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Psychologists define visualization as a “cognitive tool to access the imagination to realize all aspects of an object, action or outcome.” Self-help author Napoleon Hill’s famous saying, “Whatever the mind can conceive and believe, it can achieve,” is the epitome of visualization.

In ways we still don’t completely understand, visualization works: a classic study showed that basketball players who regularly imagined making free throws improved their shooting percentages even though they didn’t practice more.

Visualization often has a prominent role in personal finance. Take retirement: you are asked to imagine an ideal retirement scenario, where you’d like to live, what you’d do, when you’d want to start. Ideally, this vision motivates you to save and instructs your choice of products or strategies.

As helpful (and necessary) as visualization can be, it doesn’t guarantee success; many visualizations don’t come to

fruition. Visualization may give us a better chance of becoming our best selves, but it doesn’t give us the power to control others or nature. We can visualize a sunny day, and plan accordingly, but it doesn’t mean we can stop it from raining.

And many visualizations don’t work because they are not fully formed. Most visualization focuses on positives, things you want to happen because you believe that they would be beneficial and rewarding. But imagining a positive future is only half the picture.

## Negativity Bias

Most of us have what psychologists call a negativity bias, the “tendency for negative events and emotions to affect us more strongly than positive ones.” “Bias” implies a perspective that is distorted. But that does not mean our negativity bias is false.

In their book, “The Power of Bad: How the Negativity Effect Rules Us and How We Can Rule It,” John Tierney and Roy Burmeister explain that negativity bias is logical, and in many cases beneficial. There is a primal wisdom in your negativity bias because “Life has to win every day. Death has to win just once.”

- **In a survival situation...**you should be reluctant to eat unidentifiable berries – even if you’re very hungry – because they might be poisonous.
- **In the workplace...** Robert Sutton, a professor of management science at Stanford, documented how one bad employee can corrupt an entire workgroup (“Bad is Stronger Than Good,” *Harvard Business Review*). This research led Sutton to formulate a hiring standard, called the “No A\*\*hole Rule,” to ensure a better workplace.
- **With your money...**look at how just one year of negative investment returns can put a big dent in your accumulation progress. Catching up requires either higher returns (and more risk) or more money (see chart on Page 2).

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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.

SCENARIO 1				SCENARIO 2			
ANNUAL DEPOSIT	ANNUAL RETURN	YR-END BALANCE	YR	ANNUAL DEPOSIT	ANNUAL RETURN	YR-END BALANCE	
\$1,000	4%	\$1,040	1	\$1,000	4%	\$1,040	
\$1,000	4%	\$2,122	2	\$1,000	4%	\$2,122	
\$1,000	4%	\$3,246	3	\$1,000	4%	\$3,246	
\$1,000	4%	\$4,416	4	\$1,000	4%	\$4,416	
\$1,000	-8%	\$4,983	5	\$1,000	4%	\$5,633	
\$1,000	7%	\$6,402	6	\$1,000	4%	\$6,898	
\$1,000	7%	\$7,920	7	\$1,000	4%	\$8,214	
\$1,000	7%	<b>\$9,544</b>	8	\$1,000	4%	<b>\$9,583</b>	

**In this example, three better-than-average years can't make up for one bad one!**

## Harnessing Negativity Bias

While our negativity bias might protect us in desperate times, there is a tendency for it to carry into non-threatening situations, often to our detriment. It takes a lot of effort to keep negativity from dominating.

Relationship researcher John Gottman has determined that healthy relationships exhibit a “magic ratio” of 5 to 1. There must be five positive feelings or interactions for every negative one to keep a relationship stable and satisfying.

In response to this “power of bad” (in relationships and other areas), some people choose to dismiss it. “Just accentuate the positive,” they say. “Stay focused on your goals. The negative will only drag you down.”

But downplaying or ignoring the negative doesn't work. According to Tierney and Burmeister, “You'd fare better by using your rational brain to override your irrational impulses, but to do that you need first to understand just how powerful bad can be.”

## Protection-First Visualization

Think about how these insights might apply to personal finance. A plan that only considers the positive, while a well-intentioned starting point, is susceptible to disruption and failure if a negative circumstance arises – a job loss, an illness, a divorce, a market downturn. Any one of those negative events could by themselves undo a slew of positive financial actions.

