Creative
wealth maximization strategies*

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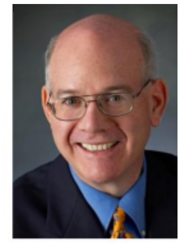

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RESIST THE FAN'S EXPERTISE

"A little learning is a dangerous thing."
– Alexander Pope

Sports may not be in your wheelhouse, but just for the experience, everyone should attend at least one football game. Ideally, this should be either a professional contest, or one at the highest collegiate level, where there will be tens of thousands in attendance. And you should watch the game from stadium seats among the regular fans, not in a luxury suite. This recommendation is made not so much for the action on the field, but that you might observe the behavior of some of the fans, particularly those who believe their knowledge of the game is so vast that everyone around them, friend and stranger alike, must be informed by their pigskin intelligence.

Within minutes of the game's opening, these "experts" will begin their bellowed critiques. It may start with an expression of general disdain, like…

"I can't believe they pay this guy to be our coach!"

Perhaps followed by a specific complaint about strategy…

"Why did they throw on third-and-two? It's two yards! If we can't make two yards running the ball, we're in bad shape!"

These commentaries will continue for the entire game, whether their team is winning or losing. Yet if afterward you read a transcript of their statements, it would be difficult to know who won or lost, because even successes may be judged as unsatisfactory ***("Well, finally!")***.

You might wonder, "Who are these guys, and what are their credentials?" In short order, they will almost certainly tell you that they…

"Played football in high school!"…
"Have been season-ticket holders for x number of years!" *and…*
"Watch a lot of football on TV!"

What you will almost ***never*** hear:

They played football at the college or professional level
They coached football at the high school, college, or professional level
They are sportswriters whose profession is reporting on football.

There are a host of psychological issues that can be discussed in regard to fans, starting with "fan" being short for "fanatic." There is the identification factor, how fans use the word "we" as if they are part of the team. And how the intensity of their identification compels them to reflexively stand for a fight song, jump out of their seats and scream at big plays, and ridicule or even threaten those who root for the opponent. (Not to mention the role of alcohol as a catalyst for this behavior.)

But setting aside any Freudian conjectures, there is an objective assessment to be made: **Most fans, especially the loudest ones, don't know that much about football.**

Want proof? Suppose you took one of these opinionated fans out of the stands and put them in a film room with a few football coaches. Before the play starts, you ask the fan a few questions, using basic terms that coaches know.

For example:

In This Issue…

- ***"What's the offensive personnel package? Is it 12, 21, or 00?"***
- ***"Pre-snap, does the quarterback see cover 2, or man-under with safety free?"***
- ***"Who sets the edge on the boundary side of the field?"***
- ***How do you double-team and bounce to the next level when the DT is in a 4i technique?***

The fan, who was so confident among 50,000 other fans, will inevitably admit, "Uh, I don't know."

Then, as the play unfolds, if asked to identify the offensive and defensive players who either executed their assignments or blew them, and determine the impact of their performance, the fan will again have to confess "Well, I guess I'm not sure."

How can people who actually **know so little** speak so authoritatively?

The Beginner's Bubble

How can people who actually know so little about what's really happening in a football game speak so authoritatively? Blame it on the "Beginner's Bubble."

Research has found that once we learn a little bit about a subject, it often produces a false sense of confidence – we over-estimate how much we know and how well we understand. In a March 2018 article published in the Harvard Business Review, *"Research: Learning a Little About Something Makes Us Overconfident,"* Carmen Sanchez and David Dunning summarize their findings:

> **It appears that Alexander Pope is right when he said that a little learning is a dangerous thing. In our studies, a little learning was just enough to make participants feel they had learned the task. After a few tries, they were as confident in their judgments as they were ever going to be throughout the entire experiment. They had, as we termed it, entered into a "beginner's bubble" of overconfidence.**

Opinionated fans know enough about the game to interpret the drama, and recognize big plays. But when it comes to evaluating strategy or dissecting the details of what just happened, they don't have a clue. They just think they do. And since most of the fans around them have similar levels of knowledge (and ignorance), no one can pop their Beginner's Bubble.

