CREATIVE
Wealth Maximization Strategies

Certified Financial Services, LLC
600 Parsippany Road Suite 200
Parsippany, NJ 07054

Richard Aronwald
Financial Specialist

February 2013

By various statistical measures, financial inequality among Americans is increasing. In short, research indicates rich Americans are getting richer, while the poor and middle class Americans are losing ground. Since the recession, rising economic tides are not floating all boats.

On a macro level, the apparently increasing divergence between rich and poor prompts many questions. Does greater financial inequality help or harm the broader economy? Does it change the political and cultural dynamics of our society? What are the demographic or behavioral factors that impact financial inequality? Should the government attempt to change this trend through regulations or policy initiatives?

On a personal level, the questions are much simpler:

– **Financially, am I where I want to be?**
– **If yes, how do I stay there?**
– **If no, how do I get there?**

Defining “Wealthy” in the United States

There’s an old saying that the wealthy are people who earn or own more than you. From a personal perspective, this may be true; our definition of wealth is relative to our standard of comparison. (As *CNBC* reporter Robert Frank writes in an August 27, 2012, commentary, “I often hear from older millionaires in Palm Beach or Carmel who insist that $8 million is not ‘rich’ where they live.”) Setting aside subjective standards, here are some metrics for the definition and distribution of wealth in the United States.

Annual Income

One of the ways to measure wealth is by annual income. The Internal Revenue Service provides annual income reports based on individual tax returns. Usually the figure used is Adjusted Gross Income (AGI). The most recent data comes from 2010 returns and shows the following:

Median household income was $34,338. This means half of all Americans in 2010 had more than $34,388 in AGI and half had less. Those above the median threshold are considered in the “top 50% of all earners,” and this group comprised 67.5 million households. The table below (using IRS data in a December 2012 *Kiplinger’s* worksheet) shows the AGI threshold for each level of earners:

To be in the…	Your 2010 AGI must be at least…	Number of households
Top 50%	$34,388	67.5 million
Top 25%	$69,126	33.8 million
Top 10%	$116,623	13.5 million
Top 5%	$161,579	6.8 million
Top 1%	$343,926	1.4 million

In most assessments, the top 1 percent of all earners qualify for designation as “wealthy.” Given the likelihood that adjusted incomes have increased a bit since 2010, it is reasonable to assert that any household with an adjusted gross income over $400,000 can be considered wealthy. (Coincidentally, the recent increase in marginal income tax rates to 39.6% from 35% affects single filers with AGIs in excess of $400,000, with a threshold of $450,000 for joint filers).

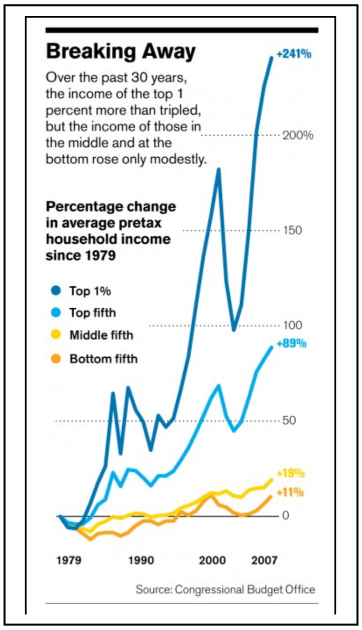
In This Issue…

Net Worth

Some assessments of wealth argue that annual income isn't the only relevant factor; net worth is just as important. Net worth calculates the value of a household's financial assets (including personal residence) minus its liabilities. Using information for 2010, a January 17, 2012, *New York Times* article calculated the following parameters:

To be in the…	**Your 2010 net worth must be at least…**
Top 50%	$ 121,000
Top 1%	$8,400,000

Using the 2010 numbers, the threshold for being in the top 1 percent is roughly 10 times greater than the median AGI. With slightly different data, the *NYT* article put the difference at 7.5 times. Whether this 7- or 10-fold difference between the top 1 percent and the median is too high is debatable. Of greater concern are numbers that show the gap is getting larger. A September 28, 2012, *National Journal* article reproduced this chart from the Congressional Budget Office. →



The three-decade trend is clear: The magnitude of the gap between the annual income of the top 1 percent and everyone else has increased dramatically. And the effect of this gap would appear to be cumulative. For, while the difference in annual income is only 10 times ($340,000 v $34,000), the difference in net worth is **69 times** ($8.4 million v $121,000). According to economist Joseph Stiglitz, the author of *The Price of Inequality*, this multiplied difference in net worth is because "the rich save – that is, invest – 15% to 25% of their income…whereas those on the lower rungs consume most or all of their income and save little or nothing." And thus, the rich get richer, to the point where some observers are worried that the U.S. middle class will disappear, and the population will bifurcate into two extremes: a small, wealthy, ruling class, and a large, dependent underclass.

