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Living Prudently in the Now

Six months into the coronavirus pandemic, the world is still trying to decipher what the "new normal" will look like. This uncertainty and upheaval is not unique to Covid-19; crises regularly expose the strengths and weaknesses in social and economic systems, and the need to change.

Sometimes the revelations – and changes – are obvious. But often the insights gleaned from a crisis are a bit more obscure and unexpected. For example, the pandemic has shown that government-endorsed vehicles for retirement planning may not be working for most American households.

IRAs, 401(k)s Doing Double Duty

Consider the provisions in the recent CARES Act that liberalized distributions from retirement plans. If read between the lines, it's obvious that a large percentage of American households…

- Don't maintain sufficient emergency reserves, and
- Are using their retirement savings as the stand-in for this deficiency.

Consequently, when an emergency arises, retirement accounts are tapped. Doing so usually triggers an unfavorable tax event and puts a long-term dent in retirement accumulation. Why are many Americans using their "long-term" retirement investments as their "short-term" emergency funds? And why did Congress make it easier to do this? Consider it a collision of incentives and reality.

Governments give tax breaks to encourage workers to save for retirement; every dollar deferred into a qualified retirement plan is tax-deductible. The immediate tax savings can be a compelling reason for workers to prioritize these plans, while neglecting others (like cash reserves).

Under "normal" circumstances, many households might get away with neglecting non-retirement accumulations if their emergencies are small or infrequent. But when faced with a pandemic that has upended businesses and lives, many households feel they can't survive today unless they tap funds originally intended for retirement.

Policymakers agree.

"Lawmakers are betting that by putting retirement cash into people's pockets early, they can help households stave off defaults, evictions and bankruptcies with minimal impact on government spending and deficits," writes Anne Tergesen in a June 4, 2020, *Wall Street Journal* article.

Of course, allowing freer access to IRAs and 401(k)s has retirement experts in a dither. They understand the problem, but fret over the consequences. Considering that many Americans were already not saving enough for the future, Noah Smith of *Bloomberg News* said "The decline of retirement seems like an ominous development."

But maybe a decline in traditional retirement planning is what ought to happen.

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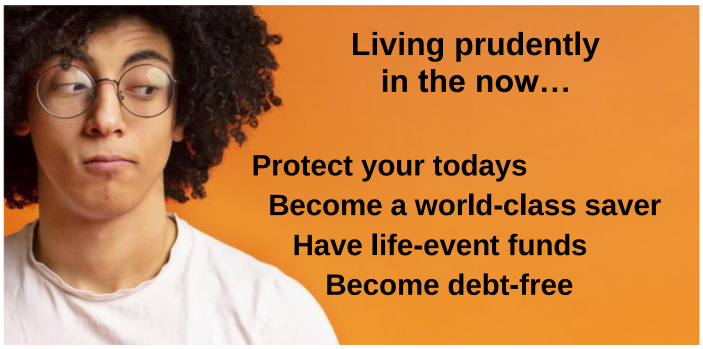
* The title of this newsletter should in no way be construed that the strategies/information in these articles are guaranteed to be successful. The reader should discuss any financial strategies presented in this newsletter with a licensed financial professional.

Linear Plans Struggle with a Non-Linear World

Here's the thing: Most conventional retirement planning models are based on the premise of incremental accumulation over a long time. Gary Allen Foster, a career and retirement coach with the website makeagingwork.com, calls it the "20th Century Linear Life Plan," which is composed of three distinct phases.

1. **Education:** you spend the first 20-30 years of life getting an education and establishing a career.
2. **Work:** The next 40-50 years are a succession of personal and financial objectives: "getta job, getta spouse, getta family, getta mortgage, fenced yard, 2 1/2 kids, two cars and a labrador retriever, getta title, getta 401(k), and getta gold watch."
3. **Retirement:** Assuming you've been able to complete your work objectives, you now have 10-30 years to kick back and enjoy life.



Success in this "20-40-20" plan is linear; you must get the first phase right (education) to have a chance to complete the "getta list" during your working years. If you don't, there are no guarantees that retirement will ever happen.

The biggest work-phase challenge is saving for retirement. Incremental saving for four decades not only requires personal discipline, but steady employment and pay that keeps pace with inflation. That's a tough plan to execute, says Tergesen:

"People are living and working longer while juggling careers interrupted by spells of unemployment and career switching. Saving steadily for 40 years to fund maybe three decades of retirement no longer matches the life cycle of a growing chunk of the population."