Other "Fans" in a Beginner's Bubble

Since this is ultimately a commentary on personal finance, you should know where this is going. Just like the opinionated football spectator, there are a host of financial "fans" who don't hesitate to speak from their beginners' bubbles of wisdom. Only instead of alcohol-fueled bluster in front of thousands of onlookers at a stadium, these over-confident fans of personal finance dispense their opinions on Internet forums and in the "Comments" section at the bottom of online articles.

Remember, these self-appointed financial experts aren't ignorant. They may know more than you, and they may be very intelligent. But is personal finance their profession, or are they just fans who think they know more than they actually do? Well, if you put them in a room with financial professionals, and asked…

- ***How do you calculate annual returns from monthly dollar-cost averaging?***
- ***What is the difference between alpha and beta?***
- ***Are cash values taxed on a LIFO or FIFO basis?***
- ***How are MEC limits calculated for life insurance?***
- ***Do RMD percentages increase or decrease over time?***

Yeah, that conversation would go pretty much like the one with the football fan in the coaches' film room, for the same reasons: Fans know just enough to be emphatically misinformed.

You Can't Pop a Beginner's Bubble…

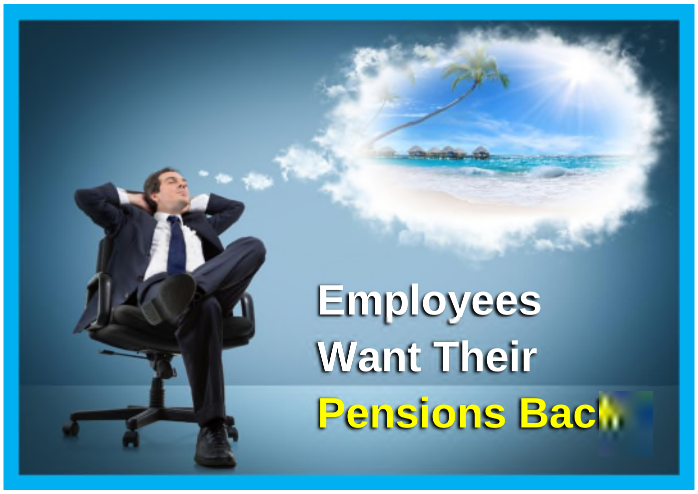
Occasionally a financial professional might venture online and attempt to set the record straight, or offer an informed perspective. But just like there is no intelligent debate in the stands at a football game, the professional's comments will be figuratively shouted down by a host of over-confident neophytes. Recognizing the futility of the discussion, the financial professional discontinues the dialog, leaving the fans to declare triumph, and further solidify their belief that they really know what they're talking about.

Very few fans, in football or personal finance, will publicly concede their ignorance, or change their opinions just because a truly knowledgeable individual tries to enlighten them. Which is fine, because a fan's approval isn't critical to your success.

…But Fans Aren't Qualified to Coach

Acting like a fan yourself can be fun, even cathartic. Watching other fans strut in their beginners' bubbles can be entertaining. But when it comes to your personal finances, you're not just a spectator, watching someone else's game. You're a player, one that might occasionally need some guidance. You want quality information and effective guidance from knowledgeable coaches, not the half-baked opinions of personal finance fans who present themselves as experts because they know enough to be dangerous. ❖

WHO IS INFORMING YOUR FINANCIAL GAME PLANS? REMEMBER, FANS OFTEN KNOW JUST ENOUGH TO BE CONFIDENTLY WRONG.



In addition to a guaranteed monthly retirement benefit from your employer, would you also like investment opportunities, funding control, and flexible distribution options? This was the question put to workers thirty years ago, in the form of the 401(k), and most of them eagerly said "Yes!"

