THE ALTFEST ADVISORY LETTER

Altfest
Personal Wealth Management

Homeowners Insurance: Why You're Likely Paying Too Much for Inadequate Coverage

BY ANDREW ALTFEST, CFP®
ALTFEST EXECUTIVE VICE PRESIDENT AND MANAGING DIRECTOR

I recently reviewed a few of our clients' homeowner insurance policies. In each case, the policies contained unnecessary costs and inadequate coverage. With this in mind, I'd like to share some common insurance problems you can avoid.

Insurance planning is inefficient, partly because property owners are asked to make their own insurance decisions. This entails looking at all risks covered by policies — dwelling, contents and personal liability — then deciding how to address these risks most efficiently, now and in the future. It would be natural to think your broker or agent

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IN THE NEWS

FT FINANCIAL TIMES | Top Financial Advisers 2017

Altfest Personal Wealth Management is pleased to announce it has been named to the 2017 edition of the Financial Times 300 Top Registered Investment Advisers. The list recognizes top independent RIA firms from across the U.S.

THE CURIOUS CASE OF MYSTERIOUSLY MOVING MARKETS

BY SUSH PODDAR
ALTFEST INVESTMENT STRATEGIST

Risk and return – fear and greed – are two sides of the same coin that drives a prudent investment decision. The prospect of a superior return propels high expectations, a.k.a. the greed of market participants, whereas the risk of loss acts as the counterbalancing fear factor. Understanding the merits of a potential investment – separating the wheat from the chaff given a set of opportunities – requires that the perceived risks be quantified and pitted against the expected upside.

The Chicago Board Options Exchange Volatility Index (VIX) is a popular measure for quantifying risk within the US equity market. It reflects investors' appetite for risky assets. A higher level of VIX can be linked to an elevated level of fear. Conversely, a lower level of VIX reflects a deeper level of complacency. Roughly speaking, the CBOE VIX Index captures the market participants' estimate of the equity market volatility over the next one month. When VIX is high, investors expect returns to be more uncertain over the next month, and when VIX is low, markets are anticipated to be calmer.

So where does VIX stand today? How does it compare to the past? What does it tell about the investment landscape today? Importantly, how is it effecting our investment decisions in managing your wealth?

Since its inception in early 1990s, VIX has averaged around 20. The lowest level experienced by VIX has been about 10. Occasionally during times of market panic, it has spiked up in the 40s. Periods of the equity market capitulation, when VIX has skyrocketed above 40, included 1998 (the Russian Debt Crisis), 2002 (the market correction following the Internet Bubble crash), and 2008 (the Global Financial Crisis).

In the post Financial Crisis era, the overall level of VIX has been quite low, and recently it's been hovering around 10 – in the neighborhood of its all-time lows. As a matter of fact, during the first couple of weeks in May, VIX ventured to levels below 10, reflecting an extraordinary level of contentment in the market. Corporate earnings for the first quarter of 2017 have been phenomenal. Equity valuations in the United States of late had been reflecting high flying expectations around earnings as well as policy reform. The earnings numbers

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already did this for you, but it might not be so simple.

First, the insurance you have will vary depending on whether you are working with a captive or independent insurance agent or broker. A captive agent works for a single company, and might not give quotes for the entire market. Independent agents and brokers work for more than one insurer, and can quote multiple companies' rates.

Which should you choose? The right answer is both. A captive agent might have limited selection. Independent agents can quote rates for more insurers, but might not be able to present a quote for the insurers exclusively represented by a captive agent. No matter whom you choose, the work on policies often is frontloaded. This means most of it is done in the beginning of the client relationship, then is too infrequently revisited to check for gaps or better options.

Here are some of the disconnects from the client homeowner policies I've reviewed that you can avoid.

Paying too much

Below are a few areas to look for cost savings:

<u>Deductibles:</u> Often, insurance policies give several levels of deductible options, meaning the amount of loss you must absorb before insurance kicks in. I have seen deductibles range from $1,000 to $25,000. I often recommend higher-deductible plans, and here's why. In one example I saw, raising a deductible from $5,000 to $10,000 reduced the policy's annual premium by over $1,100 per year. That means if you do not put in a $5,000 claim for five years, you will have saved money by having a lower premium. Note that policies can have different deductibles for riders and optional coverages – evaluating each can save you money.

<u>Contents:</u> Policies are initially quoted with off-the-shelf coverage, such as for contents and other structures (brownstone owners generally don't need coverage for a garage). Because contents is quoted as a percentage of a home's insured value, typically at 50 percent or 70 percent, you might be quoted a policy with contents coverage well beyond the value of your possessions.

<u>Discounts:</u> Homeowners insurance costs can be further reduced by bundling coverages with a single carrier. Also, umbrella/excess liability insurance can be heavily discounted for a group.

Inadequate Coverage

Many policies do not provide enough coverage. I just reviewed a 10-year-old policy with an amount of coverage only one-quarter of the replacement value of the house. In the event of a devastating fire, the homeowner would have been out more than $1.5 million.

Here are a few more things to keep in mind when reviewing your coverage:

<u>Replacement cost:</u> Most policies offer "replacement cost" coverage. This means the carrier will pay to rebuild your house or apartment when there is a qualifying claim. However replacement-cost coverage does not ensure adequate coverage. Insurance companies will only reimburse to your home's insured value. Many insurance companies will not send an appraiser to look inside your home, so the replacement cost of above standard finishes might not be reflected in a policy's insured value. More generous coverage might include "guaranteed replacement cost," which will cover the full rebuild amount. However, your enhanced replacement cost coverage might not be as generous as you think. Check whether there are limitations, such as caps of 115 percent or 125 percent of the home's insured value. Even if you have guaranteed replacement cost with no limits, take a close look at your home's insured value. In the event of a disaster you might decide to be paid a lump sum instead of rebuilding. I have found that insurance companies can be too conservative with their building assumptions, particularly in high cost areas.

