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Are You TALL Enough to Invest?

Remember going to an amusement park, and standing in line for the signature ride, the one that strapped you in, flipped you over, took you to exhilarating heights, then plunged you so fast you had a moment where your life flashed before your eyes?

Before you could get on, there was a sign. It read: ***"You must be this tall to ride this ride."*** The park's operators wanted to be sure you were big enough to withstand the thrills and chills.

A roller-coaster experience with exhilarating heights and scary plunges could be a description of investing in market-based assets whose values rise and fall daily. Except there aren't any signs or rules that say, *"You must have this much money to ride this ride."* With mutual funds, fractional shares, and direct deposits from your paycheck into the company 401(k), everybody can invest in market-based assets.

But just because everyone can be an investor, does it mean they should? Or are there financial "height minimums" that ought to be observed?

Experienced Investors Recommend…

Mark Cuban is a serial entrepreneur primarily known for owning the Dallas Mavericks professional basketball team, and as an investor on the television program "Shark Tank." As a self-made billionaire, Cuban has some strong opinions about personal finance, particularly about how and when individuals should become investors. In multiple interviews over the past decade, Cuban's advice has been consistent:

Before committing to investing, eliminate debt and accumulate an emergency fund equal to at least six months of living expenses.

In the September 2020 issue of *Men's Health*, Cuban modified his emergency fund minimum to **a year's worth of savings.** *(Because, you know, the pandemic. It's made everything a little more uncertain.)*

It might seem counter-intuitive that someone known for investing is so adamant about reducing debt and building savings before jumping on the roller-coaster. But Cuban isn't a lone voice; several individuals who have made their money investing recommend some variation of the same message. But for many Americans, no debt, and savings equal to a year's worth of living expenses is a pretty steep requirement. Do you really have to be this tall financially to invest in market-based assets? No. But it might be good if you were.

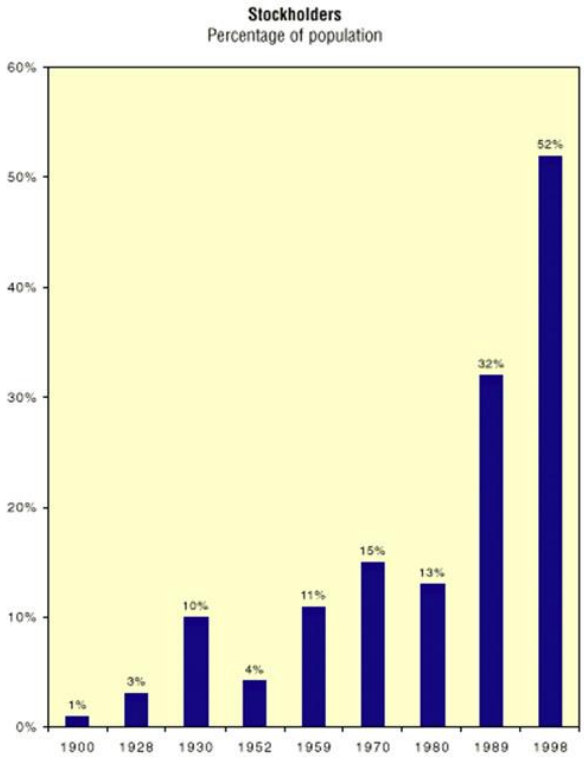
A Little History

In the "old days," (think the 1970s), the loosely defined world of personal finance usually considered stock market investing as one of the last steps up the financial pyramid. The bottom of the pyramid was steady employment and a pension. The next level was buying life insurance, making a will, paying off high-interest debt (like credit cards), and building personal savings. These savings were often held in guaranteed or low-risk instruments like certificates of deposit or life insurance cash values.[1]

In This Issue…

* 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.

Only when you had accumulated a substantial cash cushion did you entertain opening a brokerage account and buying things like blue-chip stocks or corporate bonds. While you anticipated making money, investing was something you did with money you could afford to lose.



At this time, a very small percentage of Americans were investors. PBS, in a statistical study called "The First Measured Century," found that only 13 percent of Americans owned stocks in 1980.