Unfortunately, one of the unforeseen consequences of embracing the 401(k) was that many employees lost their guaranteed retirement checks. And the extra opportunities, control and flexibility haven't been able to make up for the loss. With the clarity of hindsight, many would forfeit the retirement options they have today to get back some of those guarantees.

Defined Benefit Pension Plans: The Old Standard

Guaranteed monthly retirement checks are a principal feature in employer-sponsored pension plans. These plans are also referred to as defined benefit (DB) plans, because the monthly benefit is determined by a formula, typically based on an employee's years of service and average salary.

DB plans are attractive for long-time employees; they are funded by the employer, and a worker with 40 years of service can anticipate a lifetime pension equal to 60 percent or more of pre-retirement pay. But because these plans usually have lengthy vesting periods (such as requiring an employee to stay with an employer for 10 years to become eligible to receive ***any*** retirement income), those who change jobs frequently often forfeit retirement benefits. Most plans can include payments to a surviving spouse, but the only way to receive benefits is as a monthly check. And the pension benefits are not estate assets that can be left to heirs.

A DB plan is controlled by the employer. The company determines the benefit formula, funds the plan, selects the investments, and administers payments. The only risk for the employee: that the plan might, because of underfunding or poor returns, become insolvent, and unable to deliver the promised payments. But this risk is moderated by insurance from the Pension Benefit Guaranty Corporation, which is also paid for by the employer.

Defined Contribution 401(k) Plans: The Current Standard

In contrast, a 401(k) is an employer-sponsored defined contribution (DC) plan that allows employees to defer a portion of their wages into an individual account. Employers may make deposits on behalf of the employees as well, usually in the form of matching contributions. These deposits, and any gains that result, accumulate income-tax free until distribution. Withdrawals are made at the retiree's discretion (although minimum annual distributions are required after age 70½).

All employee contributions to a DC plan are immediately vested, no matter how long the employee has worked for the company, and no matter when they leave. Further, DC plans offer an array of investing options which could produce returns (and income) greater than what is promised by the DB plans. And besides the flexibility in taking withdrawals during retirement, any unspent accumulations can be passed to beneficiaries.

DC plans place all the responsibility for retirement success – the funding, investment management, and distribution – on the employee.

Unforeseen Consequences

When introduced, DC retirement plans were presented as a format for employees to ***supplement an existing pension*** with personal saving. What happened was employers stopped offering pensions.

Defined benefit plans are expensive liabilities for employers, and the expenses and liabilities tend to increase as the plan ages. The perceived advantages for employees in 401(k)s made it plausible for many companies to terminate their pensions, and replace them with defined contribution plans.

What would have been annual contributions to fund pension obligations became matching contributions for 401(k) participants. These matching contributions may have been equivalent to what the company would have contributed to its pension fund, but now these funds were given to all participants, not just those who were vested. And if investment returns exceeded what would have been required to provide pension benefits, individual participants could add the profits to their account balance.

In theory, these changes seemed beneficial to employees. But the switch to DC plans also off-loaded all retirement responsibilities to the employee. Companies had no obligation to make matching contributions in the future, or to remedy income shortfalls from under-funding or poor investment performance.

The reality is that many individuals are not good savers, investors, or retirement income managers. They have not saved enough, have not made good investment decisions, and find themselves ill-prepared to manage these assets for the rest of their lives. After thirty years of experience, there has been a shift of opinion about the desirability of DB retirement plans. Today, those who have pensions don't want to lose them, and many of those who don't have them wish they did.

In August 2017, the National Institute on Retirement Security (NIRS) released a report which surveyed eight states where public employees have their choice of the following retirement saving formats:

a.) a defined benefit pension
b.) a defined contribution plan
c.) a defined-benefit/defined-contribution hybrid plan.

The NIRS researchers found that more than 75 percent of employees in every state chose the traditional defined benefit pension. In two states, the numbers choosing the pension were 95 and 98 percent.

