evidence that many participants are not well-suited to managing their accounts. James Altucher, a financial professional who frequently provides commentary to mainstream financial media outlets, reports in an August 2015 article that “the average investor has returned 1.8% per year over the past 40 years.”

David Dayen, in a March 4, 2016, *Fiscal Times* article, echoes this idea that most individuals mismanage their retirement plans: “It may sound good to ‘control your own retirement,’ but in practice it just loads risk onto people without the resources to handle it.”

And it’s not just mismanagement in selecting their portfolio. Richard Eisenberg, in a January 2013 *Forbes* commentary, notes that at least one in four 401(k) participants “are breaking into their retirement accounts to use the money for financial emergencies and other purposes.” And workers between 40 and 59 – those closest to retirement – are the ones most likely to “breach” their accounts.

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Why does this happen? Eisenberg quotes Mark Fellowes, founder of a personal finance education company: “Many have failed to create emergency savings funds outside of work, so they resort to their retirement plans to handle life’s unforeseen blows.”

Even for those who accumulate prodigious amounts, the benefits may not be there. As Altucher says, “You can’t predict your tax rate 30 years from now. This completely destroys the whole ‘tax-deferred’ argument. You don’t really know if you’re saving money on taxes or not. You are simply having your money taken from you for 30 years.”

In fact, the most prolific 401(k) savers will most likely experience higher tax rates at distribution. Their larger accumulations, combined with rigid required minimum distributions (beginning at age 70½), give them very little room for tax management of their retirement income.

Even the most ardent advocates of government-regulated retirement plans are down on 401(k)s. Theresa Ghilarducci, a designer of “Guaranteed Retirement Accounts” which proposes to combine mandatory contributions with government-mandated portfolio management, and a stream of lifetime payments, says in a November 23, 2016, *Forbes* blog, “We need a new type of 401(k),” because “IRAs and 401(k) do not pay benefits for life, the way annuities and Social Security do, which is what many people want.”

It is still easy to find personal finance commentary that begins, “Why you should max out your retirement accounts.” But that doesn’t mean pre-tax qualified retirement plans haven’t jumped the shark in terms of financial relevance for many households.

Student loans for a college education

Since at least the 1950s, a college degree has been touted as the ticket to better earnings and admission to the upper-middle class. In some respects, the better earnings part is still true (Google “million-dollar difference of a college degree” for proof), but there are two qualifiers: the type of degree matters, and how much it costs to attain it. Consequently, says Thomas Donlan in a May 2015 commentary in *Barron’s*, “Students may find, as some of this year’s graduates have, that going to college is no guarantee of a comfortable job or entrance into the upper-middle class.”

People who blindly tout a college degree for everyone are ignoring basic economic principles of supply and demand. In certain fields, there are now more college graduates than there are

jobs. Consequently, between 30 and 50 percent of recent college graduates (depending on the survey) are either unemployed or under-employed, i.e., they are working in jobs that don’t require their level of education.

And the cost of a college education keeps rising faster than inflation, which means it’s getting more expensive to acquire a credential that may no longer deliver higher earnings. And yet, convinced that a degree is essential, more students borrow to pay for their education. A 2015 analysis by Mark Kantrowitz found that 71 percent of students borrow to pay for college. Two decades earlier, less than half took education loans.

Student loan debt (and there’s a lot of it) further narrows the economic value proposition for a college degree. This has a dampening ripple effect on the broader economy. Here’s a concise explanation provided by Patrick Watson from a November 2016 *Connecting the Dots* article:

- Too many people go to college because they think it is essential to career success.
- Excess supply of college-educated people drives down wages.
- Low pay plus student debt obligations make them look for the lowest price in everything they buy.
- This reduces wages for the less-educated people who sell everyday goods and services.
- Worker productivity falls as low wages discourage the more qualified workers.
- Eventually, robots become the most cost-effective labor.
- More people go to college to get ahead of the robots.

This doesn’t mean a college degree is worthless. But as Jennifer Barrett writes in a June 19, 2015, *CNBC* article “College remains a risky, and expensive investment for families – one whose value diminishes if costs increase faster than wages. At some point, if tuition costs continue to climb, the benefits simply may not be worth the price of admission for some.”