One of the reasons stock market investing was one of the last rungs on the financial ladder was the high cost of entry. Katherine Wilson, in an April, 2000 report released by the Joint Economic Committee titled, *The Roots of Broadened Stock Ownership*, said that until recently investing in the stock market "…was kind of a rich person's discipline because, in order to be cost-effective, you had to buy in round lots (100-share increments of stock) or an individual bond. It was a very restricted market for this in many ways."

But when Congress introduced the Individual Retirement Account (IRA) in 1974, offering tax deductions for deposits and tax-deferral on the growth in the accounts, things changed. "By eliminating some of the multiple taxation that exists on savings and investment, IRAs and 401(k)s became attractive relative to other retirement saving options. Americans looking for a way to protect their savings from the ravages of inflation began to look towards investing in stocks and mutual funds."

As 401(k)s proliferated, pensions, which had essentially done long-term investing for employees, mostly disappeared. This change put the onus for funding and investing for retirement on the individual. The pivot to individual investing was swift.

The same PBS statistics found that by 1998 "52 percent of Americans owned shares in public companies or equity mutual funds, either directly in their own accounts, or indirectly in retirement and trust accounts." Since 2000, the percentage of Americans owning stocks, bonds and other market-based assets has remained relatively stable. After peaking at around 63 percent before the Great Recession, a 2020 Gallup survey puts stock ownership at 55 percent (per a *Forbes* report of June 4, 2020).

Confusing Investing with Saving

Many of these new holders of market-based assets didn't see their holdings as "play money" they could afford to lose. Joseph Nocera, in his book, *A Piece of the Action: How the Middle Class Joined the Money Class*, reported that a high percentage of fund customers saw their investments as "'…general savings.' These new customers were still not investors – or rather they didn't think of themselves as investors. They still thought of themselves as savers."

Confusing saving with investing is hazardous. The assumption of saving is that money set aside today will be available tomorrow. While market-based assets may yield higher returns, there are no guarantees about the future availability of funds – what they will be worth, or if they will even be there.

This uncertainty is stressful, because many households are caught in a dilemma: They are not saving enough for a stable retirement and thus feel compelled to take investment risk to make up for this deficiency. But when money they can't afford to lose has to be put at risk, the likelihood of financial failure increases.

Jared Dillian, a former investment analyst who now hosts a syndicated radio program on personal finance, is another successful investor who advocates eliminating debt and building substantial cash reserves, primarily because it alleviates the psychological distress of precarious finances. "Debt and risk are the two main drivers of financial stress. These are the things that keep people up at night." A stressed, sleep-deprived investor is less likely to make good decisions.

Setting Your Own "Height Limit"

Jumping into market-based assets without first addressing debt and emergency reserves is a case of letting concerns about the last part of your financial life (retirement) override the importance of getting your current financial status in good shape.

The uncertainties of life make it almost inevitable that well before retirement, something is going to come up. And that something is going to require cash. If your only resource for cash is selling assets at their current market value, the timing will almost certainly be off.

There's an axiom that says, "The only good time to sell out of the stock market is when you want to, not when you have to." Households that have minimized or eliminated debt and built adequate reserves can live by that axiom. With a cash cushion and minimal monthly obligations, you are better equipped to ride the market-based roller coaster. If your investments take off, you won't have to slow them down with a financial emergency. If they plummet in value, you can make a measured decision about riding out the trough or getting off the ride.

Is the no-debt/one year of saving height requirement hard and fast? No. But it's a reliable standard, and a good starting point for a discussion with your financial professionals. ❖

> Establishing a reasonable "height limit" before you start buying market-based assets gives you the best opportunity to be a true investor, instead of a "saver with risk." And you'll sleep better at night.

Being Warren Buffett - For Your Kids

Warren Buffett is 90 years old. His estimated net worth as of August 2020 was almost $80 billion, making him one the ten richest individuals in the world. Besides his high net worth, Buffett's unique claim to fame is that his wealth is primarily due to his performance as an investor. Unlike many ultra-wealthy individuals, he did not invent something, build a business or have a special talent.

