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Investing Before and During Retirement

There are two phases in the life cycle of a retirement portfolio: the time when you're contributing to it and the time when you're using it to cover your living expenses. During each phase, the basic challenge is deciding how to invest your nest egg, and for that there are three common approaches:

✔ **Going with your comfort level.** Most people have some idea as to what investments are appealing, either because of the rate of return associated or how much safety they seem to offer. Whichever it is, people tend to pile their retirement funds in one place — which can cause problems if there is a significant decrease in that investment.

✔ **Using a one-size-fits-all formula.** There are at least several of these formulas. On the theory that the closer you get to retiring the more conservative you should become, one says you should subtract your age from 100, treat the result as a percentage, and put that portion of your portfolio in stocks and the rest in bonds. Another follows the same method, but suggests you subtract your age from 120. The appeal of this approach is that it's simple and unambiguous. The downside is that the results don't take into account the details of your circumstances, the state of the economy and inflation, or the cyclical nature of market returns.

✔ **Using a financial plan.** A plan includes all the details that the other two methods leave out. It's by far your best bet for achieving your retirement goals since it takes your circumstances and the state of the economy into account. The plan should be split into before-retirement and during-retirement strategies.

Before You Retire

The key factor is to determine what rate of growth you need to achieve in your portfolio to retire with a nest egg capable of supporting you for the rest of your life once you no longer earn a paycheck. It's a balancing act between how much you can afford to put aside every year, how much growth will maximize your nest egg, and how much risk you feel comfortable taking.

By analyzing these factors, a

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Bonds and Interest Rate Changes

Basically, interest rate changes affect bond prices as follows:

✔ **Interest rates and bond prices move in opposite directions.** The price of a bond will decrease in value when interest rates rise and increase in value when interest rates fall. The price of an existing bond changes to provide the same return as an equivalent, newly issued bond at prevailing interest rates. If interest rates are higher than the rate on an existing bond, the existing bond becomes less valuable because of the lower interest payments, causing the price to decrease. Since you receive the full principal value at maturity, holding a bond until maturity eliminates the impact of interest rate changes.

✔ **Interest rate changes have a more dramatic affect on bonds with longer maturities.** Since long-term bonds have a longer stream of interest payments that don't match current interest rates, their price must change more to compensate for those interest rate changes.

✔ **Bond price changes are less significant for bonds with higher coupon rates.** Bonds with coupon interest rates near or above current interest rates will experience the least amount of price fluctuation. ❍❍❍

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Investing

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good financial plan produces a recommended asset allocation strategy that specifies how much of your portfolio should be invested in stocks, bonds, cash, commodities, and real estate. The mix you invest in aims at a target rate of return and risk level that both meets your goals and makes you comfortable.

In general, the younger you are, the more risk you can afford to take. It's not unheard of for someone in his/her 30s or 40s to invest up to 70% or 80% of his/her assets in stocks. Conversely, younger people who are risk-averse may be able to take less risk and put more of their assets in bonds, as long as they have more modest retirement goals.

It's generally true that the closer you are to retiring, the more conservative your portfolio ought to be. But this doesn't suggest the precise proportions that you ought to put into each asset class, nor does it take into account the opportunities or challenges that current market conditions present. Those answers will come only when you get into the details of your current situation and your future goals.

After You Retire

Before you retire, your asset allocation strategy is driven largely by the goal of creating the largest possible retirement portfolio within the limits of your tolerance for risk. After you retire, the goal shifts to keeping your retirement portfolio large enough to continue generating the supplemental income you need for the rest of your life.

While this shift means your strategy aims for less growth and risk than in the accumulation stage, it's usually a mistake to revert to the most conservative strategy possible. That's because your portfolio gets eroded over time by:

✔ Inflation, which means the real value of your portfolio (as well as the buying power of the income it throws off) gets smaller every year.

✔ Taxes on income and capital gains in taxable accounts and withdrawals from non-Roth IRAs.

✔ Withdrawals that you make to support your lifestyle.

Because of this constant shrinkage, some portion of your portfolio needs to be invested in stocks, which is a riskier asset class but typically stays ahead of inflation, taxes, and reasonable rates of withdrawals.