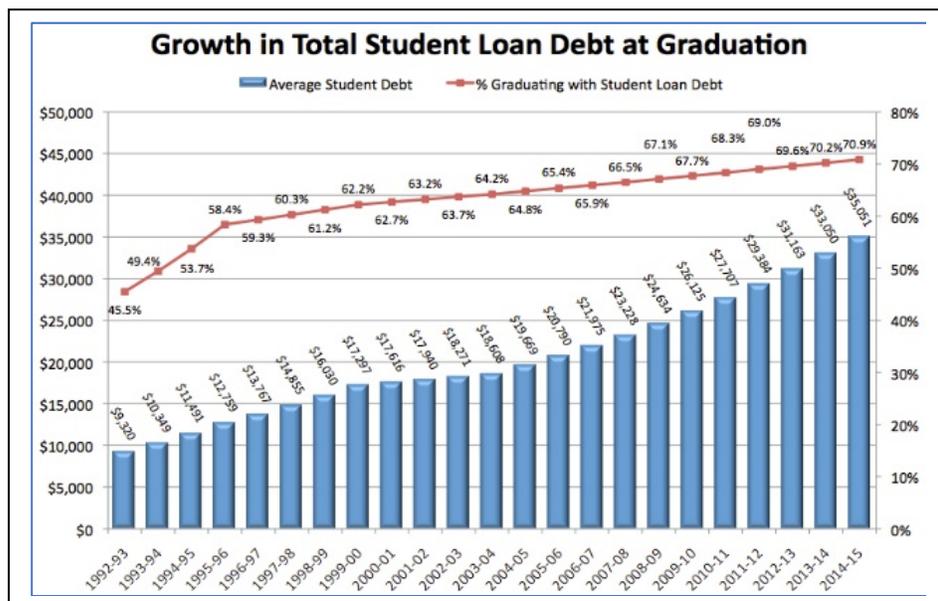
As a one-size-fits-all economic solution, there’s certainly an argument that borrowing for a college education has jumped the shark.

What Hasn’t Jumped the Shark?

Referring to the challenges facing pre-tax retirement plans and borrowing for college, you know what’s part of the problem? A

lack of available savings. Households don’t have enough safe, liquid reserves. They don’t have it for emergencies, so they pillage their 401(k)s. They don’t have it to pay for college, so their kids begin their adult lives with long-term debt. In terms of a topic that’s relevant to the quality of one’s financial life, savings – accessible, liquid cash reserves – hasn’t jumped the shark. If anything, it’s a topic that ought to get more attention, from the media and the financial professionals helping households achieve financial security.

Consider a two-income household with gross earnings of \$120,000. Conventional personal finance metrics would recommend emergency cash reserves equal to 3-6 months of either income or living expenses. If you use the income standard, that’s \$30,000-\$60,000. If you remove taxes and savings to arrive at living expenses, the number is probably still between \$24,000 and \$48,000. So how many upper-middle-class households like



this example have \$50,000 or more in cash reserves?

Well, a 2014 Federal Reserve report found that only 45 percent of upper-middle-class households (defined as having incomes from \$75,000 to \$99,999) saved *anything* in 2012. And it noted that this low level of saving wasn't just fallout from the Great Recession. In 2007, i.e., prior to the economic downturn, median liquid savings for the upper-middle class was only \$7,000.

Retirement and paying for college are the highest-ranking topics for discussion when consulting with financial professionals, which is understandable because of the strong emotional responses they elicit; we want security in our old age, and we want our children to succeed. **But one of the reasons these topics have jumped the shark is because we are neglecting the financial foundation of cash reserves that would make these projects sustainable. You can say it's boring, not sexy, and too simple. But a substantial cash reserve has never jumped the shark. Ever!** ❖



In his 1997 bestseller, *Rich Dad, Poor Dad*, Robert Kiyosaki put forward a simple formula for financial success:

“You must know the difference between an asset and a liability, and buy assets. If you want to be rich, it is all you need to know. It is Rule No. 1. It is the only rule.”

Kiyosaki's elaboration on Rule No. 1 was equally concise:

- **An asset is something that puts money in my pocket.**
- **A liability is something that takes money out of my pocket.**

For Kiyosaki, the biggest financial challenge most Americans face is their “financial illiteracy,” their inability to distinguish between assets and liabilities. His classic example is a personal residence: Is it an asset or liability? Especially for those in the middle class, a home is often mentioned as one's “greatest asset,” based on the amount of equity that usually accrues over time. But Kiyosaki disputes this notion, because maintaining a personal residence takes a lot of money out-of-pocket (in the form of mortgage interest, property taxes, maintenance costs, etc.), and puts no money back in – until the home is sold.

