THE WEALTH SOLUTION

Bringing Structure to Your Financial Life

THIRD EDITION

Steven Atkinson, Joni Clark & Alex Potts

Afterword by DR. HARRY M. MARKOWITZ,
Recipient of the Nobel Prize in Economic Sciences

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CHAPTER 2

The Key Challenges Facing Today's Investors

To understand how *360 Wealth Management* may help you achieve financial success, it's necessary to first recognize the most significant issues affecting investors today.

Chances are you're finding it more challenging than ever these days to manage your increasingly complex financial situation. But the sooner you determine where you are now and where you want to be in the future, the sooner you can set out to build a plan that tackles the major issues you face.

For more than two decades, we have worked closely with hundreds of top financial advisors who together serve thousands of investors. Our experience has taught us that investors today generally share six major concerns:

Concern 1: Preserving Wealth in Retirement

How are you going to grow and preserve your wealth so that you have the money required to meet your needs and fulfill your goals — not just today, but for decades to come?

The vast majority, regardless of their level of wealth, are concerned about preserving their wealth so they will have enough money throughout retirement.

Few of us want to be forced to downsize our lifestyles. And yet, many investors are not financially positioned to maintain their lifestyles during retirement — especially when you consider the challenges that today's pre-retirees and retirees must contend with. For example:

- **Inflation's impact.** Rising prices can decimate your savings and your ability to preserve wealth throughout your golden years. Assuming the long-term historical annual inflation rate of around 3%, an annual fixed income of $100,000 would be worth just $86,000 in five years and only about $40,000 in 30 years. A new car that costs $25,000 today would soar to more than $60,000 in 30 years. And if inflation runs at a much higher rate than normal for an extended period — a real concern given the huge amount of government spending that has occurred in recent years — the goal of wealth preservation throughout retirement could become even tougher to achieve.
- **Rising life expectancies.** Thanks to continued advances in health care, American seniors are living 50% longer than they were in the 1930s. According to the Centers for Disease Control, a 65-year-old can now expect to live another 19 years, on average.[1] For a 65-year-old married couple, there's a 49% chance that one of them will live to 90 and a 23% chance that one will reach 95.[2] While that is certainly good news, it also means that you will need to make your money last much longer.
- **Soaring health care costs.** The cost of health care has been rising at a much faster pace than the overall rate of inflation. This should be of particular concern to aging investors who are more likely than younger Americans to consume substantial amounts of health care. What's more, Medicare might only cover about 50% of a typical retiree's medical expenses. Consider that seniors age 65 and over spend an average of $4,888 per person annually for deductibles, copayments, premiums and other health care costs not covered by insurance, according to the most recent National Health Expenditure Survey.[3] That amount is more than two times the amount spent by average non-elderly adults. And the largest expenditures occurred among those 85 and older. According to the Employee Benefit Research Institute (EBRI), a retired couple age 65 would need approximately $283,000 to have a 90% chance of covering their out-of-pocket health care expenses in retirement.[4]

- **A weakening Social Security system.** It's no secret that Social Security has long been in trouble, but a look at the numbers is particularly sobering. 2010 was the first year in recent memory when the Social Security Fund paid out more in benefits than it collected in taxes. This deficit continues to this day, and based on current projections, the Social Security Trust Funds are scheduled to be depleted by 2033, according to the Social Security Administration.[5]
- **The diminished role of pensions.** Retirement has become a largely self-funded venture, as evidenced by the fact that just 32% of workers today participate in some type of defined benefit (pension) plan. That's down from a full 84% in 1980, according to EBRI. These days, the majority of workers (53%) participate in defined contribution plans — such as 401(k)s.[6]
- **Taking care of kids and parents.** According to the Pew Research Center, 15% of Americans ages 40 to 60 are raising a child while also caring for at least one aged parent. In addition, among those who have at least one living parent age 65 or older, roughly one-third say they have given their parent or parents financial support in the past year.[7]

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1 Center for Disease Control and Prevention, "National Vital Statistics Reports," Vol. 60, No. 04, 2010.

2 Society of Actuaries based on 2010 Social Security tables with 1% mortality improvement.

3 "National Health Expenditure Data: Personal Health Care Spending by Age Group and Source Of Payment, Calendar Year 2004," Centers for Medicare and Medicaid Services.

4 'Funding Savings Needed for Health Expenses For Persons Eligible for Medicare," EBRI Issue Brief, Vol. 33, No. 10, October 2012.

5 "The 2012 Annual Report Of The Board Of Trustees Of The Federal Old-Age And Survivors Insurance And Federal Disability Insurance Trust Funds," Social Security Administration, April 25, 2012.

6 EBRI Databook on Employee Benefits, updated April 2011, Employee Benefits Research Institute.

7 "The Sandwich Generation — Rising Financial Burdens for Middle-Aged Americans," Pew Research Center, 2013.