Please call if you'd like to discuss your situation. ❍❍❍

Don't Touch Your 401(k) Plan

If you leave your employer, be careful about what you do with your 401(k) funds. Your worst option is to take a distribution, pay taxes and a penalty on it, and then spend the money on something other than retirement. By doing so, you use retirement funds and forego any further tax-deferred growth on those assets. In addition, you may incur a large tax bill, since withdrawals are subject to ordinary income taxes and a 10% federal income tax penalty if you are under age 59 ½ (55 if you are retiring).

You have three options to keep your 401(k) funds in a tax-deferred vehicle until retirement:

Leave the funds in your former employer's 401(k) plan. Generally, you can leave the funds in your former employer's plan if your balance is at least $5,000. However, most plans will not allow you to borrow from your account once you leave the company. Until you consider all your options, you might want to at least temporarily leave the funds with your former employer's plan.

Transfer your funds to your new employer's plan. Find out if your new employer's plan accepts rollovers. If so, you can typically make the rollover even before you are eligible to make contributions. However, first check out the investment options to make sure the new plan has options that will fit your investment goals. Once the funds are in your new employer's plan, you'll be able to take loans if permitted by the plan. Also, if you work past the age of 72, you won't be required to take distributions from the 401(k) plan until you retire. With traditional individual retirement accounts (IRAs), you must take withdrawals once you turn age 72, even if you are still working. If you decide to transfer the funds to your new employer's plan, get the appropriate paperwork from your new employer so the funds can be transferred directly to the new plan's trustee. Otherwise, if the funds go directly to you, your former employer will be required to withhold 20% for taxes. You must then replace the 20% with your own funds within 60 days or the 20% withholding will be considered a distribution, subject to income taxes and the 10% federal income tax penalty.

Roll the funds over to a traditional IRA. Again, you should have your former employer transfer the funds directly to the IRA trustee to avoid the 20% withholding described above. Once the funds are rolled over to an IRA, you can invest in a wide variety of investment alternatives. With a 401(k) plan, you typically have a limited number of options. If you plan on leaving part of your 401(k) balance to your heirs, an IRA usually has more flexible options than a 401(k) plan. After the funds are transferred to a traditional IRA, you can then convert the balance to a Roth IRA. ❍❍❍

Overcoming a Fear of Investing

Many Americans are nervous about investing. While investing does come with risks that you need to be aware of, that's no reason to avoid it entirely. Here are three steps you can take to overcome that fear.

Start from a Position of Strength — If you have a mountain of credit card debt and no emergency savings, investing any of your money is likely to be a bit nerve-wracking. Before dipping a toe into serious investing, work on paying down high-interest credit card debt and establishing an emergency fund with at least six months' living expenses. The exception to the above suggestion? Investing in your retirement plan at work. If you get a company match, you may want to invest just enough in your 401(k) plan to get that money.

Get Educated — Familiarizing yourself with how markets work and with the basic principles of sound investing will help you understand that though investing comes with risk, it's hardly the same as playing the lottery. There may be no sure things when investing, but if you proceed with a smart strategy and stick with it over time, there's a good chance you'll come out ahead.

Set a Goal — By knowing what you want to achieve before you make any specific decisions about where to put your money, you'll be more likely to invest in a way that will get you to where you want to be. If your goal is to buy a house in five years, that means that investing in potentially high-return yet also high-risk stocks is not so smart — the risk that you could lose your down payment savings is simply too great. Stashing that cash in a certificate of deposit probably makes more sense. But if you're investing for retirement that's three decades away, you can afford to take on more risk with your investments, since you have more time to make up any losses, and you'll benefit from the potentially greater returns of high-risk investments. In that case, higher-risk stock investments make a lot of sense. The key is to keep your goal in mind and let that drive your decisions about how to invest.

Being a little nervous about investing is normal, but you shouldn't let it keep you from achieving your financial goals. Please call if you'd like to discuss this in more detail. ❍❍❍

Keeping you Informed Is a Priority

One of our goals is to keep all our clients informed on a regular basis. By providing this newsletter and sending market updates, we hope to achieve that goal. We hope to make you a more knowledgeable investor by supplying you with a regular stream of financial information.

