



**Silicon Valley Chapter
American Association of Individual Investors
Financial Planning Workshops**

Review and Case Study

Our Next Event and Special Interest Group Webcasts



- ▶ Investing in Uncertain Times: Janet Brown, No-Load Fund X
 - ▶ Saturday June 13th at 9:00am; webcast only
- ▶ Investing Discussion Group
 - ▶ Lynn Gillette: Monday June 22th at 6:30pm
- ▶ Computerized-Mechanical Investing Group
 - ▶ Bill Paseman, Don Mauer: Thursday June 4th at 6:30pm
- ▶ Financial Planning Discussion Group
 - ▶ Fred Smith: Wednesday September 9th at 6:30pm
- ▶ Fintech/Realtech Discussion Group
 - ▶ Roland Chow: To be determined

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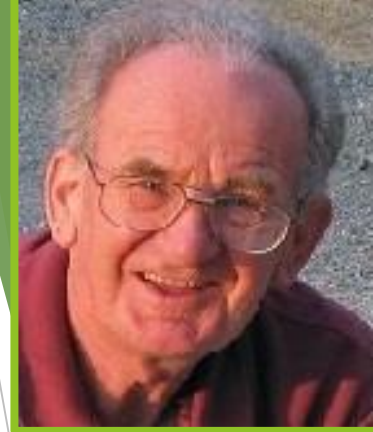
Please check us out!

- ▶ Chapter website: www.siliconvalleyaaii.org
- ▶ Meetups: www.meetup.com/AAII-Silicon-Valley-Meetup
- ▶ Facebook: www.facebook.com/sv.aa
- ▶ YouTube Channel:
www.youtube.com/channel/UC4GepcU8lzx8rZMaWNBeJtA
- ▶ AAII National website: www.aaii.com
- ▶ My email address: fred.svaaii@gmail.com

Disclaimer

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- ▶ Nothing on these sites should be considered solicitations or offers to buy or sell any financial instrument or specific trading advice for individuals.

Cycle of Financial Planning Workshops



We cover a full range of topics in the cycle:

- ▶ The Five Pillars of Financial Planning
- ▶ Investing I: Modern Portfolio Theory, Building a diversified portfolio
- ▶ Investing II: Efficient Market Hypothesis; Can you beat the market?
- ▶ Retirement Planning I: Accumulation/Distribution phases, RMDs
- ▶ Retirement Planning II: Safe withdrawal rates, Bengen's 4% rule
- ▶ Taxes: Tax diversification, Asset location
- ▶ Risk Management/Insurance: Annuities, Long-term care, Litigation
- ▶ Social Security and Medicare: Claiming strategies, Medicare myths
- ▶ Estate Planning: Probate, Executor/trustee duties, Philanthropy
- ▶ **Wrap-up: Case study reviewing previous material**

Overview

- ▶ Review of the Five Pillars of Financial Planning
 - ▶ Investing
 - ▶ Retirement Planning
 - ▶ Taxes
 - ▶ Risk Management / Insurance
 - ▶ Estate Planning
- ▶ Case Study
 - ▶ Benjamin and Geraldine Sweet

The 5-Step Investing Process

1. Personal Investor Profile, PIP
 - ▶ Age, Time horizon, Risk tolerance, Tax status, etc
2. Investment Policy Statement, IPS
 - ▶ Goals, Asset classes, Asset allocation, Trade rules, etc.
3. Design your portfolio as defined by your IPS
 - ▶ Pick specific funds for each account
4. Implement the portfolio
 - ▶ Go online and make purchases
5. Monitor your portfolio
 - ▶ Rebalance or buy/sell as documented in your IPS

Passive versus Active Strategies

- ▶ Passive investors + Active investors = Total market
- ▶ Passive investor
 - ▶ Definition: Diversified portfolio of cheap index funds
 - ▶ Market return less small expense
 - ▶ Tight distribution (all aiming for the same target)
- ▶ Active investor
 - ▶ Definition: Everyone who is not a passive investor
 - ▶ Must get market return less a larger expense on average
 - ▶ Wide distribution (aiming for diverse targets)

For Every Trade You Make

- ▶ Who is on the other side of your trade?
 - ▶ Endowment funds, Pension funds, Mutual funds
 - ▶ Individual investors (smart and not-so-smart)
- ▶ Do you have an unfair advantage?
 - ▶ Better data, more experience, smarter
- ▶ Are there enough not-so-smart individuals to take the other side of your trade?