Is the Wealth Gap an employment problem or a strategy problem?

The roots of the widening wealth gap in the United States reach back to the 1970s, when technology and global competition forced American corporations to reshape their workforces in order to remain competitive. As a result, many middle-class jobs have either migrated overseas or been replaced by automation. Gone are the days of single wage-earner families, lifetime employment, and pensions. In real numbers, incomes have been declining since the 1990s, while the costs of wealth-building essentials, particularly higher education and good health, have increased at rates greater than inflation. It's become harder to make a living, and harder to save for the future.

One response to these economic pressures has been the proliferation of debt by individuals, corporations, and governments. As Jonathan Rauch explains in a September 28, 2012, *National Journal* article:

If America gets serious about saving, there's reason to believe the wealth gap will shrink.

In a democracy, politicians and the public are unlikely to accept depressed spending power if they can help it. They can try to compensate by easing credit standards, effectively encouraging the non-rich to sustain purchasing power by borrowing. They might, for example, create policies allowing banks to write flimsy home mortgages and encouraging consumers to seek them. Call this the "let them eat credit" strategy.

In a booming economy, additional debt can accelerate growth. However, debt has a different effect when an economy is stagnant or declining. At first, easy credit may maintain economic growth, and allow individuals to improve their standard of living. But eventually, lower incomes and minimal savings lead to a contraction. People – and governments – can't pay their debts. The consequences are unemployment, fore-closures, higher taxes, fewer benefits. To varying degrees, this is where Europe, Japan, and the United States currently find themselves.

Long-term, many economists believe there will be a "re-equilibration" of income, debt, and even a narrowing of the wealth gap. Technology and the opportunity for profit will create new industries and employment. Already, many consumers are "de-leveraging" by paying off credit card balances, and forgoing further borrowing. If a higher-employed, lower-debt America takes the next step, and gets serious about saving, there's reason to believe the wealth gap will shrink as well. Here's why:

Although we tend to see banks and brokerage houses as lenders and financiers, the real source of funds for lending is the savings and investments of other individuals – particularly from the 1 percent. When people have greater capital needs, or there is a lack of funds available, those with money to lend or invest (again, the 1 percent) stand to make higher profits. As more people build savings and proportionally reduce their indebtedness, then the dynamic changes; there is more capital available, and the profits are spread amongst a larger pool of depositors and investors. In addition, increased saving and reduced debt almost always trigger increased spending, which causes the economy to expand – without the looming threat of a debt-induced collapse.

Increased saving and reduced debt almost always trigger increased spending, which causes the economy to expand.

Individual Applications

Because rebalancing usually requires some short-term financial contraction (less spending, more saving), both individuals and politicians are less-than-eager to commit to the process. The typical response is to see if a little more debt might stimulate another round of growth. History shows this is wishful thinking. You can't do much about public policy, but don't allow this thinking to influence your personal financial decisions.

The answers to the original trio of questions about your personal financial circumstances involve some combination of income and savings. If you aren't in the top 25%, determining how to **increase income** may be a critical issue. Regarding income, the *NYT* article on the wealthy provided an interesting statistic: The wealthiest 1 percent accounted for 36% of all self-employed income. Depending on your skill set and current circumstances, you may want to consider becoming your own boss - maybe not today - but sometime in the future.

And whether the goal is to maintain your current level of wealth or move up, **maximizing saving** is an essential ingredient. Referring to Steglitz's earlier comments, saving 15% to 25% of income is a benchmark for crossing the threshold and becoming a 10-, 5- or 1-percenter when it comes to net worth. Even if your prospects for higher income appear limited, increased and consistent saving can keep you from living on the wrong side of the wealth gap.

Managing debt goes hand-in-glove with increased saving. In the short term, refinancing may help cash flow, but simply shifting debt to another bank or another credit card without eventually retiring it is not productive.