“A lot of us decide to make changes but we don't have strategies in place for when it gets hard,” says Sarah Newcomb, a behavioral economist for Morningstar, in a January 2020 *Wall Street Journal* article. Better visualizations seriously consider the negative, because as Sutton, the management scientist, puts it:

**“The first order of business should be to eliminate the negative, not accentuate the positive.”**

Practically, this means taking a “Protection-First” approach to personal finance. For example:

- Tierney and Burmeister's phrase, “Life has to win every day, Death has to win just once” is a concise argument for insurance.
- For savings, conservative guarantees trump uncertain opportunities.

- The “magic ratio” of positives to negatives for relationships applies to investment gains and losses; it might not be 5:1, but you need a lot more gains than losses to keep on track.

A Protection-First approach is not cynical or pessimistic, it is pragmatic. The biggest challenge in personal finance isn't making the numbers work. It's managing your emotions and your responses to challenges. Psychologically, Protection-First gives you the best chance to realize your financial dreams.

## An Athletic Analogy

Here's a three-step visualization method often used by athletes that not only helps them visualize high performance, but high performance under pressure.

**Step 1: Visualize success.** A positive vision for the future is still the starting point. Without coaching, some athletes never take this first step; on their own, they can't articulate what they want, or how to make it happen.

**Step 2. Visualize adversity.** In any competition, athletes will be challenged by opponents, playing conditions, their own weaknesses. But many athletes are surprised when they encounter adversity; they envisioned making a free throw but didn't anticipate shooting it while trying to catch their breath in front of a screaming crowd.

**Step 3. Visualize overcoming adversity.** Contests are a series of actions and reactions; well-coached athletes know ways to counter adversity. Some measures may be strategic; a quarterback calls for a screen pass to negate a pass rush, a pitcher throws an off-speed pitch to a hitter expecting a fastball.

But athletes can't always determine what type of adversity they will face. Beyond specific strategies, they must develop habits and attitudes that help

them regroup, reassess, and put them in the best position to respond.

It should be easy to see how these same steps could improve your approach to your money.

## The Best Way to Visualize Personal Finance

Let's make one more explicit connection between athletic visualization and personal finance: A lot of “planning” in personal finance – including media commentary and discussions with financial professionals – doesn't get beyond Step 1. You



**“The biggest challenge in personal finance isn't making the numbers work. It's managing your emotions and your responses to challenges.”**

may be given opportunities to visualize financial success, and hopefully shown some ways those visions could become reality. But if these visualizations don't include Steps 2 and 3, you are seriously underestimating the power of bad, and opening the door to disappointment.

Think that sounds like negativity bias coming through? Well, maybe it is. A Protection-First approach to personal finance recognizes that as much as we might prefer it to be otherwise, bad can be stronger than good – unless we acknowledge its existence and plan to deal with it.

Positive visualizations can motivate you. But the best visualizations prioritize managing or eliminating the negatives instead of simply accentuating the positives.

That's Protection-First. It works. ❖

### In your personal finances...

- Visualize success.
- Visualize adversity.
- Visualize overcoming adversity.



In December 2019, Congress passed the SECURE Act (*Setting Every Community Up for Retirement Enhancement*). This legislation, which became effective January 1, 2020, included some significant changes for Individual Retirement Accounts (IRAs). It...

- **Removed the age cap on IRA contributions.** Before SECURE, you could not make contributions to a traditional IRA after the year in which you reached age 70½. Going forward, there is no age restriction for IRA contributions.
- **Increased the age for Required Mandatory Distributions (RMDs) to 72.** Previously, RMDs began in the year an IRA account owner reached age 70½. (*Important footnote:* IRA owners who turned 70½ in 2019 will still need to take a required minimum distribution for 2019 no later than April 1, 2020. Failure to do so incurs a penalty.)
- **Eliminated the Stretch IRA option for non-spousal inherited IRAs.** Under the Stretch provision, non-spousal

beneficiaries of IRAs (like children or grandchildren) could take annual distributions based on their life expectancy. With some exceptions, the new SECURE act requires all inherited IRAs to be liquidated within 10 years. The 10-year rule does not apply to spousal beneficiaries; they are only required to take the RMD. Also excluded from the 10-year rule: Disabled beneficiaries, minor children, those who are chronically ill or less than 10 years younger than the account owner.

