Whole Life Insurance is not A Retirement Plan

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I decided to write this article because over the years I have had several clients forget how their whole life insurance fits in with the rest of their plan, and how it is a part of a person's retirement plan, but is not a retirement plan in and of itself.

First, we have to go back a little to the foundational philosophy of what we are doing versus what we are not doing.

<u>What We Are Not Doing</u>

We are <u>not following</u> the predominant "retirement nest egg" philosophy. The nest egg philosophy is this, that you should save a portion of your income into a "retirement plan" (usually a 401(k) or IRA), select where you want your funds allocated with a selection of mutual fund options, and then watch the interest compound over time to eventually become "your number" (ING) ("Your Number" is a marketing campaign that ING is promoting to help people calculate exactly the amount of money they will "need" in order to retire).

Here are some of the myriad of problems with this thinking. First, no one knows for sure what you will need. No one knows how much you will need to live on, what food will cost, what gas will cost, what heating and electricity will cost, what technology will cost, what health needs you will have, or anything else for that matter. We can guess, but the results of our guessing will simply be a guess, based on guesses.

The second big problem with this style of planning is that it assumes that you will get compounded rates of return on your money in the stock market. Let's take a quick look at this. Let's say someone invested $100,000 in the S&P 500 back in Jan 2000. I know, bad timing, right? Well, none of the mutual funds on Wall Street at that time were saying, "you'd better sell all your shares and get out of the market". Nope, they were still telling everyone to keep buying and ignore the fact that the S&P was riding a huge bubble (much like today). Anyways, back to the example. If someone invested $100,000 in the S&P 500 in Jan 2000, that investment would be worth $130,073 today. That's without any fees attached. Now, you might be thinking, "that's not too bad", right? Well, compare that to if the same person would have invested the money in high grade bonds (AA or AAA rated). Those have averaged more than 3.5% during the same time period. $100,000 invested in high grade bonds would have produced $49,000 in interest. That's $19,000 more than the S&P would have provided. Just a side note: The S&P 500 is widely accepted as a good representation of the stock market as a whole. So, if we look at that information, over the past 14 years, the stock market has performed at a significantly lower rate than 3.5%.

Now, let's use that and apply it to the Nest Egg philosophy of planning for retirement. Let's say someone felt they needed $80,000 per year in retirement income, in today's dollars (meaning that it could buy what $80,000 could buy today). If the nest egg were invested in something conservative at the time of retirement, let's say something like high grade bonds, then the nest egg could continue to earn 3.5%, at least for now (this rate can change up or down over time). If the person bought term life insurance and subsequently cancelled it prior to retirement (which is also part of the nest egg philosophy to “self-insure”), he would not have life insurance, and therefore no way to replace any of the retirement assets if they were spent or lost. So, the only sure-fire way to guarantee that the person doesn’t outlive his retirement is to simply not spend it. If the person isn’t going to spend down his retirement assets, then he can only live on the income it produces. That means, at 3.5%, the person would need to have a nest egg of at least $2,285,714 in today’s dollars. That really means the person would need to have closer to $4,128,000 if the person is 20 years from retirement.

Now that we know what the person’s number is, we can determine how much money that person needs to save each year for the next twenty years. Let’s suppose the market does much better than the past 14 years, and actually grows by an average of 6% per year (more than twice as much as it has over the past 14 years). If the person had no money saved for retirement at this point, he would have to save only $105,865 per year to reach it. I’m being sarcastic by saying “only”. Impossible? Yep. Most likely someone who has a goal of making $80,000 per year in retirement income is currently making less than $100,000 per year while working. What makes it more impossible is that you can’t invest in the stock market without incurring management fees of some kind. Most mutual funds average more than 2% per year in management fees. Low cost funds still charge up to 1% per year. So, instead of making just 6%, you would really need to make closer to 7 or 8% to reach your goal.

Here’s the final problem. Even if all the stars aligned, and you did reach the nest egg goal, what’s to say that that amount is going to be right? Even if it’s right for the first year in retirement, what will the next twenty to thirty years look like? There’s no way to predict it, and there’s really no way to achieve it, at least not this way.

What does this mean? It means that products like IRA’s, 401(k)’s, and their underlying mutual funds are not going to produce what they are promising. They are failing and will continue to fail. This philosophy of “retirement planning” is actually an experiment that is failing miserably. Without Social Security retirement benefits and Medicare, there would be about 70% fewer retirees today. That’s the percentage of Americans that are currently retired, that are nearly entirely dependent on SS benefits. Scary!

<u>What We Are Doing</u>

My philosophy, which isn’t really mine (I’ve just adopted it and continue to promote it), is based on what has worked and what will continue to work. It is not an experimental philosophy.

Unfortunately, for many people, my philosophy requires a lot more work and effort than the nest egg philosophy. The nest egg philosophy only requires that a person choose how much of his/her paycheck to invest each pay period, and choose which funds it should go in (among those offered). That’s why so many people want to believe it works. They would love to be able to retire in the future without putting a lot of time and effort into it. The unfortunate thing about that is, it doesn’t work. It is too good to be true.

What I teach is what I call Velocity of Money Multiplier. Velocity of Money is referring to the movement of money in a person’s plan. The Multiplier is referring to getting multiple uses of the same dollar throughout a person’s lifetime.

Here's a quick example (just an example, not saying that everyone should invest in real estate): Let's say a person buys a rental property. He saves money somewhere first, usually bank accounts are used, but I recommend using whole life insurance (I'll get into the benefits of this later). He invests a down payment into the property when he buys it. Let's say he buys a $200,000 property and invests $60,000 down. A $200,000 home in Owasso, where I live, would rent for somewhere around $1,500 per month pretty easily. The mortgage on the property would be $140,000. The payment on that mortgage would be $709 + taxes and insurance. I would estimate the cash flow to be somewhere around $500/month to start with.

