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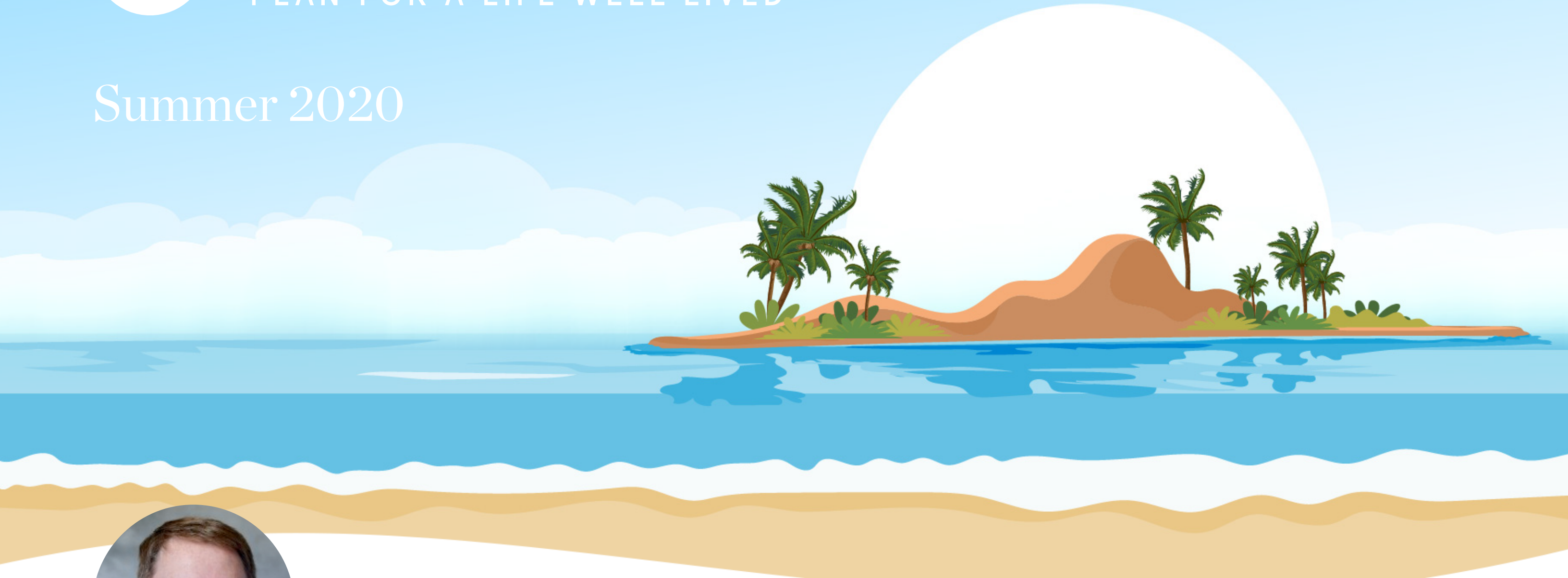
PLAN FOR A LIFE WELL LIVED

Summer 2020



Avoiding Common Mistakes in Your 50s

By Darren Zagarola, CFP®, CPA, PFS

Once you enter your 50s, you are officially closer to retirement than the age when you started working. Retirement ceases to be a distant concept, and it's essential to put a plan in place.

Mistake #1: Believing it is Too Late to Start Planning and Saving

It is never too late to develop good habits and start saving for retirement. You do not have to "go without" to save. Every little bit helps, especially if you can take advantage of compounding interest. Start with a written plan that includes realistic savings goals and a budget to help you understand where you are spending. You may discover you do not have to make significant changes to your lifestyle, or you may realize that you need to delay some of your goals. But the longer you wait to start saving, the less you will have available to meet your retirement needs.

