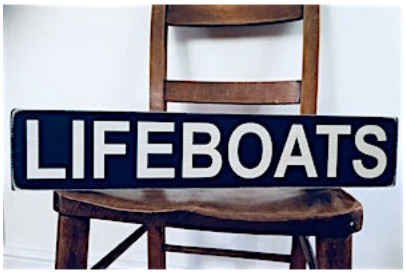
'Dull' Investments Shine in a Crisis

By Kerry Pechter *Thu, Mar 26, 2020*

Three retirement experts talk about boring products that you might wish you owned right now: I-Bonds, cash value life insurance and annuities.



During bull markets, products like whole life insurance, annuities, and inflation-protected government bonds look too conservative for most investors to bother with. But during bear markets, guaranteed products (and those who recommend them) start to make sense.

RIJ spoke recently with three champions of ultra-safe products. Antoine Orr and Michael Seibert are insurance-licensed representatives of RIAs (Registered Investment Advisors). Zvi Bodie is an emeritus professor of management, pension fund expert and author.

Spoiler alert: You won't read much here about profiting from the current volatility. Rather, you'll read about products your clients might wish they bought a year ago, or that they might want to buy after the current crisis passes and before the next one begins.

No risk-free risk premium

Zvi Bodie, a retired pension expert who has taught at Harvard, MIT, and Boston University, and a prolific author of textbooks and popular books on safe investing (*Risk Less & Prosper,* Wiley, 2011), admits that when the stock market started its multi-decade ascent in the 1980s, he was an avid buyer of equities.

Zvi Bodie

But Bodie got out of the market when the price/earnings (P/E) ratio reached 40 in the late 1990s. Since then, he has invested mainly in equity-indexed certificates of deposit (CDs).

He's now enthusiastic about **I-Bonds**, which are tax-deferred, liquid, inflation-protected Treasury savings bonds whose yield tracks inflation. They cannot lose value (though there are small penalties for withdrawals in the first five years), are exempt from state and local taxes, and yield a small fixed interest rate plus the rate of inflation. The current "composite yield" is 2.22%.

"I-Bonds are better than Treasury Inflation-Protected Securities (TIPS)," he said. "They're perfect for an emergency fund. The only 'drawback' is that you can't buy more than $10,000 worth per year."

Bodie has also contested the validity of the gospel that stocks always "pay off in the long run." If stocks (or baskets of stocks, called indices) were safer the longer you hold them, he has pointed out, then investment banks would happily sell long-dated shortfall put options on them. But no one writes such options; they'd be too expensive. "How can there be a risk premium if there's no risk?" he often asks.

The source of the confusion, he explained over the phone this week, is what he calls the "**Bodie Paradox**." Over any specific time period, "the probability increases that stocks will beat the risk-free rate," he said, referring to the rate on risk-free Treasury bonds whose maturities match the designated time period.

But, paradoxically, the potential magnitude of an extreme equity market loss grows over time—because unforeseen black-swan events like the COVID-19 pandemic happen from time to time. "Two things determine risk: the likelihood of a bad thing, and the severity of a bad thing," he said. "When there is a shortfall, it's really terrible. And you have to take that into account."

'Sadly, he's all in stocks'

Michael Seibert and I met at a modish restaurant near Allentown, PA, called Grille3501. Once a Pennsylvania Dutch eatery called "Trinkle's," Grille3501 reflects this small East Coast city's evolution from Amish-flavored mill town to satellite of New York.

Michael Seibert

Seibert was under some time pressure. The S&P500 Index was falling. Later that afternoon, he would call a nervous new client—a 62-year-old man whose existing wealth consisted of ownership of a successful business, the cash value of a large whole life policy, and a 401(k) account holding $700,000 in equities.

"Sadly, he's in all stocks," Seibert told me. "He's not retiring for four or five more years, so he's holding on tight. When stocks rebound, whenever that may be, we'll move some of the money to a fixed income annuity (FIA)."

During crises, he said, "Retirees have four volatility buffers: Cash, the cash value of life insurance—either spending it or borrowing against it—a reverse mortgage line of credit, or taking Social Security earlier than planned."

Seibert is a representative of **1847Financial**, and a national trainer with **Wealth Building Cornerstones**. He said that his business has blossomed since he positioned himself a few years ago as a retirement income specialist. Recently, he earned his Retirement Income Certified Professional (RICP) designation from The American College and started following the teachings of the College's Wade Pfau—who recently wrote a **paper** on the potential synergies between life insurance and annuities in retirement.

He's trying to deliver those synergies to his new 62-year-old client. As the client approaches retirement, Seibert may recommend that he follow a "covered assets" strategy.

This move involves taking advantage of a client's whole life policy to buy a single or joint-and-survivor income annuity with other savings—but only if the client is healthy and has a substantial life-expectancy. The purchase premium of the annuity and the death benefit of the life policy are roughly equal, so that the client and his family are equally and simultaneously protected from mortality risk and longevity risk.

'C' stands for control

Antoine Orr's clients are likely to be middle-class people who need to get out of debt and save before they invest. Perhaps lacking enough investable assets to attract asset-based advisers, or perhaps very conservative, they're part of the vast market traditionally served by commission-based, insurance-driven advisers.

Antoine Orr

Orr is president of **Plancorr Wealth Management** in Nottingham, Maryland and West Palm Beach, Florida. He's both an insurance agent and an IAR (Investment Advisor Representative), as well as author of the 2009 book, "**Inside the Huddle**," and creator of the **IVEST LLC** marketing system.

"LLC" stands for Liquidity, Leverage and Control. "First, there's liquidity. When you're liquid, you can jump on any opportunity or need that arises without going into debt," Orr told *RIJ*. "Second, we want to find out if you can borrow against an asset without interrupting its growth. The last issue is control: Do you control the outcome, the fees, the preservation of the asset, and taxes on the back end? Most people don't have liquidity or leverage or control."

Orr said that his clients often "feel powerless on the way to prosperity." They're contributing to 401(k) accounts, making extra mortgage payments, and paying down credit card debt.

But they're also paying fees and interest and accumulating a future tax liability. "People feel like they're held hostage by their finances, and I'm there to help them negotiate their way out of that. I say, 'Only put money in to stocks after you've paid down your non-mortgage debt, strengthened your free cash flow, are highly liquid, and have leverage and control over your assets.' Once we've taken care of the foundation, then we can talk about stocks and P/E ratios. Even if they don't make money there, they'll be OK."

Right-size the lifeboats

If you've never sold insurance or you consider Treasury bonds too stingy with yield, or if you don't like "products" and never accept commissions from life insurers, then the strategies described above probably won't make much sense to you. They may seem too safe or, in the case of insurance, too self-serving.

Indeed, carrying a lot of whole life insurance or inflation-protected bonds may also seem absurd—like sailing on a ship with lifeboats bigger than the ship itself. But none of the three experts cited here suggests that safe assets should constitute the bulk of every portfolio.

My big takeaway from talking to these three retirement specialists is that most people, particularly younger workers and pre-retirees, should make sure they have a foundation of safe assets *before* they start taking risks. As many people learn the hard way, it's much easier to establish a safe foundation before a crisis than after a crisis begins.