Creative
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Can You Be Trusted with Your Money?

An underlying assumption in much commentary about personal finance is that most people are terrible with money. Financially illiterate, manipulated by marketing, distracted by present concerns, and guided by emotions, the masses repeatedly make stupid financial decisions.

Ostensibly, the purpose of personal finance columns, books and seminars is to educate, to reveal the error of our ways, and illumine a path to financial enlightenment and prosperity. But sometimes there's an insidious assumption behind the instruction: Even with education, most of us still lack the character – the self-discipline, the rationality, the focus, etc. – to make good financial decisions. Thus, "education" suggests that your best shot at financial stability and prosperity is to remove yourself from the equation. Instead, entrust your future to pre-set strategies that minimize your involvement. And for the big decisions, rely on experts, those chosen few who are smart enough and strong enough to be impervious to human foibles.

Depending on your perspective, this beneath-the-surface message could be either a cynical way to sell products and services, or represent genuine paternal concern ("We just want what's best for you."). But instead of debating intent, maybe it would be better to broaden the discussion. Maybe you should know yourself enough to decide if you want to be trusted with your money, and what advantages might arise from those decisions.

Consider the following illustration as sort of a self-evaluation of your interest in financial responsibility.

The Best Way to Pay Off Debt?

In Personal Finance 101, debt is understood as something to be carefully managed, minimized, and eventually eliminated. Because poorly-managed debt is a major stumbling block to financial security and often results from bad habits, the recommended "fixes" are usually pretty strict: cut up the credit cards, downsize, use all available funds to accelerate payoffs, etc. And don't do it again.

So when it comes to getting a mortgage – a big debt – the recommendation typically follows the same track: select the shortest term you can afford, and plan to make extra principal payments whenever possible. In practical application, this means opting for a 15-year mortgage instead of a 30-year one. To reinforce the wisdom of a shorter payment period (albeit with higher monthly outlays), you might see the following:

For a $250,000 mortgage at 4.5% interest:

TERM	MONTHLY PAYMENT	TOTAL PAYMENTS	TOTAL INTEREST
15 yrs	$1,912	$344,248	$ 94,248
30 yrs	$1,267	$456,015	$206,015

It's simple, right? Assuming you can afford a 15-year monthly payment, it makes no sense to select the 30-year option. What's the point of

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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.

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CAN YOU BE TRUSTED WITH YOUR MONEY?

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paying more interest over a longer period to borrow the same amount? And if there's extra money available, additional principal payments each month will only pay it off faster.

This information is accurate, but it's not the whole story. There is a compelling counter-argument that taking a longer term actually is the better option. Here's why:

You can realize additional financial benefits by selecting the 30-year mortgage and saving the $645 monthly difference in a separate account. If this accumulation earns a return equal to the mortgage interest rate, it will pay off the mortgage in 15 years. To repeat: Paying the bank $1,912 each month or dividing the same amount into $1,267 for the bank, and $645 in a personal account earning 4.5% results in the same outcome.

Apart from the identical end result, consider how a separate accumulation delivers additional benefits.

The monthly obligation is lower. There is a cash flow benefit in minimizing your monthly payments. And you're living in the same home whether you pay $1,912 or $1,267/mo. But in the event of a financial emergency (loss of employment, medical incident, etc.), which amount would be easier to afford, and thus more likely allow you to stay in the home?

There is a growing accumulation under your control. This accumulation can be used for emergencies or opportunities. While larger payments also accelerate home equity, this accumulation is not under your control. The approval of a lender is necessary to access this value – and the refinance or line of credit comes with another payment schedule.

Potential tax deductions for mortgage interest are greater. The 15-year mortgage accrues $94,248 of interest. In the example where a 30-year mortgage is paid off with a lump sum in the 15th year, the cumulative interest is $143,593, a 53% increase. If this interest is deductible, the 30-year schedule produces significant tax savings.

The gains from the separate account could be greater than the interest rate. (And even if they aren't, it may not matter.) If the outside account earns more than 4.5%, the mortgage could be paid off earlier than 15 years, or result in a surplus after the mortgage balance has been paid. And even if the separate account underperforms the mortgage interest rate, the payoff change may not be significant. At 4%, a lump sum payoff occurs in the 183rd month, just three months past 15 years. At 3.5%, the payoff comes in the 188th month. For 15 years of the benefits listed above, will a few extra months really matter?