This report mirrors other surveys indicating most American workers prefer pensions. A recent Gallup poll found that 51 percent of workers would leave their current job for a job that offered a pension.

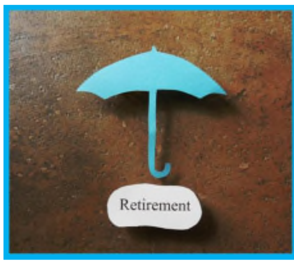
Will Defined Benefit Pension Plans Make a Comeback? (Maybe, but probably not.)

The toughest task in retirement planning is funding. Someone – employer or employee – has to set aside money for the future. And guaranteeing how much those savings will be worth in terms of future income is almost as difficult. It is understandable that employees would prefer a retirement plan that puts those responsibilities on an employer. It is also understandable that most employers, particularly those in the private sector, would rather avoid the open-ended financial obligations that come with funding and maintaining a defined benefit plan.

Conceptually, pensions are very attractive to employees. But historically, the default outcomes of pension plans are termination or insolvency. This is true even with public sector plans. In October 2017, CNBC reported that in all but two states, the average public pension funding ratio was 68 percent, i.e., plans had just 68 cents for every dollar owed in future payments. In response, some states have decreased or frozen existing benefit levels, and closed the plans to new hires. As currently configured, it's hard to see conventional defined benefit pension plans making a comeback.

However, there are alternatives that incorporate many of a pension plan's benefits. Two examples:

- The guaranteed lifetime income feature of a pension can be duplicated by using DC plan savings to purchase a lifetime annuity from an insurance company.
- Although the tax treatment may not be the same, some non-qualified deferred compensation (NQDC) plans often have employer funding provisions along with future income guarantees. NQDCs have long been used for individualized executive compensation packages, and can be customized to suit many employee scenarios.



There are alternatives that incorporate many of a pension plan's benefits.

Employees may think they want their pensions back. What they really want is employer assistance with retirement funding, and relief from investment risk and income management. Individually and corporately, there are ways to address these concerns without returning to a format that hasn't proven to be sustainable.

Whether you're an individual who wants more financial certainty in your retirement program, or part of a management team that wants to offer more attractive retirement options to its workers, now might be a good time to explore pension alternatives with your financial professionals. ❖

of Retirement?

When you are buying a car, there is a sticker price on the windshield, and there is the "real" price, the one that includes the other costs that come with the transaction. That's why a $15,000 sticker price ends up at $16,500 once you add sales tax, title, license and transfer fees.

There are parallels in retirement planning. In the conventional narrative, the "sticker price" for retirement is the amount needed to produce a replacement income, and success is declared when you reach "your number." But the "real price" for retirement includes more than the amount required to generate income. To enter retirement with confidence, you should accumulate additional savings for the "other costs" of retirement.

For the last 17 years, Fidelity Investments has provided estimates of how much a 65-year-old couple retiring this year will need to cover healthcare and medical expenses throughout their retirement. For 2018, this "extra" retirement cost is $280,000. Individually, this breaks down to $133,000 for a male, $147,000 for a female.

But is it really an additional $280,000?

Suppose the 65-year-old couple determines that a comfortable retirement starts at $75,000 of annual income drawn from savings, with yearly adjustments for inflation. Using a safe withdrawal rate of 4 percent, this calls for a baseline accumulation of $1.875 million. But that's just the amount needed for income. There's still the matter of addressing the possibility/probability of irregular medical expenses.

If Fidelity's numbers are correct, a prudent plan would add $280,000 to the accumulation goal, upping the target number to $2.155 million. However, many of these medical expenses, such as annual check-ups and prescriptions, can be included in a monthly budget. But other incidents, especially those associated with a long-term care situation or a final illness, could incur costs far beyond the capabilities of your monthly income. These large expenditures could eat up principal and jeopardize future income. So while you may not have to accumulate an extra $280,000, you do need some additional savings that aren't earmarked for producing retirement income.

