Retirement "Planning" … I

Typical Life Cycle

Birth ------------ Graduation day ----------------------------- Retirement day ---------------------- Death

Income: Paper route | Regular paycheck | Social Security, pension etc.

Expenses: Student loans | Mortgage | Kid's college | Go-Go ….. Slow-Go ….. No-Go years

<<<<<<<<<<<< Accumulation Phase >>>>>>>>>>> | <<<<<< Distribution Phase >>>>>

Known unknowns: Length of accumulation phase, distribution phase
Return on retirement portfolio, sequence of return risk, inflation, etc.
+ numerous unknown unknowns !

Accumulation phase (assumes saving $15,000 per annum, 7% pa return)	Portfolio at age 65
Alan starts saving 15% pa at age 35, continues every year to age 65	$1,531,096
Betty starts at age 25, continues to age 35, then stops contributing	$1,688,048
Charlie starts at age 25, continues every year to age 65	$3,219,144

Qualified plans	**Tax-deferred plans**	**Tax-free plans**
Examples	Traditional IRA, Spousal IR	Roth IRA
	401(k) and 403(b) plans	Roth 401(k) and 403(b) plans
Contributions	Deductible	Not deductible
Distributions	Taxable as ordinary income	Not taxed
Required min. distrib.	Start at age 70½	No RMDs for Roth IRA

IRS RMD tables

Table I Single Life Expectancy: For use by beneficiaries

Table II Joint Life and Last Survivor Expectancy
IRA Owner, spouse is sole beneficiary and spouse is >10 years younger.

Table III Uniform Lifetime: IRA owner
Unmarried, or Married and spouse is not beneficiary or not >10 years younger.

Roth Conversions

Convert traditional IRA to a Roth IRA Warning: recharacterization no longer allowed.
Owe taxes on deductible portions of contributions and on the earnings

The "Backdoor" Roth: Can be used when MAGI exceeds Roth limits (Single = $139K, MFJ = $206K in 2020)
Make a non-deductible contribution to a regular IRA
Then convert the non-deductible IRA to your Roth IRA
Beware the IRS "pro-rata rule"; requires total of all IRAs be used to compute share of tax owed

Asset Location

Tax-efficient products which generate qualified dividends and long-term capital gains
are best fit for taxable accounts e.g. muni bonds, ETFs, index funds, collectibles
Tax-inefficient products which generate interest, non-qualified dividends, and short-term gains
are best in tax-advantaged accounts such as IRAs, Roth IRAs, 401(k) accounts.

Household portfolio	**Tax-deferred accounts**	**Taxable accounts**	**Tax-free accounts**
	e.g. traditional IRAs	e.g. brokerage a/c	e.g. Roth IRAs
MMkt, T-Bills, CDs, etc.	*****	*	
Bonds	***	***	*
Domestic stocks	*	*****	***
International stocks		**	****
Emerging markets		*	*****

Rebalancing: Use dividends, contributions, RMDs and other distributions first, then sale/purchase.

Estate Planning Issues

Federal estate tax exemption = $11.58M for 2020, i.e. $23.16M per couple; expires at year-end 2025

But … be careful of income tax efficiency

Roth accounts are best; Heirs own no taxes, can stretch withdrawals over their lifetime

Taxable accounts are good; Step-up in basis; no tax owed if sold immediately

Tax-deferred IRAs are worst; No step-up in basis; heirs owe ordinary income tax on distributions

Consider leaving to charity. Qualified Charitable Distributions, QCD, count as RMD.

Managing your cash flow in the distribution phase

Income: 3-legged stool: Pension, Social Security, Retirement portfolio

Expenses: First cut = 80 % of final salary; No retirement plan contributions, commute expenses, lower taxes, etc.

Retirement planning software: T. Rowe Price, Vanguard, Fidelity, Schwab, AARP, etc.

Better to do a budget; Travel, increased medical expenses, long term care, etc. {See local chapter website}

Income needed from your retirement portfolio after Social Security benefits, pension, etc.

(a) **Safety first approach**

Provide a guaranteed income stream for life, regardless of stock market fluctuations

Fixed income; Bond ladder

Single premium income annuity (SPIA), Deferred income annuity (DIA) {more in March}

(b) **Probabilistic approach**

Pick a safe withdrawal rate based on historic returns, e.g. Bengen's 4% withdrawal rate.

Typically funds a higher standard of living than the safety first approach, but…..

….. small but finite risk of outliving your portfolio. {more next month}

Problems with all retirement planning software: Beware precision output to 5 significant figures; GIGO!

Output is only as good as input assumptions: Life expectancy; actuarial tables only give averages

Market returns, Sequence of return risk, Tax rate forecasts, inflation estimates

Compounding these unknowns 35 years into the future is not an exact science!

Best uses for retirement planning software: Learning tool, Comparison of scenarios, Sensitivity analyses

Even a rough plan is significantly better than no plan. Update and re-evaluate annually.

What if I can't stretch the portfolio to age 100?

Unattractive solutions: Start saving earlier, save more, work longer, reduce withdrawals, seek higher return

Consider other possible solutions: Reverse mortgage, Annuity {more in March}

Home Equity Conversion Mortgage, HECM: insured by Federal Housing Administration, FHA

Requirements: Age 62 or older, significant equity in principal residence, pay taxes, insurance

Maximum loan: Lesser of appraised value or $726,525 (2019) adjusted for age of youngest borrower

Form of loan: Lump sum, monthly payments, non-cancellable line of credit, combination of these

Cost of a HECM: Closing costs, origination fee, interest, mortgage insurance, service fees

Possible uses for HECM credit line:

Defer Social Security benefit to late retirement

Allows smaller short-term cash bucket for emergencies; lower "dead money" cost

Reduces sequence-of-return risk; minimizes need to sell equities in a bear market

Can provide living expenses if retirement portfolio is exhausted.

Non-recourse credit line, unused portion grows at interest rate; consider applying early

Potential Train Wrecks to a great retirement plan

Longevity, Long-term care, Liability litigation {more in March discussion on insurance}

Next month, January 8th, 2020: Retirement Planning … II Safe withdrawal rates, Bucket strategies

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