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*wealth maximization strategies**

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Some people LOVE checklists. They love the simplicity of the format, the tangible objectives, the endorphin rush that comes from checking an item off the list.

Suppose there was a checklist that consisted of the ideal elements in personal finance, a checklist that would give you the greatest chance for financial security, in good times and bad? Would you be able to check ALL THE BOXES – or just some of them?

There isn't one list that rules them all. Personal finance doesn't have a periodic table with every known element on it. But if you read across a range of commentary, some standards of excellence emerge. You may not be able to achieve these ideal benchmarks, at least right away. But knowing them, and working toward them, can be a clearly defined path to a better financial life, one that's both profitable and secure.

See how many you can check off.

The Starting Point

- ☐ **Money.** Whether it's in the form of income or accumulated assets, money is the Number 1 item on the list. By definition, "money management" requires money to be managed. A significant percentage of American households can't check this box. They have no assets to manage, no income to save.

Foundational Activities

- ☐ **Saving.** The recommendations from experts vary, but an ideal target is saving **20 percent of annual income.** Consistently hitting this target greatly increases your chances of maintaining your current standard of living and accumulating enough for a comfortable retirement.
- ☐ **Systematic Debt Reduction.** Another ideal goal in personal finance is to be debt-free as soon as possible – while maintaining your saving habits. The typical progression:
  - ☐ Less debt than the previous year.
  - ☐ No unsecured debt, like credit cards or personal loans.
  - ☐ No secured debt on depreciating assets, such as a car.
  - ☐ No mortgage, completely debt-free.

Accumulation Milestones

- ☐ **Cash Reserves.** Experts have a variety of opinions, but a strong cash reserve position ranges from:
  - ☐ 6 months of current income to…
  - ☐ 12 months

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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.

- ☐ **Long-term Saving/Investing.** After substantial cash reserves are accumulated, savings can be allocated to financial instruments that have long time horizons. Ideally, these assets will only be liquidated either in retirement, or to acquire other long-term assets.

Essential Asset Protection

An integral part of personal management is protecting existing assets from unforeseen calamity. Insurance is a cost-effective way to accomplish this objective. Here are some ideal insurance benchmarks:

- ☐ **Life insurance benefits equal to your Lifetime Economic Value.** This number reflects the present value of your estimated earning potential. It is not a need-based number - a minimum amount that would keep a spouse or dependents out of poverty. Rather, it's an estimate of your maximum financial value.

  Ideally, some, if not all, life insurance should be permanent, i.e., intended to remain in force for one's entire life. A guaranteed death benefit can be a significant asset in retirement and estate planning.*
- ☐ **Disability income replacement insurance equal to 70 percent of gross income**, with an own occupation definition of disability. It is true that Social Security includes disability benefits, and you may be eligible for Workers Compensation if a disabling incident occurs on the job. But these partial protections leave many households under-insured against disability, even if they buy group coverage from their employers.

  Disability in many ways is more costly than a premature death, because the ongoing loss of income and increased medical expenses often lead to slow but inevitable financial exhaustion.
- ☐ **Personal and professional liability insurance.** A civil suit seeking financial compensation can implode your personal finances. The relatively low cost of insurance far outweighs the risk of losing everything.
- ☐ **Property insurance on personal and business assets.** The ideal is full-value protection on homes, autos, buildings, equipment, etc. State governments and financial institutions make some insurance mandatory, but these requirements may or may not provide maximum replacement value.

Necessary Legal Documents

- ☐ **A Will.** An essential document that a huge segment of the population never gets around to completing. Once written, it should be kept current, particularly regarding the designation of guardians for children and executors of the estate.
- ☐ **A Trust.** Used to delineate the distribution of assets after you die, a trust can reduce estate and gift taxes, and efficiently distribute assets to heirs without the cost, delay and publicity of probate court.
- ☐ **Articles of Organization.** Documentation of incidents of ownership, partnerships, buy-sell agreements, the establishment of limited liability companies, articles of incorporation.
- ☐ **Private Financial Agreements.** For business, tax and estate reasons, intra-family loans, promissory notes, etc. should not be hand-shake agreements.