Consider your cash flow

A lower mortgage payment with a separate accumulation can deliver additional benefits.

The math and the benefits of selecting a longer payment period while accumulating the difference in a separate account are airtight, and the end result – the mortgage paid in 15 years – is the same. So why would "experts" recommend the shorter term? Because of a belief that unless contractually compelled by an outside authority (in this case, the lender), most people don't have the discipline to sustain this kind of a plan. And mentioning this option only tempts people to be irresponsible.

There are two problems with this perspective. First, if self-discipline is the issue, there are processes to deal with it. Just as when they participate in employer-sponsored retirement plans, individuals can voluntarily enter into agreements that psychologically "compel" them to save. Something as simple as authorizing automatic withdrawals from a bank account or a paycheck satisfactorily resolves the discipline problem for most households. And a financial professional who monitors the separate account provides an additional level of support and accountability.

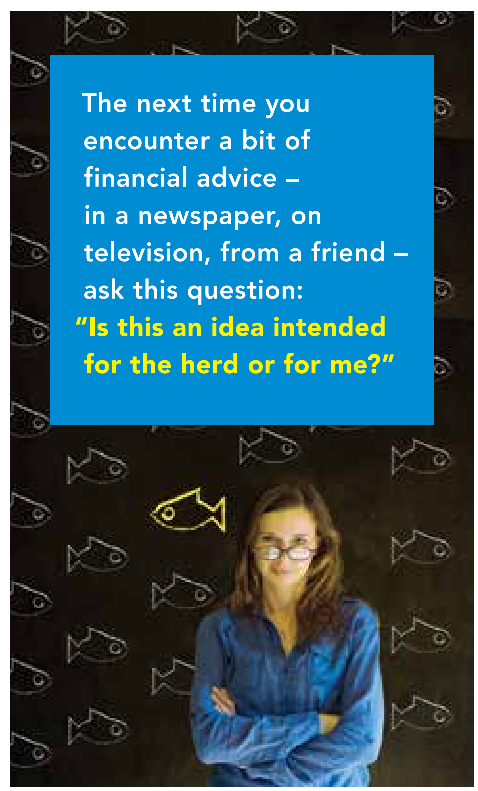
The bigger problem is that many households accept the negative assessments of their financial character. Even after hearing the logic, seeing the numbers, and understanding how this strategy can be executed with automated systems, it's not uncommon for the individual to say, "Well, I get it, but I don't trust myself. Even with automatic deposit, I'd probably mess it up. Better to just send a big check to the bank each month, and know the mortgage will be paid off in 15 years."

So…How do you evaluate your financial character? Do you trust yourself to save the difference?

For the Herd…or for Me?

No doubt, a lot of people spend too much, don't save enough and make less-than-optimal financial decisions. If this group represents "the herd" in personal finance, and the goal is to provide education and strategies for this broad audience, maybe it makes sense to provide "safe" advice that protects people from themselves.

But there is another group, perhaps smaller, that attempts to save diligently, spend carefully, and educate themselves about better financial strategies. For them, approaches that require more personal responsibility, along with professional assistance, could certainly reap additional benefits.



The next time you encounter a bit of financial advice – in a newspaper, on television, from a friend – ask this question: **"Is this an idea intended for the herd or for me?"**

The "Professional Deformation" of Life Insurance

"Every specialist, owing to a well-known professional bias, believes that he understands the entire human being, while in reality he only grasps a tiny part of him." *– Alexis Carrel*

These are terrible nails!"

You've probably heard the phase, "When all you have is a hammer, everything looks like a nail," attributed to the psychologist Abraham Maslow. It concisely explains the idea of "professional deformation," the tendency to view all aspects of life from the point of view of one's professional expertise.

Thus, a carpenter picks up a hairpin, and says, "You call this a nail?" He takes a paper clip, places it on a board, hits it, then snorts when it fails to penetrate the wood. A copper wire just collapses when he hammers it. "These are terrible nails!" he bellows.

But hairpins, paper clips and copper wire have proven value in specific applications. You can't accept a carpenter's distorted assessment that these items are terrible nails, and thus conclude they are totally worthless.

