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Before you pull the trigger on a financial decision (especially a big one), there's often a moment of hesitation. You wonder:

What could go wrong?
…And if it does go wrong, how will we respond?

To address these questions, you imagine some possible scenarios, like a job loss, or a need to put a new roof on the house. Then you decide how much time, energy and money to devote to these risks. You buy insurance, increase your cash reserves, maybe update your resume. It's basic risk management.

But what about the things that might go wrong that you ***can't*** imagine? In other words, what about the Black Swan?

The Black Swan

The term "Black Swan" originates from the belief amongst European scientists in the 17th century that all swans were white, simply because no other colorations had ever been found. However, in 1697 a Dutch explorer discovered black swans in Australia. This revealed the flaw in empirically-based thought processes: just because something has not been observed does not preclude the possibility of it happening. Every aspect of life, no matter how rigorously examined, includes uncertainties.

Nassim Nicholas Taleb is a professor of Risk Engineering at NYU finance. He is also a senior science advisor for an investment company and a former Wall Street trader. In 2007, Taleb wrote ***"The Black Swan: The Impact of the Highly Improbable,"*** which used the black swan as a metaphor for an "extremely unpredictable event that is beyond what is normally expected of a situation and has potentially severe consequences."

Taleb outlined the three core attributes of a black swan event:

1. **It is an outlier because nothing in the past can convincingly point to its possibility.** *("What? That could never happen!")*
2. **It carries an extreme impact.** *("Wow, this changes everything!")*
3. **It can be rationally explained after it occurs.** *("Well, it's obvious. I don't know why you were so surprised.")*

There Are Gray Swans and White Swans, Too

Today, the black swan has become a shorthand to explain all sorts of catastrophic events. But not all things that go wrong in a big way are impossible to predict or never-before events. Which is how we get the terms "gray swan" and "white swan."

A gray swan is a "potentially very significant event that is considered unlikely to happen but still possible." Even though the risk of it occurring is very low, the possible

In This Issue…

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fallout compels us to consider it. Some experts see climate change, population growth, or rising debt as gray swans. On a personal level, a disability or early death for a family breadwinner would be a gray swan – unlikely, but possible, and having a severe impact.

White swan events occur frequently, with a high level of predictability. They may have devastating effects, but they are not surprising. For example, businesses or individuals who default on their debt are inevitably headed for financial difficulty; they will go out of business, or file for bankruptcy. We know how these stories end, and we know how we can respond.

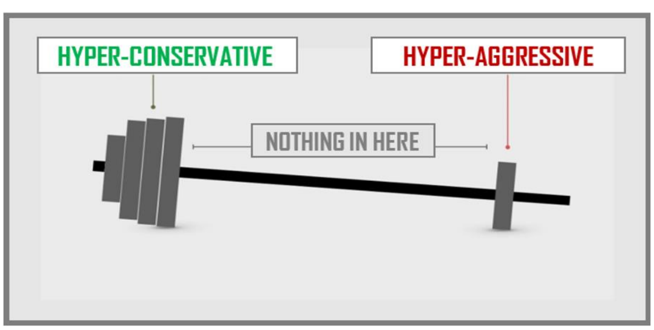
Preparing for the Black Swan

Taleb argues that because black swan events have catastrophic consequences, we must always assume they exist, and plan for them. But how do you plan for something that you can't imagine or anticipate?

In one word: Insurance.

This is not "insurance" exclusively as a policy, but as an overarching principle. Some examples of black swan insurance are:

- **Cash reserves in excess of the minimum thought to be necessary.** You might be able to get by on two months' living expenses, but as Taleb says, "There's a reason you have two kidneys." In times of crisis, you want abundant reserves, not just enough.
- **Short-term commitments and the flexibility to change.** Black swans are challenging but can present opportunities for relief or profit. If it is hard to change or liquidate your position, like in a 401(k), it could blunt your ability to adjust.
- **A willingness to accept smaller gains in order to avoid ruinous loss.** Instead of attempting to maximize every return, be content to maximize your ability to keep earning a return.
- **A commitment to insurance, even though you may go a long time without using it.** "The worst thing you can do with insurance is try to time it. You have to have your insurance at all times."
- **Diversification strategies weighted toward each end of the risk spectrum.** This calls for a majority of assets to be allocated to safe options, with the rest invested aggressively. Commonly referred to as a "barbell strategy" (because there's no weight in the middle), the reasoning is "If you eliminate the risk of ruin, you can very aggressively take non-ruin risks."