Further, well-considered saving and debt reduction strategies can be catalysts for increased income. For example, a larger down payment/smaller mortgage might result in positive cash flow from a rental property. Depending on their placement in a portfolio, dividends may be received instead of reinvested (i.e., in an integrated financial program, the saving possibilities will likely be broader than maximum contributions to a retirement plan.)

Recent public policies have not narrowed the wealth gap. Personal action remains your best strategy for crossing wealth thresholds.

- **If you are already a 1-percenter, stay ahead of the contraction curve through ongoing saving.**
- **If you want to cross higher wealth thresholds, start or step up your saving.**
- **If you aren't sure how to move forward, seek expert assistance!**

MAKING SURE YOUR FINANCIAL RECORDS AREN'T LOST IN THE DIGITAL CLOUDS

A true story, reported by *Reuters* on February 17, 2012:

> Karin Prangley, a 33-year-old Chicago estate planning attorney, attempted to guess her father-in-law's password to gain access to his business computer after he suffered a debilitating stroke several years ago at age 62. None of them worked.
>
> "At the time he owned a building supply company, and he ran most of the business through his e-mail account," Prangley says. "But he hadn't left his password with anyone, so the family had no way of accessing the contents. We didn't know which orders had been filled, what was coming in, who the business owed money to, or who to bill."

Ms. Prangley contacted the e-mail service provider for her father's account and explained the situation. Citing privacy concerns, the company said they would require a court order to release her father's password. "As an attorney, I knew that takes at least a month," Prangley says. "The business couldn't wait that long." Unable to access the company's financial information, the family eventually decided to close the business.

This incident illustrates one of the emerging issues in the brave new world of "digital estate planning." As more of our financial and personal lives are archived online, the challenge of both protecting and providing access increases. If your family, loved ones, business associates and financial advisors can't retrieve it, your digital cloud of data – financial records, photos, music collections, family documents – may vaporize. As a security programmer said, "One of the most critical last words you could say might just be your password."

Preparing for a Digital Afterlife

Digital storage has many advantages. The format is paperless, accessible at any time from a multitude of devices, and very hard to misplace or destroy. But in order for digital storage to be secure, it requires passwords. Yet documenting a password – on a piece of paper, in another computer file – compromises its security. So how do you maintain security, yet allow appropriate parties access in the event you are incapacitated or deceased? The answers run the gamut from old-fashioned low-tech procedures to sophisticated online services.

Doc in a Box. A simple solution is listing passwords on a paper document, then securing the document in a vault, safe, or bank deposit box. Depending on the terms of use for particular online storage sites, it may be helpful to also include a notarized letter of authorization. While this arrangement almost assures the document will be found in the event of a calamity, and is reasonably safe from prying eyes, other aspects can be problematic. Adding or subtracting accounts and updating passwords require regular amendments, however, many people struggle with document maintenance.

The Master Password. James Lamm, a Minnesota attorney specializing in digital estate plans, recommends this modification to having a password list: Prepare a written document containing a single master password, and store it in a secure location. This master password can be used to open a digital property list stored on a computer or other electronic device, which provides instructions for all other online accounts. This eliminates the need for constantly updating a physical document, and also adds a layer of security, because access requires both the paper document and the electronic device.

Electronic "Vault". Some digital financial organization systems include a person's important financial information and accounts, and also may offer electronic storage options for passwords, and copies of important documents and photos.

Internet Security Services. These services are still in their infancy, so changes are likely as the businesses mature. But in a variety of ways, these online services make it possible for an individual to pre-authorize the transfer of passwords and other digital access privileges to designated parties upon proof that a death or disability has occurred. Some examples:

- For a modest fee, the service allows a user to store an unlimited number of digital assets (usernames and passwords, typically) with prepared "letters of instruction" for delivery to beneficiaries after one's passing. When death occurs, someone notifies the company. After verifying the demise of the account holder, the company distributes the letters of instruction, which provide account information, passwords, and access instructions.
- Another online company uses e-mail to determine if you are dead, or at least critically disabled. The company sends the account holder emails at pre-arranged intervals, according to a schedule of the customer's choosing. If the account holder does not respond, the service sends e-mails (prepared by the account holder) to designated persons, beginning the process of verifying the account holder's status, and if necessary, transferring authorization to designated heirs.

