Strategies For Wealth
120 Broadway, 37th floor
New York, NY, 10271
212-701-7900 • 800-848-2048

David Orsolino
dorsolino@strategiesforwelath.com
www.davidorsolino.com

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Life is unfair. But what if there's a way to tip the cosmic scales of justice in your favor, at least when it comes to money?

A new advertising campaign for a retail brokerage company implies that the difference between your mundane existence and the undeserving bosses, snobs, and idiots who are living the high life can be rectified when you sign up for their self-directed investing services. Some of the tag lines:

The harder you work, the nicer the vacation your boss goes on. Don't get mad. Get _____________.

First class is there to remind you: you're not first class. Don't get mad. Get _____________.

The dumbest guy in high school just got a boat. Don't get mad. Get _____________.

("_____________" is the name of the company. It has been omitted to protect the guilty.)

The ads are snarky, and tongue-in-cheek funny. But they are also disingenuous, and right at the edge of being dishonest. Sure, it is possible that do-it-yourself investing could be a ticket to a life of luxury, but the same could be said about playing the lottery. Is it plausible to believe that DIY investing is a ***proven*** strategy for enjoying fabulous wealth? Possible, yes, proven, no.

These platforms for individual investors represent a small segment of the financial services and products available to retail consumers. But the marketing approach plays to (and reinforces) some of the misconceptions the public often has about the products and services provided by banks, insurance and investment companies, and financial professionals. And while they might want to believe they could be the lucky one who turns modest savings into fabulous wealth, most consumers would be better off if they interacted with financial institutions and professionals on more realistic terms. For instance:

1. It's "Wealth Management," Not "Wealth Creation"

To "create" literally means to make something out of nothing. Wealth creation is what happens when a college student's idea becomes Facebook.

Wealth management is what happens when financial institutions and professionals provide products and services to increase returns on, or the benefits from, existing assets. Borrowing can leverage assets, insurance can protect them, and investments may make them grow larger. But individuals must have assets to manage – income, savings, businesses, property, etc.

The benefits from wealth management can be substantial, but it doesn't transform paupers into multi-millionaires overnight. Think about all the wealthy people you know. Invariably, the origin of their wealth was their income, profits from businesses or transactions, or inheritance – not a miracle, a "secret," or a lucky accident.

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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.

2. Real returns are lower than you expect, but also better than you think.

Every year, someone hits a wealth management "home run," reaping returns in excess of historical averages. These outliers get our attention, but also distort expectations. When we hear that someone earned 15 percent last year, we wonder: "If they did it, why can't I?" and, "If it happened once, why can't it happen again?" And from those assumptions, we construct a rationale for reasonably expecting (or at least hoping for) 15 percent every year. This is simplistic foolishness.

No asset class produces above-average returns year after year; annual performances regress to their historical means – which in some cases, includes *negative* returns. With this variability, the only way to achieve above-average returns year after year is to keep picking new winners from different types of investments. Hindsight might convince you this active management approach can work, but studies repeatedly find that it **underperforms the average returns that come from simply holding an investment through its fluctuations.**

Don't buy the hype that a financial or investment firm holds the magic formula to "wealth creation."

Besides the impossibility of repeatedly selecting the highest-performing asset classes, individual investors have built-in costs, such as fees and taxes, which diminish returns. And inflation is another factor that indirectly erodes accumulation values.

For the past three decades, Thornburg Asset Management has produced reports on the historical "*Real* Real" returns (i.e., the net return after fees, taxes and inflation have been subtracted) for different assets classes over 1-, 5-, 10-, 15-, 20- and 30-year periods. Once you get past the one-year numbers, the longer-term annual returns are between 3 and 7 percent. To repeat: 3 and 7 percent.

These numbers might seem low until you realize that the annual rate of inflation for the 30-year period ending 2015 was 2.7 percent. One of the main objectives of wealth management is to have savings retain their purchasing power by keeping pace with inflation. Average annual returns of 3 to 7 percent may seem paltry, but even the low end of *real* real returns outperforms inflation.

