

JULY 2016

ARE YOU READY FOR THE



The transportation service companies, Uber and Lyft are notable large-scale gig businesses, but “sharing economy” companies like Airbnb (in which people list, find, and rent private lodgings), are also considered part of the gig economy.

Gigs Could Be Big

In theory, the gig model greatly expands opportunities for flexible, profitable, freelance employment, while providing employers with a large on-demand workforce not restricted to geographic location. Because gigs have the potential to lower employee overhead costs for businesses, many economic observers believe the gig economy will continue to grow as a preferred work arrangement. A 2010 white paper from Intuit predicted that **40 percent of American workers will be independent contractors by 2020.**

Fabio Rosati, CEO of Upwork, says the uptick in the gig economy is “just the start: The connected era we live in is liberating our workforce. The barriers to being a freelance professional – finding work, collaborating with clients and getting paid on time – are going away.”

If this gig model comes to fruition, traditional full-time, full-benefit jobs will likely decrease; instead, businesses in a common industry may develop collaborative networks to “share” a pool of qualified workers. And because of the likelihood of irregular work, many gig workers will also dabble in self-employment, micro-businesses, and other ways to supplement or smooth out their income streams.

Gig employment may also become a “glide path” for some workers to transition

There’s a burgeoning employment format that, depending on the configuration of your household finances, represents either opportunity or concern. How you see it can be quickly determined by your answer to this hypothetical job offer:

Option 1: Earn an average of \$125,000 a year for the next five years, or...

Option 2: Receive a salary of \$100,000 each year for the same period.

If trends continue, this is a compensation decision more workers are going to face. Because the transformation from the 20th-century Industrial economy to today’s Information economy is also a move from “jobs” to “gigs.”

The “gig economy” is a phrase describing work arrangements in which most employment is temporary, and businesses contract with independent workers rather than hiring employees. Technology, particularly smartphone applications, is a driving force behind the rise in the gig economy, because many aspects of the process – for both businesses and customers – such as hiring, supervision, payment for services, accounting, etc., can be procured and managed remotely.

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from full-time employment, to part-time work, to retirement. A March 26, 2016, *Wall Street Journal* article reported that “Older workers, especially women, increasingly are filling in as contractors across a range of traditional industries, from highway inspectors to health aides.”

Gigs Make Some Uneasy

But while businesses may see the gig economy as a way to streamline their operations and improve their bottom lines, there is social and institutional push-back. A July 2015 commentary in *The Guardian* succinctly articulated the concerns, saying some skeptics believe the gig format “portends a dystopian future of disenfranchised workers hunting for their next wedge of piecemeal work.”

Along those lines, the *WSJ* article acknowledged that an “expanding share of the workforce has come untethered from stable employment and its attendant benefits and job protections.” In fact, several gig contract workers have sued to be reclassified as employees, because they feel their work agreement exercises too much control over their activities and restricts them from pursuing other work. If they are not truly independent, these workers want access to benefits and protections that “real” employees have, including health insurance and workers’ compensation.

The gig economy presents a challenge for governments as well: Gig workers aren’t quite independent contractors or employees. A February 2016 report by the *Congressional Research Service* concluded that because On-Demand businesses using gig employment agreements collect a portion of the independent contractor’s earnings, and control both the marketing of their services and the provider-client relationships, there is a “potentially important difference between gig work and traditional freelance work, because it curtails the provider’s ability to build a client base or operate outside the platform.”

This status - not quite an employee and not quite a freelancer - is a legislative dilemma. At the end of 2015, *The Congressional Quarterly* reported that 23 states have advanced almost 90 pieces of legislation to restrict or regulate businesses using gig agreements.

Can You Gig?

A hopeful view of some economists is that the gig economy can allow lower-income workers to more easily find work that fits their schedules and abilities, and reduce the perceived income-inequality gap in the nation. But data from an April 2016 study by J.P. Morgan Chase found that more Americans in the top 20% of income earners participated in the gig economy (typically by renting an asset, or maintaining an online retail business) than those in the lowest quintile. In reality, many lower-income households simply can’t afford the start-up costs, cash flow challenges and overhead expenses to thrive as independent contractors. They need a steady paycheck before they can consider the opportunity for higher pay from irregular work.

And that’s sort of the crux of the matter: **Whether the gig economy is an opportunity or a threat depends on the configuration of your savings and insurance benefits.** If you



Workers increasingly are filling in as contractors across a range of industries.

have adequate liquidity and portable, personally-owned income-protection benefits (like disability and life insurance), you may have the financial wherewithal to take advantage of gig work.