The Simple Annual Check-up

- ☐ **The Income Test.** Even if you can check all the boxes today, there's still the matter of staying current, assessing your progress, and making adjustments. A simple, yet very relevant, assessment is a projection of present income under three different circumstances.

  In your current financial condition, how much income would there be ***tomorrow…***
  - ☐ if you voluntarily stopped working?
  - ☐ if you had to stop working because of a disability?
  - ☐ (for your heirs) if you died?

At various points in life, these answers can be wildly divergent. A 40-year-old could check all the boxes, but not have much income if he/she voluntarily stopped working simply because he/she hasn't been saving long enough to amass a substantial retirement fund. But should a tragedy occur, such as a disability or death, the household would remain financially intact, because the insurance could replace much of the lost income. This might prompt the cliché of "I'm worth more dead than alive," but it just proves the value of insurance.

If you check all of the boxes on this list, a tip of the cap. Most financial professionals would consider your personal finances to be in good order. This list could easily add additional categories, for things like investment diversification or tax planning, but those items are beyond the basics. A lot of households haven't completed this list. ❖

* Life insurance guarantees are based on payment of all required premiums and the claims paying ability of the issuing insurance company.

So…

How many boxes did you check?

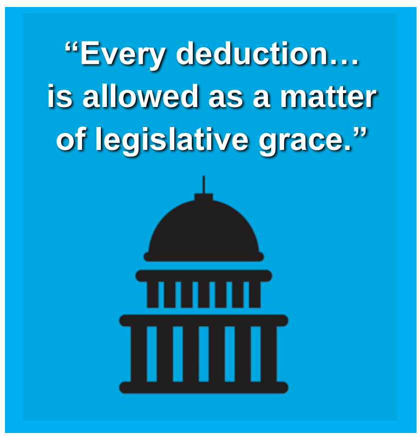
What about the ones still open?

Perhaps they should be topics for discussion the next time you meet with your financial professionals.

At the time this issue was prepared, Congress was considering two bills to change the taxation of inherited non-spousal IRAs. Neither bill (one is in the House of Representatives, the other in the Senate) had been passed. And even if a bill is passed, it could be an amended version. However, the possibility of changes in the tax treatment of IRAs gives insight into the realities of tax deferral.

The End of the Stretch IRA?

Under current tax law, a non-spousal beneficiary of an IRA (typically a child or grandchild), must make a full distribution from the account within five years, with the distributions as taxable income, or elect to make annual required minimum distributions based on the beneficiary's current age. This "stretch" provision allows the distributions – and the resulting taxes – to be spread over the beneficiary's lifetime, which in most cases, will increase the total distributions (because the undistributed balance can remain invested and generate additional earnings for a longer period) and decrease taxation (since smaller annual distributions may result in a lower marginal tax bracket).



For retirees who have significant IRA balances, the stretch provision can be an attractive tax strategy to allow heirs to receive more of the unspent IRAs. However, many legislators want to eliminate this distribution option.

The House version of the bill would do away with the stretch provision and mandate that non-spousal IRAs must be fully distributed (and taxed) within 10 years, while the Senate plan allows a stretch on the first $400,000 of aggregated IRAs, with any excess to be distributed within 5 years. (Both bills have exceptions for distributions to minor children, disabled or chronically-ill beneficiaries, and beneficiaries not more than 10 years younger than the deceased IRA owner.)

In a September 28, 2019, *Wall Street Journal* article, Texas representative Kevin Brady explained the rationale behind the proposed changes: **"IRAs are for retirement security. They are not wealth succession management tools, and I think we've now got the policy right."**

Many IRA account holders would beg to differ. The *WSJ* article referenced a 72-year-old retiree who had planned to name his four grandchildren as beneficiaries to IRAs worth more than $4 million: "All my life I've carefully saved for my family and my grandchildren," he said. "Now the government is breaking its promise to me. They should only change the rules going forward, not retroactively."

Ed Slott, a New York CPA and IRA retirement specialist, concurs: "This is not a fair way to conduct retirement policy, changing the rules near the end of a long game. People will think they can't trust Congress to keep its word about retirement rules."

A cynical view is these changes are not intended to get policy right on retirement, but simply a ploy to increase tax revenues. As one tax advisor put it, "Eliminating the stretch is a tax accelerator." Most expert commentary posits that the elimination of the stretch provision will not only speed up tax payments, but often push beneficiaries into higher tax brackets.

