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PLAN FOR A LIFE WELL LIVED

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Traditional vs. Roth 401(k) Plans: Which One is Right for You?

By Leo Chubinishvili, CFP®

Put simply, a 401(k) plan is a company-sponsored retirement account that allows employees to save for retirement tax-efficiently. The account's value grows by contributions made by the employee and (sometimes) the employer, coupled with investment performance.

In addition to the traditional 401(k) plan, where contributions made by an employee are tax-deductible from current income, many employers offer employees the ability to contribute to a Roth 401(k) account.

Traditional 401(k) Plan vs. Roth 401(k) Comparison

A traditional 401(k) plan is a *tax-deferred* retirement plan built with *pre-tax* contributions. For example, if your monthly gross paycheck is $2,000 and you contribute $400 to a 401(k) that month, your taxable income that month is $1,600. Assuming a 20% tax rate, your tax is $320, and you are left with $1,280 after-tax. The $400 you contributed to your IRA grows without being subject to tax until the money is withdrawn from the plan in retirement.

The Roth 401(K) plan is a *tax-free* retirement plan built with *after-tax* contributions. Using the same example as above, if your monthly gross paycheck is $2,000 and your tax rate is 20%, your tax is $400. Then if you contribute $400 to your Roth 401(k), you will be left with $1,200 after-tax. The benefit of the Roth 401(k) is that no income taxes will be due when you begin taking distributions after the age of 59 ½. This applies to contributions made to the Roth 401(k) and any account earnings.

Which Retirement Savings Plan is Better?

The simple and most common answer to this question is, "It depends on your future income and taxes." If you anticipate being in a higher tax bracket in retirement, a Roth 401(k) plan may make sense now because you are foregoing a current tax deduction at lower tax rates than you would pay in the future when you begin taking distributions. Conversely, if you expect your future tax bracket to be lower than it is today, the Traditional 401(K) is probably better.

If only your current and future tax rates were so clear. Unfortunately, that is not true. Not only can tax rates change via new tax law, but your expected need for income from your investments can change as well. Let's look at a real-world example:

Let's assume a 25-year-old married couple, each with an income of $60,000 (or a total of $120,000) and living expenses of $84,000.

(Continued on Page 3)

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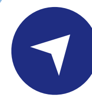

The Difference Between Rich and Wealthy

By Howard Hook, CPA, CFP

Ask someone whether they want to be rich or wealthy and they will probably tell you they are the same thing. Truth be told, the words are often used interchangeably or even together. Look up the word "rich" in Webster's online dictionary and you'll find this definition:

"Having abundant possessions and especially material ***wealth.***"

You will also find that wealthy is a synonym for rich. But are they the same?

For me, wealth implies something beyond being rich. Rich to me means someone with a lot of money. But someone who is wealthy, not only many times is rich, but is also someone who understands what having money can do for them, their family and community.

Another way to think of it is being rich ends when you die (if not sooner), but being wealthy can transcend your lifetime and be passed on to your heirs.

And no, a wealthy person is not someone who is uber-rich. Being *wealthy* cannot be measured by counting how much money you have. Being *rich* can be.

So how do you build wealth?

The best thing about building wealth is that it is not job or career specific. Building wealth is not reserved for only doctors, lawyers or investment bankers. It is reserved for those people who understand that to be wealthy they must delay the instant gratification that comes with making more money and instead save it.

Those savings can then be used to educate your children or grandchildren. It can be used to further your own education, too. Wealth can be used to join or start a cause that you care deeply about or to give back to an organization that was instrumental in helping you get to where you are today.

Many of you reading this last paragraph may think you don't have enough money to do these things. But the beauty of building wealth is that no one is keeping score. Every little bit helps. While setting up a scholarship at your alma mater may be great or paying for your children or grandchildren's college tuition would be ideal, it's the thought behind the action that really counts.

The vehicle used to build wealth matters. Making the decision that you wish to build wealth and leaving all your excess earnings in a checking or savings account is way too conservative and actually will erode your purchasing power and destroy wealth. On the flip side, taking too much risk and watching your hard- earned savings disappear is also not the right way to build wealth. Instead, as Goldilocks learned from the three bears, something right in the middle is the best way to build wealth.

Building wealth correctly can be boring. Many times the best way to do so is to save money on a periodic basis into a portfolio of well-diversified investments. Boring, I know. But that's okay. You can reserve all the excitement for the time when you have achieved your goal of being wealthy and can now do the things you want to do.

Once you achieve wealth, it is important to understand how to stay wealthy. Saving and resisting the urge to spend money is a difficult thing to do. Once you have accomplished it, you need to continue to steward your wealth so it does not disappear quickly.

The same principles that guided you as you built your wealth should continue after achieving it. Diversification, which is not concentrating wealth in only one type of investment, as well as making sure your wealth is protected against unforeseen circumstances — e.g. a lawsuit — are the best two ways to preserve your wealth. Thankfully, both can be accomplished. Maintaining a diversified portfolio helps reduce the risk of overconcentration, and making sure you have the appropriate liability insurance can protect your wealth from lawsuit losses.

Finally, building wealth is not only for the very young. Many people start building wealth once they have satisfied other goals, which could include buying a house or raising children. Starting young has the advantage of having more time for your wealth to grow, but starting at a later age also can provide perspective that you may not have had when you were younger.

