Creative Wealth Maximization Strategies

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Financial Guidance from the Internet?

For those whose educational experiences included cursive penmanship lessons in elementary school, using a manual typewriter for term papers in high school, and solving complex math equations on a slide rule in college, the digital revolution is almost beyond comprehension. From personal computers to cell phones to cameras to ATM machines, every aspect of contemporary life has changed because of digital technology. But for magnitude of change, nothing today matches the Internet. Wherever you are, an Internet connection delivers an unlimited array of information, communication options, entertainment, products and services. Because it has become ubiquitous so quickly, we already take it for granted, but the Internet's impact has been stunning. In this virtual digital universe, you don't have to travel to see the world; the world comes to see you.

Many of the changes caused by the Internet are easy to identify: They are marked by the phrase "you can do that online." You can register online, bank online, work online, shop online, visit online, get an education online. At the edge of digital technology, you can even live in completely different worlds online, ones that are "real" even though they are virtual. It's mind-bending, and technology geeks tell us this is only the beginning.

But what about planning your financial future? Can you do that online? It is an interesting question, one that has several layers of answers, some "yes," some "no."

The Internet's Commoditization of Financial Services

Commoditization is defined as the process of making a product or service ***fungible***, so that consumers see no qualitative difference between each individual item, regardless of where it was made or who provided it. A dollar bill is fungible; each one is like the next, and both buyers and sellers accept each bill as having the same value. Many physical goods are fungible, like lumber, corn, gasoline, etc. In their most basic form, some services may be fungible as well, such as delivering a package, filing a tax return, changing the oil, or making a hamburger.

When goods or services become commoditized, price becomes the principal factor in consumers' decisions to buy. Businesses that cannot provide a commoditized good or service at a competitive price will lose market share and go out of business – unless they find a way to add value, and differentiate their product or service enough to command a higher price.

It's easy to see how the Internet has commoditized products or services whose purchase was previously often based on factors besides the lowest price. Because of the Internet, hotel rooms and airfares have become commoditized, and many travel agencies are out of business. News delivery has become commoditized, which is why your daily paper may now only be available online. Even very specific items, like a particular television or automobile, can be commoditized because the Internet allows consumers to locate almost every 40-inch flat screen TV or every red Mustang that's available for sale.

In the realm of personal finances, the Internet has moved a number of financial items toward commoditization. For example:

In This Issue…

Savings accounts: An individual looking to deposit money in a saving account or Certificate of Deposit can use the Internet to easily survey the offerings of banks nationwide to determine the best interest rate available.

Mortgages: What is the determining factor for most mortgage decisions? The interest rate. Again, a quick Internet search can bring a host of lenders to a prospective borrower's door.

Auto Insurance and Term Life Insurance: Once the consumer determines the parameters of coverage, the buying decision is primarily based on the premium. Serving as a de facto independent agent, the Internet can scour the marketplace for the best prices.

You and your unique financial circumstances are not a commodity.

Where Internet Commoditization Doesn't Work

When the product or service fits, the Internet is a fantastic tool for commoditizing. This offers benefits both to the consumers and providers of goods and services. For the consumer, the benefit is typically lower prices. For the provider, the opportunity is access to more potential customers. In this regard, it might be correct to say that commoditization facilitates personal financial planning. But in some ways, the Internet's strongest features are detrimental to helping individuals achieve greater financial success.

Remember, if you know exactly what you want, the Internet can find it. Want to locate a 2008 Mercedes-Benz E 350 for sale? You can do that online. But what if you want guidance on your asset portfolio, or an opinion on permanent life insurance? Can the Internet provide financial advice?

Not really. An Internet search can put a pile of information on your digital doorstep, but offers no way to sort the pile. Asked to provide financial guidance, the Internet typically delivers a mish-mash of competing opinions, marketing materials, research reports, and forum comments – then leaves you to sift through the stack, and make your own judgments. The education that results may make you financially more astute. This might be a good thing, if your objective was to become more informed about financial issues.