These black swan strategies are not new or ground-breaking. In fact, some veterans in the financial service industry may recognize parallels to the principles espoused by Bob Castiglione, a life insurance professional whose perspectives on personal finance were influential in the late 20th century. Castiglione asserted that a truly effective financial plan should "succeed under all circumstances," including the ones you can't anticipate. He also said that robust insurance allows you to successfully take bigger risks.

Is the Coronavirus a Black Swan?

Taleb was asked this question in a March 30, 2020, interview with *Bloomberg News*. His answer: "It was not a black swan. It was a white swan. I'm so irritated at people who say it's a black swan." He went on to say that epidemics are regular occurrences, and while the characteristics of a particular virus may vary, their existence and impact have long historical precedent.

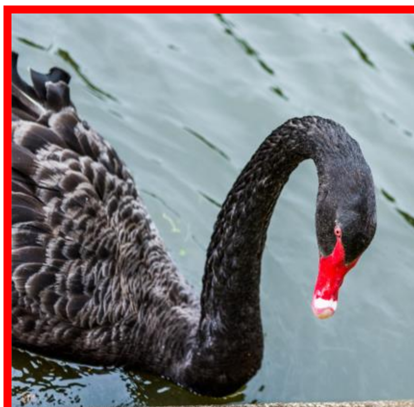
However, just because the coronavirus is a white swan, doesn't mean there isn't a black swan, too. In an April 25, 2020, *Wall Street Journal* commentary, Holman Jenkins mused "Novel pandemic diseases are not a black swan. Our lockdown response was a black swan."

He has a point; prior to March 2020, it was unimaginable that the governmental response to a pandemic would be an almost-universal decision to shut down economies and quarantine a large percentage of the population for indefinite periods. The cumulative impact of these decisions has been huge and far-reaching. And in retrospect, experts will eventually assert that it was not a surprise. You can say the lockdown meets all the criteria for a black swan.

"Avoid Being the Turkey"

The premise behind these "protection-first" approaches is that success comes not from maximizing the mediocre circumstances, but surviving the unexpected and the extreme ones. For many households, the coronavirus has been a black swan stress test for their personal finances. So how much should these "insurance" strategies figure in your future plans? It depends on your circumstances.

Taleb writes that a black swan event depends on the individual; "What may be a black swan surprise for a turkey is not a black swan surprise for its butcher." The ultimate objective of insurance is to "avoid being the turkey." By identifying areas of financial vulnerability, you can "turn the black swans white," making them problems that are knowable and manageable. ❖



History proves that black swan events exist and suggests that more will occur. Will you be prepared for what you can't imagine?

Will You Lose Your Rings in Retirement?

A Facebook user's profile page has a section for "relationship status," typically used to indicate "single," "in a relationship," "married," etc. Most people wouldn't think to identify their relationship status as "retired," but retiring often brings a big change in your relationships.

If you do a little reading (or just ask a recent retiree) about how life changes in retirement, one of the most common observations: workplace relationships quickly atrophy and evaporate. Some typical comments:

– ***"Within a year you will lose touch with many of the people you worked with and saw and talked to every day."***

– ***"The only time I see them or talk with them is when I go to the funeral of another former co-worker."***

If you didn't like your co-workers, no longer having a relationship with them might be a relief. But for many of us, the workplace is our primary – and sometimes only – source of social contact outside of family members and a few close friends. Work is our "outer ring" of casual acquaintances that connects us to our community and society at large.

In his 2014 book, "The Vanishing Neighbor," Brown University research fellow Mark Dunkelman identifies three rings of relationship for Americans. The inner ring is comprised of family members – a spouse, siblings, adult children – and a few long-term friends. We see these people frequently, and we trust them with the details and emotions of our lives. Citing research by anthropologist Robin Dunbar on our capacity to maintain relationships, this inner ring usually consists of fewer than 15 people, often only three or four.

