OPUS
Advisory Group, LLC

Opus Advisory Group, LLC
2500 Westchester Avenue
Purchase, NY 10577
914-825-1000
fax 914-251-0345
info@opusadvisory.com

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"The wise man does at once what the fool does finally."
- Niccolo Machiavelli

Sully-nomics

"Sully" is Capt. Chesley Sullenberger, III, the pilot of US Airways flight 1549, who flawlessly executed an emergency landing of his Airbus A320 in the Hudson River on Jan. 15, 2009, preserving the lives of all 155 passengers on board. As a result of his heroic response, Sully became an instant celebrity.

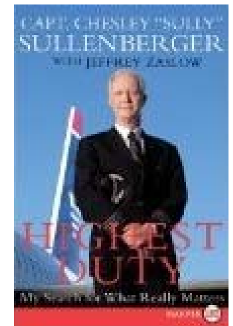
Unlike many media-manufactured celebrities, the individual behind the deed turned out to be just as impressive. Speaking with genuine modesty, Sullenberger credited his training and vocational commitment as the elements that prepared him to perform coolly under pressure. The public's positive response to Sullenberger's action and his explanations created a demand for more information. This summer Sully collaborated with *Wall Street Journal* writer Jeff Zaslow to write ***Highest Duty: My Search for What Really Matters***. The book, released October, 2009 not only recounts the details of the emergency landing, but devotes significant time detailing the upbringing and character-shaping events that equipped Sullenberger to handle the challenge of safely landing a plane on the water with both engines out.

"In so many areas of life you need to be a long-term optimist, but a short-term realist."

For Sully, the ability to perform the unexpected under pressure was the result of a lifetime of preparation. In an October 14, 2009 *WSJ* column about writing the book, Zaslow discusses Sullenberger's diligence in preparing for circumstances he might face as a pilot. This diligence was more than safety checks or reviewing accidents experienced by other pilots. Sully also believes one aspect of preparing well is having the right mindset. He tells Zaslow:

"In so many areas of life you need to be a long-term optimist, but a short-term realist."

When you consider it, being a long-term optimist and short-term realist is a pretty solid financial philosophy as well. Things may happen, some of them bad, some of them good. Some issues may be hazardous, other benign. But on the whole, if the short-term items are handled appropriately, the long-term prognosis is overwhelmingly favorable.



This perspective usually resonates with people; at a gut level they know it is true. But quite often, other perspectives on personal finance subtly influence us to ignore or override this approach, particularly the short-term realist part of the equation.

Here's an example: When asked, what do most Americans state as their primary financial objectives? The frequent answer: "Retirement." This is certainly a worthy long-term objective. But applying Sully's mind-set, what's the best way to prepare for positive long-term success? By addressing the short-term issues realistically.

Realistically, one of the best ways to sustain a long-term saving plan is to first establish some cash savings, typically equal to three to six months of income. A financial cushion can absorb unexpected expenses without requiring either an end to long-term saving or expensive withdrawals from a retirement plan.

Realistically, one uninsured incidence of disability longer than 30 days could seriously delay or derail any retirement plans. Implementing a disability income replacement program solves this short-term challenge.

Realistically, the best time to buy life insurance is when you are young, healthy and most insurable. If circumstances deny you the time to build a retirement fund, life insurance steps in to replace your earning and saving potential.

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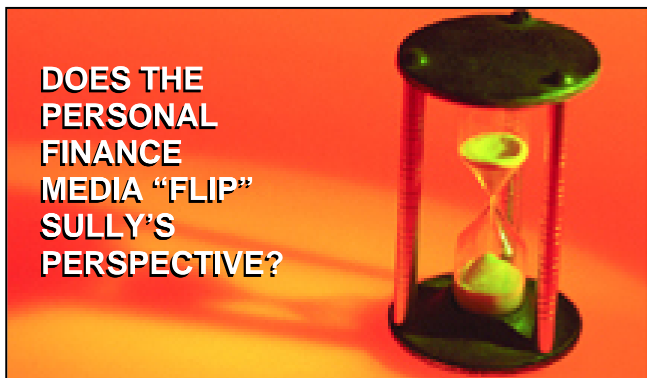
Realistically, the longer debts remain outstanding the greater the long-term lost opportunity costs that compound against you. Planning (and acting) to become debt-free is a short-term action that will undoubtedly deliver long-term dividends.