Here's where the Velocity of Money comes in. The cash flow coming in would be about $6,000 per year, which would make the cash on cash return be 10% (10% of $60,000 is $6,000). Already better than any bond, right? Additionally, the cash flow from the rental would be only partially taxable, as the investor would also depreciate the cost of the property against the income, making some or all tax free for several years into the future.

Additionally, the investor would likely increase the cost of rent over time. At 3% inflation, the rent would go from $1,500 per month, to $2,709 per month within 20 years ($3,641/mo in 30 years).

The cash flow can then be used to do something else, like pay off personal debt (your mortgage on your residence, or car loans), or rebuild savings and invest in more properties. This is the Multiplier. You invest your $60,000 and within 10 years, you get it all back, plus you still own the property, and it's still paying you an income. If every ten years, I bought one new property from the cash flow generated by each property, by the thirtieth year I would have four properties, producing at least $3,641 per month per property ($14,564 total per month). All of that, with no additional money out of pocket. The only amount invested was the initial $60,000. The rest came from the investment properties themselves. Velocity of Money Multiplier.

The total value of the properties, if they increased by 3% per year only, would be over $9,000,000. If you think that 3% growth is too high, ask your parents what home prices were when they first got married, and compare that to the cost of an average home today.

Imagine what this person could do if the person continued to save and invest more of his/her earnings?

Again, I am not recommending that everyone invest in rental properties. I just used them in this example. However, I have seen and continue to witness my very own clients doing this exact thing, and it is definitely working.

My recommendation is that you follow these three rules for investing:

1- Invest in what you know – invest in what you are either already an expert in, or are willing to become an expert in. Don't invest in things you don't know and understand (i.e. the stock market for most fits that category – not understandable).
2- Invest in what you can control – invest in things you have to work on, things that require effort, and things that you can control, things that you are the owner of. This could be rental properties, land, franchises, or your own ideas (intellectual property – which is the number one producer of wealth, and always has been).
3- Don't chase returns – people are always behind the carrot. The stock market does well, so people jump in (after the fact). Real estate booms, so people jump in. Gold does well, so

> people jump in. All the while, they don't really take the time to become experts. They're just chasing carrots. Every time making someone else rich in the process. The wealthy are almost always getting out of whatever is becoming popular. They are ahead of the carrot. They are the ones dangling the carrot out there for the public. Also, they are the ones buying it back when everyone is jumping ship!

The hard part about this philosophy is that you have to be the one to figure out where you should be investing. I'm not going to tell you. What's good for one, is not necessarily good for another. Investments, like most things that really work, should be based on you individually. It is unique to you.

<u>Where Does Whole Life Insurance Fit In?</u>

Now that we are reminded of the difference in philosophy, we can answer this question. When a couple retires, what allows them to utilize their assets without the fear of running out of money? Just today (06/09/14), there was an article in Yahoo Finance entitled "Retirement Savings Fears Grip Americans: "I Don't Have Enough" (by Eric Pianin). First of all, it's very clear evidence that the predominate philosophy of buy term and invest the rest in your retirement plan, is not working. It states that "40% of retirees run the risk of running out of money for daily needs". Running out of money is a retiree's number one financial concern in study after study.

So, what allows a retiree to utilize all of his assets, but not run out? Life insurance. The problem is, there really is only one type that can do it on a for sure basis, whole life. Why? Because it has a guaranteed premium (can't increase), guaranteed cash value (no costs come out of it, and it earns at least 4% every year), and a guaranteed death benefit (for sure, for sure, for sure).

Whole life insurance allows a retiree to spend an amount of his assets equal to the death benefit, knowing that when he dies, his wife will get that amount replaced to her, tax free. That is a huge benefit! It's the same as if the person had twice the amount of assets, but acquiring it is not based on the performance of an investment market. It is guaranteed.

Many people state that the problem with whole life insurance is that it's so expensive. I disagree whole-heartedly and can prove otherwise. The fact is this. If you keep paying for your whole life policy, your cash value will continue to grow, and it will eventually be more than what you've paid into it. Additionally, you will have had access to the money (Velocity of Money Multiplier) throughout your lifetime, for emergency reserves, funding of a vehicle, or even investing. Now, I have to put a plug in here for maintaining six months to one year of income storage. So, if you do borrow your cash value for investment purposes, I highly recommend not going below six months of income savings. And, I recommend that the six months of income savings be in your life insurance cash value (performs better than any bank account by far!). With that said, you do have access to all of your premium paid during your lifetime. Thus, whole life insurance really doesn't "cost" you anything. It's actually going to give you more money than if you used a different method.

I've had some people say, "I don't believe in whole life insurance". There really isn't anything to believe or not believe. Whole life insurance is contractual, and it's factual. It's not something you have to hope works out. In fact, in the insurance world, it's one of the few products that is going to pay out guaranteed. The insured is guaranteed to die. The policy is guaranteed to pay out. The cash value is guaranteed to exceed the premiums paid, and is guaranteed to earn 4% or more each and every year. The cash value is accessible to the owner of the policy. None of this is a maybe. It's a for sure.

So, going back to the question, whole life insurance is not a retirement plan. Retirement plans are part of the Nest Egg philosophy (all of them). They are designed for you not to use your money for long periods of time. Whole life, on the other hand, is designed for you to use throughout your entire life, which is why it's called "whole life".

I hope this article helps you understand better why whole life is a great part of your plan, and that it is not, by itself, a retirement plan, but in fact is a great foundation for building and utilizing wealth over a lifetime.