Another factor that doesn’t get much attention: The gig economy favors two-income households, particularly if one has a full-time job with benefits. With a stable income as a base, it’s easier for the other income-earner to pursue work that offers higher pay, or flexible hours, or work assignments outside one’s local area.

If gigs are creeping into your line of work, or if you think you’d be interested in transitioning to a gig arrangement, now might be a good time to assess your readiness. Some possible considerations:

- If you currently have group benefits, perhaps some of them should be replaced with personally-owned policies. And you may want to make these changes now, instead of when you’re ending regular employment.
- The prospect of relying on a gig income might prompt adjustments to your saving allocations. For example, maximum contributions to a tax-deferred retirement plan, with its restrictions on early access, may no longer be optimal.

The possibilities and potential problems in the gig economy reinforce the idea that opportunity comes to those who are prepared for it.

ARE YOU UP FOR A GIG? ❖

**IN THE RIGHT LANGUAGE,
'WEALTH MANAGEMENT'
STARTS WITH...**



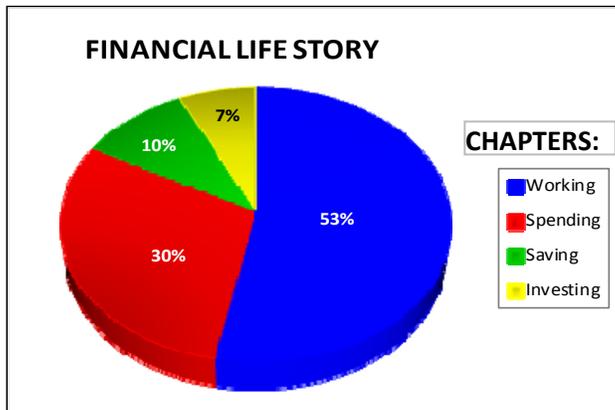
There are times when having a standardized universal language for personal finance, like there is for chemistry, would benefit everyone. Chemistry has a Periodic Table of Elements, and each element is distinctly defined and assigned a specific position on the Table. When chemists talk, oxygen is always called “oxygen,” and always has the same atomic number.

But if oxygen were a component of personal finance, some branding expert might rename it “Life Source™” as part of the “E\$\$entials©” finance program. Sometimes, the biggest challenge

in personal finance is getting everyone to speak the same language.

Here's an interesting example:

In 2015, Riedel Strategy, an independent research firm, was commissioned by a wealth management company (note: 'wealth management' is a prime example of a marketing phrase with an inexact meaning) to study the financial lives of individuals with a minimum of \$500,000 in investable assets. To gain a deeper understanding of their attitudes toward money, researchers asked the participants to think of their financial life as a story, and to divide it into chapters, giving each chapter a high point, a low point and a turning point. The chapters of these "financial life stories" were sorted into four categories, then analyzed. Using this template, here is the content of a typical American financial story:



- 53% of the chapters are about **Working**.
- 30% of the chapters are about **Spending**.
- 10% of the chapters are about **Saving**.
- 7% of the chapters are about **Investing**.

Different Stories?

The story concept and the results are interesting. But what does it mean in terms of wealth management? That depends on how you interpret the language of the study.

In an April 18, 2016, opinion piece for the *New York Observer*, Barnaby Riedel, the research firm's founder, gives his take. Starting with a question "What is the meaning of a financial life?" Riedel believes his research shows wealth management companies and consumers have very different answers.

As one of his bullet points, Riedel says the wealth management industry's "financial story" says...

- **Your financial life is about saving and investing.** Protecting and growing your assets is the task at hand and if you do it well you'll be O.K.

But consumers say...

Your financial life is not about saving and investing. It's about **working and spending**. Around 90 percent of the important events – both good and bad – in their financial stories were connected to working and spending. It was promotions, vacations, tough bosses, etc. Saving and investing are important, but these areas matter least in how most people evaluate success in life. Accomplishments, experiences and relationships carry greater weight.

Riedel's comments are framed in such a way as to imply that wealth management companies and individuals have completely opposite perspectives on money, i.e., wealth management companies are focused on saving and investing, while consumers

are concerned with working and spending. And to better serve its clients, wealth management needs to recognize the differences and change its story.

But the apparent disconnect between wealth management companies and individuals could be a result of the language Riedel uses. With different words – for the same things – an entirely different perspective is possible.

Same Story + New Language = Different Conclusions

Let's consider re-naming some of Riedel's designations. For starters, let's change "working" to "income," because from a financial perspective, that's why people work – to earn an income. If we pair income and spending (instead of working and spending), we are talking about "cash flow," i.e., how much comes in, and how much goes out.