But one of the reasons people consult experts is to shortcut the education process, and delegate the tasks to those more qualified. The Internet actually makes financial guidance harder, because expertise cannot be commoditized. Instead, as consultant Ryan Hanley writes (ironically, in an Internet blog post), the unfiltered volume of information available by way of the Internet means that "over time it's hard to discern the Expert from the Hack." (*The Commoditization of Expertise and Why You Should Never Trust a Guru*, May 28, 2012). Instead of clarity, an Internet search for guidance often makes it harder to understand the issues or come to a conclusion.

Further, you and your unique financial circumstances are not commodities. Unlike a commodity, you are distinguishable, which means there are no generic plans to follow and no standard solutions to your financial challenges. If you try to use the Internet for financial guidance, one of two things will eventually occur: You will either become smart enough to be your own advisor, or you will connect with a real person – online, over the phone, or face-to-face – to serve as your advisor. Financial guidance is a one-on-one communication relationship discussing a unique situation. There are no online tests or self-diagnosis programs to replicate the process.

Not that Internet entrepreneurs won't keep trying to make advice a commodity. The Internet retains its relatively free access by allowing advertisers to subsidize the service. That's why the news article you're reading has sidebars and banner ads with "simple rules, weird secrets, and special tricks" to eliminate belly fat, get a lower mortgage, purchase real estate, etc. It's digital junk mail. Skim it if you want, but don't look to it as a source of reliable information.

Integrating the Individual and the Digital

Going back to an assertion made earlier in this article: When you know exactly what you want, the Internet can find it. In the context of financial guidance, the Internet can be a great asset for accurately representing your present condition, implementing the strategies that you develop from consultation with a financial professional, and tracking your progress. Many financial service companies offer online tools to automate these reporting and assessment functions so that you have a constantly updated real-time picture of your financial condition. This information can be invaluable in helping you and your trusted financial professionals stay on track and quickly make adjustments. This process maximizes both the value of individual consultation and power of digital connections.

If you aren't already monitoring your financial progress in this fashion, it's almost certain that your finances are under-performing. And once you've adopted this format, you will most likely find it easy to maintain, and wonder why you didn't do it sooner. But remember how it took a little time to master the upgrades on your new smartphone? It's the same with switching to a new method of financial guidance. The changeover process – entering your data, meeting several times with a professional – takes a little time. But these steps are necessary to establish the two key elements: the specialist and the technology. Together, these two pieces offer individuals the best opportunity to maximize their financial potential.

HAVE YOU INTEGRATED YOUR FINANCIAL SPECIALIST(S) AND DATA ON A SINGLE PLATFORM? ❖

WHY YOU SHOULD TAKE AN INTEREST IN PASSIVE INCOME

– Even if You Haven't Retired

From a financial perspective, the heart of retirement planning is providing *passive income*. Passive income is income that is not derived from one's labor. Instead of working to make a living, in retirement an individual's accumulated assets become the source of income.

In the personal financial services arena, a default source of passive income for many retirees is derived from interest-bearing financial instruments. These products deliver a regular stream of interest payments at pre-determined rates, and many include guarantees. Savings accounts, Certificates of Deposit and bonds are three common types of interest-bearing financial options. Regular, secure payments offer retirees a measure of financial certainty, which is an important consideration when passive income must be used to meet essential material needs.

A conventional retirement model offered by financial service institutions involves an accumulation phase and a distribution phase (using their products in both phases). These retirement models are designed for individuals whose financial plans are fairly straightforward: a portion of current earnings from regular employment will be set aside on a regular basis in order to provide future passive income.

Because of the underlying investments, the interest earned on these income-producing instruments has a strong correlation to market rates for lending and borrowing. As interest rates have declined and remained depressed, the returns from these products have diminished, in some cases significantly. This scenario challenges many retirement strategies, because lower returns mean less income; retirees are left with the undesirable option of reducing their standard of living or consuming principal in order to maintain current income levels. Or they must consider income-generating alternatives, some of which may not be offered by financial institutions.

What are some examples of other passive income instruments? For a good overview, look at the front page of IRS Form 1040. Page 1 is a compilation of all sources of income. Among the line items are several passive income categories:

Dividends: A dividend is a sum of money paid regularly by a company to its shareholders out of its profits or reserves. The dividends are typically distributed quarterly, but other arrangements (such as monthly or annually) are also common.