As digital storage increases, digital access will become more important – and probably more sophisticated. If you store data in the digital clouds, make sure you provide a way for the right people to find it.

PLAYING "NOW" AND "LATER" WITH LIFE INSURANCE

If you Google the phrase, "life insurance is a bad idea" you won't get any true matches. What you will get is "**term** life insurance is a bad idea" or "**whole** life insurance is a bad idea." People don't disagree with the *concept* of life insurance; there's just a lot of discussion over what type of coverage to obtain, and how to use it. **To sort through the chatter, most of the issues can be distilled to a discussion of "now" and "later."**

One approach to life insurance is to view it as a costly, but often necessary "evil." For those with current financial obligations (spouses, children, mortgages, etc.) greater than our assets, life insurance is a necessary purchase. The cost cannot be avoided, only minimized. From this perspective, the best strategy **in the present** is to find the lowest premiums. For **the future**, the goal is to accumulate enough other assets as fast as possible so that the insurance can be dropped as soon as possible. The only way to stop the ongoing cost of life insurance is to eliminate the need for it, by "self insuring" through the accumulation of savings. This "get-only-what's-needed-and-get-rid-of-it" approach to life insurance has some strong adherents in the financial community.

In another perspective on life insurance, the paradigm is reversed. At some point in **the future**, death is a certainty – for everyone. This makes life insurance unique, because if the policy is kept in force, there will be a benefit distributed to beneficiaries; the premiums will result in a long-term financial gain. Even if some of the original reasons for obtaining life insurance are no longer relevant, the guaranteed distribution at death can provide some valuable benefits, perhaps in retirement or part of a larger inheritance and estate planning strategy. However, having an insurance policy that will deliver benefits later usually means paying higher premiums **right now** for the same amount of coverage.

Besides the now-and-later philosophical differences on life insurance, there are three other now-and-later factors impacting your life insurance decisions:

Your need for insurance. A breadwinner with a spouse and children has some compelling reasons to secure a large amount of coverage now, because it represents their long-term economic value to the family.

Your insurability. Obtaining coverage is dependent on one's health. In general, we are healthier now than we will be in the future. Waiting to secure coverage at a later date runs the risk of not being able to get it.

Your ability to pay for it. The arc of a typical financial life features peak obligations (student loans, dependents, car payments, mortgages, etc.) at the beginning, with peak earnings in later years. Some items may not be affordable until later in life.

Balancing now and later

The challenge for consumers is deciding how to balance their financial allocations between using them today or committing them to tomorrow. If you want a life insurance program that will deliver in the future, this almost inevitably requires cash value insurance; the premiums for term simply become prohibitive in old age. But immediate financial obligations cannot be neglected either, so short-term life insurance can be better than no insurance.

Given these considerations, here is a simple now-and-later strategy for life insurance:

- **Obtain as much coverage as possible while in good health, even if the coverage is term.**
- **Systematically convert the term coverage to permanent coverage over time as financial circumstances allow.**

A life insurance professional who understands the now-and-later issues of both insurance and your unique circumstances should be able to tailor a program to your specific situation. Done right, life insurance can be a great financial asset – both now and later.

RISK MANAGEMENT: LIABILITY PROTECTION

"What are the odds?"

This is one of the basic questions at the heart of every insurance discussion. In this case, the odds involve the likelihood of being sued. Here are some numbers provided by IFG Trust Services Inc., an international investment firm specializing in asset protection:

> **Americans have a 10 percent chance of being sued in any given year and a 33 percent chance of being sued in their lifetimes.**

Do you like those odds? Litigation, even if eventually settled in your favor, can pose a significant disruption to your financial plans. Besides the potential for financial loss through judgments, pending or unresolved lawsuits can impede your ability to secure financing or enter into new business arrangements. Simply responding to legal actions – even frivolous ones that are dismissed – can incur tens of thousands in attorneys' fees.

Considering the potential costs in both time and money, ensuring your liability insurance program provides adequate protection is an essential of risk management. While most homeowner and automobile insurance offers a measure of liability protection, a closer review of your circumstances may prompt a desire for broader coverage.

In general, both home and auto insurance policies will assist in a legal defense – if you're sued for an incident that's covered by your policy. For example, if an injury on your property results in legal action, whether inside or outside your house, your home insurance will provide legal representation. Likewise, auto insurance will cover liability incidents that involve your vehicles. But there are many other places where litigation may arise. If you have assets to protect, such as a house, professional license, business, or savings, purchasing an umbrella policy can provide liability coverage above and beyond your home and car insurance.