Mistake #2: Not Taking Advantage of Retirement Plan Provisions (e.g. Catch-up Provisions or Company Matching)

Now that your income is higher and your kids may be out of college, this might be the first time in years that you have excess disposable income. Also, at age 50 (or older), you become eligible to take advantage of "catch-up contributions." This means the maximum amount you can contribute to your employer-sponsored retirement account is $26,000, or $6,500 more than you could at age 49.

If your budget allows for it, we recommend contributing the maximum allowable to your retirement plan. Some employers offer to match a portion of their employee's contributions. If you cannot maximize your contribution, we recommend at least contributing enough to meet the company's maximum contribution.

Mistake #3: Withdrawing Money Too Early from Retirement Plan Accounts

Retirement plan accounts are intended to provide for your needs later in life. You should avoid taking funds from your retirement accounts before age 59½, as there is a 10% penalty on the amount withdrawn in addition to the income tax on the distribution. For example, if you are in the 22% tax bracket, an early withdrawal of $10,000 from your retirement account would result in $3,200 in taxes and penalties or fees. Consider other methods of financing.

Mistake #4: Investing in Your Children Instead of Yourself

We all want our children to succeed. For some, this means giving them the gift of graduating from college debt-free. Paying for a college education is a noble endeavor. However, if you choose to fund their education at the expense of your retirement, you may have difficulty making up the difference.

Mistake #5: Not Factoring in the Cost of Adult Children or Aging Parents

You are affectionately known as the "sandwich" generation, supporting adult children as well as aging parents. This may reduce your ability to save for retirement or cause you to withdraw retirement assets early. It is a difficult position to be in and can have a dramatic effect on your plan. We recommend having a discussion with your parents about their financial plans. Understanding what will happen if they require long-term care will help you prepare for the possibility of having to support them.

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Through comprehensive financial planning and investment management, Access Wealth helps clients plan for and achieve a life well lived.

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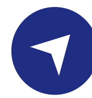

Two Things You Need to Know When Planning for a Successful Retirement

By Howard Hook, CFP®, CPA

To be as concise as possible, there are two components which contribute largely to the success of one's retirement plans: investment return and how much money you need to withdraw from your portfolio, known as your withdrawal rate. This is not to say that there are no other key variables. But those two are a good place to start when evaluating your retirement prospects.

Investment return and withdrawal rate are inextricably linked. If your investment return in a given year is less than your withdrawal rate, then your investments will decline in value that year. This becomes a race between your portfolio and your life expectancy, which is akin to the gag when you were a kid: heads I win, tails you lose. Dying early reduces the likelihood of you running out of money (but, of course, it also comes with the downside — you are dead). Living a long life increases your time here on earth, but puts extra strain on your portfolio and could cause you to outlive your portfolio.

Obviously, in those years that your investment return exceeds your withdrawal rate your portfolio will increase.

If we break it down even further, withdrawal rate is dependent upon your living expenses and outside sources of cash flow, other than from your portfolio. The most common forms of cash flow for most people are social security and pension income (for those lucky enough to have one).

To calculate your initial withdrawal rate from your portfolio at retirement you simply add up your cash flow sources, subtract from that your expenses (including income taxes) and divide the result by your total portfolio to get the initial withdrawal rate. Spoiler alert — if you are between the ages of 65 and 70 and this calculation yields a number greater than 4%, something needs to change (e.g. return to work, spend less, or marry someone with a pension).

Investment return is a tricky one. Most investments do not go up (or down) the same amount each year. As such, there is some degree of variability to those years when investment returns will exceed the withdrawal rate and those years when it will not.

This means that choosing the investment portfolio with the greatest chance to exceed your withdrawal rate in any given year is not the best one to choose for your long-term success. Research has shown that a portfolio with all stocks in it has the greatest likelihood of one-year success as compared to an all bond or all cash portfolio. But that same portfolio of stocks is also likely to have the greatest likelihood of loss in a given year.

