BURKE
FINANCIAL STRATEGIES
99 Wood Avenue South, Suite 102
Iselin, NJ 08830
(866) 603-3700
(732) 744-1240 Fax
john.b.burke@burkefinancialstrategies.com
steven.criscuolo@burkefinancialstrategies.com
christopher.trainor@burkefinancialstrategies.com
melissa.montalvo@burkefinancialstrategies.com




John B. Burke, MS, CFP®
Financial Advisor

Steven Criscuolo, CPA
Financial Advisor

Christopher M. Trainor, CFP®
Financial Advisor

Melissa Montalvo, CFP®
Financial Advisor

financial $UCCESS

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Pump Up Your Retirement Savings

Don't give up on your retirement goals if you find you've entered middle age with little to no retirement savings. Sure, it may be harder to reach your retirement goals than if you had started in your 20s or 30s, but here are some strategies to consider:

✔ **Reanalyze your retirement goals.** First, thoroughly analyze your situation. Calculate how much you need for retirement, what income sources will be available, how much you have saved, and how much you need to save annually to reach your goals. If you can't save that amount, it may be time to change your goals. Consider postponing retirement for a few years so you have more time to accumulate savings as well as delay withdrawals from those savings. Think about working after retirement on at least a part-time basis. Even a modest amount of income after retirement can substantially reduce the amount you need to save. Look at lowering your expectations, possibly traveling less or moving to a less expensive city or smaller home.

✔ **Contribute the maximum to your 401(k) plan.** Your contributions, up to a maximum of $19,500 in 2020 and 2021, are deducted from your current year gross income. If you are age 50 or older, your plan may allow an additional $6,500 catch-up contribution, bringing your maximum contribution to $26,000. Find out if your employer offers a Roth 401(k) option. Even though you won't get a current year tax deduction for your contributions, qualified withdrawals can be taken free of income taxes. If your employer matches contributions, you are essentially losing money when you don't contribute enough to receive the maximum matching contribution. Matching contributions can help significantly with your retirement

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The Need for an IRA

You may want to contribute to an individual retirement account (IRA) for some or all of the following reasons:

✔ **You'll probably need the additional funds for retirement.** Even with Social Security and pension or 401(k) benefits, you'll probably need other savings to fund your retirement.

✔ **You'll lower your taxes.** You can lower your taxes currently by contributing to a traditional deductible IRA or in the future by contributing to a Roth IRA.

✔ **You're more likely to use the funds for retirement.** If you save in a taxable account, it's easy to use the funds for other purposes. However, the government discourages the use of IRA funds for other purposes by assessing a 10% federal income tax penalty when funds are withdrawn before age 59½ (except in certain limited circumstances).

✔ **You have a wide variety of investing options.** With a 401(k) plan, you typically have a limited number of investment options. However, with an IRA, you can invest in a wide variety of investments. ❍❍❍

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Pump Up

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savings. For example, assume your employer matches 50 cents on every dollar you contribute, up to a maximum of 6% of your pay. If you earn $75,000 and contribute 6% of your pay, you would contribute $4,500 and your employer would put in an additional $2,250.

✔ **Look into individual retirement accounts (IRAs).** In 2020 and 2021, you can contribute a maximum of $6,000 to an IRA, plus an additional $1,000 catch-up contribution if you are age 50 or older. Even if you participate in a company-sponsored retirement plan, you can make contributions to an IRA, provided your adjusted gross income does not exceed certain limits.

✔ **Reduce your preretirement expenses.** Typically, you'll want a retirement lifestyle similar to your lifestyle before retirement. Become a big saver now and you enjoy two advantages. First, you save significant sums for your retirement. Second, you're living on much less than you're earning, so you'll need less for retirement. For instance, if you live on 100% of your income, you'll have nothing left to save toward retirement. At retirement, you'll probably need close to 100% of your income to continue your current lifestyle. With savings of 10% of your income, you're living on 90% of your income. At retirement, you'll probably be able to maintain your standard of living with 90% of your current income.

✔ **Move to a smaller home.** As part of your efforts to reduce your preretirement lifestyle, consider selling your home and moving to a smaller one, especially if you have significant equity in your home. If you've lived in your home for at least two of the previous five years, you can exclude $250,000 of gain if you are a single taxpayer and $500,000 of gain if you are married filing jointly. At a minimum, this strategy will reduce your living expenses so you can save more. If you have significant equity in your home, you may be able to use some of the proceeds for savings.

✔ **Substantially increase your savings as you approach retirement.** Typically, your last years of employment are your peak earning years. Instead of increasing your lifestyle as your pay increases, save all pay raises. Anytime you pay off a major bill, such as an auto loan or your child's college tuition, take the money that was going toward that bill and put it in your retirement savings.

✔ **Restructure your debt.** Check whether refinancing will reduce your monthly mortgage payment. Find less costly options for consumer debts, including credit cards with high interest rates. Systematically pay down your debts. And most important — don't incur any new debt. If you can't pay cash for something, don't buy it.