Acknowledging that every year someone, somewhere, experiences above-average returns, expecting net returns between 3 and 7 percent is more realistic. And that is often good enough to ensure that today's accumulations retain their future value.

3. Accumulation is only one phase of wealth management

Accumulation is an essential part of wealth management, and probably the easiest to execute: You pick a product, deposit money. Lather, rinse, repeat. It is also the simplest to evaluate: Calculate the rate of return, and/or see if the pile is big enough to meet your objective.

Because it's simple and essential, and because there are a lot of choices, accumulation gets a lot of attention. But there are other aspects of wealth management. These items aren't always as easy to assess or execute, but can have a greater impact.

Cost management. If your investment account is earning 7 percent, but you are paying 15 percent interest on a credit card balance, are you making or losing money? A crucial part of wealth management is accounting for costs, and finding ways to either minimize or eliminate them.

Better cost management improves cash flow, which either makes today's standard of living better, or effectively increases investment returns because more money can be set aside for the future.

Asset preservation. One of the best ways to keep your wealth plans moving forward is to avoid any backward steps. Losses can cripple accumulation plans; if an account declines five percent this year, it must earn over seven percent per year for ***the next three years*** just to average four percent. And sometimes a *guaranteed* return is better than an opportunity for a bigger one, especially for those nearing retirement.

A bigger wealth management threat is losing income that makes accumulation possible. If your wealth accumulation plans rely on ongoing deposits, life and disability insurance are essential considerations.

Preservation is also paramount during the distribution phase of wealth management, because while it's difficult to overcome a loss during accumulation, it can be devastating to encounter the same event in retirement. For financial security, monthly payments guaranteed for life can be priceless.

Distribution. Accumulation and distribution are like two halves of a football game; having the lead at halftime is good, but the most important time to be ahead is at the end. The first half of wealth management is accumulation, the second half is distribution, i.e., figuring out how to best spend or pass on what's been stored up. The way you have accumulated can impact how much you can spend; sometimes, the wealth management plan that appeared to be behind at halftime ends up dominating the distribution phase.

Don't Get Mad. Get Real.

In many personal economies, cost management, preservation and distribution get shortchanged. It can be tempting to think these not-so-simple aspects of wealth management can be resolved by finding a secret formula for having so much money you don't have to deal with them. That's madness. ❖

So don't get mad. Get real.

- **Real returns based on realistic expectations.**
- **Real protection against real threats to your wealth-building resources.**
- **Real security that leads to real enjoyment during the distribution phase of wealth management.**

And get real wealth management.

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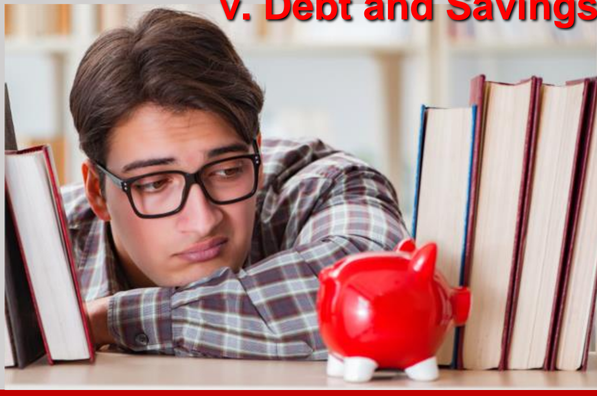


For at least 50 years, politicians and policy makers have championed a college degree as the surest path to prosperity and upward mobility. This assertion has merit: numerous studies show college graduates have significantly higher lifetime earnings in comparison to their less-credentialed peers. But a single-minded focus on getting a degree may overlook some of the costs embedded in this career track.

To help Americans attend college, the government provides grants and low-interest student loans. The combination of more students seeking a degree, and subsidies to make it affordable drives up the price. According to statistics released November 2017 by the Labor Department, college tuition has increased 400% since 1990, a rate four times higher than the Consumer Price Index.

