

Safe Money Advisory



Some Myths Never Die

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You get a call from your broker or someone else that wants you to invest money. You're told that you can expect a double-digit return and there is no risk. No doubt the "sales pitch" will be more subtle but the proposition is the same: above-market return with low or no risk. *The one immutable law of investing is: Risk and Reward always travel together.* This means the promise of high returns always carries above-average risk, and rock-solid safe investments always have relatively low returns. Nonetheless, there is an eternal myth that somehow this immutable law is not always applicable. Let's look at a couple examples.



The "life settlement" investment is gaining in popularity, because it promises above-market returns and low risk. A life settlement is an investment in other people's life insurance policies whereby you're entitled to the payment upon their death. The "pitch" is that the life settlement investment is "fractionalized" and contains small shares of hundreds of life insurance policies. Those "insured" are generally people who no longer need, or cannot afford, the life insurance and whose medical lives have been estimated to be no longer than ten years. Since the buyers of the life policies are responsible for the continuing life insurance premiums needed to keep the policies in-force, a "reserve" is created from the money invested to cover these payments. So where is the risk? What would happen if the underwriters miscalculated, accidentally or purposely, the remaining medical lives of the pool of insured people? Or what if the medical profession has a breakthrough and a major cause of death becomes treatable? If the insured do not die on time, the premium reserves may be inadequate which force investors to pay out-of-pocket to protect their investment. What's more, longer lives lower or erase the return on the investment. If there is fraud, the situation could get ugly in a hurry. And, since you're not the one doing the medical underwriting, managing the premium reserve and collecting the death benefits, there is ample opportunity for mismanagement and fraud. So, when you hear about a 12% return from life settlements, remember that *risk and reward are traveling companions.*

Another undying myth is that you can make more money with little long-term risk if you put your money in the stock or bond markets. Historically, this appears to have some validity, but the record is far from consistent. Granted, the odds of doing well are on your side, but there is still a meaningful probability of significant losses. For example, since 2000 there have been two major market meltdowns: first was the 2000-02 dot com bubble burst that dragged the Dow (the primary indicator of market performance) down by 50%, and second was the Great Recession of 2007-09 when the Dow dropped 50% from 14,000 to 6,500. Looking back ten years from September 2009, consumer prices have risen 29.26% -- meaning what cost \$1 in 1999 now costs \$1.29. After adjusting the Dow for inflation, the market today is 29% lower than ten years ago and at the same level as early 1997. Twelve years of zero gains represents about one-half the normal time spent in retirement. If this outcome is unacceptable to you, then the market's risk is not suitable. Again, the opportunity for higher returns long-term also means higher risk.

The Ponzi schemes surfacing in the Great Recession are proof positive that investors are lured by promises of higher-than-market earnings, yet fail to recognize the risks. The risk-reward law says no investment magic, no undiscovered secret, and no mastermind that consistently avoids losses while earning above-market returns. Thus, if you're in or near retirement and cannot afford to lose any of your hard-earned savings that will support your non-working years, you must not be blinded by the promise of higher returns with no or low risk. Investors are generally motivated by two forces: greed and fear. If you've lost a big chunk of your retirement savings to the recent market meltdown, the *fear* of a reduced retirement and the *greed* to make up losses quickly can be dangerous. You can avoid the temptation by linking up with a financial advisor of your choice and selecting safe places for your retirement money. One last word, while bank CDs are rock-solid safe and you'll never lose money, they are generally not a suitable place for *all* your retirement money because of their low rates and the tax treatment of earnings. Again, consult your financial advisor, because there are other safe alternatives that are appropriate for retirement savings.

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