If the Linear Life Plan no longer matches your life cycle and experiences, what's the alternative? Achieving – and maintaining – a healthy present. Instead of trying to project an uncertain future using assumptions and guesses, do things that make today better, not only financially, but physically and emotionally.

Living Prudently in the Now

This idea, that the best way to plan for tomorrow is to take care of today, may seem counter-intuitive. But this approach is gaining traction with a segment of the personal finance community. Sometimes articulated as "living prudently in the now," it is often summarized in these four principles:

Protect Your Todays. Secure the assets you already have – your income, credentials, business, property, financial assets. Minimize losses because recovering from them is so costly. (It's math: if you lose 15% this year, you will have to earn more than 15% to get back on track.)

Become a World-Class Saver. Embrace the habit of saving as much as you can. Some people try to project the minimum amount they need to save, and are surprised and disappointed when something goes wrong. Forget the assumptions. Get better at saving and your finances will improve.

Have Life-Event Funds. The Linear Plan puts the last objective, Retirement, ahead of everything else. Then everything else gets in the way, which messes up retirement. The stronger your Life-Event Funds (your cash reserves, liquid investments, etc. that can be used today if necessary), the more likely you will succeed with longer-term investment for the future.

Become Debt-Free. Getting out of debt isn't a financial product you can buy. Which may explain why there's a lot more chatter about portfolio allocations than reducing debt. But the faster you become debt-free, the better your todays ***and*** tomorrows will be.

By establishing a healthy financial present, you are laying the foundation for a healthy future, whatever it ends up looking like for you.

Broaden Your Prudent Perspective

"Living prudently in the now" isn't exclusively about personal finance. There is practical value in applying it to the physical and emotional aspects of your life as well.

"Lifestyle behaviors have an outsize influence on health and longevity," says Michael Joyner, a Mayo Clinic researcher. A 2011 study in the *American Journal of Public Health* found that adopting healthy lifestyle behaviors (regular exercise, wholesome diet, no smoking) can increase lifespan by 11 years.

There is also psychological value in including enjoyment in the present. The linear approach says, "a trip to Europe will be a huge opportunity cost for your retirement account. Wait until you retire, when you'll know you can afford it." The risk is that you may not have either the health or the resources at the end of life to make the trip. The excessive focus on Americans not saving enough for retirement implies that the future must be addressed before today can be enjoyed. That's impossible to verify. How can you prove your future is secure enough to deserve some enjoyment today? ❖

A healthy lifestyle and a balanced approach to spending are other applications of "living prudently in the now" that improve your prospects for a long and enjoyable life. The way to a better financial future starts with improving your present.

A ONE-CLUB SUGGESTION FOR PERSONAL FINANCE

The Rules of Golf permit a player to carry no more than 14 clubs during a round. A typical club mix includes a driver, several woods, a set of irons, one or two wedges and a putter. In theory, this mix gives a player the right club for every shot, from driving off the tee to rolling the ball into the cup.

But while the Rules of Golf state the maximum number of clubs allowed, they do not specify a *minimum*; it is possible to play a round of golf carrying just one club. In fact, there is even a version of golf known as "One-Club," where the player uses one club for all shots, from tee to green.

One-Club can be an amusing diversion for a recreational round, but serious golfers will occasionally play a round of One-Club to reinforce the basics of club control and shot-making.

Most of the time, a 5- or 6-iron is the club of choice for One Club, because they can be used off the tee or out of a bunker, yet have a flat enough blade to finesse a putt as well.

Yes, There's an Analogy Coming…

Similar to golf, the financial service industry offers a variety of "clubs" for your personal finance game. There are unique financial instruments for saving for a down payment, funding a college education, building a retirement account, covering medical expenses, ensuring an inheritance, etc. And like golf, you get to select the clubs in your financial bag. But…

Unlike most golfers, a household doesn't typically start their financial life with a full mix of clubs; most households can't afford a full set before they start to play.

Instead, they play the early rounds of their financial lives using a limited number of clubs, with the idea of adding more in later rounds. They are playing something that looks more like financial One-Club (or maybe Two- or Three-Club), hoping they can avoid financial traps or rough patches until they get a full set.

If you have to play financial One-Club, which product should be your 6-iron?