In a self-perpetuating loop, tuition increases force more students to borrow, in ever-larger amounts. The upshot: even when they earn more money after graduation, these "start-up costs" reduce their economic advantage. This is especially true with student loans, which exert a financial drag on many graduates long after they've left college.

A Tale of Two Cousins

"A Tale of Two Cities" is a historical novel by Charles Dickens that begins with the sentence "It was the best of times, it was the worst of times." The novel tells the story of two men who have a physical resemblance, but very different life stories. In a similar manner, this article considers the career paths of two cousins.

Nick (and Nora)

Nick is 37, married to Nora, with three kids, ages 10 to 2. He is a teacher and Nora is a speech therapist. Between them, they have three college degrees, and earn right around $100,000. They live in a Midwestern college town, and just bought their first home.

Nick and Nora borrowed heavily for college, and graduated with a combined student loan balance of $80,000. Thirteen years later, they still owe $40,000, with minimum monthly payments of $300. Besides their mortgage, they also have a car payment. Other than Nick's employer-funded teachers' pension, the family's only savings are $1,000 in an emergency fund.

Nick and Nora admit that student loan debt was the reason they delayed having children, and couldn't afford to buy a home until two years ago. Combined with the cost-of-living increases that come with a growing family, saving has been a challenge; emergencies have often been paid with credit cards. On their current schedule, Nick admits they will still be making student loan payments when their oldest daughter is a college freshman.

Josh

Nick's cousin Josh is 31, single, and currently living at home. He tried college for one year, but it wasn't a good fit. Josh works for a machine repair company and does some custom welding on the side, for a total income of between $35-40,000. He also is an aspiring property manager; with his father's financial assistance, he has acquired two rental properties.

Josh owns a restored Lotus sports car, and with three of his friends, is part of a racing team that enters a $500 "lemon" in weekend endurance races around the Midwest.

Josh is frugal, almost to the point of being cheap. Other than the mortgages on the rental properties, he has no debt. While he doesn't skimp on his automotive hobbies, he currently has $50,000 in the bank.

The Key Difference

Other than sharing a last name, Nick (and Nora) and Josh have very little in common. Their life stories feature different educational backgrounds, different careers, different family units.

Nick and Nora are textbook examples of the college career path: they have degrees, professional designations and work in their field of study. According to the conventional narrative, they are on the career track that leads to the American Dream, at least the financial version of it.

Josh doesn't have a college degree, and probably never will. But he works, saves, and has some financial ambitions.

In this overview of their financial lives, two items stand out like flashing neon signs:

Cousin #1: $40,000 student loans + $1,000 savings
Cousin #2: $0 student loans + $50,000 savings

In the tale of these two cousins, who has the better financial condition? The assessment doesn't hinge on college degrees, or long-term employment prospects; it's the debt and the savings. That's the key.

It may not be the easiest route, but the surest path to prosperity and upward mobility is minimizing debt and maximizing savings.

The Best Financial Education

These anecdotal observations are not meant to diminish a college education. Both Nick and Nora recognize they have professional, personal and social benefits because of their college experiences. At the same time, they see that their decisions to borrow 15 years ago limit their financial options today.

So how do you make good decisions about borrowing for college? It's tough. Not many 18-year-olds know their career track; they usually decide – and change their minds – after they start college. And the job of financial aid counselors is to find money for college, not figure out how you'll pay it back. But should you trust the get-a-college-degree narrative, and hope the money will work out, when sometimes it doesn't?

All debt, even low-interest student loan debt, weighs on your financial progress. A college education is worthwhile, but when it comes to money, being smart about debt and saving is worth more. ❖

Unintended Consequences:
401(k)s Clobber the Best Savers

Besides producing revenue for governments to operate, taxes are used to influence behavior. "Sin taxes" on tobacco and alcohol raise their prices, and hopefully deter their use and abuse. Tax credits may prompt consumers to install solar panels or buy an electric car. Deductions for contributions to IRAs and 401(k)s can encourage retirement saving.