The next level for Dunkelman is the middle ring, people we interact with on a regular basis because we live in close proximity; they are our neighbors. Our relationship with them is often casual, but may also include moments of extended interaction; we sit next to them at block parties, attend school events together, go to the same church, or patronize their businesses (the drycleaner, mechanic, convenience store owner). Our connection is ongoing even if it is mostly superficial.

The third level of relationship, the outer ring, exists primarily because we have something in common that brings us into contact with others. Most often that singular connection is our workplace, although it could be a shared religious or political affiliation, or a hobby. If the common bond dissolves (we leave a job, stop building birdhouses, etc.), the relationships will usually disappear as well.

Dunkelman posits that the middle ring of relationships is shrinking for most Americans; they often don't even know their neighbors' names, let alone interact with them. Instead, our lives are increasingly connected to either our small inner ring, or our large but tenuous outer ring. (This includes online connections: instead of buying from a local business, we have an impersonal "outer ring" relationship with Amazon.) When we stop working, our relationships shrink dramatically.

Shelter-In-Place: A Retirement Preview?

Some retirement experts recommend a pre-retirement "test drive," a planned month-long separation from work that isn't filled with travel or bucket-list moments, but just living, as a way to get a perspective on daily life without a workplace connection.

If you have been sheltering-in-place over the past few months, you may have just had your test drive. Even with happy-hour Zoom calls, the connections to your outer rings have probably been weakened. It's not a perfect comparison, but the lockdowns might give you a sense of how your relationship rings could change.

Your sheltering-in-place experience might change your mind about aging in place, the idea of retirees continuing to live in their home. Aging in place has been promoted as a desirable retirement objective, one that allows for independence and continuity. But aging in place also has the potential for social isolation. If there's no outer ring from work, and no neighborhood middle ring, a retiree's social circle can implode.

How to Keep Your Rings

Social isolation is associated with physical and mental health issues, and the internet is full of commentary on how to address it. Among the most common recommendations:

Keep working, perhaps part time, or in a different place. Staying engaged in a work environment keeps you connected to an outer ring.

Volunteer. This is another opportunity to establish a new outer ring, typically with a flexible time commitment.

Plan to (eventually) move to a retirement community. One of the selling points of retirement communities, especially for the last years of retirement, is that they can offer both middle- and outer-ring relationship opportunities. You have the proximity of a neighborhood and the commonality of your stage in life.

Kathleen Greer, in a February 13, 2020, commentary for *Employee Benefit News* notes:

"There is much written about retirement-readiness, but most of it is focused on financial or legal issues. To sail smoothly into this next phase of life, it is also important to consider the emotional side of retirement. This requires a hard look at yourself, your sources of identity and self-esteem, your need for structure and your desire to give back. ***In addition, don't forget how retirement will change your relationships, both inside and outside of the house."*** *(emphasis added)* ❖

Do your retirement plans include maintaining your rings of relationship? Do your financial professionals know these priorities? A happier life is – at any age – surrounded by strong rings of relationships.

A REAL-LIFE RISK TOLERANCE TEST

The technical definition of asset volatility is a "measure of the dispersion of returns for a given security or market index." The dispersion of returns is the spread in values over a specific time; the greater the fluctuations, the higher the volatility. Typically, higher volatility correlates to higher risk.

Volatility is a strong influence on investor behavior; sudden swings in value often prompt investors to buy, sell, or change their strategies, frequently to their detriment. To mitigate against making a poor decision in haste, many financial professionals ask prospective investors to assess their risk tolerance, i.e., how much volatility they think they can comfortably handle.

These self-assessments are well-intended but often meaningless. They ask prospective investors to imagine their response to something they may not have experienced. Assessing your risk tolerance is like fighting Mike Tyson: "Everyone has a plan until they get punched in the mouth." It's only after you get hit that you know how you'll respond.

This Is What Volatility Looks Like

The nine-week period from February 19 – April 24, 2020, just provided some real-life experience in volatility, and hopefully, gave some valuable insight for many savers and investors as to their true risk tolerance. To mix metaphors, let's take a ride on the rollercoaster and count the punches, using a hypothetical example of $10,000 invested in the S&P 500 index.