Some accounting professionals have taken issue with Kiyosaki's definition of assets and liabilities, primarily because of its focus on immediate return as opposed to future value. Kiyosaki has acknowledged this difference, saying he is primarily interested in the cash flow that results from a transaction, not a speculative future value.

But applying Kiyosaki's simple asset-or-liability litmus test to other financial instruments can generate some interesting discussion. For example:

Is life insurance an asset or a liability?

In light of Kiyosaki's “in-my-pocket or out-of-my-pocket” definition, an answer requires some careful thought. A life insurance policy can be:

- 1. A current asset or a liability for the policy owner.**
- 2. A future asset for the beneficiaries.**

When a prospective borrower provides financial information for a lender, life insurance cash values are considered assets. And the regular dividends² paid to cash value policyholders could be considered “putting money in your pocket,” too. So, life insurance cash values probably fit the Kiyosaki definition of an asset.

The life insurance benefit can be an asset to the beneficiaries, but only if the insured dies while the policy is in force. The question is *when* the insurance benefit will become an asset; it could happen in the next minute, or far in the future. Thus, the death benefit should perhaps be classified as a potential asset for beneficiaries.

But many insurance policies are surrendered before the death of the insured. When a policy is surrendered, any insurance benefit intended for beneficiaries is gone. And the premiums which were paid to secure the life insurance benefit retroactively become liabilities, money out of your pocket.

This quick “asset-or-liability” analysis presents several relevant conclusions:

Keeping a life insurance policy in force until the death of the insured is the only way to guarantee it will realize its full value as an asset. Every life insurance policy, term or permanent, includes an “insurance cost,” the amount kept in reserve to cover the death of the insured, should it occur. Keeping a policy in-force until death is the only way to guarantee an asset will be the end result of incurring these insurance costs. Some term policies may offer a return-of-premium feature, and some permanent policies may project cash values that exceed the total premiums paid. But these adjustments obscure the fundamental equation of life insurance: A premium is paid for the promise of a benefit in the event of the insured's death. If you don't collect a benefit after paying for it, surrendered life insurance seems to fit Kiyosaki's definition of a liability.

Life insurance may have a positive “ripple effect” on other assets. In the 1990s, global chemical manufacturer BASF had a marketing campaign that said “We don't make a lot of the products you buy, we make a lot of the products you buy better.” Properly positioned, a life insurance policy can be a lot like that slogan: It can make a lot of other assets perform better.

This synergy occurs because a permanent life insurance benefit means a guaranteed financial event will coincide with the death of the insured. This guaranteed “final transaction” can have powerful, positive ramifications on other financial assets. For example:

If a lender offers more money or better terms because a borrower uses a life insurance benefit as collateral (to ensure the lender will be repaid in the event of the borrower's death), you

Keeping a life insurance policy in force until the death of the insured is the only way to guarantee it will become an asset.

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might say the life insurance put more money in the borrower's pocket.

If having life insurance allows a pension recipient to take the "life only" option instead of "life and joint survivor" at retirement, the extra monthly income (money in the pocket) occurred because of life insurance.

Similarly, if a guaranteed³ life insurance benefit will serve as an inheritance for heirs, one might feel free to "spend down" other assets instead of conserving principal.

Whenever life insurance permits the increased "spend-ability" of other assets, the result is more money in your pocket.

However...if you buy term life insurance, remain alive, and surrender the policy (because the term has expired, premiums are too high, you no longer want the coverage, etc.), **life insurance will become a financial liability.** Money will have left your pocket to pay premiums and you will receive nothing in return. And the cost of incurring this liability will not be just the premiums, but the opportunity cost – what those premiums could have been worth if they had been used to buy an asset instead.

That said, there may be times when term life insurance is a necessary and beneficial purchase – even as a "liability." Obtaining immediate financial protection against an untimely death can provide an intangible asset: peace of mind. The long-term financial result may project as a total loss, but the near-term risk – "What would happen if I died tomorrow?" – necessitates a response.