The Professional Deformation of Higher Returns

Similar professional deformations occur in personal finance. As a field that involves money, many transactions can be quantified with a dollar value, and subsequent calculations made to compare their worth relative to alternatives. But some financial professionals become so focused on quantifiable returns that they ignore other features in financial assets that are both useful and valuable. For example, when there is a professional deformation toward the highest measurable return…

- It is easy to add up the costs of owning a home – the taxes, interest, insurance, maintenance costs, etc.– and conclude "A home is a bad investment!"
- It is easy to calculate the projected returns to life expectancy from guaranteed payments by a pension or annuity, and declare "You could do so much better."

But an obsession with total returns can't quantify either the financial or psychological value of controlling one's residence, and perhaps eventually owning it outright. It can't measure whether the property might have a legacy value, and how much it might mean to heirs. Similarly, how do you calculate the return on a lifetime of payments, for however long one lives? A full assessment of the financial return from an annuity or pension can only be determined when the recipient dies, but what is the value of knowing a check will arrive each month until that happens?

And Then There's Life Insurance…

The deformation can really get out of hand when a return-obsessed investment professional looks at permanent life insurance. The deformation is so prevalent that if you begin an Internet search with *"life insurance…"* one of the first auto-fills will be *"…is a terrible investment!"* This perspective completely distorts the potential uses and values of life insurance in personal financial plans.

Usually the deformation in life insurance involves comparing a policy's cash value accumulation to the historical performance of other choices, and concluding the larger balances from these alternatives "prove" their superiority. This simplistic assessment neglects many important elements.

First, it doesn't fully account for the "possible" value of the life insurance benefit. The deformation focuses on the cash values, but what is the return to beneficiaries on a life insurance benefit? In almost every circumstance, the return on the benefit will be higher than the return on cash value. And no matter when death occurs, a payment is guaranteed. Why should a return comparison be focused solely on cash values?

A return-focused financial professional might argue that the guaranteed protection[1] (and potential return) could be accomplished with term life insurance, using smaller premiums. But this is true only if the insured dies before the term expires. Because term premiums in old age become prohibitively expensive, the most likely outcome is the benefit will be surrendered. When this occurs, the "unused" term premiums, and the accompanying opportunity costs, now constitute a significant ***negative*** return. At what point is this loss included in a return evaluation? The return from a life insurance policy, term or permanent, can be accurately calculated only at the conclusion of the contract, either with a claim or a surrender.

Second, it doesn't distinguish between "saving" and "investing." These words have soft definitions, and often seem to be used interchangeably. But there is a distinction worth making between accumulation products that offer guarantees and liquidity (saving) and those that don't (investing). Because of the structure of these guarantees, saving products have diminished potential for high returns; they aren't designed to "win" a total return comparison. While you can quantify the rates of return, the attraction in savings vehicles comes from stability and liquidity, not highest returns. Cash value, with its guaranteed accumulations[1] and consistent dividend payments[2], could be considered an excellent long-term ***savings*** vehicle, even if an investment professional insists it doesn't meet his standards for an "investment."

Third, it doesn't account for an approach that integrates several types of assets to provide superior overall benefits. Accumulating assets is a critical component of personal finance. But spending is another, and a permanent life insurance benefit in a financial portfolio may enhance the spending utility of other assets. With the flexible, tax-free options for withdrawing cash values, provided the amount withdrawn does not exceed the policy's cost basis (premium paid), individuals may be able to blend their taxable and non-taxable distributions for optimal tax advantages. More important, the guaranteed insurance protection benefit is a significant "integrative" asset. The certainty of this "last" transaction means other assets may be liquidated or monetized instead of remaining off-limits for spending. For example, an individual can receive a tax-free income from a reverse mortgage, knowing the asset will be fully restored to the estate at his death, by using the insurance benefit to remove the outstanding balance.

Respect Expertise, Recognize Professional Deformation

Because there is some overlap with other aspects of home construction, it's reasonable to assume that a carpenter may know more about plumbing than the average Joe. Still, if a carpenter contradicts the recommendations of a licensed plumber about how to configure your bathroom, it's fair to ask: Who really knows bathrooms?

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CONNECTIVITY INSURANCE

On a Saturday afternoon, your smartphone lights up with an unrecognized caller from another state. Although skeptical that it's a telemarketer, you answer.

"Hello?"

"Hey Dad, it's me."

You hear your daughter's voice, but this isn't her phone number.

"Where are you calling from?" you ask.