Investing Takeaway

► Quote of the day

“If you must play the market to satisfy an emotional itch, recognize that you are gambling on your ability to beat the pros. So limit the amounts you play with to the same amounts you would gamble with the pros at Las Vegas.”

Charlie Ellis

Retirement Planning

- ▶ Typical life cycle
 - ▶ Birth Graduation day Retirement day Death
 - ▶ Goal of retirement planning is to even out a lumpy cash-flow
- ▶ Accumulation Phase
 - ▶ Taxable accounts
 - ▶ Tax-deferred retirement plans: IRA, 401(k), etc
 - ▶ Tax-free retirement plans: Roth IRA, Roth (401(k))
- ▶ Decumulation Phase
 - ▶ Bengen's 4% rule (1994), later variations
 - ▶ Required minimum distribution (RMD) method
 - ▶ Bucket strategies

Retirement Planning Takeaway

- ▶ Start saving early
 - ▶ Shoot for 15% of salary to maintain same lifestyle
 - ▶ Set up a Roth IRA for your kids/grandkids
 - ▶ Reimburse their contributions 2X !
- ▶ Bengen's 4% rule isn't perfect but it's a good start
 - ▶ Ignore at your own risk!
- ▶ What if you come up short?
 - ▶ Delay retirement, save more, spend less
 - ▶ Consider an income annuity
 - ▶ Consider a reverse mortgage

Taxes

- ▶ Tax Cuts and Jobs Act, TCJA (Dec 2017)
 - ▶ Corporate tax cut from 35% to 21%
 - ▶ Standard deduction increased to \$12,200 / \$24,400
 - ▶ Estate tax exclusion increased to \$11.4M
- ▶ SECURE Act (Dec 2019)
 - ▶ Setting Every Community Up for Retirement Enhancement
 - ▶ RMD delayed to age 72
 - ▶ Inherited stretch IRA is gone except for a few exceptions
- ▶ CARES act (March 2020)
 - ▶ Coronavirus Aid, Relief, and Economic Security
 - ▶ Grants up to \$1,200/adult with income <\$99,000 + \$500/child
 - ▶ Lends up to 8 weeks payroll/rent/utilities to small business

Tax Saving Strategies

- ▶ Tax diversification, Asset location
 - ▶ Taxable accounts: Tax efficient securities
 - ▶ Tax-deferred accounts: Tax-inefficient securities, low risk/return
 - ▶ Tax-free accounts: Tax-inefficient securities, high risk/return
- ▶ Bunch charitable contributions
 - ▶ Use a donor advised fund; spread a contribution over many years
 - ▶ Use the standard deduction for other years
- ▶ Tax bracket management
 - ▶ Low tax bracket window, e.g. post retirement to pre-RMD
 - ▶ Fill up low bracket(s) with capital gains, Roth conversion
- ▶ Tax loss harvesting
 - ▶ Use for long-term taxable accounts, especially legacies
 - ▶ Beware wash-sale rules

Tax Takeaway

- ▶ Keep alert to tax planning opportunities
 - ▶ Tax law changes frequently and unpredictably
- ▶ Diversify for the long-haul
 - ▶ Congress can't reach consensus on what happened last week much less what should be done for next week, or next year, or next decade.