Using Insurance

Besides additional saving, another strategy to address irregular but probable medical expenses is insurance. Supplemental medical insurance and long-term care insurance can ameliorate some of the financial trauma from large medical expenses. But while these policies may protect against specific situations, there are potential opportunity costs. Some medical events may not happen (you may not require long-term care), and some expenses may not be covered (like experimental drug treatments). In those circumstances, insurance is not a mistake, but the protection can be seen as pricy. And households that need to add $280,000 to their retirement savings may see the risk of not using the insurance as a reason to forgo it.

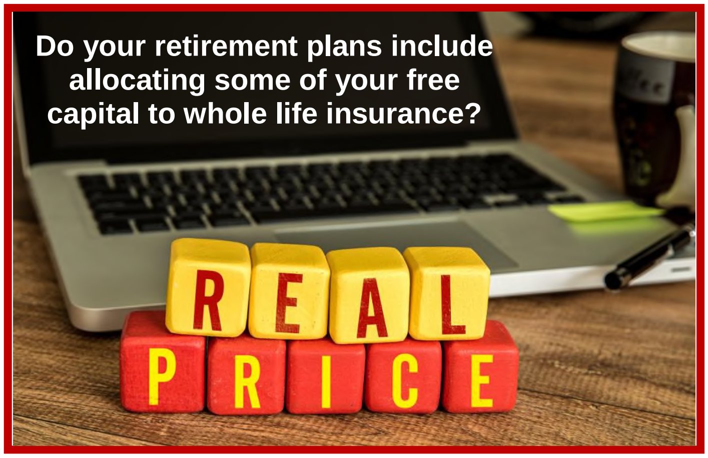
What about Whole Life Insurance?

Besides whole life's value for providing a guaranteed death benefit[1], it can also be used as a vehicle in which to accumulate cash values[2] for medical expenses in retirement. A combination of protection and cash accumulation, whole life can be applied to a range of medical situations.

From an accumulation perspective, whole life insurance cash values grow tax-deferred. Cash values accumulate through a guaranteed schedule and dividends - there is no investment volatility. And they are liquid[3]; if and/or when they are needed, the funds will be available.

Besides cash values, many whole life policies feature accelerated benefit riders, which allow a percentage of the death benefit (often up to 80 percent) to be advanced prior to death if the insured is diagnosed with a qualifying chronic or terminal illness. This option means your calculation of cash values for medical expenses is not just dollars (in cash values or somewhere else), but can also include a portion of a life insurance benefit.

The real price of retirement requires accumulating more than just your sticker price for income. In considering the potential extra costs of medical expenses, a whole life policy in retirement can be an effective financial buffer, to be applied as needed, if needed. And if not used for medical situations, both cash values and the death benefit can be used in other ways, either to enhance retirement or increase asset distributions to beneficiaries. ❖



1 All whole life insurance policy guarantees are subject to the timely payment of all required premiums and the claims paying ability of the issuing insurance company. Policy loans and withdrawals affect the guarantees by reducing the policy's death benefit and cash values

2 Dividends are not guaranteed. They are declared annually by the insurance company's board of directors.

3 Policy benefits are reduced by any outstanding loan or loan interest and/or withdrawals. Dividends, if any, are affected by policy loans and loan interest. Withdrawals above the cost basis may result in taxable ordinary income. If the policy lapses, or is surrendered, any outstanding loans considered gain in the policy may be subject to ordinary income taxes. If the policy is a Modified Endowment Contract (MEC), loans are treated like withdrawals, but as gain first, subject to ordinary income taxes. If the policy owner is under 59½ any taxable withdrawal may also be subject to a 10% federal tax penalty.

If you're a Gen-X or Millennial household, there's a looming monthly expense you may not have included in your budget: the cost of caring for aging parents or extended family.

