NOVEMBER 2020

BLOCK OUT THE NOISE:

It's All About INCOME

So many choices, so many voices, so little clarity.

With a single click from your laptop or smartphone, you can buy shares on a foreign exchange, get competitive quotes for insurance, analyze years of financial data, verify on-the-spot prices of precious metals, and execute hundreds of other financial transactions – all by yourself.

In this open access environment, financial institutions recognize they must differentiate themselves from their competitors; companies can't simply present and explain their products and services, they must ***market*** them.

Marketing may help consumers remember the name of the company or its products, but it is questionable if it provides consumers with any clarity regarding their financial decisions. Truth be told, most mainstream financial "information" does little more than add noise to the cacophony of emotional images and conflicting financial perspectives competing for your attention.

To block out the noise, and get clarity in your financial life, you need a unifying principle, one that provides a framework for evaluating all possibilities. This principle is simple, yet it addresses your most pressing financial challenges, and allows for opportunities. Quite simply…

It's all about income.

It is not about total return, net worth, or determining your risk tolerance, or any other idea that says "if you do this one thing, everything will be just fine." There is only one thing, and it is income. When you solve for income, everything else is possible.

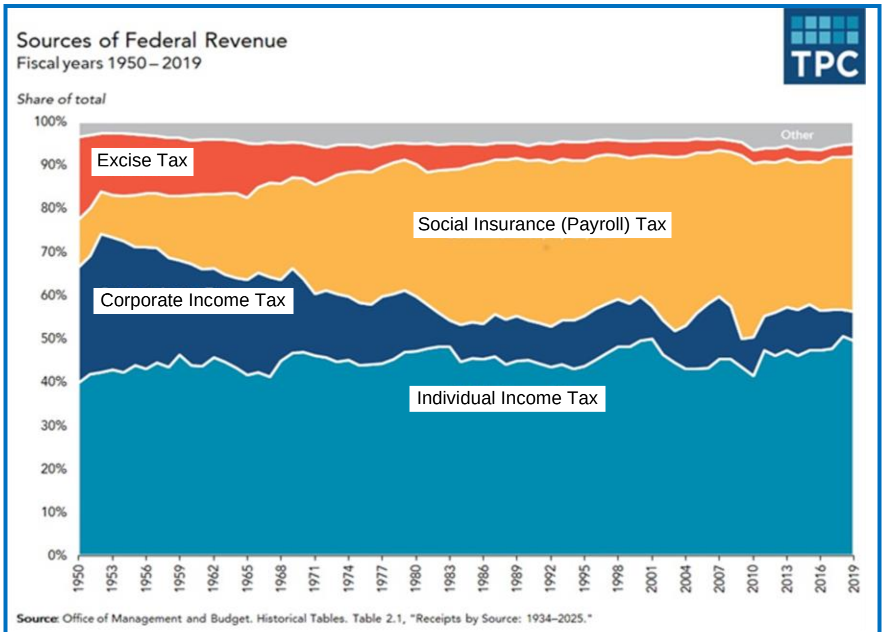
The Compelling Case for Prioritizing Income

Most Americans do not live in a closed, self-sufficient economic system where all material needs and desires can be met by growing our own food, making our own clothes, generating our own electricity, etc. In order to acquire both the necessities and luxuries of life, we use money. Every day, we need more money to support our standard of living. We need income, i.e., "money received, especially on a regular basis, from work or through investments."

The economic, social and political centrality of money received on a regular basis cannot be overstated. Every election cycle, politicians of every stripe inevitably tout "jobs creation" as one of their legislative priorities. Is this because more people want to *work*? No, it is because people want – and need – ***the income*** that comes from having work. The debates about Social Security, Medicare and health insurance are ultimately concerns about providing and preserving income, and the costs of doing so. Income is the fuel of government; 90% of federal funding is derived from various taxes on income. *(see graph on Page2)*

In This Issue…

Even the Government Knows: "It's all about Income!"



In personal finance, there are three primary actions you can take to improve your income. You can generate income, accumulate deferred income, and protect income. While a large segment of the financial service industry focuses heavily on accumulating deferred income, one could argue that most households would experience greater success if they placed more emphasis on generating and protecting income.