✔ **Stay committed to your goals.** At this age, it's imperative to maintain your commitment to saving. Please call if you'd like help reviewing your retirement savings program. ❍❍❍

How to Avoid Credit Card Dependence

Ask yourself these questions to evaluate your dependence on credit cards:

✔ Do you rely on credit cards to make it until your next paycheck?

✔ Does it seem you always have to put unexpected expenses on your credit card?

✔ Do you think you spend more than you would with cash because your card has rewards or discounts?

✔ Do the holidays leave you with a mountain of credit card debt?

If you answered yes to these questions, you are probably relying too much on your credit cards. If you are concerned you are too dependent on credit cards, there are steps you can take to become credit card independent.

✔ Put your credit cards somewhere for safekeeping to reduce the temptation to use them as your regular form of payment.

✔ Become more disciplined with spending by enacting a cash-only policy. While many people use debit cards as a convenient way to pay cash, be careful. Many financial institutions will allow you to overdraft your account when you use a debit card and may charge a large fee for this overdraft privilege.

✔ Consolidate your balances to the cards that have the lowest interest rates and close the rest of your credit card accounts to reduce the amount of available credit and, thus, the potential amount of debt you could incur. While closing credit cards can have a negative impact on your credit score, it's still better to have a temporary credit score setback than to go deeper into debt if you can't control your spending. To reduce the impact to your score, you should also consider keeping your oldest credit card in addition to a lower interest-rate card.

✔ Shock yourself into reality by looking at a few important things on your credit card statement, including: how much you are paying in interest on an annual basis, how long it will take you to pay off the balance, and how much you will pay in interest if you are only making the minimum monthly payment. This information can be a real eye-opener.

Please call if you'd like to discuss this in more detail. ❍❍❍

5 Facts about Estate Planning

When it comes to the future, most Americans have a blind spot: estate planning. Maybe it's because of an unwillingness to think about mortality or a sense that wills and trusts are only for the wealthy that people put off this important financial planning task. Whatever the reason, there are a lot of estate planning slackers out there. That's a problem, because not having an estate plan could put your family's financial future in jeopardy and cause other serious consequences. Here are five facts everyone should know about estate planning.

1. Everyone Needs an Estate Plan

Yes, estate planning is absolutely necessary for the wealthy. But the rich are far from the only ones who need to think about the future. Pretty much everyone needs an estate plan, regardless of how old they are or how much money they have, and can benefit from putting documents in place that clarify who should receive their property after they die, what kind of healthcare they'd like to receive if they were incapacitated, how surviving family members will be provided for, and more. Estate planning is especially important for those who have children, complicated family situations, special needs family members, or own certain types of assets (like art, intellectual property, or a small business).

2. A Will Is Not Enough

Wills are an important part of estate planning, but they are just one piece of a larger puzzle. Wills clarify who should receive your assets after you die. But you may also need other documents, like a living will, which explains what kind of medical treatment you'd like to receive if you can't make decisions on your own, a healthcare proxy (a person who will make healthcare decisions on your behalf) and a power of attorney (a person who is authorized to make legal decisions on your behalf when you're not able to). In some cases, you may want to set up trusts to provide for your heirs or charities. An estate planning attorney can help you understand which estate planning documents are necessary in your situation.

3. Your Beneficiary Designations Supersede Your Will

Many people assume that the instructions in your will take precedence over any other directions regarding their estate. That's not always the case. Beneficiary designations on retirement accounts, life insurance policies, and bank accounts aren't superseded by your will. So, even if your will leaves your entire estate to your surviving child, a retirement account that names your brother as the primary beneficiary will still go to your sibling. That's why it's important you review your beneficiary designations regularly and update them when your life changes (birth of a child, divorce, etc.).

4. You Can Leave More to Your Heirs if You Structure Your Estate Properly

If you have a sizable estate — one that exceeds the $11.7 million federal estate tax exemption in 2021 — you may want to look into strategies that will allow you to pass that money to your heirs in a way that avoids estate taxes. There are numerous legal techniques you can employ to do this, such as transferring assets and property to a trust, making gifts during your lifetime, setting up family foundations, or leaving money to charity. Even those with smaller estates should keep taxes in mind. Did you know, for example, that life insurance proceeds pass tax-free to beneficiaries? That's important to keep in mind when you're considering how to make sure your spouse and children will be provided for if you die unexpectedly.

5. It's Important to Talk to Your Family about Your Estate Planning Decisions

Disagreements among family members about how to distribute an estate are far from uncommon. Often, those squabbles break out over unexpected or unclear provisions in the deceased's estate plan. If one member of your family feels he/she isn't getting his/her due, it can make the process difficult for everyone. Drawn out legal battles that eat away at the wealth you've accumulated — and wanted to leave to your heirs — may result. Even if you think your family can handle your estate civilly, it may still be a good idea to sit down as a group or with individual family members to discuss your wishes and explain your estate planning choices. If you plan to leave more of your wealth to one child than the other, make sure your children know about that so they don't end up feeling blindsided and betrayed after your death. ❍❍❍

When Is It Gambling?