Realistically, some of this might sound boring, and not very sophisticated. But when you consistently address your short-term economic realities, it makes you a long-term optimist.

DO YOU WANT TO GIVE YOUR LONG-TERM PROSPECTS THE BEST CHANCE TO SUCCEED?
BE *DILIGENT* ABOUT YOUR SHORT-TERM FINANCIAL REALITIES.



Just for fun, check the covers of the most popular personal finance magazines at your local bookstore rack. What do you see? How about these headlines, culled from current issues:

- **"Put Off Retirement? No Way!"**
- **"The Best Time to Invest in a 401(k)? Now!"**
- **"How to Be a Better Investor"**

A sizable chunk of words, column space and conversation in the personal finance media is devoted to long-term activities, like investing and retirement planning. Nowhere to be found in the headlines or as a lead story: debt, disability, life insurance, emergency savings. Even the things to do "now" (i.e., the supposed short-term things that require immediate action) are really long-term items. **Why don't the short-term realities get more ink?**

Perhaps personal finance magazines figure most of their readers have already taken care of their short-term financial realities. But any quick study of Americans' financial habits will find most of them underinsured, deficient in savings and carrying significant debt.

Another possibility is the feeling that long-term financial issues, like saving for retirement, must be addressed even if the short-term realities aren't under control: better to start making deposits in a 401(k) at an early age and possibly have to borrow from the account than wait until the short-term issues, like debt and insurance, are resolved.

It's not that the majority of the financial media is against savings accounts, insurance, or debt reduction. Probably the biggest reason the short-term financial issues receive less attention is because they aren't attention-getting. There are no extraordinary gains, or tantalizing potential fortunes. The short-term issues are not often inspiring or heroic.

Interestingly, Sully acknowledges the ordinariness of his own situation, saying he is not comfortable with being called a hero for his actions. "A hero runs into a burning building," he says. "Flight 1549 was different because it was thrust upon me and my crew…I don't know that 'heroic' describes that. It's more that we had a philosophy of life, and we applied it to the things we did that day."

Sully received correspondence from people saying similar things. One that he found most touching said:

"It's clear that many choices in your life prepared you for that moment when your engines failed.

"There are people among us who are ethical, responsible and diligent. I hope your story encourages those who toil in obscurity to know that their reward is simple – they will be ready when the test comes. I hope your story encourages others to imitation."

Heroic incidents, including financial successes, are inspiring. It is good for us to know about them. But much of the success we see has a **foundation of diligence and preparation.** And it wouldn't hurt if the process of laying a successful foundation received a little more press.

5- MINUTE FINANCIAL THOUGHT:

What if you decided to commit a small percentage of your annual income (1 percent or less) to the establishment of a long-term legacy project? The end result could be an inheritance, or a bequest to a favorite institution or charity. It might take the form of an endowment, proceeds from a life insurance policy, or something else. Who knows how your diligence and commitment with 1 percent or less of your income might benefit future generations?

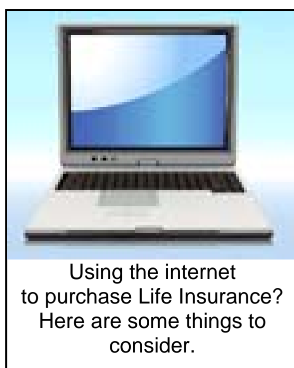
Q: CAN YOU BUY LIFE INSURANCE ON THE INTERNET WITHOUT THE ASSISTANCE OF A FINANCIAL PROFESSIONAL?

A: Maybe, but is this a good thing?

Along with advertising for automobiles and beer, there are several commercials in heavy rotation on cable sports channels for insurance. One ad features an animated "virtual world" where consumers can meet all their insurance needs with a click of a button on their computer. Another ad shows a make-believe insurance "grocery store" with consumers choosing their products off the shelf, and paying at a check-out counter, where they are met by a perky cashier.

One of the driving ideas behind both commercials is that technology, primarily the internet, is changing the way people obtain insurance. Consumers can shop nationwide for the best coverage, and they don't need an agent to do it. Currently, the primary offerings from this direct-to-the-consumer business model are auto and homeowners insurance, along with some term life insurance.