Risk Management / Insurance

- ▶ Insurance is inherently expensive
 - ▶ Premium = Actuarial cost + Operational cost + Profit
 - ▶ Best for low probability / high cost risks you are not prepared to cover yourself
- ▶ Social Security
 - ▶ Full retirement age, Early retirement, Late retirement
 - ▶ Usually best for high earning spouse to maximize retirement benefits by delaying to age 70
- ▶ Medicare
 - ▶ Traditional Medicare versus Medicare Advantage
 - ▶ Medicare myths

Insurance Takeaway

- ▶ Self-insure for the small things
- ▶ Beware potential train wrecks
 - ▶ Longevity; consider an annuity
 - ▶ Long term care; consider a LTC policy
 - ▶ Litigation; consider an umbrella policy

Estate Planning

- ▶ The primary documents
 - ▶ Will/Trust
 - ▶ Durable Power of Attorney for financial affairs
 - ▶ Power of Attorney for health care; Health care directive
 - ▶ Letter of intent
- ▶ Probate: Pros and cons
- ▶ Practical aspects of serving as an executor/trustee
- ▶ California Right-to-Die law: Requirements and limitations
- ▶ Philanthropic opportunities
 - ▶ Consider buying cheap QALYs in third world countries
 - ▶ Quality Adjusted Life Year = Percent improvement X # years

Estate Planning Takeaway

- ▶ Just do it !!!
 - ▶ The perfect is the enemy of the good
 - ▶ Pick an attorney and get a plan on record now
 - ▶ The plan can be fine-tuned later as circumstances change
- ▶ Don't even think of implementing a DIY strategy
 - ▶ Working with a good attorney is worth every penny
- ▶ Most of the tough decisions do not involve \$ signs

Case Study

Benjamin and Geraldine Sweet

- ▶ Married couple, both age 58, married 3 years ago
 - ▶ Ben has an adult son, Charlie, age 35
 - ▶ Married to Dora with 2 teenage boys, live in Phoenix
 - ▶ Second marriage for Geri also, no children
- ▶ Ben is an engineer at HiTech start-up
 - ▶ Salary \$155,000 per annum plus stock options
- ▶ Geri is a real estate attorney at BigBank
 - ▶ Annual salary is \$190,000
- ▶ Ben and Geri hope to retire in about 4 years
 - ▶ Would like to travel and “see the world”

Ben and Geri continued

- ▶ Moved into Geri's home in Campbell, worth \$1.6M
 - ▶ Recently refinanced; 15-year 4.5% mortgage, \$1.2M
- ▶ Vacation house in Flagstaff, currently worth \$736,500
 - ▶ Ben bought in 2006, 30 year mortgage, \$500,000
 - ▶ Try to rent this house when they are not using it
- ▶ Geri owns a rental house in Visalia, worth \$628,000
 - ▶ Small positive cash-flow

Ben and Geri continued

- ▶ Excluding their home Ben and Geri have an investment net worth of just about \$1.6M
 - ▶ Ben contributes \$400/month to his traditional IRA
 - ▶ Geri has a 401(k) to which she contributes 8% of her salary
- ▶ Personal non-investment property
 - ▶ Ben owns a 2-year old Tesla, \$28,000 outstanding loan
 - ▶ Geri drives a 5-year old Mercedes

Ben and Geri's Balance Sheet

<u>Assets</u>		<u>Liabilities</u>	
Investment port.	\$2,299,669		\$758,000
Investment net worth	\$1,541,668		
Personal use assets			
Home	\$1,600,000	Mortgage	\$1,200,000
Furniture, etc	\$25,000	Credit cards	\$35,000
Ben's Tesla	\$35,000	Ben's car loan	\$28,000
Geri's Mercedes	<u>\$25,000</u>	Other	<u>\$2,000</u>
Total	\$1,685,000	Total	\$1,265,000
Personal use net worth	\$420,000		
Total net worth	\$1,961,669		

Income and Expense Statement

Income

Ben's salary = \$155k, Geri's salary = \$190k	\$345,000
Ben's vacation house rental	\$15,000
Geri's rental property	\$36,000
Interest and dividends	<u>\$8,800</u>
Total income	\$404,800

