Ultimate Tools to Longevity Risk Planning

Managing risk is as important today as it has always been. For example, when it comes to our biggest asset, our home, we're protected with homeowners insurance. When it comes to our cars and the risk of liability in the event of an accident, our autos are insured. And of course, when it comes to our health and the enormous potential cost of doctors and hospitals if we were to become ill, we have protected ourselves with health insurance. Because health risks are so high, the government actually requires by law that they are insured.

There is even a way to mitigate the risk of having our loved ones exposed to economic hardship in the event of an untimely death with life insurance. But what about stock market and inflation risk? Surprisingly few have protected themselves from the inevitable dips and downturns in the market that exposes their hard-earned life savings to definite peril.

One of the largest groups of investors are people saving for retirement. According to a survey conducted by Legg Mason, the primary goal of retirement investing is for people to maintain their current lifestyle in their later life; however the survey also found there are three primary issues people fear which can prevent them from living the lifestyle they want later in life: 1) having a catastrophic health event that could use up their retirement funds; 2) living longer than their retirement funds would last (otherwise known as Longevity Risk; and 3) their income won't keep up with inflation (Purchasing Power Risk).

These are all valid concerns, and they all point to the underlying issue: risk of market returns. Where do retirees put their assets today? Most people, not wanting to risk all their money in the volatile stock market, let their money sit idly by in what they perceive as safe investments. These traditional parking places are savings accounts, money markets, bank CDs and Treasury bonds. They hope that through these vehicles, they can earn a modest income stream. The problem is that the returns on these particular vehicles are actually very low. Right now, the average rate available on money market and savings accounts is about .50%.

The one year bank CD rate is around 1% and you might get 1.5% for a five year Treasury bond and 2% for a ten year Treasury, if you're lucky. That means that you have locked your money up for a decade, and it's earning you less than 55 cents per day. That does not provide enough to cover the modest income stream most hope for.

Let's move to the opposite end of the investment spectrum and look at equities. Right now the current P/E ratio for the S&P 500 stands at about 25.7% (based on a report by Crestmont Research). This is just shy of its 20 year average of 26.8%. That is exciting, but if we go back to the technology bubble in 1999, the ratio stood at an extreme 44.2%. Twenty-six percent is high. It's worrisome. Retirees need to be cautious. In fact according to Yale professor, Robert J. Shiller, this is a terribly fearful place for retirees to be because a normal long-term PE ratio should 15% based on trailing earnings.

In the higher-risk environment in which we find ourselves today, the goal is to not only invest, but to feel safe and secure. Retirees need to be less emotional about their money and be taught how to position their savings to take advantage of opportunities. The Great Recession taught us we cannot continually endure the dramatic ups and downs of the market. Right now we are in the seventh year of the most recent bull market. It's one of the longest bull markets in US history. We don't know when a market correction will come, but we can all agree it is coming, probably sooner than later. We also need to remember that brilliant research does not equate to beating the stock market. The stock market has out-smarted Nobel Prize winning laureates and Professors at Harvard Business School and MIT. Many a guru have claimed to have figured out the market, but no matter how compelling their logic, advisors need to use common sense and good judgement in their client's investment decisions.

If we look at the current economic status both in the US and the global environment, one fact stands out. We face a real crisis, but this time, equities will not be the cause of major consumer loss when the collapse occurs. The losses are going to happen in the bond market. Bonds get overlooked because the mainstream financial media knows that stocks get papers read, the news watched, and radios listened to. Stock market stories are usually much more dramatic then bonds or currencies. That may soon change.

Most do now know that we have a formidable 100 trillion bond bubble. For the last 30 years, Western currencies have been covering over the decline and living

standards by issuing debt. In the simplest terms, sovereign nations spend more than they collect in taxes. Our Federal Reserve likes to spend a lot of money, much of it on social programs. While they spend, they don't increase taxes as much as they should to cover the costs. Instead, they issue fiat money as well as new debt to fund these various programs. The US is not alone in this; most Western nations are completely bankrupt due to excessive social spending. All of the spending has been fueled by the issuing of new bonds.

As I just noted, the global bond market is well over 100 trillion dollars and is growing rapidly. Indeed US corporations issued over 1.5 trillion in new debt in 2014 alone. This is an all-time record, but it gets worse. It is actually the third consecutive all-time record for corporate debt issuance, which means that the bond bubble is more than $100 trillion because it is growing on a month-to-month basis. Adding to that, consider that 81% of all derivative trades are based upon interest rates which equate to bonds. Globally, the interest rate derivative market is an unbelievable 555 trillion in size.