But every tax is subject to the principle of Unintended Consequences; there will be "outcomes that are not the ones foreseen and intended by a purposeful action." Taxes change the terms of economic activity, and will cause people to adjust accordingly. Makers of tax policy know this, but it is difficult, if not impossible, to predict what will change. Adjustments may not manifest themselves for years. And sometimes, it turns out the tax has influenced the wrong group of people toward an unintended result. That's sort of the story of the 401(k).

A Fundamental Assumption May Not Be Correct

While there have always been some contrarians when it comes to pre-tax retirement plans, it has taken almost 40 years for mainstream commentators to reconsider the long-standing recommendation that employees make maximum contributions to their 401(k) accounts. A November 2017 article by Mitch Tuchman on MarketWatch.com titled *"How This Classic Savings Strategy Could Get You Clobbered with Taxes When You Retire"* begins:

> The logic of the 401(k) system is well understood by most people. Saving more results in an immediate reward – lower taxes today. Every dollar you put into a 401(k) or a traditional IRA is untaxed this year. It grows free of investment taxes, too. The government gets its cut years later, once you retire.
>
> Even then, the taxes taken on these withdrawals are at your personal income tax rate. Presumably, you will spend less in retirement and fall into a lower tax bracket.

So far, this sounds like anything you've heard or read in the mainstream financial press. But Tuchman pivots to an ominous conclusion:

> That's a great deal if you do in fact, spend less in retirement. Yet many retirees spend more, at least at first, then slow their spending, only to pick it back up later on.

Whoa, whoa, whoa! If retirees were presumed to "spend less and fall into a lower tax bracket," then what will happen when "many retirees spend more?"

Answer: the taxes they pay on distributions may exceed the deductions they received when the money was deposited.

The Wrong Carrot Dangling in Front of the Wrong People?

Forty years ago, when IRAs and then 401(k)s were introduced, the intention was to supplement retirement saving, especially for lower wage earners. For this demographic, it was reasonable to assume a lower tax bracket in retirement. However, several factors should have given policymakers pause.

The United States has a graduated income tax. Higher earnings result in higher marginal tax brackets. So those who earn the most receive a proportionally higher tax break from a 401(k), and have a bigger up-front incentive to make contributions.

The biggest contributors will inevitably accumulate the largest balances. For a variety of reasons, it is also plausible to think the most successful retirement account savers are the ones most likely to see their distributions taxed at a rate higher than the deductions they received on their deposits. Retirees with large 401(k) balances have limited ability to avoid this "tax flip" because required minimum distributions force them to make taxable withdrawals even if they don't need the money for living expenses.

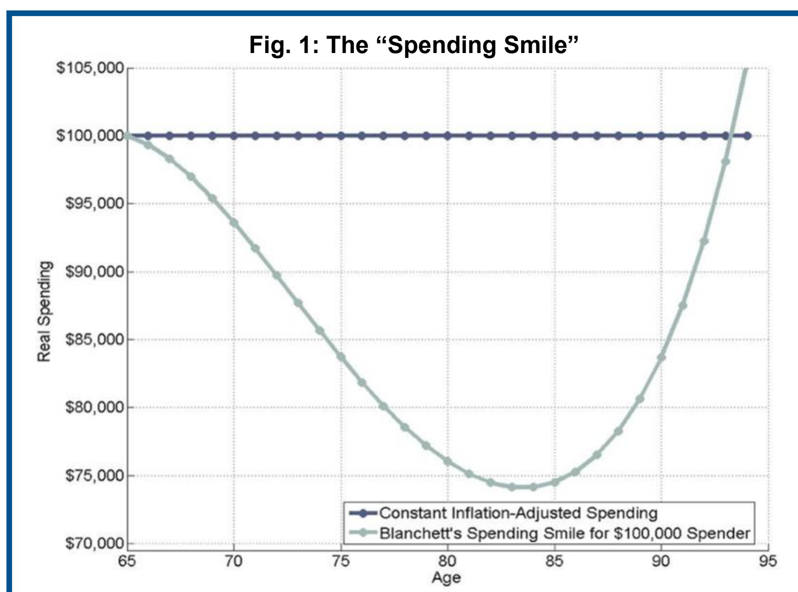
The unintended consequence: High earners are the best savers because they receive the biggest immediate reward, but also pay a steeper price in retirement because they've saved so much money. Where's the win-win in that scenario?