Expenses

Housing	\$117,200	Investments	\$87,000
Income taxes	\$89,452	Transportation	\$25,800
Insurance	\$4,000	Travel/Entertainment	\$41,500
Medical exp	\$15,000	Personal items	\$10,000
Utilities	\$4,000	Miscellaneous	<u>\$10,848</u>
Total expenses			\$404,800

Risk Management / Insurance

- ▶ Homeowners insurance
- ▶ Both cars are insured
- ▶ Health insurance thru HiTech and BigBank
 - ▶ Assume Medicare will cover their needs after they retire
- ▶ Geri gets life and disability insurance as a work benefit
 - ▶ Life insurance (2x salary), Ben is the beneficiary
 - ▶ Disability insurance (80% of salary)
- ▶ Ben's work does not provide life or disability insurance
 - ▶ In 2012 Ben bought \$200,000 20-year term life insurance
 - ▶ Charlie is named as the beneficiary

Risk Management / Insurance Discussion

- ▶ Ben's life insurance
- ▶ Health insurance after retirement
 - ▶ COBRA
 - ▶ Medicare, Medigap and drug policies or Advantage plan
- ▶ Longevity risk, annuity
- ▶ Long-term care needs
- ▶ Liability coverage

Retirement Plans

- ▶ Ben has a traditional IRA at Fidelity
 - ▶ Contributes \$400/month, current value = \$106,564
- ▶ Geri has a 401(k) at work
 - ▶ Contributes \$1267/month, current value = \$214,049
- ▶ They plan to withdraw \$8,000/month when they retire plus a little extra to cover their travel expenses

Retirement Plans Discussion

- ▶ Saving rate
 - ▶ Ben: $\$4,800 / \$155,000 = 3\%$ pa
 - ▶ Geri: $\$15,200 / \$190,000 = 8\%$ pa
- ▶ Planned withdrawal rate
 - ▶ $\$96,000$ pa from $\$1,541,669$ investment portfolio = 6.2% pa
 - ▶ Does not include Medicare costs
 - ▶ Need to cut back on annual expenses and travel plans
- ▶ Possible solutions
 - ▶ Postpone retirement to age 67 or possibly 70
 - ▶ Reverse mortgage

Estate Plan

- ▶ Ben drew up a will in 2013
 - ▶ The bulk of his estate goes to Charlie's two teen-age sons
 - ▶ Charlie is the executor
- ▶ Geri also has a will
 - ▶ Half her estate goes to support Susan's special needs daughter Sara
 - ▶ Remainder gets split amongst her brother's three children
 - ▶ Susan is the executrix

Estate Plan Discussion

- ▶ Ben and Geri's wills are out of date
 - ▶ No arrangements for incapacity
 - ▶ Probate may be expensive; multiple states
- ▶ A trust (or trusts) may be more suitable
 - ▶ Cheaper long-term solution
 - ▶ Can include financial and health care power-of-attorney forms
 - ▶ Tighter control over inheritances for Ben's grandsons and Geri's niece and nephews
 - ▶ Easier to provide care for Sara

Tax Returns for Last Year

▶ Federal income tax

▶ Ben's salary \$155,000 + Geri's salary \$190,000 =	\$345,000
▶ Less Geri's 401(k) contribution	-\$15,200
▶ Taxable interest	\$3,800
▶ Dividend income \$5,755 + Capital gains \$8,663 =	\$14,438
▶ Less Ben's IRA contribution	<u>-4,800</u>
▶ Adjusted gross income	\$343,239
▶ Less standard deduction	<u>-\$24,400</u>
▶ Taxable income	\$318,839
▶ Federal income tax	\$64,293

▶ State income tax

▶ Total state income tax	\$24,159
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Taxes