"This is my roommate's phone. We decided to go to her house this weekend, and when I was cleaning up this morning, I spilled coffee on mine, and now it doesn't work."

"Ah, I see."

"Dad, how am I going to get reconnected? I can't do anything without my phone!"

It's true, isn't it? Today, everything happens on your smartphone. With its multitude of features and connectivity, it's not just a device for calls and texts. It's your e-mail, calendar, Internet connection, camera, electronic boarding pass, and personal banking station. For many of us, smartphones have become our interface for all things social, academic, work-related, and financial. So, when your connectivity gets doused because of a malfunctioning smartphone, you're really disconnected from life.

And that brings up an interesting personal finance question:

Is your smartphone an asset worth insuring?

The price of any insurance is correlated to the likelihood of an incident, and how much it will cost to restore or replace the loss; higher premiums (relative to the object or event insured) reflect the greater likelihood of a claim. For smartphones, there are two distinct losses, the device and the data stored in it.

In the past few years, expanded Internet capabilities in smartphones have resolved many of the data and security issues because contact info, pictures and other personal data are often archived online instead of in the device. These items can be quickly accessed and transferred to a new phone in the event of a broken or lost device. Kill switches, which can remotely deactivate lost or stolen phones, have proven an effective deterrent against data thieves. (Thefts have decreased each year since 2013.)

The biggest problem is damage to or loss of the device. And in comparison to other insurable property, the likelihood of losing smartphone connectivity due to theft, damage, or malfunction is quite high.

- According to a February 2016 Verizon survey, 49% of American mobile phone owners have broken or lost their mobile phones. And 54% say they drop their devices at least once a week.
- A 2011 study by a company that provides an address and contact organizer application estimated that 33% of people either lose or break their phones. Another nugget from the same study: 19% of people have dropped their smartphones in the toilet.

Consequently, the cost of insuring a smartphone, when calculated as a percentage of its purchase price, can be fairly steep. While a $250,000 home in many locations might reasonably be insured for a cost of less than one percent of its value (i.e., $2,500 or less), the percentage is somewhere between 25% and 50% for a smartphone. A $500 device could easily cost $250 to insure during its two to three years of active use.

Another Option: Buying/Keeping a Spare

Another issue for smartphones: innovation often compels owners to upgrade regularly. If you're in the habit of buying a new device every two years, insuring it becomes a short-term proposition: are you more likely to upgrade it before you lose or break it? For those who frequently upgrade, there may be an interesting insurance alternative.

An older, retired smartphone can serve as a backup, one that can be easily activated in the

SMARTPHONE INSURANCE

PROVIDERS. Most wireless service providers offer insurance for new devices at the time of sale. This coverage usually must be obtained within 14 to 30 days of activation. Consumers can also purchase similar device-specific insurance from outside insurance companies. It may also be possible to include the device under the "contents" coverage in a renters' or homeowners' insurance policy.

PROVISIONS. Standard protection obtained from wireless service providers typically covers accidental damage, out-of-warranty malfunction, loss and theft. Homeowners' and renters' policies insure possessions, including smartphones, but only if they're stolen or damaged by a covered event, such as a fire.

Almost every insurance plan includes a deductible. For wireless company plans, these range from $50 to $200. On a homeowner's policy, it will be the standard deductible, typically $100-$500.

Some plans make good on the loss with a replacement of the same model, which may be either new or refurbished. Others make a cash settlement, based on the age and model of the device.

PREMIUMS. In purchase contracts where the price of the phone is folded into a monthly service bill and amortized over the term of the contract, the insurance is added in the same manner. A sampling of monthly fees at the end of 2016 ranged between $8 and $15/mo., and is typically applied over a two-year period to match the payment plan for the smartphone. Most providers and outside insurers also offer a single premium payment option, with a range of $80 to $150. Adding a smartphone to one's renters' or homeowners' insurance may be less than $10/yr., but the much lower premiums reflect the restrictive conditions under which a claim may be paid.

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CONNECTIVITY INSURANCE

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event the current model is unavailable. This single device can be the "insurance," not just of one person, but perhaps a group of people (like a family of five, of which one person will drop a phone in the toilet).

However, keeping a spare is only a partial solution. A backup can quickly restore connectivity, but it doesn't replace the lost or malfunctioning device.