Many companies have a long history of regular dividend payments to their shareholders. But dividends are not guaranteed; some companies declare no dividends, either because there are no profits, or because the company's management decides to reinvest profits instead of distributing them.

Owners of participating life insurance policies may also receive dividends, which are considered a return of unused premium. Early in the policy's existence, the owner often forgoes receipt of these dividends, instead adding them to the policy's cash value in the form of paid-up additions. But the size of the dividend typically increases with the age of the policy, and policy holders may find it desirable to receive these larger dividends as an annual income source.

Rents: Passive income may be derived from real estate and equipment rental agreements. If rental income exceeds the costs of ownership and maintenance (such as mortgages or loans, taxes, and operating costs) the profits may provide a steady stream of income. Of course, rental income is dependent on occupancy rates or how often the truck, trailer or other asset is rented. While lease agreements may establish a degree of certainty in regard to expected income, there are no guarantees that rents will be collected, or that the results will be profitable.

Royalties and fees: A royalty is a payment made to the legal owner of a property, patent, copyrighted work or franchise by those who wish to use it to generate revenues and profits. When entertainment companies publish a writer's novel or record a musician's ballad, the artists receive compensation for the use of their talent. A portion of every book or song sold today, tomorrow, or a decade later, results in a passive income stream to the owner of the work. These royalty checks will be proportional to the ongoing use of the product (i.e., the number of sales), and may continue for as long as the product is sold.

There are other types of royalties. Depending on the terms of their compensation agreements, brokers and sales reps can receive a passive income from trail commissions or renewal fees long after they retire*. Franchise and licensing fees, paid for the privilege of using a branded product or service, are another form of royalty.

Royalty agreements are legally enforceable contracts, so the owner of the royalty has the assurance of receiving this passive income. But the amount of income will vary depending on future sales.

Limited Partnerships: This is a business arrangement in which some of the participants are investors only, and are not considered to be material participants. Limited partners generally do not have any management responsibility and are not responsible for the debt obligations of the business. Thus, the income that limited partners realize from their partnerships is treated as passive income.

* Trail commissions would generally be classified as ordinary earned income as opposed to passive income for federal tax purposes.

As a rule, establishing these streams of income is not as easy as selecting a savings account and making a deposit. And, as is implied by their different lines on a tax return, these different forms of passive income may also have different tax treatment. The consideration of these alternatives entails careful study and usually requires some expert assistance. Given this caveat, several things should be obvious in this casual review of passive income sources:

1. **The potential returns from many passive income sources are equal to, if not greater, than those offered by interest-bearing financial instruments, particularly given current interest rates.** For the mass markets that the mainstream financial media is trying to reach, interest-bearing products are a one-size-fits-all solution for the accumulation-distribution retirement paradigm. But the ultimate goal of retirement planning is to produce a reliable and profitable passive income stream. Interest-bearing financial products may be used to accomplish this objective, but they aren't the only way. It makes sense to consider the alternatives, especially given the low rates of return, and the subsequent loss of purchasing power over time.
2. **The principal advantage of interest-bearing financial instruments in providing passive income is their lower level of financial risk and/or guarantees.** Safety and certainty are important financial considerations, and these features explain why interest-bearing products have a place in almost every retiree's portfolio. The suitability of including these non-guaranteed passive income programs must be weighed in light of their perceived risks.
3. **You may want to consider developing alternative passive income strategies before retirement.** Some passive income streams are really deferred compensation plans; the producer makes a decision when to receive income, and in what form. For example, an author could elect to receive a one-time, up-front payment for writing a book and waive the right to future royalties. The immediate payment is certain and guaranteed, while the royalties are often dependent on unknown future events. There are a slew of anecdotes about authors, actors, entertainers and other producers whose long-term financial fortunes turned – for good and bad – on their election of an immediate or future compensation. For many high-level executives, a deferred compensation package is a critical component in their employment agreement.
4. **How you approach developing passive income for the future might affect how you save today.** The conventional accumulation-distribution retirement income model has some advantages, but can also be restrictive. Qualified retirement plans have regulations that discourage early withdrawals; once the money is deposited, the financial cost of making changes may be prohibitive. Many accumulation products, such as those that invest in equities, historically deliver the best results when held for longer periods, so a decision to invest today is really a long-term decision. Research repeatedly shows that jumping in and out on these products results in poor investment performance. If you want to seriously consider other passive income strategies, a first step might be to reposition some of your ongoing saving allocations, perhaps to make a down payment on a rental property, buy a share of a limited partnership, etc.