A March 2018 study from a major U.S. life insurer, titled "Financial and Lifestyle Costs of Caregiving" found that three in ten Americans are either presently serving as caregivers or have done so in the past, while one in five expect to do so in thefuture. Caregiving was defined as "a situation where you are responsible for providing care – or the resources for that care – to someone or several people over a substantial period of time."

Caring for elderly family members is not a new social trend. What is different, at least in the United States, is the extent to which caregiving may become the norm for successive generations. According to the report, "Gen X and even Millennials are the heart of the sandwich generation and struggling with the pressures of caring for aging family members and their own children while building financial security and maintaining a lifestyle."

Older Americans: Living Longer, Living Alone

In the past, caregiving duties were primarily managed by spouses; wives cared for aging husbands, and vice versa. But a range of demographic and social changes have altered this dynamic. A November 2016 report from Kaiser Health News points to increased longevity, a large and graying baby boom generation, the decline in marriage, the rise in divorce, increased childlessness and family mobility, as factors that have "upended the traditional caregiving support system."

As a result, "Americans spend less time than ever in a married state," says Susan Brown, a sociologist from Bowling Green State University. Data from the 2015 U.S. Census reports that 43 percent of those 65 and older now live alone. And these aging single adults often have limited family connections to tap for caregiving assistance. Jonathan Vespa, a demographer for the Census, sums it up: "As people have fewer children, there are fewer people in that next generation to help take care of the older generation."

Younger Americans: Staying Single, or Marrying Later

Changes among younger generations affect the caregiving dynamic as well. More young adults are staying single, and those who do marry are waiting until their late 20s. Both factors impact the younger generation's caregiving abilities. Single households don't have the economic efficiencies that usually come from marriage, i.e., two providers under one roof. And when married couples have children later, it makes the "sandwich" of simultaneously caring for both aging adults and growing children more likely – and more likely that caregiving will not be just an emotional and time commitment, but also a financial one.

The Financial Impact of Caregiving

The "Financial and Lifestyle Costs of Caregiving" report found that approximately seven in 10 caregivers provide financial support. Support ranged from modest amounts, like paying co-pays on medications, to major lifestyle changes, like caregivers switching from full-time to part-time employment. Experienced caregivers reported making the following adjustments to provide financial assistance:

- **67%** Reduced living expenses
- **25%** Withdrew money from non-retirement savings
- **21%** Worked more, including additional employment
- **21%** Borrowed money
- **19%** Withdrew money from retirement savings
- **19%** Cashed in or sold assets
- **17%** Stopped or reduced contributions to non-retirement savings
- **15%** Stopped or reduced contributions to retirement savings

Reading between the lines, many of these caregivers resorted to more than one of these options; i.e., besides reducing living expenses, they worked more, or borrowed money. The harsh reality: In almost every circumstance, caregiving exacts a toll on the personal finances of the caregiver.

And Yet…People Avoid Planning for It!

Writing about these issues in a March 2018 *ThinkAdvisor* article, Emily Zulz pointed to perhaps the most astonishing finding from the survey: "People who believe they will provide care in the future are not taking steps to prepare."

This avoidance is often two-sided: Aging adults may not want to face their need for assistance, or reveal their financial insufficiencies. Family members who are potential caregivers might be hesitant about interfering, and quite frankly, reluctant to take on the assignment.

But a tough situation will almost certainly become worse if everyone waits until it is an emergency. It will likely be more expensive, with less options. Having a discussion today about caregiving may not change the practical or financial realities of the situation, but it does give everyone more time to prepare, to adjust, to look at different possibilities.

And as a practical note, it's probably the prospective caregivers who should initiate the conversation, because one of the reasons an older adult may need care is that some of their faculties – cognition, mobility, stamina, etc. – are declining. A study published by Merrill Lynch found that over 90 percent of caregivers were managing the finances of the aging adult within four months of beginning care. ❖

Caregiving for an aging parent or family member is a noble and compassionate decision. It is also potentially costly.

Pre-emptive discussion, and the inclusion of financial professionals in the conversation, is a path to making the best of a challenging situation.

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