Another Example of a Fundamental Financial Decision

The long-term solution to insuring mobile connectivity is more durable devices. Compared to landline equipment, wireless communication is markedly less reliable. Old telephone companies used to boast about "99.9 percent reliability" for their transmission systems and devices. Today, wireless communication promotions still ask "Can you hear me now?" As devices become better protected against user abuse or neglect, insurance costs will probably decrease.

But whether it's protecting your mobile connectivity or some other asset, the fundamental insurance question remains the same: are you willing to pay to transfer the risk of loss to someone else, instead of bearing the full cost yourself?

Entrepreneur Garrett Gunderson, in his 2007 book "Killing Sacred Cows," says people with a Producer mindset "love insurance because it transfers their risks, and they know it saves them money in the long run." The prices established by insurance company actuaries accurately reflect the likelihood of claims and their resulting costs. In the long run, in the aggregate, insurance not only provides peace of mind, but saves money.

It's Never Too Late to Pass Along Financial Wisdom

"Teaching Kids about Money" is a regular personal finance topic. Articles usually include discussions about setting allowances, developing good saving and spending habits, explaining how compounding works, etc. Giving your kids knowledge and experience with these items is certainly worthwhile. But a lot of it truly is "kid's stuff" from a financial perspective. The "adult world" of personal finance is a lot more nuanced and complex.

And ironically, when your children become adults they might be much more receptive to your accumulated financial wisdom. This quote is frequently attributed to Mark Twain, but never verified. Whoever said it spoke a timeless truth:

"When I was a boy of 14, my father was so ignorant I could hardly stand to have the old man around. But when I got to be 21, I was astonished at how much the old man had learned in seven years."

If you have adult children, now might be an opportune time to have some educational dialog about your financial experiences. A possible format for these conversations: Two simple phrases…

"I wish I had…" **and** *"I'm glad I did…"*

Take a moment to reflect on the arc of your financial life; skim through the ups and downs, the major events, the memories. As you process your financial history, identify moments where, looking back, you would say, ***"I wish I had…"*** or ***"I'm glad I did…"*** What do you find?

If you're like most of us, you probably have items in both categories. Like:

"I wish we had made an offer on that vacation home."

"I wish I had taken that job offer."

Or…

"I'm glad I talked with our attorney about a will."

"I'm glad we started saving when we did."

Here's another item for reflection: For those "I wish I had…" situations, would it have taken very much to change them to "I'm glad I did…"? Possibly quite a few could have been different

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THE "PROFESSIONAL DEFORMATION" OF LIFE INSURANCE

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Likewise, many investment professionals who are well-versed in strategies to maximize returns probably have some familiarity with real estate, pensions, life insurance, and other financial issues. While these return-focused professionals may passionately believe all financial challenges can be solved by amassing the largest accumulation, this narrow approach overlooks the benefits from products and strategies that don't meet their high-return criteria.

Just like a well-built home taps the expertise of a variety of specialized workers, your financial plans may benefit from the counsel of several financial professionals, instead of one who claims his/her approach can do it all.

When you engage a well-rounded mix of financial professionals, it is less likely there will be professional deformation in your financial affairs.

[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.
[2] Dividends are not guaranteed. They are declared annually by the company's board of directors.

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with just a small reallocation of time or money.

Conversely, when it comes to "I'm glad I did…" events, how many significant benefits and great memories were triggered by modest actions? In retrospect, many of the milestones in our financial lives may have tipped one way or the other on small decisions.

Your adult children will most likely appreciate hearing about your successes and your regrets, because both types of events can be instructive. And if you're a typical parent of a typical adult child, you'll probably be surprised at what your children know, think they know, or don't know, about personal finance – even if you taught them well when they were just kids.

If you don't yet have adult children, the "Wish-I-had/Glad-I-did" format is still worth your time, because it may prompt you to consider what you'd like to tell your children when they are adults. Seemingly small decisions made today will shape your future. You want it to be filled with "Glad-I-did" stories, don't you?

And if you're an adult child, the same questions are a good way to prompt your parents to share their financial wisdom.

Money, like politics and religion, can be a sensitive topic for public discussion. But this is family, and you may be their only teacher. Surveys repeatedly show that a high percentage of Americans graduate from high school and college with a substandard financial education. And sharing your wisdom is not just for their benefit. Continuing to discuss personal finances with your adult children may be a small but critical step to planning for generational wealth transfers.