"Every deduction…is allowed as a matter of legislative grace."

In light of these comments, you can certainly understand the frustration. For three or four decades, savers made contributions based on the expectation their IRAs would receive a certain type of tax treatment. Then, at the end, the rules may change, and not in their favor.

But this perspective overlooks a very important truth about tax deductions: Taxpayers are not entitled to them; they are government favors that can be revoked at any time.

In a 1938 ruling, (White v. United States, 305 U.S. 281), the Supreme Court said:

> **"Every deduction from gross income is allowed as a matter of legislative grace,** and only as there is clear provision therefore can any particular deduction be allowed, and a taxpayer seeking a deduction must be able to point to an applicable statute and show that he comes within its terms." *(emphasis added)*

In other words, deductions are not a promise to the taxpayer. Congress can change the rules whenever it wants. And it does. Two similar incidents:

- Prior to the Tax Reform Act of 1986, interest on credit cards and other personal loans had been deductible on income taxes for several decades. But Congress eliminated those deductions – completely – with the new rules.
- Investors in limited partnerships used to be able to deduct losses incurred by the partnership from other income, such as business income or income from investments. Since investors could deduct more than what they invested, they were considered true tax shelters, and many were purchased exclusively for the tax savings. In 1987, this deduction was eliminated, leaving some investors with worthless investments and no tax advantage.

In both instances, consumers often made long-term financial decisions with the tax deduction in mind – and the expectation that the deduction would remain the same for the future. IRA account holders made similar assumptions and may experience similar disruptions.

IRAs Have Taxes Due

The dilemma with IRAs and other qualified retirement plans that hold pre-tax deposits is the transaction includes a deferred tax obligation; a portion of the account belongs to the US Treasury. With the current Stretch IRA provisions, it can easily be forty to seventy years before the government recoups the deduction that was granted at the time of deposit. That's a long time. The legislative rationale for eliminating the Stretch provision is that taxes owed by retirees should be paid during their lifetimes, not deferred again to beneficiaries at a lower rate. And Congress has the authority to enact this change.

Which leads to this question…

Are you comfortable using a qualified retirement plan, with its up-front deductions and deferred tax obligation, as your primary vehicle for retirement accumulation? Remember, those deferrals are a "matter of legislative grace;" the terms can change at any time. ❖

The more successful you are at saving, the more you may want to diversify where those savings are deposited.

At all income levels, there are households that are broke, don't save, or live beyond their means. Conversely, you'll find some – at all income levels – who thrive; they live within their incomes, save prodigiously, yet have money to spend.

The difference between these two groups can't be attributed to the amount of money in their respective personal economies. The difference is behavioral: one group has developed sustainable financial habits, the other has not.

How do people acquire these good financial habits and maintain the discipline to become financially healthy? That question bedevils financial professionals, policy makers, and behaviorists. In their quest to encourage financial well-being, you'll find a range of recommendations, such as:

- **Improved consumer education**
- **Better tools, like online programs that track your financial activity**
- **New strategies**
- **Default mechanisms that remove decision-making, and "nudge" people toward better choices**
- **Accountability programs**

All of these approaches have merit, and in some cases, may lead to better financial outcomes. But none of them have proven to be a silver bullet for sustained behavior modification. In fact, many of these approaches only accentuate how time-consuming, labor-intensive, and expensive it is to develop good habits. Many people don't have the time or emotional energy – or the dollars – to attend a class, make weekly data entries in a computer program, thoroughly evaluate new ideas, or pay someone to be their "personal trainer" for finances. That pretty much leaves them with accepting or rejecting the one-size-fits-all default options offered by an employer.

There might be a simpler solution: **When you're saving, save room for dessert.**

This concept is a variation on a time-tested approach to weight loss. Which, when you think about it, has a lot in common with developing good financial habits.

- A critical factor in losing weight is learning to consume fewer calories today in order to look and feel better tomorrow.
- A critical factor in accumulating wealth is learning to spend less today to provide a better life tomorrow.

Sustaining Delayed Gratification

Both weight loss and financial health require delayed gratification for extended periods. This is psychologically challenging. We must repeatedly forgo the known pleasures of the present for the hope of future benefits that may or may not come to pass.