More to the point, Buffett's wealth is a product of his persistence and longevity as an investor. He's been doing what he's been doing for a very long time.

In his new book, *The Psychology of Money*, Morgan Housel notes some interesting facts about Buffett, and makes some profound conclusions.

Fact 1: Buffett began serious investing when he was 10 years old. By the time he was 30 he had a net worth of $1 million, or $9.3 million adjusted for inflation. (Remember, Buffett's worth today is $80 ***billion.***)

Fact 2: ***$70 billion*** of Buffett's wealth was accumulated after he qualified for Social Security, in his mid-60s. While he was already wealthy by any conventional measure, Housel says 90 percent of Buffett's wealth was achieved ***after*** he reached retirement age!

Elaborating on these ideas in a September 8, 2020, article on cnbc.com, Housel offers the following thought experiment:

What if Buffett had been a "more normal person" who spent his teens and 20s figuring out what he wanted to do, settled into a career path in his 30s and worked until he was in his 60s? Even if he achieved the same investment results as the real Warren Buffett, his "normal Warren Buffett" net worth would be $11.9 million. For the average retiree, that's a lot of money, But it's nowhere close to $80 billion.

Housel concludes:

"Warren Buffett is a phenomenal investor. But you miss a key point if you attach all of his success to investing acumen. **The real key to his success is that he's been a phenomenal investor for three quarters of a century.** Had he started investing in his 30s and retired in his 60s, few people would have ever heard of him.

"Effectively all of Warren Buffett's financial success can be tied to the financial base he built in his pubescent years and the longevity he maintained in his geriatric years.

"His skill is investing, but his secret is time. That's how compounding works."

Compounding Across Generations

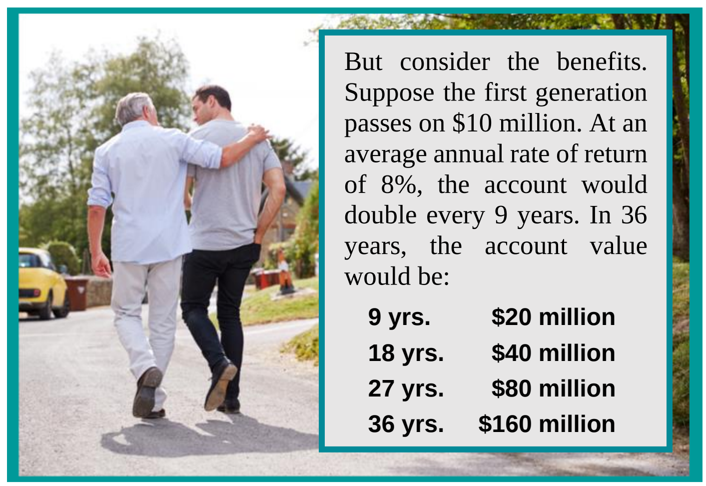
Did you start investing when you were 10 years old? No, didn't think so. At this point in your life, is it likely that you'll live long enough to realize a 75-year accumulation plan, like Warren Buffett? Probably not. That's too bad. Because if you don't have the time, you have no chance of achieving similar results.

But wait…

What if you decided to implement a long-term compounding plan across ***two*** lifetimes instead of just one? What if you started an accumulation plan, nurtured it for 30-40 years, then handed it off to your children for another 30-40 years? That's 60-80 years of compounding. And because compounding is a geometric progression, the numbers can get really big in the second 30-to-40-year window.

This is the power of leaving an inheritance. It is the chance to allow assets to compound long enough to produce wealth. Most of us don't have the resources, foresight or knowledge to achieve long-term compounding in one lifetime, but stretching it over two lifetimes is certainly doable, provided both generations are interested in carrying out the plan.

And that's often a sticking point: getting two people to commit to the same project for 60 or 70 years is no small task. The parent, as the initiator of the plan, has to not only start the process and maintain it for the first 30-40 years, but must also develop an heir who will be both willing and capable of continuing to manage the plan.



