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STRATEGIES

Consider life insurance as an asset class in your portfolio

Last year brought some brutal economic lessons. Asset classes such as municipal bonds went down in value, as did all equity investments. Many people who thought their home was a safe investment were disappointed. We found out that some of our largest financial institutions were writing credit default swaps and not reserving to pay claims.

Stocks rise and fall on a daily basis, creating market volatility for which some investors — because of age or risk aversion — are ill-prepared to handle.

But an investor with a long-term time horizon can be rewarded. For example, the 30-year period starting in 1977 provided total annual equity returns from large-cap stocks of 12.27 percent. Remember that inflation, taxes and fees can erode those nominal returns. During the same period, inflation was an annualized 4.45 percent and taxes further reduced returns by another 2.63 percent. The combination reduced an apparent double-digit return to a real compounded return of 5.19 percent.

Most observers think we're headed into a period of both higher inflation and increases in the level of state and federal income taxes. So what asset class should be considered that reduces both volatility and taxation? The answer may surprise you.

When added to a portfolio, life insurance can build value for both retirement planning and wealth-transfer planning while reducing overall portfolio volatility.

Life insurance is an ideal vehicle to integrate into a balanced portfolio as a separate asset class. It will provide cash in the form of a death benefit. The cash value can provide the policy owner with retirement income with the same volatility as a bond alternative under more tax-favored with-

Personal Finance



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drawals.

This retirement stream can be used for income, mortgage payments or long-term care. The tax-deferred cash accumulations can be accessed income tax-free.

Most importantly, the death benefit is based upon an event unrelated to what happens with the stock or bond

markets. There are many people whose family's net worth shrank dramatically in 2008, and many of those don't have the time needed to recover their lost sums.

Consider the case of Carol, 79, who has an investment portfolio with stock in XYZ company worth \$1,040,000. She has held the stock in her late husband's company for many years and has seen a large portion of its value decline. She expects it to grow about 4 percent per year over time.

Her life expectancy is 14.3 years, but it will take 23.4 years to recover its 2007 value. If she were to liquidate her stock position and purchase a single-premium guaranteed life-insurance death benefit of \$2,067,661, with the after-tax proceeds she could rebuild her estate without worrying about the volatility of the market.

The life insurance also creates an income tax-free death benefit.

To provide income beyond Social Security during retirement, many people rely on employer-sponsored plans, investments and life insurance. As the time to retirement gets shorter, it's wise to scale back on more risky investments and increase the allocation to less-volatile components.

If you include cash-value life insurance

as part of your fixed income allocation, you'll get both tax-free income at retirement and a death benefit for your spouse or heirs.

A 65-year-old man purchasing a \$1 million life insurance policy, with a guaranteed annual premium of \$25,999.86, would have a 5.88 percent after-tax return on his death benefit at his life expectancy of 85.

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The answer may surprise you.

Life insurance as any asset class must be managed, but the components are a little different. Modern life-insurance policies contain many useful features. Depending on whether you use universal, whole life or "no lapse" policies, they may include options such as flexible payments, the ability to select and manage the underlying sub-accounts and the ability to change the desired death benefit.

Many of today's policies also provide for current expenses that are substantially lower than those guaranteed in the policy. Because the insurance company has the right to change the expenses imbedded in the policy, it's always wise to monitor the performance of what you bought to ensure the optimal outcome.

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