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Retirement ROADMAP

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Tax-Smart Plan for In-Retirement Withdrawals

The following sequence may make sense for retirees to preserve the tax-saving benefits of tax-sheltered investments for as long as possible.

1. For retirees over age 70½, the first stop for withdrawals are those accounts that carry required minimum distributions, or RMDs, such as Traditional IRAs and company retirement plans such as 401(k)s (to avoid paying penalties).
2. For retirees who are not required to take RMDs or have taken their RMDs and still need cash, turning to taxable assets may be an option. A good start may be selling assets with the highest cost basis first and then moving on to those assets where cost basis is lower (and the tax hit higher). Relative to tax-deferred or tax-free assets, these assets have the highest costs associated with them. However, taxable assets could also be valuable to tap in later retirement years because retirees will pay taxes on withdrawals at their capital gains rate, which is generally lower than the ordinary income tax rate.
3. Finally, after taking RMDs or tapping taxable assets, retirees still in need of cash may want to further tap company retirement-plan accounts and IRAs (Roth IRA assets last.)

401(k) and IRA plans are long-term retirement-savings vehicles. Withdrawal of pretax contributions and / or earnings will be subject to ordinary income tax and, if taken prior to age 59½, may be subject to a 10% federal tax penalty. Direct contributions to a Roth IRA are not tax-deductible but may be withdrawn free of tax at any time. Earnings may be withdrawn tax and penalty free after a 5 year holding period if the age of 59½ (or other qualifying condition) is met. Otherwise, a 10% federal tax penalty may apply. Please consult with a financial or tax professional for advice specific to your situation. ▪

Concerned About Longevity?
3 Mistakes to Avoid

Longevity is often cheered as an achievement, but the downside of living well beyond one's average life expectancy is that it can strain (or worse, completely deplete) an individual's financial resources. The first step in addressing longevity risk is to evaluate just how great the odds are that either you or your spouse will have a much longer-than-average life span. Health considerations, family longevity history, employment choices, and income level may all be factors. If you've assessed these considerations and are concerned about longevity risk--or if you've determined that you'd simply rather be safe than sorry--here are three key mistakes to avoid.

Mistake 1 | **Holding a Too-Conservative Portfolio**. When investors think about reducing risk in their portfolios, they often set their sights on curtailing short-term volatility—the risk that their portfolios will lose 10% or even 20% in a given year. But a too-conservative portfolio (one that emphasizes cash and bonds at the expense of stocks) can actually enhance shortfall risk while keeping a lid on short-term volatility. But, right now, interest rates have much more room to move up than they do down, which may reduce the opportunity for bond-price appreciation during the next decade. With such low returns, retirees with too-safe portfolios may not even outearn the inflation rate over time.

Mistake 2 | **Not Delaying Social Security Filing**.* Because it provides an inflation-adjusted income stream for the rest of your life, Social Security is designed to provide you with at least some money coming in the door even if your investment portfolio runs low (or out) during your later years. If you file early (you're eligible to do so as early as age 62), you permanently reduce your annual benefit from the program.

Delayed filing, on the other hand, has the opposite effect, amping up the value of your hedge. Not only will your benefits last as long as you do, but they'll be higher, perhaps even substantially so, as well. Those who delay filing until age 70 may receive an annual benefit that's more than 30% higher than what they would have received had they filed at full retirement age (currently 66) and more than 50% higher than their benefit had they filed at age 62.

Mistake 3 | **Not Adjusting Withdrawal-Rate Assumptions**. Just as savings rates are the main determinant of success during the accumulation years (much more than investment selection, in fact), spending rate is one of the central determinants of retirement plans' viability.

The 4% rule, which indicates that you can withdraw 4% of your total portfolio balance in year 1 of retirement, then annually inflation-adjust that dollar amount to determine each subsequent year's portfolio payout, is a decent starting point in the sustainable withdrawal-rate discussion. But it's important to tweak your withdrawal rate based on your own situation. If you have a sparkling health record and it looks likely that you'll be retired longer than the 30-year withdrawal period that underpins the 4% rule, you may be better off starting a bit lower.