1. Generate Income

The foundational element in every personal economy is the ability to generate income. In a June 2020 commentary, "How to Live a Stress-Free Financial Life," Jared Dillian observes that one of the hardest things in personal finance is "*'How do I get more money?'* In fact, it's so hard that most financial gurus skip right past it."

For most of us, the default option for income generation is work, getting paid for services rendered. But a focus solely on employment for income generation may be short-sighted. Interest, dividends, royalties, rents and other forms of passive income can significantly boost current income. Andrew Carnegie, one of the richest individuals of the late 19th century, said his life changed when he received his first dividend. "I shall remember that check for as long as I live," Carnegie wrote in his autobiography. "It gave me the first penny of revenue from capital—something that I had not worked for with the sweat of my brow. 'Eureka!' I cried."

Many households might benefit from using their financial assets to generate more ***immediate*** income. For example, it's possible that saving for a down payment on a rental property might deliver more lifetime income value than simply adding to your 401(k).

2. Accumulate Deferred Income

Setting aside money for future consumption – in a savings account, a 401(k), a mutual fund, etc. – is simply deferred income. In this context, a key question is "how much income will these deferred assets generate?" But we tend not to calculate the value of our assets in the context of income. The conventional measurements are typically lump-sum valuations, like:

"What's the market value of your house?"

"How much do you have in your retirement account?"

"What's your net worth?"

Robert Merton, in a 2014 *Harvard Business Review* article, "The Crisis in Retirement Planning," says this deemphasis of income as a metric in measuring one's financial fitness is one of the reasons many Americans are so poorly prepared for retirement.

"Investment decisions are now focused on the value of the funds, the returns on investment they deliver, and how volatile those returns are. Yet the primary concern of the saver remains what it always has been: Will I have sufficient income in retirement to live comfortably?

The trouble is that investment value and asset volatility are simply the wrong measures if your goal is to obtain a particular future income. Communicating with savers in those terms, therefore, is unhelpful—even misleading."

Whatever you save, and wherever you put it, you should consider the income value of these assets, not just their market value. A person with a $500,000 home and $250,000 in saving has the same net worth as a person with a $250,000 home and $500,000 in savings, but their deferred income potential is not the same.

3. Protect Income

Since most income generation comes through work and employment, it makes sense to protect both the generating asset (i.e., the individual) and its income potential. One of the reasons health insurance is such a prominent political issue is because almost everyone's income is affected by their health, and the cost of maintaining it. The same rationale extends to obtaining both disability insurance and life insurance: when individuals stop generating income, everything else usually grinds to a halt.

Income protection is more than protecting the individual's ability to earn income. As recent history shows, sudden changes in markets can turn profitable investments into sizable losses. Given this volatility, individuals may consider it prudent to keep some deferred income in insured accounts that guarantee future income.

Bringing Clarity to Your Financial Decisions

When your framework is income, most financial issues can be easily understood and resolved by answering the question:

"How does this affect my income?"

Any answer that increases your income potential, adds to your deferred income or protects your income is probably a good one.

There are nuances and art in using income as a clarifying principle. You have to find a balance between planning to increase today's income or accumulating more deferred income. Likewise, protecting existing income, typically with insurance, may also mean forgoing opportunities for even more income.

But if you keep income as a guiding principle, it will likely change your mindset about many financial decisions. For example, when income is forefront…

- You might buy a $250,000 personal residence instead of a $500,000 one in a more-affluent neighborhood, because a $500,000 home produces the same income as the $250,000 one: zero. It may be better to live in a less-expensive home and either increase your current income or add to deferred income.
- You might weigh the advantage of developing passive income today, rather than assuming/hoping your work will provide both current income and enough deferred income to eventually retire.
- You can easily determine your "retirement number"; it's when your accumulated assets can produce an income sufficient to support your standard of living.

Consider making decisions that increase your income benefits and your financial life will make steady progress. ❖

Do your financial actions improve your income position, both now and in the future?

Are you working with financial professionals who understand why income is important?