- **The Ride Starts:** In 9 of the past 10 years, the S&P has delivered positive returns on a year-by-year basis, including three years with returns in excess of 26%.
  DEC. 31, 2019 Balance: $10,000.00
- **A Steady Climb:** You know how the first leg of a rollercoaster is usually a slow climb to the first drop? That is the beginning of 2020. By Feb. 19, 2020, the index has risen 4.81% and the S&P records an all-time high.
  FEB. 19, 2020 Balance: $10,480.90 (+4.81% from Dec. 31, 2019)
- **The First Drop:** As the severity of the coronavirus becomes apparent, markets get nervous. The index declines for seven straight sessions (February 20–28), losing 12.76% of its value.
  FEB. 28, 2020 Balance: $9,143.54 (-12.76% from Feb. 19, 2020)
- **The Rebound:** Through March 4, the index zig-zags sharply upward, gaining 5.95% in three trading days.
  MAR. 4, 2020 Balance: $9,687.58 (+5.95% from Feb. 28, 2020)
- **Down Again – a Lot:** From March 7 - 23, there's a **28.52% decline.** On the way down, the index moves into "bear" territory, i.e., it has fallen more than 20% from its February 19 high. Taking just 16 trading days, this is the fastest decline into a bear market in S&P history, exceeding even the Great Depression (which took 36 days).
  MAR. 23, 2020 Balance: $6,925.32 (-28.52% from Mar. 4, 2020)
- **Trending up, but bumpy.** If it wasn't for what had just happened, this would look great. From the March 23 low, the index rises 26.79%. Unfortunately, gains and losses are not equivalent; the total decline from February 19 to March 23 represented a 33.92% loss of value. Even after a strong positive upturn, the index is still 16.23% below its high point. From the first of the year, the total loss is 12.20%. And the day-to-day "dispersion of returns" are greater; even with an upward trend, volatility is higher.
  APR. 24, 2020 Balance: $8,760.61 (+26.79% from Mar. 23, 2020.)

SUMMARY: $10,000 to $8,760.61 (-12.20% from Dec. 31, 2019 to Apr. 24, 2020.)

What Does This Rollercoaster Tell You?

Remember, this is a hypothetical, based on the performance of the index; if you are an investor, these results will not mirror your portfolio's actual performance. But your individual experiences may have been equally volatile, and hopefully, a good test of your true risk tolerance.

Even if you are not currently investing, this history provides some perspective. Watching someone else get punched in the mouth isn't the same as taking the hit yourself, but it can still be instructive. ❖

This wasn't a hypothetical roller-coaster; the volatility really happened. How will it impact your allocation plans going forward? That's a great topic to discuss with your financial professionals.

S&P 500 Index is a market index generally considered representative of the stock market as a whole. The index focuses on the large-cap segment of the U.S. equities market. Indices are unmanaged, and one cannot invest directly in an index. Past performance is not a guarantee of future results. All investments and investment strategies contain risk and may lose value.

NOT HAVING INSURANCE MAKES ME "MORE CAREFUL"

Dog person or cat person? Paper or plastic? Cellphone case or no protection?

The first two questions could be part of a tabloid personality quiz. The last question? Well, your answer might reveal something deeper.

A state-of-the-art smartphone can cost more than $1,000, easily. A protective case for the same phone averages $50. (You can spend more, but if you do, it's for style, not protection.) Protective cases are optional, but there are reasonable arguments for buying one to protect what has become an increasingly expensive and essential device.

- According to SquareTrade Inc., a provider of extended warranties for consumer electronics, the majority of warranty claims for smartphones are the result of user negligence (as opposed to theft or defective components), usually because the device was dropped, stepped on, etc.
- Extended warranties for high-end smartphones can equal 20 percent of the cost of the phone, and most warranties have deductibles to be met before paying for replacement or repairs.

Given the cost of either repairs or insurance, it's not surprising that 80 percent of smartphone users buy a protective case; it's a less-costly form of insurance.

The 20 percent that don't buy a case make for interesting study, though.

No Case = "More Careful"?