For many Americans, the accumulation-distribution model is a workable retirement strategy. But the outcomes from using this approach are dependent on two variables: the amount accumulated while working, and the interest rate that can be secured to deliver the passive income. Today's historically low interest rates have prompted many retirees to consider passive income alternatives. But even if the returns were higher from interest-bearing financial instruments, some individuals might benefit from beginning to develop other passive income sources for retirement – and even before retirement.

As you evaluate your current circumstances, and your prospects for retirement, the following questions may be relevant:

- **Does your current employment situation offer the opportunity for deferred compensation?**
- **Have you considered developing other passive income sources?**
- **Do your current saving allocations allow for the possibility of establishing a passive income before retirement?**

If any of these concepts pique your interest, make sure they are a topic of discussion the next time you meet with one of your financial professionals. ❖

RETIREMENT PLANNING DISEASES: Do You Have These Symptoms?

In 2006, Dr. Gregory Salsbury authored a book titled ***But What If I Live? The American Retirement Crisis***, which identified what Salsbury saw as seven key challenges to the retirement dreams of Americans. These challenges were a combination of fiscal events and social behaviors that Salsbury felt were coming together to create a "'perfect storm' for a generation of under-saved and over-spent Baby Boomers."

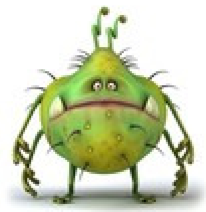
In 2010, Salsbury, an executive vice president for a national insurance company, came out with another book, ***Retirementology: Rethinking the American Dream in a New Economy.*** Coming in the wake of the Great Recession, the book proposes Americans need to revise their thought processes and planning strategies in order to survive and thrive in a new financial environment.

In an attempt to help readers better understand the interweaving of financial concepts and behavioral psychology at the heart of the book, Salsbury develops some amusing new terms. In the language of "Retirementology"…

- **Equimortis** [ek-wi-**mawr**-tis]: The dangerous condition of relying on home equity to fund retirement.
- **Bingefy** [**binj**-ih-fy]: Justifying a big-ticket purchase because you were previously frugal.
- **Kinphobia** [kin-**foh**-bee-uh]: Fear of having to tap into retirement savings to support extended family.
- **Ohnosis** [oh-**noh**-sis]: Realizing you really should have started planning for retirement years ago.
- **Finertia** [**fi**-nur-**shuh**]: Paralysis brought on by trying to comprehend contradictory, overwhelming and confusing financial information.

In a press release that accompanied the book's issue, Salsbury said, "People may not remember the precise psychological terminology behind these behaviors, but they will certainly remember 'bingefy' and hopefully take steps to avoid it."

Are These "Generation-Skipping" Afflictions?



Fortunately, Salsbury's wryly amusing descriptions of the financial afflictions affecting Baby Boomers may not be part of a behavioral epidemic in the United States. Witness the headline from a front-page *Wall Street Journal* article on September 25, 2012:

Watching Parents Fail
Sparks New Rebellion: Saving Money

An excerpt from the opening of the article:

> **As older Americans lose jobs, lose homes and delay retirement, their children are watching and reacting. Growing numbers of young Americans are boosting savings, cutting spending and planning for retirement.**

The article goes on to note the distinct differences in the financial habits of the Greatest Generation, i.e., those who grew up during the Great Depression, and the Baby Boomers born between 1946 and 1964. While the Depression-era generation was generally thrifty and debt-averse, Boomers have tended to spend and borrow.

As a result of their spendthrift ways, many Boomers found themselves ill-prepared to weather the layoffs, declining housing values, and investment losses that accompanied the financial recession. Recent data from the Federal Reserve and the Center for Retirement Research show Boomers are approaching retirement age with, on average, "less than one-quarter of the amount they need to maintain their standards of living when their work life ends."