Riedel's language and paradigm make it seem that working and spending are activities exclusive to individuals, while saving and investing is where wealth management functions – and there isn't much common ground. But if working and spending are considered "cash flow," wealth management can offer considerable value that, it seems, most individuals would want.

- Wealth management products like life and disability insurance protect income, both now and in the future. They guarantee cash flow even if an individual dies or can no longer work, and preserve spending power.
- Saving and borrowing strategies can impact an individual's ability to spend. If you want a new boat, should you finance it, borrow from your 401(k), or start saving? What about a 15- or 30-year mortgage? The best answers to these spending questions might come from a combination of wealth management products and ideas.

Cash Flow is the Lifelong Element of Wealth Management

With the torrent of financial media attention to topics like historical performance, risk assessments, leading indicators, or Monte Carlo projections, it might seem like wealth management is focused exclusively on saving and investing. But if you learn the language of "cash flow" (instead of "working and spending"), you could argue that this is where wealth management really begins, and plays a lifelong role. Steve Romanowski, a wealth management professional from Michigan who advocates this perspective, says he has a "laser-like focus on cash flow. I make sure people are in the best possible position for today before I start talking about tomorrow."

Intuitively, Riedel's research showing the emphasis individuals place on working and spending seems on target. These are every-day essential financial events that demand attention today, and will continue to do so the rest of our lives. When working and spending are understood as the two sides of cash flow, wealth management's role in our financial story changes. Instead of being seen as a small part of your financial life story (the 17 percent that Riedel classifies as saving and investing), wealth management becomes vital – today and in the future – to the chapters that matter most.

ARE YOU AND YOUR FINANCIAL PROFESSIONALS SPEAKING THE SAME LANGUAGE ABOUT CASH FLOW? ❖

Self-Insurance:

Done Best by...

Insurance
Companies



Self-insurance is one of those magic phrases that grabs your attention. It implies “shortcuts” and “cost savings” and “what they don’t want you to know.” For those who believe every financial institution is part of a global conspiracy, self-insurance is your chance to stick it to the man.

The concept of self-insurance is simple: instead of paying premiums to an insurance company, you systematically set aside a pool of money to be used if an unexpected loss occurs. If the house burns down or the car is totaled, you don’t file a claim, but use the accumulated funds to replace it.

For the do-it-yourself financial gurus, self-insurance is often a recommended strategy. Here’s a statement from a software developer who retired at 50, and now blogs his financial insights:

(T)he short answer to the question “When should you self-insure?” is “Whenever you can.” Remember that insurance is generally a business, run at a profit. That means that *whenever you can reasonably self-insure, you will also turn a profit. You’ll come out ahead in the long run.*

Notice the walk-back statement: *whenever you can.* Which, after further examination, turns out to be, not very often. In fact, the rest of the article is a fairly comprehensive argument that while **self-insuring might sound attractive, it’s not practical.** Instead, the commentary ends up making a strong argument for using insurance companies. Here’s a bit of what follows:

(B)efore you cancel all your policies, and put yourself or loved ones at risk, do ask yourself some tough questions:

1. Will you be “in business” to pay a claim? This is why you can’t self-insure for life (or disability) insurance, at least not as long as you have dependents relying on you for income. If they need you to be alive and working to put bread on the table, then part of caring for them is buying enough insurance so they are not destitute should you pass from the scene.
2. It’s not enough just to be “in business” (alive). Could you afford to pay a claim from your *liquid assets*? You’ve got to have the cash flow to make good, without taking losses elsewhere. That’s why most people can’t self-insure their home (even though the chances of losing a home to a house fire are miniscule) or health care.

Does this sound like an argument for self-insurance? Actually, it sounds like basic information from an insurance agent on why it makes sense to *buy insurance*. The writer says some self-insurance might be effected by reducing coverage amounts, changing waiting periods or increasing deductibles. But the necessity of being in business/alive and having sufficient liquid assets pretty

much negates the self-insurance concept for life, disability, health, and home protection.

While noting liability insurance protection is required by law, the author does see self-insuring potential for the replacement of an automobile. But to do that...

You must keep \$5,000-\$10,000-\$15,000, or whatever you think you’d need to pick up some reliable used transportation on short notice, available in an insured savings account or low-volatility investment.

After which, he immediately concedes...

And I’ll guess that’s where most people get cold feet and decide to pay an insurance premium instead: it’s a lot of cash to part with all at once.