### Why the Stretch IRA Is No More

For existing IRA owners with significant accumulations, the elimination of the Stretch IRA option is significant.

The Stretch IRA was an easy-to-execute inheritance plan. The owner of the IRA simply designated a non-spouse as beneficiary; whatever was left in the account at the owner's death was transferred directly to the beneficiary. The beneficiary, as new owner of the IRA, could

- make lump-sum distributions, in any amounts, with the requirement of full liquidation in 5 years, or
- make annual RMDs based on the beneficiary's age.

These options had been in place for more than three decades and were based in part on longstanding principles of pension law. Using the Stretch provision, RMD distributions could conceivably continue for the beneficiary's lifetime, meaning that taxes deferred by original IRA owners might not be paid until decades after their deaths.

Legislators justified the change in distribution rules by saying that the tax deferrals for IRAs were intended mainly for the benefit of owners and their spouses, not younger heirs.

According to Steve Gibbs, a Tennessee estate planner, "The gist of the change brought about by the SECURE act is that beneficiaries will now have to pay the income taxes due for distributions over a shorter period – often at a higher rate and without the benefit of additional growth earned during a longer period of deferral."

### Other Transfer Methods for Unspent IRAs

The tax-deferral offered by IRAs makes sense if the taxes due at distribution are less than the deduction received on the deposit. To that end, many financial professionals have recommended postponing distributions as long as possible, or at least until owners were sure to be in a lower tax bracket. The Stretch was the ultimate expression of this approach, deferring the tax to future generations.

Anticipating the elimination of the Stretch, financial professionals have been formulating other options to maximize the transfer value of existing IRA accounts to non-spousal beneficiaries. Here are three approaches endorsed by multiple sources. Each strategy presumes the IRA is not currently needed to provide retirement income and seeks to minimize the tax costs of transferring it to heirs.

1. **Start RMD distributions now,** even if you haven't reached mandatory RMD age. The IRA owner pays the tax, then systematically deposits the remainder in non-qualified accounts. Smaller annual distributions over a longer time may result in a lower effective tax cost for the IRA owner, and some non-qualified investments may provide favorable tax treatment for beneficiaries when they inherit the accounts.

2. **Convert the IRA to a Roth IRA** during the original account owner's life. A conversion requires the owner to pay tax on the entire IRA accumulation, either out-of-pocket or by reducing the amount transferred to a Roth IRA. But once in a Roth IRA, the owner does not have to make RMDs or pay tax on distributions. And when beneficiary inherits the account, they won't owe any taxes either.
3. **Use IRA distributions to purchase Whole Life insurance.** After paying the tax, the remainder of annual RMDs can pay premiums on a whole life insurance policy, with an insurance benefit equal to the IRA balance, and the non-spouse as beneficiary. At the account owner's death, the beneficiary receives the life insurance benefits tax-free.

Annual distributions by the owner can minimize the current tax costs, while providing a guaranteed, tax-free life insurance benefit to heirs, likely in an amount greater than what would be left in the IRA.

In a January 10, 2020, *ThinkAdvisor* article, Gibbs makes an interesting observation:

**“Both whole life premiums and RMDs are based, in part, on life expectancy. Thus, a death benefit approximating the value of the IRA is often obtainable for annual premiums completely covered by the RMD – depending on factors like your age and health status.”**

Some caveats: All of these options assume the owners don't need distributions from their IRAs for current retirement needs, and that they want to leave the undistributed IRA balances to non-spouse heirs. Using life insurance also requires the IRA owner to be insurable – no small matter if the owner is over 70. ❖

The old adage says,  
**“You can't take it with you.”**

There's a corollary:  
**“but you want to leave as much as you can to those of your choosing.”**



The Stretch IRA was a simple way to accomplish this objective; the tax issues were transferred to a beneficiary, under generally favorable terms. The elimination of this option makes the transfer process for IRAs a little more challenging, but you have options. Especially if you **plan ahead**.



**Y**ou probably know interest rates for savings accounts are really low. Like tiny-almost-nothing low. In November 2019, bankrate.com reported the national average annual percentage yield (APY) for savings accounts was .01 percent, and concluded, “It’s a rough time to be saving money.” No kidding.