Whether or not life insurance is an asset depends on you. With the help of a financial professional, you can choose to structure your life insurance program so that it performs like an asset, or a liability. ❖



As much as we might want to believe there is a magic formula for personal finance which simply requires plugging in the right numbers, success or failure has a lot more to do with our psychological makeup and personal habits than getting the numbers right. The math is the easy part; it's the human element that gums things up. Consider just a few of the "essential" personal factors necessary for financial well-being:

- healthy lifestyle habits.
- stability in career and personal relationships.
- the discipline of living within one's income, and learning to save.
- a willingness to delay gratification to achieve long-term goals, while allowing enough immediate rewards to stay motivated and content in the present.

- an acknowledgement of risks, and how to address them, whether it be through insurance, guarantees, or appropriate management strategies.

It's no wonder there is a burgeoning field of research called behavioral finance, which "seeks to combine behavioral and cognitive psychological theory" to help individuals achieve better financial outcomes. This could mean re-framing a concept (seeing your retirement goal as a monthly income instead of a lump sum accumulation), or applying behavioral "nudges" like automatic withdrawals to make sure saving occurs. And it might be understanding what – or who – we can blame if things go wrong.

Getting Help – So There's Someone to Blame

Passing the Buck: "Delegating Choices to Others To Avoid Responsibility and Blame," is a July 2016 research article by Mary Steffel published in the professional journal "Organizational Behavior and Human Decision Process." Here's the opening statement from the executive summary:

"In seven experiments, we found that participants who were tasked with choosing meals, hotels, investments, or tasks to complete, were two to three times as likely to delegate if the choice affected others and if the options were unappealing."

We might think of "delegating" as passing an assignment off to a subordinate, such as a boss delegating a project to one of her reports. But delegating in this context is different: it's seeking someone *above* us – in knowledge, expertise, or authority – to make the decision. And if things go wrong, there's an implied understanding that the delegate will bear responsibility for the outcome.

Steffel's research makes another thing very clear: Delegation must be conferred upon a **real person**, not an inanimate process. Arriving at a hotel choice by flipping a coin or using an Internet search engine does not qualify as delegation because the responsibility for the decision remains with the person who flipped the coin or selected the technology.

It is also important to note that "delegating up" did not improve outcomes; it just gave the initial decision-maker cover in case things went awry. And while that might sound cowardly, it might be desirable. Better for their relationship if a couple can blame a third-party "expert," instead of having to deal with either the failure or disappointment of one person toward the other.

What about Delegating Money Decisions?

There are certainly personal finance scenarios where our choices could affect others and the options may be unappealing. First, there's a recognition that financial decisions have consequences, not only for the individual, but for a spouse and/or family members. Then there's an awareness of our limited financial knowledge, whether it involves investments, insurance, taxes, borrowing, etc. Add the challenge of scarce resources, of often not having enough money to address every issue immediately. The "it's-all-on-you" responsibilities in personal finance can be daunting.

At this point, we may seek help, and delegate parts of our financial program to someone else. But is expert assistance intended to resolve our challenge, or simply relieve us of the responsibility for the decision? And do we have enough self-awareness to answer this question truthfully?



Michael Kitces, a registered investment advisor who blogs frequently on client management issues, offers an interesting insight on how a consumer’s desire to off-load responsibility may result in less-than-optimal decisions when working with financial professionals.

“Unfortunately, the delegation blame-game also helps to explain why so many advisors with strong personalities and sales skills, but little actual competency, still succeed in gaining clients. (T)he decision to delegate is more about the perceived authority of the delegee to accept blame, than their actual expertise to make a better (financial) decision.”

In short, a desire to delegate may make us more susceptible to sales tactics and less objective in our assessment of both the recommendations and character of the person we’re working with. One of the best ways to mitigate against engaging a financial professional simply to off-load responsibility is to establish a relationship with one before there are hard decisions to be made. When a working relationship has time to develop without pressure, both parties have a better chance of forming a successful working arrangement.