Ask a Caddy

Most professional golfers employ a regular caddy. A good caddy can improve a golfer's score due to their knowledge of the course, advice on club selection, help in reading greens, and familiarity with the player's abilities. If we were your "financial caddy," here is a one-club suggestion: **Whole life insurance.**

Whole life insurance is a unique combination of financial products. There is a life insurance benefit, guaranteed cash values[1], options to waive premiums in the event of disability, the reasonable expectation of dividends[2] (which can be used to reduce premiums, buy additional insurance, be taken as income, etc.).

Just as a 6-iron isn't as long off the tee as a driver and doesn't have the lift of a sand wedge, whole life insurance isn't necessarily the "best" club for every financial shot. But under a variety of conditions, a whole life policy delivers financial certainty. When you only have one club, it's arguably the one that can get you around the course, from tee to green, round after round.

Saving for a down payment? Over time, cash values can be a great option for accessible, guaranteed tax-free accumulation.

Paying for college? Cash values are available without penalty before retirement, and don't count as eligible assets when calculating financial aid.

Managing retirement income? Cash values can be a source of supplemental retirement income[3], allowing you to selectively manage distributions from other accounts and your tax bill.

Hitting a rough spot? The financial hardship of an untimely death can be tempered by the insurance benefit. In the event of a qualifying disability, the company pays the premiums, maintaining both the insurance benefit and cash value growth. In general, cash values are available on demand either as partial surrenders or loans, with no age restrictions. And most states give policyholders substantial liability protection from creditors and litigants[4]. In a difficult spot these provisions could keep you from flailing in a financial trap.

While other financial products may report better historical results under specific conditions, it's hard to beat whole life insurance as a one-club, do-it-all financial product.

Whole Life Will Stay in Your Bag, Too

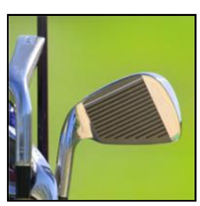
Not only is Whole Life a legitimate club choice for the first rounds of your financial life, it's also one to keep even as you add others. Over time, cash value growth typically accelerates due to increasing dividends; a sizable accumulation can serve as the fixed base in a diversified portfolio. The guarantee that a tax-free life insurance benefit will be paid at death makes it possible to "spend-down" other assets while living, or ensure that heirs will receive an inheritance. Instead of using it as a do-everything one-club, you can decide how best to position it in your unique circumstances.

Those who can afford any financial club in the marketplace often continue to keep whole life insurance. Liz Sonders is the chief investment strategist at an American multinational financial services company. Between her position and expertise, she has her pick of financial products. In a February 2018 interview in *Kiplinger's Personal Finance*, she was asked "How do you invest your own money?"

As you would expect, Sonders listed a number of products representing a diversified asset mix. Then she added:

"A decent chunk of our retirement will also be funded via whole life insurance. We like its protection-for-life trait, along with the level premiums and cash value."

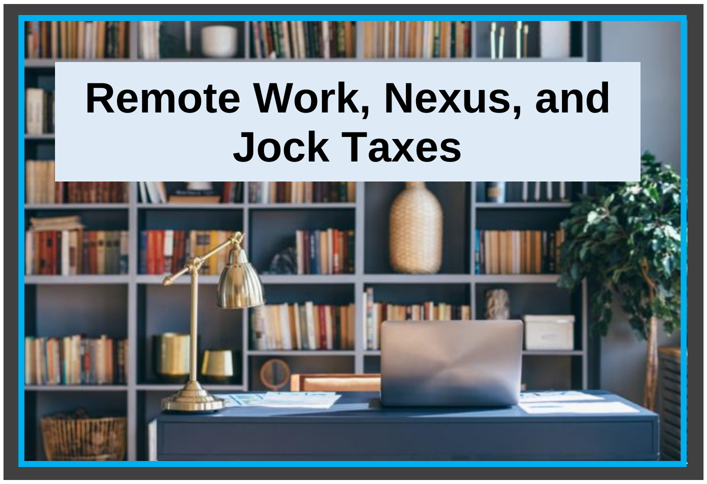
Even though she has a full set of clubs, this financial professional keeps whole life insurance in the bag. ❖



How many clubs are in your personal finance bag? Is whole life one of them? You may not have to play One-Club, but don't neglect this one club.

See footnotes on page 6.