But wait, there's more.

The "Spending Smile," a 2014 study from Morningstar researcher David Blanchett, finds that spending often increases at the beginning of retirement, as former workers relocate, upgrade cars, or indulge in leisure pursuits and travel. But once new lifestyle routines are established, the sobering prospect of running out of money in old age prompts a progressive frugality. Between ages 65-85 retirement spending tends to ***decrease*** about ***one percent per year***, and doesn't begin to tick up again until the medical expenses of old age start to increase monthly overhead. Hence, the spending "smile." (See Fig. 1)

This first phase of the spending smile often produces what

Fig. 1: The "Spending Smile"

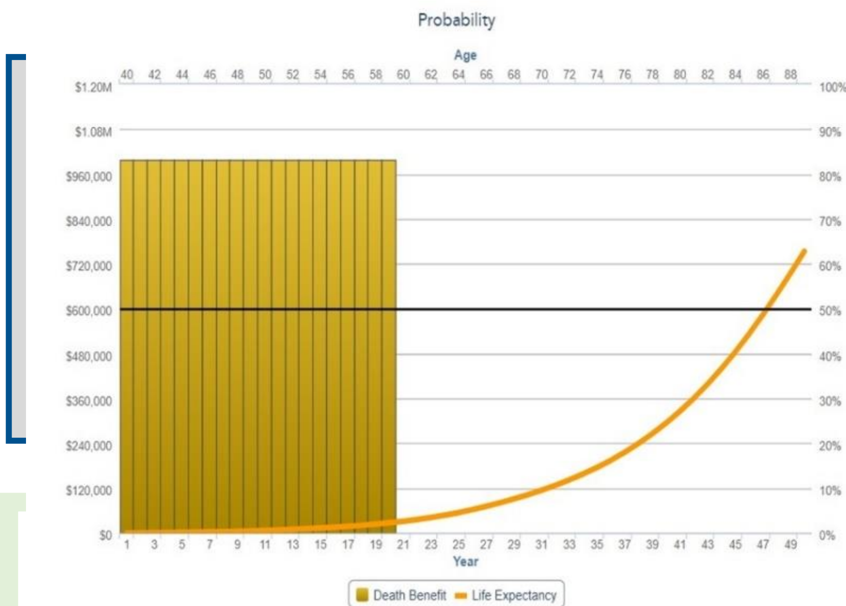


Tuchman calls a "tax avalanche." Larger distributions from retirement plans not only result in more taxable income (at potentially higher marginal rates), but often trigger taxes on Social

Security benefits. This piling on of taxes can be particularly punitive if a retiree has allowed retirement account balances to compound until 70½, when Required Minimum Distributions start. Tuchman says:

"The worst case is paying taxes on both Social Security income and on required minimum withdrawals from your 401(k) at the same time. It happens to millions of people every year. Essentially, you fall victim to an avoidable tax avalanche."

How is the tax avalanche avoidable? One possibility is to take withdrawals from 401(k)s first, and delay Social Security, which can minimize or eliminate the taxation of Social Security income. Another is to use Roth retirement plans for ongoing accumulations, where contributions are made on an after-tax basis but growth and distribution is tax-free. (Life insurance cash values, which receive similar tax treatment to Roth accounts, may also be an option for this same strategy.) These after-tax plans can be used to selectively add retirement income while avoiding the costly avalanche. ❖



When the primary focus of a personal financial plan is naximizing accumulation, things that don't contribute directly to his objective are often given the briefest of discussions, and valuated in the simplest of contexts.

This is unfortunate, because "simple" approaches to these ther issues can be costly. Consider term life insurance.