Glenn Ruffenbach is a former *Wall Street Journal* reporter and editor who answers readers' questions in a column that discusses issues facing retirees. In a September 8, 2020, article a reader asked:

"What do you think about a person building his or her own annuity? Is there a good way to do this?"

"Building his or her own annuity," means managing your money to provide a predictable income stream for as long you live. Instead of paying an insurance company a lump sum to provide a guaranteed lifetime income, the D-I-Y version requires the individual to construct and manage a portfolio to accomplish the same thing.

Ruffenbach's response was an acknowledgement of the difference between theory and reality:

"There are ways to create [retirement income to last a lifetime]…But I think the do-it-yourself approach can be difficult for many investors and carries some sizable risks."

Ruffenbach pointed to the challenge of volatility. Even the safest or best-performing portfolio of non-guaranteed assets will fluctuate in value. Systematic withdrawals when assets are declining, especially in the early years of retirement, increase the risk of outliving your savings. A D-I-Y retiree must either choose an income level below expected returns or adjust income downward to minimize principal loss. In contrast, "A highly rated insurance company has an edge: it will keep pumping out cash, year after year, regardless of market and economic conditions." (Note: Annuity guarantees are backed by the strength and claims-paying ability of the issuing insurance company.)

Volatility has a psychological component too. While it's possible to construct a portfolio, which provides consistent retirement income, Ruffenbach asks "will you have the discipline to keep from fiddling with it?" Staying the course can be emotionally challenging when the ship is carrying all of your retirement assets.

But perhaps the greatest challenge with a D-I-Y annuity is ***how long you have to do it.*** This strategy requires constant management and adjustment. This responsibility can become problematic simply because of the likelihood of declining mental and physical abilities. At the end of your life, when funds may be dwindling and financial needs may be heightened, you may be least able to continue to do it yourself.

The Impact of Personal Experience

In the abstract, it's easy to acknowledge that a decline in mental and physical ability could make retirement income management a challenge. But first-hand experience can make the message hit home. The "sizable risks" Ruffenbach talks about with a D-I-Y annuity really are significant.

Here's a veteran financial representative, relating the situation he experienced with his father:

My dad wasn't my client: we didn't live near each other, and before I began working in financial services, he had already established a relationship with an investment advisor.

Dad was an electrical engineer who had semi-retired in his late 50s but continued working as a consultant until he was 79. He was mentally sharp, organized and tech savvy. With thirty years at a state utility, he had a sizable pension as well as two Social Security checks (for him and my mother), which meant he wasn't relying on his investments to provide all his retirement income. His D-I-Y retirement decisions mostly involved supplemental funding to upgrade their lifestyle, along with a few special distributions (a vacation to Europe, a family cruise for their 50th wedding anniversary). Since his first "retirement" when he left the public utility, Dad met regularly with his advisor, took notes, did his own research. In many ways, he was ideally suited for a D-I-Y approach to retirement income management.

But in his early 80s, Dad had some health issues which made the responsibility of managing his retirement a lot more challenging. Where before he was reluctant to share his financial information with me, Dad began asking me to take time off so I could accompany him to his reviews.

One of the last times we met with the advisor, I did most of the talking, and my dad actually dozed off. Afterward, in the car, I asked him if he understood that his investments had lost money in the past year – not a lot, but combined with the withdrawals he needed to pay for their move to assisted living, his account balance had declined considerably.

"What? I lost money? Who said that?" Dad was incredulous. I told him the topic had been part of the conversation I'd just had with the advisor. He just shook his head. After a few minutes of silence, he said, "Well, you better take care of this stuff from now on. I can't do it anymore."

He proceeded to show me all his files, added my name to the checking account and authorized me to speak with his advisor. His D-I-Y retirement management was done.

Over the next three years, both of my parents had extended hospital stays, and medical conditions that triggered some major financial decisions. I ended up managing all their money, paying the bills, filing their tax returns, everything.

I feel fortunate that I could help my dad, and grateful that he didn't hang on too long in trying to manage by himself. But if I hadn't been in the business, I'm not sure who would have stepped in. My dad might not have trusted anyone else to take care of his money, or my mother.

Anyone with financial intelligence and responsibility can start a D-I-Y retirement income strategy. But whether they can finish it is another matter.