Investment management and financial planning are ongoing processes. New ideas are constantly introduced. Consequently, we believe the best way to present a solid, regular base of financial information is through these communications.

We realize everyone has unique financial situations and needs. While most articles will be somewhat generic there should always be enough information to give you a summary of each topic discussed.

If you would like more information on a particular topic, please feel free to call us. We are happy to discuss in detail any of the articles and how they relate to you and your finances. ❍❍❍

Financial Thoughts

In a recent survey of the impact of the COVID-19 pandemic on personal finances, women have been disproportionately affected. They are more likely to be the primary caregivers for children at home and are heavily concentrated in healthcare and other front-line service work that exposes them to the coronavirus and puts them more at risk of related business closures. Given those uncertainties, only 33% of women feel optimistic or in charge of their finances while 44% of men do. Also, 31% of women reported feeling they barely have their head above water, while only 19% of men did. Only 55% of women felt confident in their ability to build emergency savings, as opposed to 69% of men. And fewer women, 54%, felt confident they could retire when they wanted, compared to 67% of men (Source: *Financial Advisor Magazine*, March 2021).

Respondents to the same survey are vowing to take charge of their finances in 2021 — 83% said they want to minimize worrying about their finances, mainly by increasing savings, and 70% indicated they are saving more (Source: *Financial Advisor Magazine*, March 2021) ❍❍❍

Upcoming Seminars

In order for Certified Public Accountants (CPAs) to maintain their NJ state license, they must attend 40 hours of continuing professional education seminars each year. Many of our readers know that we sponsor a program that offers these seminars – The Academy for Continuing Professional Education. Most of these presentations cover technical elements of accounting or taxation, but some of our seminars are of general interest. We believe there are three such seminars coming up soon, and we invite our clients to attend…free of charge, of course.

September 20, 2021: The Inside Story of Tipper "X"

Tom Hardin, through vivid storytelling, shares his journey down the slippery slope into criminal activity. He previously spent much of his career as an investment analyst in the financial services industry. In 2008, as part of a cooperation agreement with the U.S. Department of Justice, Tom assisted the U.S. government in understanding how insider trading occurred in the investment management industry.

Known as "Tipper X," Tom became one of the most prolific informants in securities fraud history, helping to build over 20 of the 80+ individual criminal cases in "Operation Perfect Hedge," a Wall Street house cleaning campaign that morphed into the largest insider trading investigation of a generation. As the youngest professional implicated in the sting, Tom was tasked with wearing a covert body wire on over 40 occasions to help the FBI bring down some of its biggest targets in the industry.

October 5, 2021: Estate Tax Planning Update and Advanced Planning Techniques

With possible changes in the estate tax law on the horizon, Deirdre Wheatly-Liss, Esq., LL.M., will provide an update of current estate tax laws and the opportunities available to high net worth individuals. Discussion will include an explanation of advanced estate planning techniques that high net worth individuals can use to leverage the use of available gift exemptions to transfer wealth to their heirs.

November 2, 2021: Common Estate Planning Mistakes — and How to Avoid Them

Steven Siegel, JD, LL.M., will speak about common estate planning mistakes and how to avoid them. Mr. Siegel will cover the failure to plan and outdated planning, mistakes and considerations when choosing beneficiaries and fiduciaries, and cautions about trusts and charitable giving. The latest planning considerations in a changing, tax law environment will also be discussed.

All seminars are on Tuesdays and run from 7:00 pm to about 9:30 pm. As of this writing, we expect the seminars to be in-person at Delta Hotels by Marriott Woodbridge, on Route 1 in Iselin, NJ.

The venue will follow current safety protocols which, as of this writing, include social distancing, sanitizing stations and masked hotel attendants.

Please consider joining us. We would love to see you. For full details about the seminars and speakers, and to register, please call Daniel Criscuolo at 732-744-1200.

Sincerely,

John B. Burke

John B. Burke, MS, CFP®
Financial Advisor