When our commitment wavers, one response may be to focus on the potential consequences of failure. It's the idea that one doughnut is the first step on a slippery slope back to obesity, or that an impulsive weekend getaway incurs opportunity costs equal to six months of retirement.

In dieting, we know that some people will respond to this pressure, but many don't. And even if they do, there is often resentment or despair. The harder it gets to maintain a diet, the harder it is to believe the sacrifice is worth it.

So it's odd that some media personalities use the same tactic to compel people to get their finances in order. They wag their fingers, saying "If you don't change your ways, you're never going to be able to retire. You'll end up broke and alone!" If the fear of failure doesn't work with food, what makes us think it will work for money?

Deprivation Kills Consistency

Brad Pilon is a Canadian nutrition analyst who's made a name for himself by promoting intermittent fasting as a sustainable program for losing weight and keeping it off. Pilon also admits that any number of plans can be effective for weight loss. But whatever approach you choose, he is adamant about this: "Save some of it for dessert." For him, that means mint chocolate chip ice cream and a beer. "Give me a pint of Guinness at dinner and a bowl of ice cream before bed and I can be 100% on track with the rest of my eating for months and months."

Here's his insight on why a little dessert is valuable:

"Deprivation kills consistency, and consistency is where your results come from. If a diet isn't sustainable, it's not going to work."

What's Your Dessert?

Not to belabor the point, but establishing good financial habits is like going on a diet with your money. Consistency in personal finance – in saving, debt management, investing – is where your results will come from. But in order to stay consistent, you probably could use a little dessert, a little bit of financial enjoyment today that keeps you on track for months and months.

Just like Pilon makes sure he has some ice cream or beer every week, your financial diet should plan for some dessert. A weekend trip, an extravagant present, a special event. Nothing outrageous or irresponsible. Just something that reminds you that it's okay to enjoy spending a little, especially when you've got your personal finances under control.

It's easy to be dismissive of "saving room for dessert" as a financial strategy, to see it as a worthless bit of mental gymnastics. If you're one of those people who is already financially fit, that's fine. But more and more, financial behaviorists are recognizing that it's not logic or math that guides our financial decisions, but emotions and associations, many of which impact us on a subconscious level. ❖

Brian Portnoy, a behavioral finance expert with over 20 years of experience as an investment analyst says, "An investor's primary problem isn't figuring out the market — it's figuring out himself." To that end, he believes that, "The highest and best use of the financial advisor is not as investment expert. It's as behavioral coach."

In other words, a financial professional who can help you save room for dessert.

HAVE YOU BEEN "FRAMED" ABOUT RETIREMENT?

In January 2008, four economists working for the National Bureau of Economic Research (NBER) published the results from an extensive study about retirement decision-making. The study was based on two simple one-question scenarios. Of the 1,300 respondents (all over the age of 50) half were presented with Scenario #1, the others with Scenario #2. A comparison was then made between the two groups.

The setup:

Each scenario features fictional, identical individuals, named **Mr. Red** and **Mr. Gray.**

At the onset of retirement, both Mr. Red and Mr. Gray make permanent decisions on how to use a portion of their money for retirement.

Each has personal savings as well as $1,000 per month from Social Security to provide retirement income.

Both men have already set aside money to leave for their children when they die.

For each scenario, respondents were asked to evaluate which retirement option represented the "better deal."

Scenario #1

Mr. Red's plan: Mr. Red can spend $650 each month, along with Social Security, for as long as he lives. When he dies, there will be no more payments.

Mr. Gray's plan: Mr. Gray can choose an amount to spend each month in addition to Social Security. How long his money lasts will depend on how much he spends. If he spends only $400 per month, he has money for as long as he lives. When he dies, he may leave the remainder to charity. If he spends $650 per month, he has money only until age 85. He could also spend down faster or slower than each of these options.

Scenario #2

Mr. Red's option: Mr. Red invests $100,000 in an account which earns $650 each month for as long as he lives. He can only withdraw the earnings he receives, not the invested money. When he dies, the earnings will stop, and his investment will be worth nothing.

Mr. Gray's option: Mr. Gray invests $100,000 in an account which earns a 4% interest rate. He can withdraw some or all of the invested money at any time. When he dies, he may leave any remaining money to charity.