Getting Past the Premium to the Real Numbers

A principal attraction of term life insurance is that it offers rotection against a premature death at a low initial cost. For those vho prioritize accumulation, low cost insurance makes more noney available for investment. But when you take a deeper look t the economic factors inherent in term life insurance, you see hat an accurate assessment of cost goes beyond simply adding up he premiums.

The Living Balance Sheet®*, a proprietary software program for financial professionals, has a module that produces customized projections of the not-so-obvious economic factors associated with a decision to use term life insurance to protect an individual's economic value. The following illustration and assessment are derived from this hypothetical scenario:

- A 40-year-old male non-tobacco user obtains a 20-year level premium term life insurance policy of $1,000,000 at preferred rates from a highly-rated company.
- The annual premium is $1,320.
- After 20 years, the term ends, and no new coverage is secured.

The "Probability" chart (Fig. 2) blends two data sets in one illustration.

- The vertical bars on the left side illustrate $1 million of life insurance protection for 20 years.
- The yellow line and right column indicate the annual probability of death from ages 40-90; at 40, there is a less than one percent chance of dying; at 86, the odds are about 50-50.

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This is the actuarial element in term insurance: there is a low likelihood that death will occur during the term, which explains "the low initial cost." After age 60, the probability of dying increases steadily. This clearly reveals why very few term life insurance policies (some experts say less than one percent) result in a claim: most policies are expected to terminate before the insured does.

Adding It Up

In this example, the most likely outcome from a decision to buy term life insurance will be 20 years of premiums paid, no death, and a termination of benefits. Twenty years of premiums adds up to $26,400. But the financial impact is more than the premiums.

Considering the very low probability of a death occurring during the term, it is reasonable to apply an opportunity cost to the premiums – what the money could have been worth if it had not been used to buy life insurance. At an annual time-value-of-money rate of 7 percent, 20 years of premiums result in a cumulative opportunity cost of $31,502 by age 60.

But opportunity costs don't stop compounding when a policyholder stops paying premiums. The $31,502 keeps accruing until the insured's death. And someone healthy enough to qualify for a preferred life insurance policy could live a long time. If our healthy non-tobacco user makes it to 90, those premiums will have compounded to a value of $440,865.

The time value of money rate is arbitrary – you could assume more or less – but it makes the "low initial cost" of term insurance look a little more expensive, doesn't it?

And, while the odds are long that death will occur before age 60, it is an absolute certainty that death will occur. If the coverage had stayed in force, there would have been a $1 million payment to beneficiaries. But, because the policy ends after the 20th year, the death benefit will almost surely be forfeited.

A life insurance death benefit is a financial certainty that enhances or improves the utility of other assets. This financial certainty can be particularly relevant in financial plans where the coverage is designed to be in force for one's entire lifetime. Surrendering a life insurance death benefit is a loss that should be included in a financial impact assessment. Here is a summary of the Total Financial Impact of this hypothetical decision to buy term life insurance:

Total Premiums:	**$26,400**
Time Value of Money @ 7% (to age 90):	**$414,365**
Lost Death Benefit:	**$1,000,000**
Total Financial Impact:	**$1,440,765**

Is it time for an in-depth look at life insurance?

You may not have evaluated term life insurance beyond the initial premiums. And even though you've been shown a different perspective on the financial impact of buying term, it might conflict with the simple view you had before. So…

You could manipulate these numbers by finding a lower premium, assuming death at an earlier age, and using a different time value of money assumption, which would still result in…a total financial impact in excess of $1 million.

You could say, ***"Yeah, but…"*** and refuse to accept the logic behind the calculations, even though there are plenty of instances where a life insurance benefit is considered a financial asset.

Or you could say, ***"Hmm. Maybe there's more to this than I thought."***

And when a financial professional says, "Has anyone ever shown you how you can be the beneficiary of your own life insurance?" you might say, ***"I'm intrigued. Tell me more."***

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David Orsolino
Strategies for Wealth
120 Broadway, 37th Floor
New York, NY 10271
p. 212-701-7922 l Efax. 800-848-2048
Email: dorsolino@strategiesforwealth.com

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