An umbrella policy, typically, is integrated with existing homeowner or automobile insurance. The umbrella coverage may be issued as a separate policy, or added as a rider to one of the existing property insurance policies. Tying the two coverages together usually results in a discounted premium.

Other Forms of Liability Protection

In addition to a personal liability umbrella, some occupations also require malpractice or errors and omissions insurance. Besides insurance, individuals or businesses with substantial assets may also find some liability protection through legal documents and the careful positioning and titling of property, savings or other valuables.

- Trusts, Limited Liability Corporations, and other business structures can also minimize or isolate potential financial losses from litigation.
- Assets held inside qualified retirement plans or life insurance policies (as cash values) have some "safe harbor" provisions that may restrict their seizure by plaintiffs who receive a favorable judgment in court.
- In some instances, changing the ownership of an asset (titling a home in a spouse's name only) may also limit liability.

The protections offered under these arrangements vary by state, so expert counsel is a must.

"It won't happen to me." Really?

Even when faced with the numbers regarding their potential liability, many honest, law-abiding, conscientious citizens want to believe their situation is different. "Other than an accident that might occur in my car or on my property, who could sue me?" they say. This type of thinking is naïve.

Some people make their living exclusively through financial judgments; their occupation is "professional plaintiff." And others make a living by coming up with creative reasons to press litigation. Do these people abuse the legal system? Maybe; sometimes. But in order to provide a measure of justice for everyone, the legal system has to allow plaintiffs the opportunity to air their grievances, even if they are eventually found to be without merit. And this means the innocent have to be prepared to incur some legal expenses (or buy insurance) to defend themselves. It's a "cost of doing business" in the United States.

The organization Faces of Lawsuit Abuse (www.facesoflawsuitabuse.org) publishes the stories of individuals, companies and governments served with outrageous, mind-boggling lawsuits. Keeping in mind that most of these complaints have yet to be heard, and that many will be dismissed, it still makes for amazing reading. For example:

– There's the fan of a National Football League team who sued because the team sent him too many text messages – after he had signed up for the service ("too many" was three additional texts). According to a November 11, 2012 FoxSports report, the plaintiff is seeking "$500 per excessive call for negligent violations and up to $1,500 per call for willful violations."
– A Michigan woman filed a $5 million class-action suit against a financing company for the leftover gas still in her repossessed car. The logic for asking for $5 million to recover approximately $29 in gasoline? An estimate of how many other cars had been repossessed in the past six years. The suit was dismissed.

In these stories, the damages are minimal or the case has been dismissed. And the defendants were large corporations with in-house legal counsel. But what if a small business owner encounters the same situation? Here's the 14-year-long ordeal of a family-owned pest control business in Georgia:

In 1996, the owner was sued by an individual claiming he got sick due to pest control work done by the company. The owner investigated the claim, found that the individual had not been near the worksite, and decided to contest the claim.

The case went to trial. The jury found against the plaintiff and absolved the business from liability. The plaintiff refused to concede and appealed the verdict. Five years later, after a second trial, a jury came up with an identical verdict: the pest control business was not liable.

Yet the issue is still not resolved. The plaintiff is threatening to pursue a third trial – or will accept a $500,000 settlement.

Besides endless hours and numerous legal expenses associated with multiple trials, the uncertainty and emotional distress has made it hard for the business to plan for the future or contemplate expansion.

"You're unable to do anything during that process," the owner says. "It ties you down so much. It tears me up to this day, sitting there thinking that everything I built is on the line."

CHECKLIST:

- ✓ **DO YOU HAVE COMPREHENSIVE LIABILITY INSURANCE PROTECTION?**
- ✓ **DO YOUR LEGAL DOCUMENTS INSULATE VALUABLE ASSETS FROM JUDGMENTS?**
- ✓ **DO YOUR FINANCIAL ASSETS RESIDE IN SAFE HARBORS?**

CREATIVE
Wealth Maximization Strategies

Certified Financial Services, LLC
Richard Aronwald
Financial Specialist
raronwald@cfsllc.com

600 Parsippany Road Suite 200
Parsippany, NJ 07054
973 263-0622