In each scenario, who made the better decision?

In **Scenario #1**, **72%** felt **Mr. Red** made the better decision.

In **Scenario #2**, **79%** felt **Mr. Gray** made the better decision.

But wait…

Each scenario presented the same options! Mr. Red's plan is the same in both scenarios, and so is Mr. Gray's! Why did respondents overwhelmingly choose Mr. Red in one and Mr. Gray in the other? The difference is the "framing," the language used to describe the benefits and drawbacks of each plan.

Consumption vs. Investment

In the first scenario, the emphasis was on **consumption,** how much could be spent, and for how long. From this perspective, a larger monthly amount, with the guarantee of continuing, no matter how long one might live, was seen as the most attractive.

The second scenario highlighted **investment.** While the numbers remained the same in terms of possible monthly income, the second scenario also mentioned that Mr. Red would have access only to the earnings from his investment, and nothing left when he died. In contrast, Mr. Gray could access his principal at any time and could leave any remainder to heirs.

If you haven't already guessed, Mr. Red's plan is a lifetime annuity. In exchange for a lump sum payment, an insurance company guarantees monthly payments for a lifetime, no matter how long it is. As employer pension plans have been replaced by defined contribution plans, such as IRAs, 401(k)s, etc., an increasing number of retirees are considering annuities for retirement income.

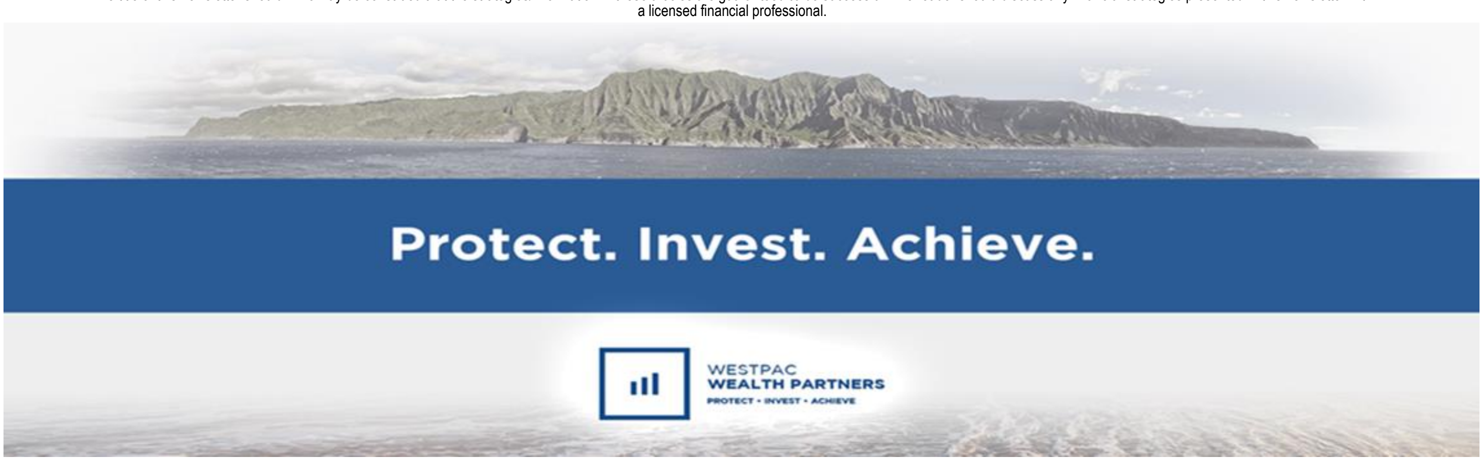
But because many retirees have an "investment" frame of reference, the idea of "losing" any leftover principal at death can make them reluctant to invest in a lifetime annuity.

Jeffrey Brown, one of the NBER researchers, says that while an "investment" frame of reference is fine for accumulation, it's wrong for spending:

"The messages that individuals receive when encouraged to save are all about how much you have in your account and your rates of return. But really you should think about how much can you eat each month, how much can you consume." ❖

How do you frame your retirement? Is it how much you have, or how much you can spend?

All investments and investment strategies contain risk and may lose value. Annuity guarantees are based on the claims paying ability of the issuing insurance company.



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