The primary purpose of an annuity is to provide a guaranteed income all the way to the end of life, no matter how long that is. When you do it yourself, you can't guarantee you'll be able to do it to the end. ❖

Whenever uncertainty and volatility tick up, one of the default recommendations of personal finance professionals may be to encourage consumers to pay down debt. Right now, with interest rates near all-time lows, refinancing to accelerate a mortgage payoff has been a frequently mentioned debt reduction strategy.

The prospect of reallocating savings to pay off your mortgage in 10 years can be intriguing; a paid off mortgage eliminates a big monthly bill and decreases financial stress. But before you decide to refinance with a 10-year mortgage, you might want to consider a different way to accomplish the same objective.

Let's Do the Math

Suppose you're seven years into a 30-year mortgage at 4.00% interest on an original loan of $350,000. Your monthly payments are currently $1,671, and your outstanding balance is $301,203. You are considering two refinancing options:

Option 1:
A 10-year mortgage at **3.25%,** with payments of **$2,943/mo.**

Option 2:
A 30-year mortgage at **3.40%,** with payments of **$1,336/mo.**

Some notes:

- Option 1 is $1,300 more than your current monthly payment and pays off the mortgage in 10 years.
- Option 2 costs more because longer terms usually come with higher interest rates. The new monthly payment is $335 less than the current one, but also pushes the payoff date back to 30 years.

If you can afford the increase in monthly payments (perhaps by reallocating some funds that were previously earmarked for saving or investment), should you take the 10-year mortgage? Maybe, but there's another possibility:

> Consider refinancing with the 30-year mortgage and save the $1,607 difference between the monthly payments *– **with the intent of still paying off the mortgage in 10 years.***

Depending on your level of financial literacy, you may already know that if the savings yield a return equal to the interest rate, the accumulation could be enough to pay off the mortgage in 10 years. If investment returns exceed the rate of interest, the accumulation may allow you to pay off the mortgage in less than 10 years.

To match the certainty of the 10-year mortgage, consider allocating the savings in Option 2 to conservative investments, ones whose average annual returns are slightly less, say 3%. Combined with the higher interest rate, this means Option 2 could take slightly longer than 10 years to pay off the mortgage. *(How much longer? Read on.)*

Even with the numbers tilted slightly in favor of the 10-year mortgage, choosing the longer term and saving the difference can have several advantages:

- **The monthly obligation is significantly lower**; should you encounter financial difficulty, the smaller payment will be easier to maintain.
- **More money under your control.** With a 10-year mortgage, home equity may increase much faster, but this equity can only be accessed with a lender's approval. With the separate account, the accumulation can be available at any time, for any reason, in any amount.

Which Balance Sheet Works for You?

Since we're talking about the same amount of money ($2,943/mo.), the same asset (the house), and the same outcome (paying off the house in 10 years, or close to it), this discussion is really how you'd like to arrange your balance sheet. To illustrate this difference, let's take a look at the numbers at two intervals.

After 5 years:	Option1	Option 2
Mortgage balance:	$162,815	$269,689
Additional cash assets:	$0	$104,147
After 10 years:	**Option1**	**Option 2**
Mortgage balance:	$0	$232,344
Additional cash assets:	$0	$225,126

Because the 30-year mortgage is at 3.4% and the projected savings earn 3%, after 10 years (120 months), the cash assets are $7,000 short of being able to pay off the mortgage. However, with just three more months, the accumulation is large enough to pay off the mortgage balance. Considering the benefits of a lower monthly obligation and greater financial control, paying off your mortgage in 123 months instead of 120 may still be an effective debt-reduction strategy.

Some might argue that earning 3% in a side account is riskier than the certainty of using a 10-year mortgage to accelerate debt payments. While a 3% return might seem plausible, it's not guaranteed.

Let's get ultra-conservative and put the difference in guaranteed accounts earning only ***1 percent annually.*** Guess what? The accumulation would be enough to pay off the mortgage in 11 years. Conversely, how much more financial risk (and stress) is there in committing to a mortgage payment that's almost twice what you're paying right now for the next 10 years?