The internet is definitely changing consumer habits, but can the average consumer really buy life insurance as simply as they buy groceries? Probably not, because while technology can certainly change the factors that determine customer decisions, some of the factors needed to obtain insurance, particularly life insurance, are not affected by technological change.



Using the internet to purchase Life Insurance? Here are some things to consider.

The Economic Impact of Internet Technology – what it affects, and what it doesn't.

Internet technology changes geography. Before the internet, the ability to conduct a nationwide (or worldwide) search for many products and services was impossible. As an example, most people wanting to buy a car checked with their hometown dealers or scoured the classified ads in local publications. Because shopping for rare or unique automobiles often required finding specialty brokers or people who had insider connections, most buyers were limited to what was locally available.

Today, even local automobile dealers use the internet to offer a nationwide search and delivery of vehicles to their buyers. In theory, it is now possible for every for-sale automobile to be available to every prospective buyer in America. The local and national marketplaces are one and the same.

Internet technology causes commoditization. Commoditization occurs when a product or service reaches a point where there are no features that differentiate it, and consumers buy on price alone. As a Wikipedia entry puts it, with commoditization "a product is the same no matter who produces it, such as petroleum, notebook paper, or milk. In other words, copper is copper."

Watching the above-referenced insurance commercials, commoditization is definitely in play, because lower prices are prominently featured in the message. In other words "auto insurance is auto insurance," and the "best" auto insurance policy is the one with the lower premiums.

Internet technology simplifies the purchasing process by eliminating brokers and distributors. One of the selling points of internet commerce is the "direct-to-you" aspect. Want to find the cheapest price for a hotel room? You don't need a travel agent or broker. You can negotiate your own deal by communicating directly with the innkeeper. Similarly, if you want a price for automobile insurance, just enter some information on-line, and within minutes you'll receive quotes from several companies via e-mail. This means brokers (such as insurance agents) are no longer needed to serve as gatekeepers and interpreters of unique or specialized information.

How does Internet Technology Affect the Purchase of Life Insurance?

The prevalence of the internet and personal computers may make it possible for a consumer to access a torrent of information about individual life insurance programs, but it's questionable whether that information can be processed to good effect if it is not accompanied by professional assistance. Consider the following:

The geography doesn't change. Because most life insurance transactions are regulated by state as well as federal laws, there isn't really a significant change in geography due to technology. Insurance companies may be nationwide, but the purchase of policies is still local. Texas residents must purchase life insurance from an agent and/or company approved to write business in Texas. Although many states have reciprocity agreements and agents may be licensed in more than one state, the fact remains that the availability of some life insurance products varies from state to state. So knowing that someone in California has a unique, low-priced policy doesn't mean you can buy it in Illinois – even if the company is licensed to operate in both states. Essentially, regulation blunts the shrinking geography effect of internet communication.

Life insurance is hard to commoditize. Whenever a product or service becomes commoditized, the usual results are price wars and slimmer profit margins. To avoid commoditization, companies constantly try to

find ways to differentiate their products and services. 87-octane gasoline may be a commodity, but producers will attempt to differentiate their 87-octane fuel by adding cleaning agents, operating in prime locations (such as interstate highway exits), or offering rewards to frequent buyers. Any one of these "value-added features" creates some differentiation and may allow the supplier to charge a premium for the product.

Of all the financial products in the market place, life insurance is one of the most complex; a lot of factors figure into the makeup of a particular policy. This complexity makes it easy for insurance companies to find ways to differentiate their life insurance offerings. Thus, even when most aspects of the policy seem the same (such as the coverage amount or the length of term), it is difficult to make an apples-to-apples comparison between two policies. It's hard to say "life insurance is life insurance."

The other factor in a life insurance purchase is **you**.

Even a "simple" term life insurance policy can include riders or amendments, such as waiver of premium, accelerated benefits provisions, conversion credits, and future purchase agreements. When the policy in question includes a cash value component (as with whole life or universal life), the differentiating features expand. There may be dividend options, loan and withdrawal provisions, surrender values, etc. The inclusion of investment options, which are available in variable life policies, only adds another level of differentiation.