The end result: Too many investors face a higher level of uncertainty about their future prospects than their parents and grandparents did. In the wake of that uncertainty, you simply have to be smarter, plan better and question many of the assumptions long-held by previous generations and many in the financial services industry. We believe that traditional "rules of thumb" advice such as needing 70% of your working income during retirement cannot be taken as gospel anymore. Your retirement plan needs to reflect the realities of the world today and in the future.

Concern 2: Minimizing Taxes

You've probably heard the adage that "it's not what you make, it's what you keep that counts." Not surprisingly, taxes are a major concern for most investors.

That concern is well founded, as taxes can significantly erode your ability to grow and preserve wealth. A $1 investment in stocks back in 1926 would have grown, before taxes, to $3,533 at the end of 2012 — but just $712 on an after-tax basis.[8]

There's cause for additional concern. Taxes during the past decade or so have been hovering at relatively low levels, but may be set to rise. Trying to predict tax code changes is a risky bet, of course. But you need to be aware that higher taxes across the board could be on their way — and at the very least, build sufficient flexibility into your plan so you can make adjustments should your tax situation change. The good news: You can take steps to minimize the taxes you pay and keep more of what is yours by using a variety of techniques that will be explored later.

Concern 3: Effective Estate and Gift Transfer

The ancient Chinese adage that "wealth never survives three generations" seems equally applicable today. A major concern for many investors is ensuring that their heirs, parents, children and grandchildren are well provided for in accordance with their wishes. And yet, our experience is that most investors don't have an estate plan — and many of those who do have outdated plans. Even more troubling: 61% of all American adults don't even have a will, according to a 2013 Harris Interactive study.[9]

Many investors don't take the appropriate actions in this key area because they assume they don't possess enough wealth to necessitate estate planning. Regardless of your net worth, the ability to ensure that your assets go where you want them to has numerous and important potential implications — from being able to help a child or grandchild go to college to ensuring the continuity of a family-owned business to simply avoiding probate. Take college tuition, for example. College education expenses have risen at a rate of more than 5% annually during the past decade, according to the College Board.[10] That means a child born today could need over $250,000 to attend a four-year public college in 2032 — more than triple today's college costs.

Passing on wealth and using it to benefit your heirs as you see fit requires the implementation of the right strategies for your goals and situation. As you'll see later, those strategies might include everything from correct titling of assets to smart gifting strategies and trusts designed to provide maximum benefits to a spouse, family members or charities.

Concern 4: Wealth and Income Protection

A significant number of investors today are worried about keeping wealth safe from potential creditors, litigants, children's spouses and potential ex-spouses, as well as from catastrophic loss. They also want to be sure that their loved ones are protected in the wake of major health problems or other unforeseen events.

In today's highly litigious culture, nearly everyone needs to consider the possibility of being sued. Increasingly, investors are realizing the importance of confronting some tough questions:

- What would happen if I were the victim of a lawsuit?
- What would happen if one of my children married a "gold digger," then divorced and was sued for a large sum?

8 Morningstar, Inc. 2013.

9 http://www.harrisinteractive.com/vault/2013_MAWMPressRelease.pdf

10 "Trends in College Pricing 2012," The College Board.

- What would happen if one of my children were in an accident in my car or someone suffered an injury in my home?
- What if a major disability prevented me from working and generating an income for my family?
- What if I end up needing to live in a nursing home or require home health care services?

Strategies aimed at wealth protection can motivate creditors to settle, decrease the possibility of being sued or minimize the financial impact of a judgment. Trusts and insurance can also play a role in protecting your wealth and income from an unexpected hardship.

Concern 5: Charitable Gifting

Charitable gifting is also very important to many investors. From direct gifts to formal gifting structures like donor advised funds and private family foundations, many investors are looking to ensure that their money is being used by their chosen charities to make an impact on the issues they care about most.

Simultaneously, these investors want to make sure that their philanthropic goals don't conflict with their ability to secure a comfortable retirement for themselves and leave a legacy for their families.

Concern 6: Finding High-Quality Financial Advice

For decades, much of Wall Street and the financial services industry have been driven by a sales-oriented culture that stressed pushing products instead of providing comprehensive solutions.

This concern reached a peak during the market downturn of 2008 and 2009 fueled by the revelation of the largest Ponzi scheme in history, and the fact that the largest investment firms in the world suffered tremendous losses from bad investment decisions they made on their own behalf. All of this created a significant and still-growing sense of dissatisfaction in, and distrust of, the financial services industry among many investors.

We recognize that many of you are looking for financial guidance and assistance. With that in mind, we've included a chapter in this book to help you find professionals who offer objective advice and who act only in the best interests of their clients. The good news is that during the past decade or so, more and more advisors have begun adopting a more comprehensive process such as that discussed in the following pages. If you choose to work with an advisor, you may find great benefit in using the guidelines and best practices in this book.

By focusing on life issues as they relate to financial issues, you can be assured that the decisions you make are in agreement with your overall goals.

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