Anecdotal evidence from a December 2019 *Wall Street Journal* story included smartphone owners who said they didn't buy a case because they felt it wrecked the visual esthetics of their phone, or didn't like the silhouette of a bulkier, protected phone when they put it in their pocket. For some, vanity trumps practicality.

And then there are those who insist *not* having a protective case makes them less likely to need one. A 27-year-old engineering grad student said, "My main argument is that by not having a case I'm more careful." A university technology director affirmed this perspective: Having no protective case "makes me pay attention," he said. "I have friends that break every phone even though they have cases."

Translation: Not having protection makes you less likely to need it.

Can this be true? Does it apply to other types of protection/insurance? For example, does it make sense that people without life insurance will be "more careful," and less likely to die young?

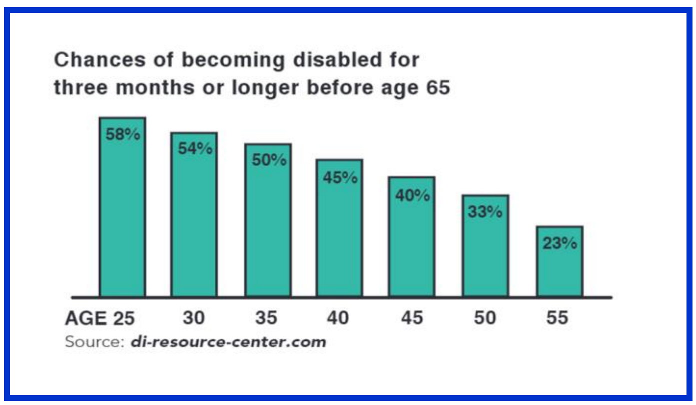
The answer to the life insurance question is "no." Even though the incidence of an early or untimely death is relatively slim, most people recognize the value of life insurance because of the magnitude of financial loss that would follow. But life insurance is an outlier.

With other insurance, the greater the probability of a claim, the more likely you are to believe an incident can be avoided, and consequently conclude it's safe to forego insurance.

- With smartphones, you see the carelessness of others and think, "I'm not like them. They need a case because they don't pay attention." Who needs insurance against carelessness when you're careful?
- One of the challenges in the Affordable Care Act is the mandate to obtain health insurance. Younger, healthier Americans balk at the requirement, saying they don't need the coverage; "careful" living is all that's necessary to maintain their health.
- Automobile accidents, the fender-bender types, are a common occurrence. Almost every driver has had one or knows someone who has. Most of the time, the accident was preventable; someone was driving too fast, was lost (or texting on their smartphone). When you associate accidents with the fender-benders from your experience, it's easy to think you can avoid a "real accident" by simply being a responsible driver. This becomes the justification for being either uninsured or underinsured. (Because so many drivers thought this way in the past, every state except New Hampshire makes auto insurance mandatory for all drivers.)

What about Disability?

The incidence of disability, from either injury or illness, is a far greater threat than most people realize. According to statistics from the National Safety Council, individuals are three to six times more likely to be disabled for three months or longer during their working lifetimes than they are to die. And the younger you are, the more likely it will occur (because you have more years to live and work). At 25, the chance of disability is almost 60 percent!



And yet…many Americans are under-insured for disability. A December 2018 survey sponsored by Google Consumer Surveys and PolicyGenius found that only 12.5% of Americans had disability insurance. What's the disconnect? It comes from the same twisted "I can be careful" logic, which produces comments like:

- "I can rely on Workers Compensation *(which only covers work-related incidents)* because I don't get sick, and I don't do dangerous stuff in my personal time."
- "It's too expensive, and I'll never use it. I'm one of those people who shows up for work even if I'm sick or hurt." *(Proportionally, the annual premium for disability income insurance protection is probably less than the cost of buying a case for your smartphone.)*
- "If I get disabled, I'll still work." *(This actual statement was made by a tree farm owner who insisted he could continue running his business from a hospital bed!)*

Each excuse has two common elements: a definition of disability as being avoidable, and a belief that not having insurance will compel them to be careful enough not to need it.

Getting a protective case or an extended warranty on your smartphone is a small protection issue.

Your ability to earn an income isn't in the same category as a smartphone.

"I'll be careful" isn't insurance, and your ongoing income is much more valuable than a $1,000 electronic device.