In a similar vein, it's important to not set and forget your retirement-plan variables, such as your spending rate and your asset allocation, because retirement progresses and new information becomes available about your health and potential longevity, market valuations, and so forth.▪

How to Widow-Proof (or Widower-Proof) Your Portfolio

Plenty of people who pass away or become debilitated leave their spouses with overly complicated financial plans, too little information, and no clear instructions about where to turn for help. Below are some of the key ways to make sure that doesn't happen to your family.

- **Start the Conversation.** Even if your spouse is happily hands-off, it's important that he or she is looped in on the basics of your financial plan, including how much you have, your chief financial assets, and what type of withdrawal rate your portfolio can safely support. Alternatively, or in addition to having a money conversation with your spouse, share at least the basic information about your finances with your most financially literate (and trustworthy) child.

- **Simplify.** Assuming a financial plan includes a well-thought-out asset allocation and reasonable intra-asset-class diversification, less may be more in terms of the number of individual holdings. That's particularly true if you're concerned about your spouse's ability to manage the portfolio on his or her own. Of course, multiple accounts with multiple providers may be inevitable in some households, but collapsing your overall number of accounts (and the holdings within them) could be a good starting point on the road to portfolio simplification.

- **Shape Up (and Share) Your Record-Keeping System.** Organizing files in broad, easy-to-understand categories *(for example 'Investments', 'Insurance', and so on)* is a good starting point, with subfiles for each account. Another good idea is to create a master directory, which can be either electronic or paper. It should contain financial assets such as bank, fund, and brokerage accounts; company-retirement plan and pension fund details; real estate holdings, and business interests. Alongside or beneath each account name, include account numbers, URLs, passwords, key contacts, and phone numbers. Include similar details for debts you owe and insurance policies. Having such a document can be a good way to provide your spouse with a 3,000-foot view of your household's finances; just be sure to tell him/her where to find this document and keep it password-protected or under lock and key.

- **Provide Guidance on Where to Go for Cash.** Many surviving spouses may not have adequate cash reserves to fund their near-term living expenses. Stashing too much of your portfolio in cash may carry a steep opportunity cost right now, but every retiree household should aim to keep at least two years' worth of living expenses in true cash. It's also important to provide your spouse with guidance on which assets are most liquid and appropriate to tap in a pinch and which are less so.

- **Put It on Autopilot.** Putting as much of your investment plan on autopilot as possible can allow your portfolio to run itself for a time if need be. A key benefit is that you'll be less tempted to override your carefully laid investment plan at an inopportune time, but another is ease of use. Investigate what options your investment provider has for automating your investment program. Switching on features such as automatic required minimum distributions is a good example of this idea.

- **Help Identify a Suitable Advisor**. Many individuals with spouses who are disengaged financially take comfort in knowing that their spouse will be able to turn to an advisor after they're gone. If you think your spouse will eventually need to turn to an advisor, it doesn't hurt to begin the search for a qualified advisor while you're still around to help with the screening.▪

Financial Aid for College:
A Few Tips

Key to understanding financial aid eligibility is learning how financial aid formulas work. They're rather complex and vary from school to school, but they basically use answers to questions about family income, assets, and size to help arrive at a special number known as the expected family contribution, or EFC. The EFC represents the amount of tuition, fees, and other college costs the family is expected to cover based on its financial situation and other factors. Not all assets are counted when calculating the EFC (for example, assets held in retirement accounts don't count).

Financial-aid awards are based on the previous calendar year's income, so some families use strategies to reduce income the year before applying.

However, income plays a far greater role than assets in determining EFC. As much as 47% of income may be used in calculating a family's EFC, whereas parental assets are assessed at a maximum of 5.64%, and student-owned assets at a maximum of 20%. Financial-aid awards are based on the previous calendar year's income, so some families use strategies to reduce income the year before applying. For example, if one parent is considering retiring or going back to school, doing so will likely reduce the family's income, thus increasing aid eligibility. A parent also may ask that a work bonus be postponed to reduce income that counts against aid.

One common mistake families make is selling securities the year before the student enrolls as a way to cover college costs. But any capital gains from the sale count as income in the following year's financial aid calculation, so it may be best to sell securities the year before the base year (in other words, two years before the student enrolls), when the proceeds won't be counted as income. ▪

This should not be considered tax or financial planning advice. Please consult a tax and/or financial professional for advice specific to your individual circumstances.

Have questions about your Retirement Plan?

We are here to assist you.

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