...which is another argument for using an insurance company to protect your assets. Paying out of pocket substantially reduces liquidity in the moment (and what happens if you have another loss soon after?) and incurs an opportunity cost – you forego what could have been earned if the money remained invested. By using insurance, your liquidity needs are lower, and more assets can be allocated to higher-yield options.

After acknowledging that self-insurance isn’t workable for the big financial risks many consumers face, the author further reinforces the superiority of the insurance company model, i.e., pooling assets to spread the risk of loss over a large number of people.

How likely is a claim? Insurance companies have the data and the business volume to answer this question very precisely, and **that’s why they can run highly profitable businesses under conditions where we, as individuals, cannot.**

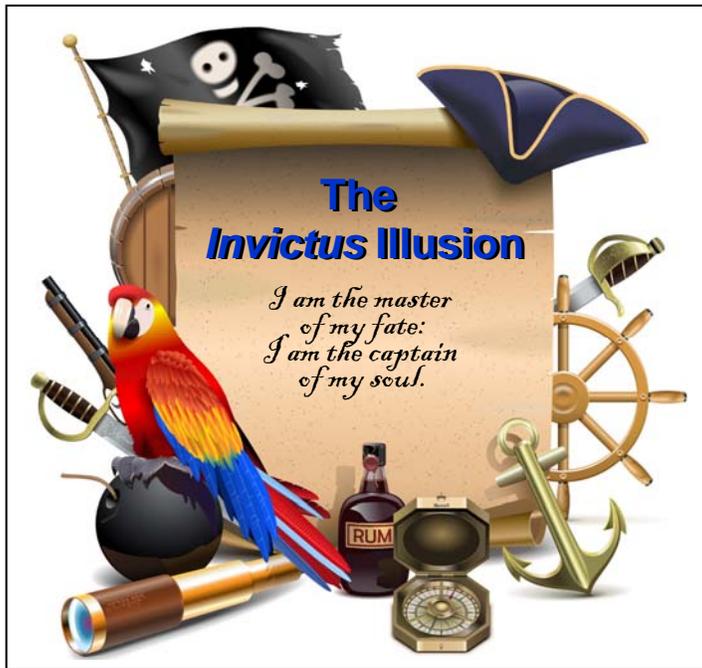
To make self-insurance work, you need to insure more than one asset. Insurance works because the accumulated reserves cover multiple lives, cars, homes, etc. When you are attempting to exclusively insure just *your* life, *your* income, *your* home, there is no spreading of the risk.

The author claims there may be circumstances where our knowledge about a particular risk may be better than the insurance company’s. In his situation, he sees his son as a very responsible teen-aged driver of an old, high-mileage, used car. Self-insuring a vehicle whose replacement value is marginal may make sense, but the savings are minimal. You may “turn a profit” by self-insuring, but it isn’t a very big business.

This article on self-insurance ends with an ironic twist. Remember, the writer is a former software developer:

I’ll admit there is one area where I’ve always found it easy to justify a service contract: my computers. Access to a functioning computer has been critical to my livelihood ever since the start of my career. Being down, even for a few hours, is guaranteed to produce frustration, and possibly even loss of income. I’ve never had a problem paying a few hundred dollars annually to avoid that...Insuring my computers is essentially a business decision.

The replacement cost of a computer, even a really good one, probably isn’t as much as a car, a home, or annual medical bills. If anything might be a candidate for self-insurance, it’s a relatively low-ticket item like a computer. But for his really important assets, the author doesn’t self-insure. And really, that’s the same for everyone. ❖



The shift from employer-funded pensions to personally-managed retirement accounts like 401(k)s promised opportunities for individuals to produce returns greater than those guaranteed by a company-managed pension fund. It perhaps neglected to consider the *lifelong management responsibilities that come with personal control* – not only when accumulating, but when spending. **A looming dilemma for many retirees is whether they will be able to manage their wealth as they age.**

The harsh reality is that even if retirees heed practical advice (choose your caregivers wisely, make sure your children get along) and are diligent to follow through on details (updating beneficiaries, appointing representatives), diminished mental capacity is a wild card that can trump the best-laid plans. Yet precisely because they have assumed responsibility for funding and managing their retirement during their working years, retirees sometimes resist the possibility that they may not be able to maintain control to the end of their lives. Call it the “*Invictus Illusion*” (...or Delusion).