Remote Work, Nexus, and Jock Taxes



The shelter-in-place lockdowns have been a catalyst for businesses to consider how many of their employees can work remotely, not only during a pandemic, but permanently. Instead of gradually dipping their toes into this new work arrangement, Covid-19 has forced both employers and employees to jump in with both feet, accelerating what could be a significant shift in how businesses operate and people work.

The potential is obvious. With high-speed residential internet connections, improved teleconference technology and expanded computing options a lot of office work can be performed remotely. An extensive two-year study by Stanford University in 2018 found that allowing employees to work from home was beneficial for both company productivity and employee morale. Remote work can reduce fixed costs for employers (like office rent), while expanding the pool of available talent. Employees eliminate commuting time, have more employment options and lifestyle choices because they don't have to live close to their work.

A May 2020 *Wall Street Journal* article says, "Employers are formulating plans to allow many of their staffers to keep working remotely when the crisis is over," which could impact "everything from rent to congestion to migration in urban work environments."

Employees experiencing remote work for the first time are on board. In a survey by recruiting agency Robert Half, 6 out of 10 workers said their work-life balance improved since they no longer commute to an office, while a study from Mental Health America found that 97% of people believe that flexible work would improve their quality of life.

"I love working remotely."

"Not So Fast My Friend…"

It's too early to declare remote work the new normal. Businesses with a longer history of remote work arrangements say communication and collaboration can suffer when co-workers are no longer physically in the same space; prior to the pandemic, companies like IBM and Bank of America made news by bringing remote workers back to local campuses. Some managers attribute the recent success of remote work to the carry-over of established in-office connections, which may not be replicated by future generations of workers with remote-only interactions.

And there are tax issues, especially when an employer and remote worker are not physically in the same state. When that happens, employees may be treated like professional athletes for tax purposes.

Nexus and "Jock Taxes"

In taxation, "nexus" is a term that defines the obligation of individuals and companies to collect and pay taxes on business activities which occur in a particular jurisdiction, such as a state or municipality. Having a nexus in a state requires the individual or business to file appropriate documents and pay the corresponding taxes or fees.

For employees, nexus is usually simple: if you physically work and reside in the same state, your earnings are subject to that state's tax laws. But if you earn money in one state and live in another (such as a remote worker who lives in Connecticut and works in New York City), you may be required to file non-resident tax returns for every state in which you work. This is where "jock taxes" come in.

Because professional athletes "work" in different venues across the country, they are subject to income taxes in every state in which they play. An athlete who spends an entire season in the National Basketball Association will file more than 20 state returns, each with unique tax rates and definitions of adjusted gross income. Some states give filers credits for taxes paid to other jurisdictions, some don't; it is possible for some income to be double-taxed at the state level or not at all.

If you work remotely part-time in a state different than your employer, the same work may be taxed at different rates depending on where it was performed. This means different withholding rates as well as filing additional state returns.

To further complicate matters, six states have rules that claim tax authority over out-of-state remote work under a "convenience" definition. Per the AICPA, if a person has a job based in one state but lives and works in another state ***out of convenience*** rather than because the employer requires it, that person owes income tax to the state where the job is based. An employee of a New York-based business who ***elects*** to work remotely from another state still owes full income tax to New York on that compensation.

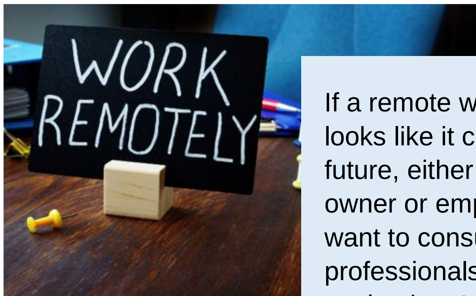
For businesses, the nexus issues of employees working in another state generally require that the employer registers and pays workers' compensation and unemployment insurance premiums in the state in which the employee performs their duties. Failure to do so may expose the employer to liability, including financial penalties for noncompliance.

Employers are also responsible for adjusting state income tax withholdings according to the state in which their employees work.

New Opportunities, New Details

With these complex issues in play, tax advisers are urging both employers and remote workers to act promptly to determine how remote work might change their withholding and reporting requirements for their 2020 return, especially since this year may include periods of both in-office and remote employment. If your remote work is in a different state than your employer, you should track days spent working in different states, as audits typically require verification of your work locations.