The other non-commoditized factor in a life insurance purchase is **you**. Your health and other aspects of your life figure into whether you can obtain coverage. Insurance companies can adjust their underwriting criteria, thus allowing or limiting access to certain features. This selectivity may range from additional fees (i.e., "table ratings"), to coverage limits (both maximum and minimum) and discounts for non-tobacco users or good drivers.

Since any one item listed above can change either the cost or performance of a life insurance policy, there is a high degree of differentiation. Rather than being a commodity where it's hard to tell one item from another, life insurance policies are almost like fingerprints: they all contain some common features, but each one is unique.

Most people need the assistance of a life insurance agent. Because life insurance is a complex product and because the purchase of it is typically infrequent, buying life insurance is not as easy as walking down a grocery store aisle and grabbing something off the shelf. In order for your life insurance purchase to help you reach your financial objectives, it is almost essential that competent and trustworthy brokers (i.e., life insurance agents) are part of the decision-making process.

The various components in a life insurance policy are based on rational financial principles, and separately, these concepts (shared risk, time value of money, opportunity costs, etc.) aren't hard to grasp. The complexity of life insurance comes in the way these financial principles can be configured, both to construct a policy, and to meet your financial objectives. For example, a desire for a high level of immediate protection may prompt a prospective buyer to consider a term insurance policy. In contrast, someone wanting to maximize inheritance may want the features of a whole life policy.

Imagine what it would be like to shop once every 10 years for a power tool used only in underwater escapes from a sinking automobile. While almost everyone drives, very few people have had to escape from a sinking vehicle in the past 10 years, so this tool, while potentially lifesaving, is probably not something you think about when you wake up each morning. Unless you have a great memory (or keep good notes), you probably don't recall the details of the last time you bought the tool. And it's a good bet the "new and improved" models have features you've never seen before.

Life insurance is the same way. You don't buy it very often, you probably don't think much about using it, and some things have probably changed since the last time you made an application. You could make this a "do-it-yourself" project by logging on to a web site and getting a quote for term life insurance. But how likely is it that a five-minute info-surf is going to resolve a major financial decision regarding a complex financial instrument?

The internet certainly facilitates the process of understanding and purchasing life insurance. Before the Digital Age, agents carried rate cards in their briefcases, and requesting an illustration for a specific policy meant calling the home office, then waiting for a proposal to be sent by mail. Now computers and electronic communication provide instant delivery of all the details. But the other aspects of life insurance still require a personal touch. The processes of providing life insurance may change with technology, but life insurance is not ready to become an "electronic grocery-store" purchase.

"If I have seen further it is because I have been standing on the shoulders of giants."

- Sir Isaac Newton

HOMEOWNERSHIP AFTER THE BUBBLE: ASSESSING THE "-IC" FACTORS

Suppose you owned an asset with a market value of $500,000 in 2007. Because of the economic turmoil of the past two years, that same asset is worth $300,000 today, and is rather illiquid – i.e., there aren't very many buyers, even at the reduced price. Suppose this asset is your home.

Is it likely that your home, and other personal residences, will regain their lost values? And if so, how long will it take?

Providing accurate financial predictions for the future is difficult even for experts, but residential real estate is particularly hard to figure because the issues impacting homeownership go beyond falling prices. In fact, it's possible to consider that the United States is on the cusp of a great societal change regarding the "American Dream" of owning one's home. And since a personal residence often constitutes both the biggest purchase and largest asset in many Americans' financial lives, the future of residential real estate could have a significant impact on their overall financial well-being. Some things to consider…

A Quick Recap of the Bubble:

Encouraged by government programs to expand homeownership for all Americans, lenders were able to make loans to home buyers with poor credit, questionable income and limited savings. As more people became prospective homeowners, the demand for residential housing went up, both for existing homes and new construction. Increased demand drove a subsequent increase in real estate construction and prices, and the housing boom was ignited. According to the Case-Schiller U.S. National Home Price Index, average residential home values increased almost 90% from 2000 to 2008, an annual increase of just under 8%. In some parts of the country, the increase was even higher.