A good financial delegate can share the responsibility for making a decision, but only you have to live with the outcome – even if there’s someone else you can blame. ❖

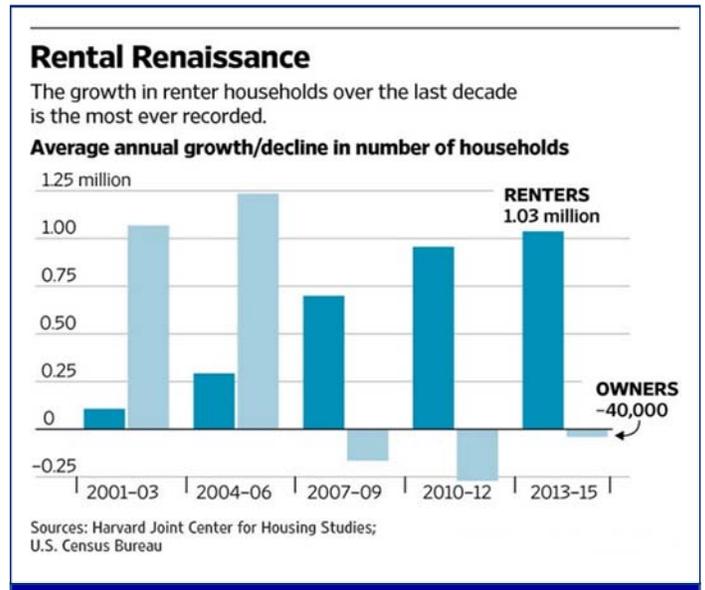


Remember this term: *Horizontal Apartments*. That’s what some real estate developers are calling clusters of single-family homes in rental communities that combine the privacy of individual residences with professional property management to take care of repairs, yard maintenance and more.

These developments, first appearing in Texas and Arizona, typically feature subdivisions of 100 or more rental homes on small lots in suburbs near larger metropolitan areas. Intended to appeal to both Millennials moving up and Baby Boomers downsizing, horizontal apartment communities offer the freedom and flexibility of renting, but with more privacy than a typical apartment complex. And some experts think this format could be a game-changer in the housing market.

Why So Many Renters?

Like other periods of economic distress, the Great Recession decreased the number of home-owning households, and increased those who rent their living quarters. But the magnitude of the increase in renters has some wondering if larger demographic issues are also a factor. Per a report by the Harvard Joint Center for Housing Studies, “The number of renter households increased by 9 million between 2005 and 2015, marking the largest increase over any 10-year period on record.” (see graph)



Some argue that the uptick in the single-family rentals could be short-lived; as the economy improves, more renters will turn into homebuyers. But maybe not. For a variety of reasons, the Millennial generation has what might be characterized as “delayed-onset adulthood”: their career paths are slower (and often start with a “boomerang” back to their parents’ basement), they are marrying and starting families later. Stagnant wages and tighter lending standards make it harder for households to meet down payment requirements. At the same time, Baby Boomers are looking to cash out their home equity and reduce monthly living expenses by unloading their homes.

Horizontal apartment communities seem to reflect these trends. Developers say their average renters are in their late 30s, often have school-age children, and want to get out of apartment-complex living, but don’t have either the resources or long-term job stability to buy a home. The combination of relatively older tenants, especially those with young families, projects to longer rentals. “We hope they stay four to seven years as people keep their kids in school,” says Mark Wolf, a Texas developer. Matthew Blank, principal of an Arizona management group with several horizontal apartment communities, sees this arrangement as the new transitional step to home ownership. “People who rent from us are most likely to buy a house in the future.”

Horizontal Apartments Are A “New Thing” Because Americans Don’t Save

Developers say higher real estate prices in some areas of the country make horizontal apartment projects impractical. And while some property management companies are trying the same concept with a portfolio of single properties scattered in primarily owner-occupied residential neighborhoods, they don’t have the same neighborhood “control” over exteriors and security like they would in a contiguous complex. But even the few horizontal apartment developments in existence may reflect a subtle change in home ownership dynamics.

Historically, a decision to rent or buy has hinged on fluctuating economic and social factors, like interest rates, tax deductions, space for growing families and access to good schools. And with the exception of the zero-down, no-doc lending policies that precipitated the Great Recession, a decision to buy a first home always included coming up with a sizable down payment.

And that might be the real story here: Horizontal apartments are housing for grown-ups who haven’t been able to save for a place of their own. The monthly rent costs aren’t much different than those of a homeowner, but not having savings has limited their choices and spawned the horizontal apartment format. You could say the future of horizontal apartment developments is largely dependent on the savings habits of Millennials; less saving equals more horizontal apartments.



There have been, are, and will be financially sound reasons to renting instead of buying a house. In every housing scenario, the person with savings will have better options. ❖

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John Driscoll & Company, Inc.

5080 N. 40th Street, Suite 400
Phoenix, AZ 85018

Phone 602.957.7155

Fax 602.956.7711

www.JDriscollCo.com

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