Especially for smaller employers, a simple solution to the maze of multiple state tax rules might be to reclassify out-of-state remote employees as independent contractors. This possibility presents challenges for both employers and employees. Independent contractors may be ineligible for company benefits, such as health insurance or retirement plan participation. This format puts additional reporting and withholding responsibility on the worker, which might make the job less attractive. ❖



If a remote work arrangement looks like it could be in your future, either as a business owner or employee, you might want to consult with financial professionals as part of your evaluation. Like most opportunities, there are possibilities and pitfalls.

Technology Dilemma: When Is Easier Better?

In theory, technology makes life easier. But does it make life better? For financial behaviorists, the value of Fintech – computer programs and other technology used to support or enable banking and financial services – depends on the activity. For example:

Paying Bills

In the "old world," a bill appeared in your mailbox, and was sorted into a pile. At the due date, or after getting paid, you wrote a check, and mailed in the payment. The process had several touchpoints, each one reminding you of the obligation and its place in your personal economy.

Today? There's an app for that. You see a reminder, make a swipe, and it's done. Once in a while you check your balance online. Very easy peasy. But better?

Kevin McAllister, in a March 2019 "Young Money" column, doesn't think so. "By making personal finance so much easier to do, technology also has made it so much easier to ignore."

What's the problem? For McAllister, technology erodes the connection between our lifestyle and its costs. When we get disconnected, we are less likely to "recognize the short- and long-term consequences of our spending decisions."

Following this logic, automatic monthly payments are even worse; you don't even have to tap and swipe to pay the bill. When expenditures are out of sight and out of mind, some financial professionals believe it leads to financial ignorance, because "if you don't constantly think about where your money goes, you won't think about whether you're spending it wisely," says McAllister.

On the other hand, there's…

Investing for Retirement

Robert Merton, an MIT economist and professor, has a different take: technology's potential for encouraging a disconnect in personal finance can sometimes be a blessing. In a *Harvard Business Review* article titled "The Crisis in Retirement Planning," Merton makes the following observation:

"Experience suggests that ***customer engage-ment in investment management is not necessarily a good thing***… Consumer education is often proposed as a remedy, but to my mind it's a real stretch to ask people to acquire sufficient financial expertise to manage all the investment steps needed to get to their pension goals. That's a challenge even for professionals." *(emphasis added)*

Merton notes that "many technologically sophisticated products are actually designed to minimize learning requirements on the part of the user." Electric cars could make their speed control a knob on the dash or a toggle on the steering wheel. But electric car designers continue to use a pedal, so drivers don't have to learn a new skill, just adapt familiar skills to a new vehicle.

In a similar way, Merton recommends that financial technology should be used to make it easier to assess familiar financial situations and delegate the details to financial professionals. Instead of an encouragement to "constantly think about where your money goes," we should spend less time wrestling with financial matters. He concludes his *HBR* article by saying, "It seems perverse to deny savers the benefits of financial technology."

Merton's vision of technology that productively disengages us from our money requires two conditions:

- A platform that provides accurate and easy-to-understand information.
- Professional assistance is included.

As an example, The Living Balance Sheet®* is a financial organization tool used by some financial professionals to provide a clear assessment of an individual's current financial condition, their priorities, and progress. With the individual's authorization, many of the items reported on the Living Balance Sheet can be automatically updated through electronic interfaces with banks, investment firms, or insurance companies.

This information can be easily distilled in a one-page summary or expanded for deeper analysis, by both the individual and the financial professional. The technology does the grunt work to gather and assemble the data, and once a decision is made, the financial professional can facilitate the execution. Rather than constantly thinking about money, the individual has one simple financial assignment: fund the plan, i.e., save. Simple, effective, better. ❖

What role does technology play in your financial management? Do you use programs or processes that make it easier to think less and enjoy more? Or does your technology disconnect you from achieving your financial objectives?

*The Living Balance Sheet® system displays the financial holdings identified by the client based upon information and valuations provided directly by the client or by electronic feeds from the client's financial institutions. Valuations provided by electronic feeds reflect the most current information provided by the financial institution as of the date and time noted but can reflect valuations from an earlier date and time.

Footnotes from Page 3:

1. All whole life insurance 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 Guardian'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 loans considered gain in the policy may be considered 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.
4. State creditor protection for life insurance policies varies by state. Contact your state's insurance department or consult your legal advisor regarding your individual situation.