Discussion

- ▶ Current tax rates
 - ▶ FIT bracket = 24%, effective rate = 18.5%
 - ▶ SIT bracket = 9.3%, effective rate = 6.9%
 - ▶ Total bracket = 31%, effective rate = 25.4%
- ▶ Would a Roth IRA make sense?
- ▶ Tax rates in retirement

Investment Portfolio

Ben & Geri's CU checking (\$1,500) and savings (\$8,500) accts	\$10,000
Ben's Fidelity IRA: Contrafund = 63%, MM = 27%, + 4 funds	\$106,564
Geri's BigBank 401(k): ESOP = 36%, S&P 500 = 35%, FI = 10%	\$214,049
Ben's eTrade a/c: XOM = 49%, INTL = 8%, +12 other stocks	\$96,257
Geri's Schwab acct: Putnam G&I fund = 26%, Muni = 10%	\$192,215
Ben's stock options: Recent market value	\$125,784
Geri's CDs: Miscellaneous 1 to 3 years	\$190,000
Ben's vacation house: Mortgage = \$398,000	\$736,500
Geri's rental house: Mortgage = \$360,000	<u>\$628,800</u>
Total investments	\$2,299,669
Investment net worth	\$1,541,669

Investments Discussion

- ▶ Need a written Personal Investor Profile (PIP)
 - ▶ Personal data: Married couple, age 58, etc.
 - ▶ Risk tolerance: Ben and Geri regard themselves as aggressive investors ...
 - ... but with their planned retirement approaching should they consider taking a more conservative approach?
 - ▶ Timeframe: Ben and Geri need to recognize that their long-term approach may not be suitable now.
 - ▶ Tax status: Their portfolio includes both taxable and tax-deferred accounts. These should each be managed appropriately

Investments Discussion

- ▶ Need a written Investment Policy Statement (IPS)
 - ▶ Asset classes: Fixed income, equities, domestic, foreign
 - ▶ Asset allocation: Critical decision
 - ▶ Asset location: Taxable/ tax-deferred and tax-free accounts
 - ▶ Investment strategy: Passive/active
 - ▶ Trading/rebalancing rules
 - ▶ Prohibited investments if any
 - ▶ Expected risk and return