Portfolio performance compounds year after year, which can be both good and bad. Too much of a loss, especially early on after retiring can set you back immediately and make you scramble to recover. Too much of a gain can tempt you to spend more money than you originally planned (a phenomenon we saw the past few years prior to 2020) and throw you off track as well. It's hard to reign in your spending, especially during good times.

Choosing a mix of investments, some in the stock market, some in the bond market, and some in cash can provide diversification and help narrow the range of likely investment returns in a given year. This will assist you in evaluating whether the portfolio will sustain the withdrawals you expect to make from your portfolio.

The right mix of all three of these different types of investments is hard to generalize. Understanding the role each type plays in the portfolio can help you begin to get a sense of how much to have in each.

The role of stocks in your portfolio should be to grow the portfolio long-term over and above the rate of inflation.

The role of bonds in your portfolio is to lower the overall volatility of the portfolio and to provide a stream of income. The bond market can provide positive or less negative returns when the stock market declines.

Cash in the portfolio also lowers the overall volatility in the portfolio, but also plays the crucial role of providing for your cash needs, especially during times of market downturns. Using the cash in your portfolio to provide for your needs gives your stock investments time to recover and grow once economic conditions improve.

As we work our way through these current economic conditions, those investors who understand the relationship between their withdrawal rate and their investments will have the greatest chance to emerge unscathed. That's a good feeling to have.

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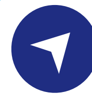

Do Alternative Investments Have a Place in Your Investment Portfolio?

By Leo Chubinishvili, CFP®

Recent events have created an enhanced need for investors to diversify their portfolios. This is due to things such as the economic downturn, stock market volatility, a low-interest-rate environment, the potential for rising inflation, and a possible tax code change, to name a few.

Alternative investments — essentially anything that is not a stock or bond — offer portfolio diversification, as well as the potential of downside protection and greater returns. The important question for investors, however, becomes whether they should include alternative investments and if they are appropriate based on individual goals, risk tolerance, and time horizon.

Examples of alternative investments include real estate, private equity, hedge funds, commodities (including precious metals and natural resources), managed derivative funds (including future and option contracts), foreign and cryptocurrencies, and even tangible assets such as art and collectibles.

Some of the above examples are very complex and should only be used by investors with a sound understanding of how they work. Because of this, some strategies may not be available to the general investing public, and are instead only available to "accredited investors." Private equity and hedge fund investments are two types of investments that should not be used by someone who does not understand how these investments work. An easier way to add real estate exposure to your portfolio is to invest in a publicly-traded real estate investment trust (REIT), which trades like a stock.

Alternative investments can be purchased directly, such as buying gold bars or real estate property. For purposes of diversification and liquidity, however, they usually work best when purchased via a mutual fund. Most of these funds are actively managed. Yet, some index funds do exist for investors who want exposure to alternative investments but prefer owning an index (i.e., a commodity index rather than owning a mutual fund that purchases companies that produce those commodities).

Advantages of Having Alternative Investments in Your Portfolio

As Miguel de Cervantes penned in his novel, *Don Quixote*, "It is the part of a wise man to keep himself today for tomorrow, and not venture all his eggs in one basket."

Ultimately, investors wish to generate returns commensurate with the level of risk they are willing to accept in their portfolio. To do that, you must diversify your portfolio with investments that do not always all go up at the same time and do not all go down at the same time. If we have portfolios A and B, both with the same level of risk (standard deviation), yet portfolio A has generated higher returns, then portfolio A is a better portfolio to invest in since it's risk-adjusted rate of return is greater than portfolio B.

Alternative assets tend not to move in the same direction as stocks and bonds, which make them good assets to add to a portfolio to achieve better risk-adjusted returns. This could potentially lessen losses during market downturns or periods of economic recession.

Disadvantages to Alternative Investments

A significant disadvantage of owning alternative investments is that owning them via direct ownership may not be as liquid as owning them via a mutual fund, where gaining access to those funds is easier (if needed). Additionally, the complexity of certain types of alternative investments may make it difficult to evaluate whether they are appropriate for inclusion in your portfolio. Certain types of alternative investments are harder to value due to their illiquidity and may also involve higher fees.