But consider the benefits. Suppose the first generation passes on $10 million. At an average annual rate of return of 8%, the account would double every 9 years. In 36 years, the account value would be:

9 yrs.	**$20 million**
18 yrs.	**$40 million**
27 yrs.	**$80 million**
36 yrs.	**$160 million**

This is mind-boggling. In one generation, the value grows from $10 to $160 million – with no additional deposits.

Hypothetical example for illustrative purposes only. All investments contain risk and may lose value, past performance is not a guarantee of future results.

Generational Compounding with Life Insurance

Art Sanger, a prominent life insurance specialist from the late 20th century, often paired this two-generation compounding concept with whole life insurance because it reduced the management responsibilities for both the first and second generation. The second-generation heir is assured of an inheritance in the form of a tax-free death benefit when the parent/first generation passes. These proceeds are used to fund a life insurance policy on the heir(s). The cash values[1], as well any dividends[2], accumulate tax-free in a predictable pattern, with minimal management responsibility required of the second generation. Over 60-80 years, the cash value accumulation inside a life insurance policy can be substantial.

Being "Early Buffett" for a Next Generation

It may be too late for many of us to participate as long as Warren Buffett has; even if we have the resources, we just don't have the time. But it's not too late to consider laying the foundation for potential successive generations. Inheritance planning is one of the few activities in personal finance that has a chance to fully realize the long-term benefits of compounding.

You're probably too old to have the same timeline as Warren Buffett, but you might be able to help your children and grandchildren. An inheritance can give them the time to make compounding truly meaningful. ❖

Retail therapy might do wonders for some people, but for dedicated savers, just the idea of increased discretionary spending gets them twitchy, because every dollar spent is one that isn't saved. Which can lead to discussions like this.

"Honey, look at this new jacket I bought. It was regularly $100, but I got it on sale for $50. I saved $50!"

"So we have $50 more in our savings account?"

"What? No, you don't understand. I said I saved $50 because it was on sale."

"I heard you. Where did you put the $50 you saved?"

"Well, since the coat was on sale, I used the other $50 to buy boots because they were on sale too! I actually saved $100!"

"I don't get the saving you're talking about. It sounds to me like you spent $100.

"Well, yes I did, but don't you think it's great that I saved $100 doing it?"

"I'm confused. Where did you get the money to buy the jacket and boots?"

"From our savings account."

"How much money was in the account?"

"$1,000."

"And how much did you withdraw?"

"$200. That's what I thought I would spend for a new jacket and boots. But I didn't! I only spent $100. That's how I saved $100. And I deposited it back in the account."

"So, what's the balance now?"

"$900."

"It seems to me that if we started with $1,000 and saved $100, there ought to be $1,100 in the account. But you're telling me there's only $900. That sounds like we spent $100."

"Arrgh! You take all the fun out of shopping!"

There is a little embellishment here, but this conversation actually took place. As a disinterested reader, you might find it amusing. But if you were one of the parties involved, there was some underlying frustration. Because it highlighted a bigger issue: **when is it okay to enjoy spending money?** When one person derives pleasure from efficient spending while the other just sees an expense, there can be conflicts.

Balancing Saving and Spending

Obviously, the retail sector and the financial services industry have very different definitions of "savings." Which makes sense, because both groups are competing for the same discretionary dollars. And since many American households aren't saving enough for retirement, it's easy to demonize the retailers for using "savings" to encourage more spending.

The contrast is especially apparent at year-end. The holiday season is usually a time of increased consumer spending, much of it for discretionary, non-essential items. By mid-January, when credit card statements start showing up, the financial news media is usually filled with stories about how to recover from your holiday spending hangover. In a passive-aggressive way, these articles typically condemn frivolous consumption, and obliquely ridicule or scold those who have over-indulged.

But while saving is essential to long-term financial and emotional health, spending money also plays a crucial role in our well-being. Remember: the ultimate purpose of saving money today is so that it can be spent tomorrow. Over the course of our financial lives, we should not only strive to develop good saving habits, but healthy spending patterns as well.