Believing You are Unconquerable Doesn't Make it So

Invictus, meaning “unconquerable” or “undefeated” in Latin, is a poem by William Ernest Henley. The first stanza ends with this memorable couplet:

**I am the master of my fate,
I am the captain of my soul.**

Invictus was written in 1875 while Henley was hospitalized for tuberculosis of the bone. As the disease spread to his foot, physicians decided that in order to save Henley's life, they had to amputate his leg below the knee. Henley survived, but used a crutch the rest of his life. (A bit of trivia: A large, powerfully built man, Henley was a prominent figure in the English literary community, and served as the inspiration for the character Long John Silver in Robert Louis Stevenson's classic *Treasure Island*.) The last lines of Henley's poem resonate with our heroic aspirations. When one has an unconquerable will, the facts

don't matter. As one modern critic puts it, “*Invictus* is a poetic middle finger to the cosmos.”

Unfortunately, there are a few things *Invictus* doesn't consider. We are only the masters of our fates and captains of our souls as long as we can convince others we aren't *incompetent*. Once someone decides we've lost touch with reality, all it takes is a court-appointed guardian to revoke our captaincy and put our fate in someone else's hands. As an example, consider Sumner Redstone.

Sumner Redstone is 93 years old. As chairman emeritus and controlling shareholder of communication industry giants CBS and Viacom, he is extremely wealthy. In his business life, Redstone has been characterized as both brilliant and ruthless in getting what he wants. He has personified the *Invictus* ideal, often dismissing questions of who will succeed him in his businesses by stating he intends to live forever.

Alas, Mr. Redstone's failing health and declining mental acuity has prompted a series of high-profile lawsuits, filed by his children and a former mistress, on the issue of whether Mr. Redstone is still capable of managing his assets or taking care of himself.

Per a May 13, 2016, *New Yorker* piece, when Mr. Redstone dies or is deemed incapacitated, his voting stake is transferred to a seven-member trust, and his daughter will assume his seat on the board. One way or another, investors are eager for this transition to occur, because Redstone's uncertain leadership status has been seen as partly responsible for the 40-percent decline in the company's stock value. At this point, Mr. Redstone is hardly the captain of his fate.

Greater Responsibility = More Legal Challenges?

Mr. Redstone's circumstances are not a unique consequence of his wealth. Rather, they are the result of two factors: declining mental capacity, and financial assets in which others – family, friends, and business partners – believe they have a vested interest. Indirectly, the decision to invest individuals with greater financial responsibility for their retirement has significantly multiplied the likelihood of legal battles over family assets.

Anthony Webb, a senior research economist at the Center for Retirement Research at Boston College, elaborates:

“These days we have 401(k) plans and lots and lots of choices that never confronted our parents...If you are really smart and you are in your 50s, this is something that you can handle, though the evidence is that a lot of people have difficulty even then. The problem for the future is, what do we do if we have a whole load of 80-year-olds who have Alzheimer's and have \$1 million in their retirement plans? It's a recipe for disaster.”

Some observers long for the “good old days” of retirement. As Kelley Holland of cncb.com put it in a February 19, 2015, article: “The decline in financial decision-making ability wouldn't be quite so bad if people were retiring with defined benefit pensions.”

Annuitization: A Pre-Emptive Strike?

Ms. Holland's response isn't just a nostalgic longing for the past. Increasingly, financial experts acknowledge that including a pension – i.e., a stream of payments guaranteed for life – in a retirement plan can alleviate some of the concerns about declining mental ability in one's later years.

This strategy requires reallocating some of one's assets to buy an annuity from an insurance company. Instead of a cash asset, the retiree now owns a stream of payments, which may be received immediately, or scheduled for distribution at a later date. Once payments begin, the retiree has no management decisions, and the annuity isn't an asset that can be liquidated and transferred.

Shlomo Benartzi, a behavioral-finance expert from UCLA says an annuity solves two critical issues for retirees. In an article published in the fall 2011 Journal of Economic Perspectives, Benartzi says the irrevocable decision to annuitize removes complex investing decisions from the retirement equation, simplifying management responsibilities. This is not only a present benefit, but offers future peace of mind, because Benartzi says studies show that guaranteed incomes boost retirement happiness.

Using an annuity to ensure a lifetime income can be a pre-emptive action to mitigate against a possible mental decline. It not only relieves you of management and control concerns, but does so for others. An annuity is one asset where you won't have to ask family or friends to make financial decisions on your behalf.

Of course, for those who are used to being in charge of their money, the idea of giving up control of a portion of one's assets today so that something will be there tomorrow in the event of a mental decline is challenging. Benartzi acknowledges "that some retirees especially sensitive to losing money, view giving up money in exchange for guarantees as a loss." This is what the Invictus illusion looks like in retirement: a belief that no matter what, you will remain an effective manager of your finances as you age. ❖

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