But eventually rates will go back up, right? The experts have divergent opinions.

### Regression to the Mean

Regression to the mean is a term from statistics for the tendency of rates to move toward their historical long-term averages. When rates are abnormally high, the most likely change is for them to decrease – to regress toward the mean. With unusually low rates, the next move should be up.

But rates have been low for more than a decade. Many economists who expected an “upward regression” in interest rates think it should have happened by now.

This persistence of low interest rates has prompted some to think we might be in a period of “secular stagnation.”

### Secular Stagnation

Economists often characterize market-driven economies as cyclical, predictably fluctuating from growth to contraction, and back again. But occasionally the fluctuation stops, and the economy gets stuck in one phase. Economists use the term “secular” to indicate its lack of movement.

Larry Summers, a Harvard professor and former economic advisor for several presidents, sees the current economy in a state of “secular stagnation,” in which “growth has a tendency to be sluggish and inflation has a tendency to decline.” Commenting in a November 2019 interview on NPR, Summers said this is “not a temporary cyclical situation. It’s a secular, or longer term, situation unless policy intervenes very strongly.” If governments and central bankers don’t change their monetary policies, Summers believes this stagnation will persist.

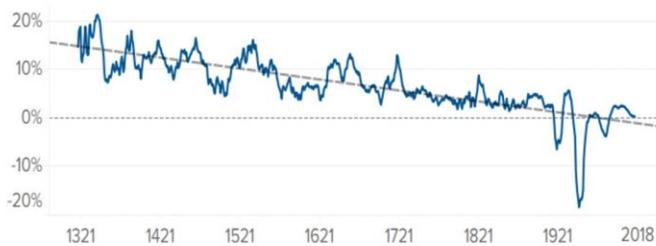
When considering regression to the mean or secular stagnation, a key factor is time. How many years are considered to calculate the average in a regression to the mean? How long does it take for a cyclical condition to become secular?

### The 700-year Trend



## Real rates have been in decline since the 14th century Black Death

Real interest rate for personal loans, 10-year moving average



SOURCE: "Eight centuries of global real interest rates" from the Bank of England

Much of the research on economic cycles and interest rates is based on data from the past century. But a new study says the periods used to argue for regression to the mean or secular stagnation are too short.

Paul Schmelzing, a Yale research associate, studied "real" interest rates (that is, corrected for inflation) back to the early 14th century, when capitalism and free markets began to emerge. In a paper published by the Bank of England in January 2020, Schmelzing reported that real rates have declined steadily for seven centuries, and that the trend is still downward.

Schmelzing's data begins in 1311 with banking transactions in the Venetian city-states, moves to Spain's financial dominance in the 1500s, progresses through the ascendance of the Dutch and English financiers in the 17<sup>th</sup> and 18<sup>th</sup> centuries, and concludes with the United States and the present global economy. During that time, real interest rates have fallen from an average of around 10% in the 15th century to just 0.4% in 2018. (See chart.)

From this perspective, today's low interest rates are not an outlier destined to rebound to a higher "normal." And as for secular stagnation, Schmelzing says economists need to face the likelihood that "such imbalances may have been a continuous condition for five centuries."

### Lower Rates Are Logical, but Inflation Skews Perceptions

Schmelzing argues that "both the real rate, and the inflation rate have become less volatile over time." Interest rates are a reflection of risk; higher interest rates are needed to cover greater risk of loss. Conversely, lower rates, both for loans and bank deposits, suggest there is less risk in the financial system. In the context of 700 years, financial transactions of all types are less risky today. Consequently, the cost of borrowing, and the price banks will pay to acquire money to lend, is decreasing.

Schmelzing also notes that in every century, there have been "safe investments," ones that provided a high degree of security and guaranteed returns, and individuals have always wanted these types of assets, even when returns have been paltry.

If you're old enough to remember when savings accounts paid 8% (the 1980s), you should also remember that inflation was high as well; even at 8%, money in savings accounts still lost purchasing power. No one likes earning .01%, but the main objective of saving isn't to retain purchasing power or beat inflation, but to accumulate principal. When it comes to saving, interest rates and inflation are background noise. ❖

That said, once you have a base of savings, there may be ways to improve your external rates of return by getting Velocity on your Money (VOM). Your personal economy doesn't have to be stuck in a secular stagnation.

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