While alternative investments have underperformed the stock market recently, we believe there is a place for these types of uncorrelated investments in most portfolios. For example, here at Access Wealth, some client portfolios do include a mutual fund that invests in global real estate as well as a mutual fund that invests in mergers and acquisitions, both of which are considered alternative investments. The inclusion of these funds in a portfolio requires significant analysis and research to be sure they fit well with the other pieces of the portfolio.

If you decide that alternative investments should be part of your portfolio, we caution you to not invest more than 10% of your total portfolio into these types of investments.

If you have any questions about alternative investments or specifically about the alternative investments we are using, please contact us, and we would be happy to discuss it further with you.

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Mistake #6: Investing Too Conservatively
Retirement may be your biggest goal, but it is not the end goal. You still have 25 – 30 years of living to do. And in the early years of retirement, you may be increasing your living expenses for travel and other lifestyle changes. To keep pace with inflation, you still need exposure to equity investments. Having too conservative of an allocation could decrease the purchasing power of your portfolio in the future. Being too aggressive puts your savings at risk. Therefore, you need to balance the risk/reward of your portfolio through proper asset allocation. Building a well-balanced portfolio can be complicated, and it's advisable to work with a trusted financial planner who can illustrate how different scenarios can impact your short- and long-term objectives.

Mistake #7: Eliminating Good Debt vs. Bad Debt
You are probably earning more now than in previous decades. If you have been able to control your expenses that means you have additional savings that can be used to further your goals. This may include paying down outstanding debt, including credit cards, student loans, or a mortgage. Consumer debt and student loans typically have higher interest rates than mortgage debt and should be paid off first.

Most mortgages have a term of 15 – 30 years, and you are probably more than halfway through the repayment period. As you approach the end of the mortgage term, your monthly payment is allocated more to the principal than interest. If you use your excess cash flow to pay down the mortgage now instead of using it to accumulate assets for retirement, you may not achieve your long-term goals. Or worse, you may need to borrow money against the equity in your home later in life and discover you are unable to access the liquidity for certain reasons.

Remember, having a mortgage is not bad. It provides flexibility and liquidity to one's financial plan, and current interest rates are close to all-time lows.

Mistake #8: Failure to Update Your Estate Plan to Reflect Your Current Wishes
If you have not prepared an estate plan, which includes a Will, Power of Attorney, and Advance Medical Directive, you should do so immediately. Now is also the time to consider whether you wish to leave assets in trust for your heirs or leave them outright.

Mistake #9: Failure to Update Your Life Insurance Policies
Life insurance policies should be reviewed every five years, or in conjunction with a life-changing event. Common problems we see include:

- Term policies purchased early in life might be expiring, yet the protection is still needed.
- The financial need for the insurance might not be the same as when you obtained the policy, requiring you to purchase additional coverage, or reduce coverage if you no longer require it.
- Beneficiary designations might need to be updated.

Mistake #10: Failure to Plan for Future Health Care Costs and Long-Term Care Costs
Long-term care and health care costs are significant financial risks. More than half of Americans over age 65 will need some form of long-term care, which can be incredibly expensive. Long-term care is custodial care, not medical care, and thus not covered by standard health care policies. Such care can take place in your home, an assisted living facility, or a memory care facility. You should start to consider obtaining a private policy in your mid to late 50s unless you have a family history of illness that would require you to get the policy earlier. The premium cost for a policy increases based on your age and health. There are several options for policies, including traditional individual policy, shared policies covering you and your spouse for a total number of years, or hybrid policies that include long-term-care coverage as a rider on a life insurance policy.

Unfortunately, these are not the only mistakes we have seen. They are, however, the major ones that, if corrected, can make a significant difference in your financial health.

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