Alas, the economy softened, and many of the new homeowners with poor credit, questionable income and limited savings proved unable to make their mortgage payments. Large numbers of defaults led to a flood of foreclosures, many of which were unloaded by lenders at steep discounts. With fewer qualified buyers and a glut of homes available at reduced prices, the bottom fell out of the market. The degree of decline varies geographically, but decreases of 30% from 2007 highs are common, with some areas seeing drops as steep as 80%.

Economic Factors

The fallout from declining real estate values has been predictable. First, there are fewer qualified buyers. While reduced prices have motivated some people to buy new homes, the recession has sharply reduced the number of qualified homebuyers – more households are unemployed, under-employed, in transition, or broke. Second, to avoid repeating previous mistakes, banks have understandably tightened their lending requirements, meaning obtaining a mortgage isn't as easy as it used to be. The end result is a significantly reduced pool of prospect buyers for residential real estate.

A shrinking pool of prospective home buyers makes it harder for existing homeowners to move up, or simply sell their home. When residential real estate was booming, it wasn't just new homeowners that were buying and selling. Existing homeowners saw a chance to leverage their increased values by trading up to more expensive homes. But with depressed prices, existing home sellers often won't net enough equity to trade up. And those who would like to sell their home (because of a job change, retirement, or other issues) are finding they can't afford to take the financial hit of selling in a down market – it makes more sense to stay where they are, or rent out the home.

Geographic Factors

In certain parts of the country, "out migration" is occurring, i.e., people are leaving the area, and overall population is declining. In some areas, the migration reflects declining employment opportunities (such as Rust Belt automotive communities), while other migration may reflect subtle changes in the way people live in the 21st century (more on this in the "Demographic" section). But in any place where the population is declining, the numbers of potential homeowners drop as well, and there's a strong likelihood housing prices will decline.

The Demographic Factors

Another factor affecting residential real estate is the changing nature of residential housing, particularly as the Baby Boom generation swells the ranks of retirees. Since the end of World War II (and the start of the Baby Boom), the major residential housing trend has been a steady migration to suburban living – stand-alone, one-family residences in subdivisions. According to a September 19, 2009 *Wall Street Journal* article by Glenn Ruffenach, nearly half of the U.S. population lives in suburbs. These neighborhoods "may have been

a good place to grow up. But the suburbs are proving a tough place to grow old." He continues:

> "Indeed, as the country ages, suburbia's widely assumed benefits — privacy, elbow room, affordability — tend to vanish. Maintaining yards and homes requires more effort; driving everywhere, and for everything, becomes expensive and, eventually, impossible. (Research shows that men and women who reach their 70s, on average, outlive their ability to drive by 6 and 10 years, respectively.)"

Suddenly, the seclusion of "place of our own" is seen as isolation from extended community. What happens to the residential real estate market if most of America doesn't want to live in a subdivision anymore?

The Historic Factors

From 1900 to the end of World War II, the national homeownership rate remained remarkably stable at slightly less than 50%; a 1997 report by the Fannie Mae stated the rate was never lower than 43% or higher than 48%. Fueled by the Baby Boom and government-sponsored incentives following the war, the homeownership rate jumped dramatically, rising to 64% in one generation (by 1964), and has remained at this level since.

Is it possible that homeownership might return to numbers similar to the first half of the 20th century? Perhaps. However, as baby boomers age, there may not be enough new homeowners to buy their homes. If the government decides to overhaul the income tax code and eliminate some incentives, some of the mathematical rationale for owning your own home could change.

Dealing with the "ic" factors

For the past few decades, buying a home has been touted as a smart financial decision. The expectation of steadily increasing values, the ability to sell and leverage up to a better home, the access to equity through home equity lines of credit, and favorable tax treatment of mortgage interest led many realtors (and homeowners) to boast "your home is your biggest asset." Events of the past two years may cause some reassessment.

For many individuals, there is immeasurable intangible value in owning one's home. This alone could provide justification for buying a home, even taking a mortgage. But while everybody needs a place to live, many of the wealth-building arguments for homeownership might merit a re-examination in light of the changing landscape, both economically and sociologically.

If the particulars of your situation are changing your view of homeownership, there may be ripple effects to other parts of your financial life. You may want to save differently, restructure your mortgage, or adjust your investment priorities, and look at other opportunities.

Those sound like good reasons to meet with your financial professionals, and consider ways to address how the "ic" factors of homeownership may affect you.

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