You Can Save Your Way to Less Debt

You can manipulate these numbers, change interest rates, the size of the mortgage, etc., to produce different results. Which could lead you to a different conclusion about which strategy delivers the most benefits. But in the end, the decision depends on how much you value lower monthly payments and greater financial control, compared to the certainty of paying off the mortgage in 10 years. **Sometimes saving your way to less debt can be the better approach.** ❖

Could this idea work for you? That's something you might want to discuss with your financial professionals at your next review.

Guardian and its subsidiaries do not issue or advise with regard to mortgages. All investments contain risk and may lose value.

Getting Then Giving.
(Or Is It Giving Then Getting?)

The bulk of conversation in personal finance is about getting, about getting more money, higher returns, better benefits. But perhaps there should be more conversations about giving. Because whether it's causation or correlation, there's an interesting connection between giving and success, both emotional and financial.

Giving *Produces* Wealth?

For the last two decades, economist Arthur Brooks has written about a puzzling phenomenon: giving seems to increase wealth and well-being.

Using data from the Social Capital Community Benchmark Survey, which covered 30,000 respondents in more than 40 communities, Brooks found that $100 of additional giving resulted in a $375 increase in earnings. This seemed counter-intuitive to Brooks; he thought people gave more because they had more. But the data suggested that "more giving doesn't just correlate with higher income; it *causes* higher income."

At first, Brooks didn't believe his research ("because I was a trained economist"). But the deeper he studied the psychological factors associated with giving, the more he came to believe it was true. A predisposition to giving is a key ingredient in happiness and success. "Happiness is the secret to success. Charity brings happiness, and happiness brings success," says Brooks.

In a 2009 essay, "Why Giving Matters," Brooks said that it doesn't matter which comes first. Either way, the effects are positive, and they reverberate beyond the individual.

"So what do we conclude? Is income driving up donations or are donations driving up income? The answer is both. When our country gets richer, people give more away. And as we give more away, that translates into economic growth for our country."

Whether getting leads to giving, or vice versa, is a chicken-or-the-egg discussion. Either way, the undisputable evidence is that giving is good for us, and good for others.

Chuck Feeney: The "Broke" Billionaire

A September 15, 2020, *Forbes article* carried this tantalizing headline:

"Exclusive: The Billionaire Who Wanted to Die Broke . . . Is Now Officially Broke"

Charles "Chuck" Feeney, now 89, was an entrepreneur who cofounded airport retailer Duty Free Shoppers in 1960. Though he amassed a multibillion-dollar fortune, Feeney was notably frugal and low-key; he always flew coach, often with a plastic bag as his carry-on luggage.

With his low profile, no one knew that Feeney had embarked on an audacious scheme: After two decades of making money, he determined to give it all away before he died. In 1984, he secretly transferred his shares of DFS to Atlantic Philanthropies, a charitable foundation he had established, with the intention of fully disbursing the funds anonymously over the next four decades.

Feeney's plans might have remained undetected, but in 1997, DFS was sold to a French conglomerate, revealing his sale 13 years earlier. The "James Bond of Philanthropy" had been outed, but the giving continued. Today, as the foundation prepares to wind down, it has donated more than ***$8 billion*** to various charities and causes.

In Atlantic Philanthropies' 2019 annual report, Feeney summarized his perspective on giving:

"I see little reason to delay giving when so much good can be achieved through supporting worthwhile causes. Besides, it's a lot more fun to give while you live than give while you're dead." ❖

Traditionally, Thanksgiving is a time for gratitude, to reflect on the good things in our lives, and to share some of our bounty with others. It may also be a time to consider how intentional giving, as well as getting, might improve your well-being, financially and emotionally.

BTW: Broke isn't, y'know, "broke." It's a small thing, but in the past decade, various reports have mentioned that Feeney isn't completely indigent. He has approximately $2 million set aside in personal assets to pay for what remains a modest lifestyle. He and his wife live in a rented apartment, he doesn't drive a car, and he still wears a $10 Casio watch. But he isn't in poverty.

When a frugal ex-billionaire approaching 90 keeps $2 million in reserve, it gives you some fresh perspective on what it takes to live confidently in retirement. In comparison to $8 billion given away, $2 million isn't much. But it's still $2 million. ❖

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