Seeing the struggles of their parents, a number of Boomer children – sometimes referred to as "Generation X" – appear to be getting the message. Data shows a marked increase in employee participation in retirement plans by those under age 35, as well as a significant decrease in credit card debt. As one financial planner told the *Journal*, "You run into people who are 33 years old and are buying long-term care insurance. That is the result of personal experience."

It is the hope of most parents that the lives of their children will be better than their own. Part of making that hope a reality is instilling good financial habits, as well as setting good examples. Don't let "Ohnosis" and other financial afflictions have ripple effects to future generations.

A September 18, 2012, press release for a report from the

Consumer Federation of America announced that 67% of middle class Americans acknowledged making a "really bad financial decision," one that resulted in an average loss of $23,000. "Middle class" was defined as households with an annual income between $30,000 and $100,000. By comparison, 61% of upper income Americans (those with household incomes in excess of $100,000) reported making a really bad financial decision, with the resultant loss averaging $61,000.

Here are some interesting companion findings from the survey: While over 80% of the respondents rated their ability to make financial decisions as "good" or "excellent," the survey also found a **strong correlation between financial loss and the absence of expert financial input.** In fact, among the middle class cohort, 17% said they "wouldn't seek any information or advice, and just make a decision."

So…while almost two-thirds of the respondents acknowledged making a "really bad financial decision" (and almost half, 47%, acknowledged making more than one), four-fifths of those surveyed said they were "good" or "excellent" at making financial decisions? And at least one fifth of the group was so confident that they wouldn't want any outside input before making their "good" or "excellent" decisions? *Hmmm…*

Maybe it would help to put the cost of these really bad financial decisions in better perspective. The loss that results from a bad decision is not only the immediate dollar amount, but also the ***opportunity cost*** – what could have been earned in the future if the money had been retained. For example, suppose a really bad financial decision, one that results in a $50,000 loss, occurs at age 40. Life expectancy for the average American is now approaching 80, which means the financial impact of this decision generates a pretty lengthy opportunity cost period. If a 5% annual rate of return is used, the 40-year opportunity cost of a $50,000 mistake is $351,999 (see Figure 1). That's a seven-fold increase!

Beginning with $50,000, compounded at 5% annually…

FIGURE 1

End of…		End of…	
YR 1	$52,500	YR 21	$139,298
2	$55,125	22	$146,263
3	$57,881	23	$153,576
4	$60,775	24	$161,255
5	$63,814	25	$169,318
6	$67,005	26	$177,784
7	$70,355	27	$186,673
8	$73,873	28	$196,006
9	$77,566	29	$205,807
10	$81,445	30	$216,097
11	$85,517	31	$226,902
12	$89,793	32	$238,247
13	$94,282	33	$250,159
14	$98,997	34	$262,667
15	$103,946	35	$275,801
16	$109,144	36	$289,591
17	$114,601	37	$304,070
18	$120,331	38	$319,274
19	$126,348	39	$335,238
20	$132,665	40	$351,999

Opportunity cost is the hypothetical calculation of a very real financial concept. Although the rate of return used for calculation is subjective, lost money has an ongoing cost. With this in mind, some other observations follow.

- First, in terms of impact, **the most costly financial mistakes are the ones made early in life**, simply because the lost opportunity cost accrues over a longer period of time.
- Second, avoiding and minimizing financial loss plays a significant role in long-term wealth accumulation. Really bad financial decisions, wasteful spending, poor accounting, whatever. Anything that results in unnecessary shrinkage of net worth hinders your financial potential.
- Third, **the best financial advice is not the kind that squeezes more return out of your existing assets, but one that helps you minimize losses.** This is not necessarily the most eye-popping or glamorous process, but it delivers consistent, profitable results.

Good financial counsel is not a guarantee against loss, but the research indicates most individuals are not as financially savvy as they think. Have you made a really bad financial decision? Don't make another one by deciding to go it alone. One of the ancient Proverbs still rings true today:

"There is wisdom in a multitude of counselors."

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