Summary of Ben & Geri's Financial Plan

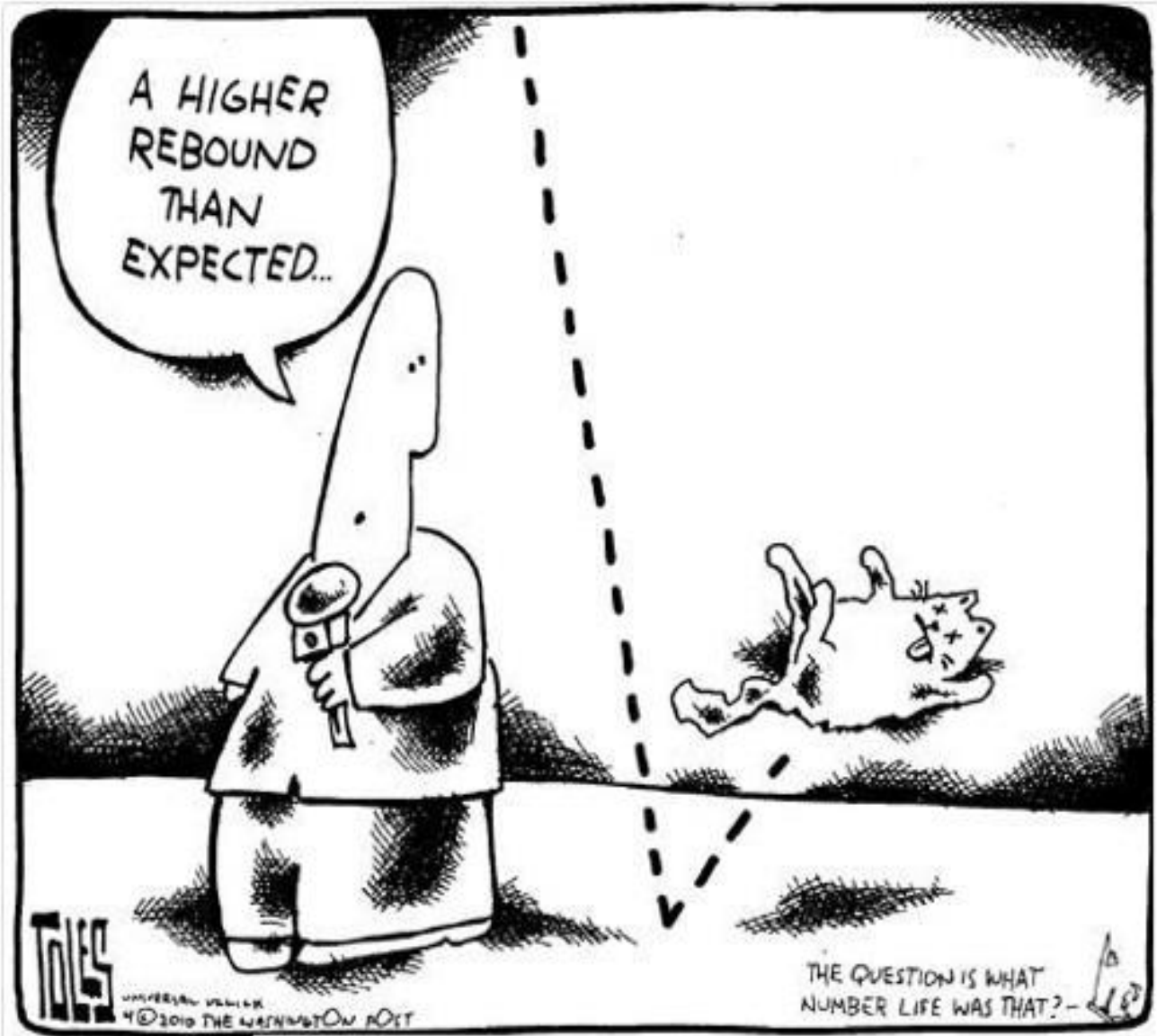
- ▶ Major action items
 - ▶ Insurance: Consider LTC policy, Income annuity
 - ▶ Retirement plan: Postpone retirement, save more
 - ▶ Estate plan: Need a trust
 - ▶ Tax situation: Asset location
 - ▶ Investment plan: Need a coherent strategy
- ▶ Consider hiring a CFP
 - ▶ Help set goals and formalize a plan
 - ▶ Provide support to implement the plan

Further Reading

- ▶ *A Random Walk Down Wall Street*, Burton Malkiel, W.W. Norton & Co.
- ▶ *Winning The Loser's Game*, Charles Ellis, McGraw Hill
- ▶ *Determining Withdrawal Rates Using Historical Data*, William Bengen, Journal of Financial Planning, October 1994
- ▶ *How To Make Your Money Last*, Jane Bryant Quinn, Simon & Schuster
- ▶ *Social Security Made Simple*, Michael Piper, The Oblivious Investor
- ▶ *Key End-of-Life Planning Tasks to Complete*, Michael Falk, AAII Journal, March 2020
- ▶ *Doing Good Better*, William MacAskill, Gotham Books

Useful Websites

- ▶ www.aaii.com Broad selection of financial planning material
- ▶ www.siliconvalleyaaii.org Previous presentations on various topics
- ▶ www.letsmakeaplan.net Find a CFP professional
- ▶ www.santaclaracountylib.org Free access to Morningstar, Value Line, etc.
- ▶ www.immediateannuities.com Annuity quotes
- ▶ www.martindale.com Martindale-Hubbell database of attorneys
- ▶ www.estateplanning.com Comprehensive source of useful info
- ▶ www.givewell.org Research-backed philanthropic ideas



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DEAD CAT BOUNCE