Whichever coverage you have, make sure you have inventoried your contents, listing them, providing serial numbers, and by taking photos. Even photographing your interior finishes is a good idea.

<u>Loss Assessment Coverage:</u> If you own an apartment, check to see whether you have enough loss assessment coverage. Loss assessment coverage protects you from a building assessment due to your building having inadequate coverage when the building is damaged or someone has been hurt on premises. Your loss assessment coverage should be tied to your building's Master Policy.

So what should you do next? Revisit your policy. Shop it for quotes with multiple brokers and agents. Bring it to your next review meeting with our firm. You might find several ways to reduce cost and increase coverage.

Andrew Altfest is a leading voice on the firm's Portfolio Action Group, which sets strategy for investments. He leads the firm's efforts in the tax management of portfolios. In 2012 and 2013, Andrew was named to Financial Advisor's Due Diligence/Research Manager All-Star Team. Andrew's commentary has been featured multiple times in influential publications. He earned an MBA from Columbia University's Graduate School of Business and a BA with honors in English from Cornell University.

THE CURIOUS CASE OF MYSTERIOUSLY MOVING MARKETS

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surely did not disappoint! Interestingly, not only the US corporate earnings, but also the global earnings surprised on the upside, pointing to a much longed for indication of a synchronized global economic recovery. Many reasoned: economics trumps politics. Yet, there has been an awkward anxiety about the US equity markets' calm given the high valuation levels and a seemingly mercurial populist movement across the globe.

The placid tranquility of the US markets was finally deflated in the third week of May as political uncertainty piqued. Firing of the director of the FBI, followed by the naming of a special prosecutor to independently investigate Russia's attempts to influence US elections led market participants to question the administration's ability to push for tax and other reforms in a timely fashion in this acrimonious environment. VIX jumped by 60% – from 9.8 on May 8 to 15.6 on May 17. While the VIX has trended back since then, the episode revealed the market's vulnerability to geopolitical shocks, despite the improved economic backdrop.

In our portfolios, we have taken advantage of the lower VIX levels by purchasing a modest protection against significant market drops. When VIX levels are higher, purchasing insurance (put options) on downward market moves becomes costlier -- think about buying insurance on a house when a wildfire is raging nearby. On the contrary, buying protection becomes cheaper when VIX is lower, analogous to buying insurance in a safe neighborhood where the insurer's assessment of wildfire risk is low. The currently low-VIX environment gives us an opportunity to protect some part of our portfolio at a lower cost.

As is true for any other insurance product, when buying insurance in the financial markets we have to consider the probability of an anticipated hazard as well the cost of insuring against it. What kind of event are we trying to protect against -- is it a comet-hitting-the-earth type, a cataclysmic event? Or, is it just a bump in the road? Or, is it somewhere in between?

Given the strong economic backdrop currently in place, we think that a comet-hitting scenario is farfetched. Similarly, there is perhaps little use to spend precious resources (dollars) on trying to insure against minor upheavals in the market. Finally, buying pure downside protection, even when VIX is at a historic low, is still costly. Financing this purchase is a nuanced decision that needs careful consideration and execution. We have opted for a modest level of protection in place for now. In addition to providing a cushion during down markets, it should act as a source of funding that we can tap into and purchase attractively priced assets if liquidity shocks hit the markets.

Sush Poddar is an Investment Strategist at Altfest. Prior to joining Altfest, she was an Executive Director at a large investment bank, where she spent a decade as a Trading Desk Strategist. She holds an MBA in International Finance from Thunderbird School of Global Management at Arizona State University and a Bachelor's degree in Computer Science & Engineering from Osmania University, India.

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BARRON'S TOP 100 INDEPENDENT FINANCIAL ADVISORS IN THE NATION 2013, 2014 2015, 2016

THE ALTFEST ADVISORY LETTER

In This Issue:

E-mail rrezvi@altfest.com to receive the next Altfest Advisory newsletter via email.

ALTFEST PERSONAL WEALTH MANAGEMENT: IN THE NEWS

1. Altfest Personal Wealth Management has been selected by *The Financial Times* as one of the "Top 300 Registered Investment Advisors" in the US.

2. Lew Altfest offered some thoughts for entrepreneurs who contemplate opening their own investment management firms, in the *CFA Institute Magazine* article "Firm Commitment."

3. Andrew Altfest was quoted in "Overhaul Your Portfolio as Interest Rates Rise" in the *US News and World Report* and *Yahoo! Finance*.

4. Karen Altfest was recently interviewed for *The Wall Street Journal* piece, "Tax Moves to Make Now, Ahead of Potential Overhaul." A related article will soon appear in *The Bottom Line*.

5. Steve Cadoff offered some comments regarding housing opportunities for retirees in the *Bankrate.com* article "4 reverse mortgage loan secrets of wealthier retirees."

6. Financial Advisor IQ featured Karen Altfest in the article, *"How to Take Advantage of Trump's Tax Proposal."*

7. Andrew and Karen Altfest were interviewed for *Financial Planning Magazine,* "Can Handing the Firm to a Relative Work?"

8. Karen Altfest co-hosted a webinar with attorney Marty Shenkman and Dr. Stanley Teitelbaum. The webcast was designed for lawyers, accountants and other financial colleagues to help recent widows and widowers navigate their financial and legal needs.

9. Lew and Karen Altfest contributed to a new book, *The Art of Practicing and the Art of Communication in Financial Planning*.

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