Mae West once said, "I generally avoid temptation unless I can't resist it." Have you been tempted to invest in Tesla stock? It is soaring. You would have turned $10,000 into about $75,000 if you bought it at the beginning of the year. Wouldn't you like to have some of those profits? Is that a temptation you can't resist?

We did not recommend Tesla. Sure, in hindsight we wish that we had. But haven't we all witnessed or heard from a friend, colleague or relative who made a small fortune at the casino? When does an investment look more like a gamble than it does, well, an investment?

Tesla and a very small group of stocks called the FANG stocks have led the NASDAQ index to a gain of 40% this year, far outpacing the Dow Jones Industrial's return of 6%. The FANG acronym has been expanded to FAANMG, so the list includes Facebook, Apple, Amazon, Netflix, Microsoft and Google. Maybe we should call them the magnificent 7. With Tesla, the seven stocks, which are only 1.4% of the S&P 500 by count, represent almost a third of the value of the S&P 500, having outperformed now for the last five years, up 420% over that time.

There are other examples of greed-fueled stocks other than the magnificent 7, many of them IPOs (initial public offerings). Names include Airbnb, DoorDash, Rocket Companies and Palantir Technologies. Investors have made a lot of money in a hurry.

In the 1990s, stock market investors were attracted to a small group of stocks called the "dot com" stocks. That group returned 400% in the five years to 2000. Mae West might have said of the fun "too much of a good thing can be wonderful." Until it wasn't. In early March of 2000, those stocks crashed, erasing every bit of their profits from 1995 to 2000. Investors late to the party, who bought in early 2000, lost nearly 80% of their money. As a recent headline in Barron's recently put it, "It's feeling like 1999 all over again."

When is it gambling?

We think it is gambling when an investor is looking for quick gains; when an investor doesn't consider the investment as buying into a business that he or she wants to own long term. After all, buying a stock is buying part ownership in a company. That perspective requires discipline in determining a fair price. On average, when you buy the S&P 500 today, you are paying 2.5 times annual sales, or 30 times annual earnings. Those numbers are historically high; we try to find stocks that are cheaper than that.

Tesla has not yet turned a full-year profit, so we can't say what the multiple is on earnings. But it is selling at 21 times sales, or nearly 10 times what you would pay for the average stock in the S&P 500. That seems like gambling to us because the pursuit is seemingly all about temptation and not about properly valuing a business. Tesla is worth more than GM, Ford and Toyota combined.

As a group, the magnificent 7 trade at 8.8 times sales. Seems expensive, though not as expensive as Tesla. Most of our clients own Microsoft, many own Apple, and growth-oriented clients own Google. They have been fun to own. But we think now might not be the time to buy those stocks.

There was another group of high-priced stocks that preceded the dot com stocks, and they were called the Nifty Fifty. They led the market forward in the 1960s up until 1972. At the time, they were considered "one-decision" stocks. You bought them with the idea of never selling them. Familiar names included GE, Coca Cola and McDonald's, but also Polaroid and Sears. The group crashed in 1972, also losing almost 80% of their value. Some stocks like Polaroid never recovered. Polaroid's workers were recently bailed out by the Pension Benefit Guarantee Corporation, the quasi-government version of the FDIC, but for pensions, not banks. They were bailed out because Polaroid went out of business.

GE, Coca Cola and McDonald's lost a lot of value in 1972 but eventually recovered, and patient investors did just fine. Presumably some of the magnificent 7 and the IPO cousins will also work out in the long run, but we think things are already changing. Though Tesla is still moving up, the group is down since Labor Day by an average of 4% while the S&P 500 is up 5%. We think investors are now buying some of the cheaper, and often more profitable names.

We have stuck with our tried-and-true process throughout this volatile year. We prefer companies with good balance sheets that are more profitable than the S&P 500 (as measured especially by free cash flow). We look for growing sales. Most of the companies we favor pay dividends. We try to find the stocks with less risk. Not too many years ago, a study by Nardin Baker and Robert Haugen concluded that "Low Risk Stocks Outperform within All Observable Markets of the World." The paper was a follow-up on six other academic papers that concluded the same thing, that low risk stocks do not always outperform high risk stocks, but that they have outperformed on a consistent basis all the way back to 1926, the limits of their data.

You might call ours the tortoise approach. We believe strongly that over time, investors will be rewarded for taking on some risk and owning stocks. But we don't like to take more risk than is necessary. Paul Samuelson, the first American to win the Nobel Prize in Economics in 1970, once said, "Investing should be more like watching paint dry or watching grass grow. If you want excitement, take $800 and go to Las Vegas." We couldn't agree more.

Sincerely,

John B. Burke

John B. Burke, MS, CFP®
Financial Advisor