In their 2013 book "Happy Money," psychologists Elizabeth Dunn and Michael Norton explore what they call the "Science of Happier Spending." It turns out that our attitudes toward both saving and spending are greatly impacted by our emotional connections to money. And it is possible to manage and reshape these connections to make it easier to save and spend productively. Quoting the blurb on the book's front cover:

"If you think money doesn't buy happiness, then you're just not spending it right."

Developing healthy spending habits now lays the foundation for a good retirement. Studies have repeatedly revealed a "consumption gap" for many retirees because they have been so obsessed with saving that they never get comfortable with spending, even when they can afford it.

Seeing the Holiday Season as Practice

The holiday season can be a good time to practice healthy spending habits. For some, it might start with developing a greater awareness of the types of purchases that bring the most enjoyment, and why. Another good habit: planned spending instead of impulse spending. Studies have shown that planned purchases can actually bring more satisfaction because of pre-purchase anticipation. Even spontaneous spending can be "planned" by deciding on a preset amount that can be spent without accountability or discussion. It's sort of like setting a limit before you go to the casino, so you don't need to feel guilty about what you spend. ❖

As 2020 comes to a close, it seems like a defining year, one in which "everything has changed." From the pandemic to social unrest to the presidential election, there's a lot of material for pundits to declare "things will never be the same," and make bold predictions about the "new normal."

Then you look at history.

Since the beginning of the 20th century, it seems like a "defining" year or a defining sequence of events, happens at least once every decade.

- The 1900s began with the assassination of President McKinley and were characterized by intense, often violent conflicts between unions and employers.
- The next decade was consumed by the first World War, and the Spanish flu pandemic that followed.
- The "Roaring 20's" ended with a thud as the stock market crash of 1929 ushered in the Great Depression.
- The Depression dominated the 1930s, eventually giving rise to a civil war in Spain, and authoritarian governments in Europe instigating a Second World War.
- The 1940s saw five years of global military conflict come to a close with the dropping of the first atomic bomb.
- The mutually assured destruction of the atomic weapons led to the "cold war" of the 1950s, which even pushed into space with the launch of Sputnik.
- The 1960s were truly a momentous decade, with the assassination of President Kennedy, the war in Vietnam, and the rise of the civil rights movement.
- The 1970s were dominated by the Watergate scandal, and an oil embargo.
- The 1980s started with high interest rates and ended with the collapse of the Soviet Union, which prompted one optimistic political scientist to declare that "we've reached the end of history."
- The "end of history" continued with the Gulf War in the 1990s, and climate change concerns.
- The first decade of the 21st century opened with the 9/11 terrorist attacks and closed with the Great Recession.

In the immediate aftermath of these events, many people saw them as game-changers, ones that historians would view as pivotal moments in time. And in some ways, they were, at least to an extent. But when big moments happen so frequently, are they really big moments, or just the normal way that history unfolds?

Whether 2020 was a watershed moment for you or just another drop in the bucket, it is prudent to reflect on what has transpired, and the potential impact on your personal economy. Because a clear perspective on the past can help chart your future.

And since almost everything in the universe of personal finance is wired to end on December 31, then start anew on January 1, it makes sense to select a time after the first of the year to reassess your financial position. By January 31, 2021, most of us should have year-end statements for saving, retirement and investment accounts, as well as the income reported on W-2s, 1099s, K-1s, etc. This mountain of financial information is current, and just begging to be evaluated.

Along with the convenience of having a stack of year-end statements, your early 2021 financial assessment can be made even easier by getting **a financial professional to help you.** Many financial service businesses offer comprehensive software and online aggregation programs to quickly compile and sort financial information into net worth and cash flow statements. Involving these professionals helps you get the job done, and also provides better information for them to assist in improving your financial future. ❖

As 2020 winds down, one of the last things on your financial to-do list is to schedule an annual review early in 2021. Before December 31, make an appointment for an annual financial review, with your spouse or family members, as well as your financial professionals. It will give you a leg up on making 2021 a game-changer.

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. Some whole life polices do not have cash values in the first two years of the policy and don't pay a dividend until the policy's third year. Talk to your financial representative and refer to your individual whole life policy illustration for more information.

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