Right now in this current environment, successful individuals and families are in a hungry state for trusted guidance that helps them achieve their most important financial goals and dreams. As advisors, we need to be proactive, truthful, and earn our client's respect as their trusted fiduciary by working in their best interests and help them achieve what they desire.

If our clients are worried about their money being safe while earning a decent return, there is an answer. There are vehicles that offer safety as well as being guaranteed tax-free or tax efficient. They are insurance instruments that can insure against losses in the stock market. These particular vehicles transfer stock market risk to another entity, an insurance institution, so that no matter what happens in the market, there's never a loss. Keep in mind, these retirement protection vehicles can also provide tax-advantaged or tax-free income for life, and since they never lose money, the purchase power of retirement income can last the needed 25 to 30 years or more.

CPA extraordinaire, Ed Slot, says the greatest gift in the tax code is life insurance. Today's life insurance is not your grandparents' old life insurance, locking up money until the insured passes away. There have been significant changes over the years, and the current array of vehicles include dividend-paying whole life, index life insurance and guaranteed universal life insurance products. These life insurance vehicles can help you and your clients achieve a competitive, guaranteed, predictable growth that is higher over the long term compared to what the conventional, safe-money vehicles are paying. Some even have a market-like return with the use of an index of S&P 500 or other alternative indexes if the market drops. And to appease investors' worries over long-term or catastrophic illnesses, most life insurance vehicles can provide living benefits for health care crisis protection from a stroke, heart attack, and disability or nursing home costs. They are backed by the legal reserve system, and they not only provide tax-free income for life, but a tax-free, probate-free death benefit that pays to your beneficiaries in the event of death.

When it comes to educating clients, we like to use the faucet and bucket theory. During our working years, roughly ages 18 to around 64 years old, we are pouring funds into our retirement bucket. This is the accumulation stage, with money coming in from our work, our 401(k)s and IRAs, and through other investments. Stockbrokers and money managers deal with this first phase, as their main focus is on growing the money. At some point, we hope the bucket is full enough so that we can retire and begin the distribution phase. At this point, the bucket has some rusted holes in it, the first of which is long-term care. This particular hole can turn into a hemorrhage, with long-term care costing $6000 – $8000 a month. That is a hole that definitely needs to be plugged. We also need to seal off the "inflation" hole. Inflation is going to ramp up and reduce the purchase power.

However, one of the largest rusty spots we have to be aware of is taxation. The government is interested in the distribution phase because much of the investment money we put in our bucket came in the form of 401(k)s and IRAs, and the government would like to get paid its share on that money. This is why people 70 ½ and older are required, by law, to take money out. When qualified plans were first conceived, tax-deferment seemed like a good idea. However, right now, we are at an 18 trillion dollar deficit. The only way we can earn our way out of this is to increase taxes. Did you know if you averaged the tax rate since 1926, it would sit at a whopping high 60%? Today's highest tax rate is 39.6%. With the real possibility of 78 million baby boomers dropping out of tax-paying rolls and into entitlement rolls of Medicare and Social Security, taxes will surely increase. This leaves money in tax-deferred vehicles exposed to more risk than advisors would like to believe. Unfortunately, I think people in their retirement years are going to be in for a rude awakening; they may be planning on getting, say, a $5,000 a month income, but with higher taxes, they may only get $3,800 or less of that money. Taxes, in short, can be a rusty hole turned volcanic explosion if it is not managed well.

We need a savings vehicle that keeps our money safe. Life insurance in the forms I mentioned above works well at sealing all of the holes in the bucket.

Through the use of life insurance, our clients can still maintain tax-deferred growth and be linked to stock market-like returns with indexed life insurance products. Keep in mind, IUL products can provide long term care protection and offer guaranteed death benefits for our clients' families. Two things in life are certain: death and taxes.

As a CFEd®, RFC® and Business Development Advisor with BCA Marketing, I strongly believe it's a necessity to embrace and implement tax-advantaged and tax-free income planning strategies in order to take care of our clients. That way, if our clients live another thirty years, they can leave a tax-free legacy to their children and grandchildren, while providing true protection from longevity risk.

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Joseph Clark, CFEd®, RFC®, has extensive knowledge in preservation and distribution of wealth, retirement planning, reduction of financial risk, tax efficiency and protecting assets from catastrophic illness. He is an experienced teacher, consultant and advisor with Brokers Choice of America. Joseph also works with personal clients through his agency, Clark Advisory Group.

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