The bottom line is that any age is the right time to start. Are you ready?

This is an excerpt of an article that appeared in *SBH Medicine.*

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401(k) Plans *(Continued from Page 1)*

They both contribute 8% ($9,600 total) to a 401(k). Their salary and expenses grow by an inflation rate of 3%, and the rate of return on their investments is 6%. Let's now compare what happens when they contribute to a Traditional 401(k) plan vs. a Roth 401(k) plan throughout their lives. Note: Total Expenses are a combination of $84,000 living expenses plus projected income taxes.

401(k) Type	Year	Age	Salary	*Total Expenses (a)*	*401(k) Contributions (b)*	Total Outflows (a) + (b)	Net Cash Flow
Traditional	2020	25/25	$120,000	*$103,592*	*$9,600*	$113,192	**$6,808**
Roth	2020	25/25	$120,000	*$105,704*	*$9,600*	$115,304	**$4,696**

As you can see from above, they have more net cash flow when contributing to a Traditional 401(k) because of the current tax deduction they receive for contributing to a Traditional 401(k).

Roll this scenario forward 20 years, and you see their portfolio assets (which include retirement and non-retirement assets) is greater under the Traditional 401(k) scenario. This is due to the excess cash flow under the Traditional 401(k) scenario being invested in a non-retirement account.

401(k) Type	Year	Age	Total Portfolio Assets	Retirement Account	Non-Retirement Account
Traditional	2040	45/45	**$669,879**	$492,573	$177,306
Roth	2040	45/45	**$575,352**	$492,573	$82,779

This continues until they are both age 67, at which time they retire and roll their respective 401(k) plans to an IRA or Roth IRA. As expected, the Traditional 401(k) scenario continues to be better, with Total Portfolio Assets exceeding the Roth 401(k) scenario by almost $400,000.

401(k) Type	Year	Age	Total Portfolio Assets	Retirement Account	Non-Retirement Accounts
Traditional	2062	67/67	**$3,297,128**	$2,746,298	$550,830
Roth	2062	67/67	**$2,900,167**	$2,746,298	$153,869

At age 72, the couple will be required to take a minimum distribution (projected to be approximately $126,000) from their Traditional IRA accounts, and pay income tax on the total amount withdrawn. The Roth IRA, however, does not require RMDs, although they can withdraw funds from the account if they need to (and pay no income tax on the amounts withdrawn).

This will continue each year, with the required distributions from the Traditional 401(k) growing each year. In our example, distributions will need to be made from the Roth IRA account as well to cover any living expense shortfall; but much less will be needed since those distributions are tax-free. At age 94, the comparison of the Total Portfolio Assets has flipped, with the Roth 401(k) option showing the larger account balance.

401(k) Type	Year	Age	Total Portfolio Assets	Retirement Account	Non-Retirement Accounts
Traditional	2089	94/94	**$9,200,566**	$2,998,172	$6,202,394
Roth	2089	94/94	**$11,595,941**	$11,595,941	$0

(Continued on Back Page)

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(Continued from Previous Page)

The Roth Scenario shows $2.4M more in Total Portfolio Assets than the Traditional scenario. The difference is even greater if you consider income tax still need to be paid on the distributions from the Traditional IRA, but none on distributions from the Roth IRA.

In summary:

1. You can save more cash during your working years by using Traditional 401(k) contributions, as it lowers your taxable income. Conversely, while you save less cash using a Roth 401(k) in your working years, the retirement savings grow tax-free.

2. The RMDs can be substantial in retirement, which will increase your taxable income. On the other hand, Roth contributions do not have RMDs.

When choosing a Traditional 401(k) plan or a Roth 401(k) plan there is no one-size-fits-all answer, as individual financial factors are different and can change over time. While you are young and in a lower tax bracket, it may make sense to contribute to a Roth 401(k). As you earn more money and move into a higher tax bracket, switching over to a Traditional 401(k) where you will benefit from a larger tax deduction could make sense. Doing it this way, at retirement you will have two different buckets of retirement money to choose from, depending upon your tax situation from year to year.

These are not easy decisions. Speak with your financial advisor about your specific situation.

Firm News

Access Wealth Recognized as a Future 50 RIA

We are proud to share that Access Wealth has been selected as a Future 50 RIA by Citywire USA.

"We are honored to be acknowledged as a leader within the investment community," said Howard Milove, a principal and senior wealth advisor at Access Wealth. "We take pride in the long-standing relationships we have developed with our clients and are constantly evaluating how to improve efficiencies and the overall client experience. We are humbled to be recognized as an up-and-coming industry leader."

Firms were assessed using a system that evaluates 10 key areas.

SECURE Act Webinar Recording Available

The SECURE Act will likely impact virtually everyone's retirement and estate planning. If you missed our webinar on February 12, visit access-wealth.com/blog to view the replay, or contact us for a direct link.

Monthly Insights Delivered to Your Inbox

In addition to this printed quarterly newsletter, we are now emailing clients a monthly newsletter with other relevant, timely articles written by our advisors. Also, on the third Tuesday of every month, we are releasing a short Video of the Month. If you have not received these communications yet, please contact us to ensure we have your correct email address.

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