

RETIREMENT MATTERS



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YOUR RETIREMENT PLANNING NEWSLETTER

Depending on Social Security?

Future benefits may not be there in full for program beneficiaries

If you've ever read the fine print on your annual Social Security statement, you'll see it written in black and white: **"Social Security benefits are not intended to be your only source of income when you retire."** But here's the real clincher: "The law governing benefit amounts may change because, by 2034, the payroll taxes collected will only be enough to pay about 79% of scheduled benefits."

That doesn't mean the program is expected to run out of money, though. It only means that, unless Congress acts, the program will not be able to generate enough revenue to cover the costs of the program.¹ That said, given the risk that Social Security could run short of money within a couple of decades, you should plan for the possibility, however remote, of reduced benefits.

Why benefits may fall short: slower growth, aging population

- In 2018, Social Security's cost exceeded its income for the first time since 1982, partly due to lower projections for economic and labor-force growth, forcing the program to dip into its \$3 trillion trust fund to cover benefits.²
- The 83-year-old program's costs are rising because America's population is aging, and revenue growth is slowing because the economy isn't growing as fast.

Does that mean you'll get no Social Security benefits, or reduced benefits? There's no way to know for certain how the government will address the issue (Congress has debated how to shore up the program's finances but has not yet agreed on what to do).

Don't ignore the "What if's"

It may be sensible to consider a couple of alternatives if Social Security runs short of its growth projections — just to be on the safe side. You can do that by estimating your Social Security benefit at 80%, 50% and 0% to see if you will have enough to fuel your future lifestyle and spending needs. Smartasset has a simple



calculator at that uses your age, annual income and marital status to project what your annual Social Security payments might look like. <https://smartasset.com/retirement/social-security-calculator>

If you're a younger saver, you may need to change your spending, saving and investing strategies to make up for lost guaranteed income.

Penny wise?

President Franklin D. Roosevelt signed the Social Security Act into law on August 14, 1937, a law which he said "will give some measure of protection to the average citizen and to his family against the loss of a job and against poverty-ridden old age." In January 1937, Ernest Ackerman was the first person to collect Social Security benefits. He received a one-time payment of 17 cents.³

¹ "David Harrison, "Social Security Expected to Dip Into Its Reserves This Year," *Wall Street Journal*, June 5, 2018. <https://www.wsj.com/articles/social-security-expected-to-dip-into-its-reserves-this-year-1528223245>

² Ibid.

³ Jessica Kwong, "Social Security Anniversary: Why, 83 Years Later, the Safety-Net Program is Running Out of Money," *Newsweek*, Aug. 14, 2018. <https://www.newsweek.com/social-security-anniversary-why-its-running-out-1071112>

Good Window of Opportunity for Roth IRA Conversions

The Roth IRA is a powerful tax-favored retirement option since it can offer a hedge against future tax-rate increases. But beyond tax planning considerations, Roth IRAs have several important advantages over traditional IRAs:

1. Unlike a traditional IRA, a Roth IRA distribution is tax-free if you've had the account open at least five years, and reached the age of 59½, become disabled or died.
2. You can make contributions to your Roth IRA after age 70½, depending on whether you fall within the earned income limits.
3. Roth IRAs are not subject to the traditional IRA rules for required minimum distributions at age 70½.

The Internal Revenue Code allows IRA owners to convert significant sums from traditional IRAs to Roth IRAs. But you have to follow these important rules (among others):

- The ability to contribute tails off at higher incomes. For 2019, the eligibility to make annual Roth IRA contributions is phased out between modified adjusted gross income (MAGI) levels of \$122,000 to \$137,000 (unmarried individuals) and \$193,000 to \$203,000 (married joint filers).⁴
- The conversion is treated as a taxable distribution from your traditional IRA. Doing a conversion likely will trigger a bigger federal income tax bill and possibly a larger state



income tax bill. However, today's lower federal income tax rates might be the lowest you'll see in your lifetime, and the tax benefits of avoiding higher taxes in future years may extend to family members after death.

Many tax experts suggest that the best reason to convert some or all of your traditional IRA to a Roth IRA is if you believe your tax rate during retirement will be the same or higher than what you are paying currently. Since you're no longer allowed to reverse a Roth IRA conversion, it's important to understand the tax ramifications. Talk to your tax advisor before taking any action.

TRADITIONAL VS. ROTH IRA: HIGH-LEVEL COMPARISON

Here is a simplified comparison of IRA rules and tax benefits. Remember, tax laws are complex and subject to change. Consult a tax advisor about your individual situation before taking action.

	Traditional IRA	Roth IRA
Age limits for contributing	You must be under 70½ to contribute.	You can contribute to a Roth IRA at any age.
Income limits for contributions	Your contributions can't exceed the amount of income you earned in that year or other IRS-imposed limits.	Your contributions can't exceed the amount of income you earned in that year or other IRS-imposed limits, and can be reduced or eliminated based on your modified adjusted gross income.
2019 tax-year contribution limits	If you are under age 50, you can contribute up to \$6,000. If you are older than age 50, you can contribute \$7,000. (Limits can be lower based on your income.)	If you are under age 50, you can contribute up to \$6,000. If you are older than age 50, you can contribute \$7,000. (Limits can be lower based on your income.)
Claiming deductions on tax return	You may be able to claim all or some of your contributions.	You cannot deduct your Roth IRA contribution.

⁴ Source: Bill Bischoff, "How the new tax law created a 'perfect storm' for Roth IRA conversions in 2019," MarketWatch.com, Jan. 16, 2019. <https://www.marketwatch.com/story/how-the-new-tax-law-creates-a-perfect-storm-for-roth-ira-conversions-2018-03-26>

Balancing Act: Income, Expenses and Withdrawals

In projecting what you'll need to save in order to generate enough retirement income, it helps to (1) prepare a realistic household budget and (2) understand what types of expenses you'll have once you stop earning a regular paycheck.

TYPES OF EXPENSES

Fixed Expenses – “Must Haves”
Mortgage or rent
Taxes (income and property)
Car payments, gas and maintenance (if applicable)
Health insurance
Food
Utilities

Sensible savers will plan to cover all must-have expenses before they consider splurging on nice-to-have items. You'll also need to factor inflation into your expense projections: certain sectors of the economy, such as health care, have seen prices rise much higher than everything else.

How much should you take out of your savings?⁵

Retirement brings with it many unknowns, including how much you can spend each month from the so-called “three-legged stool” of Social Security, retirement plan and personal savings. Withdrawal amounts depend on how much you've saved and the expected return on your current investment mix and age, among other factors.

Much research has focused on what percentage of account value retirees can take each year so that the money won't run out — assuming various rates of inflation. Some analysts suggest that 3.0% to 4.0% is a sustainable withdrawal-rate range in the early years of your retirement. A 4% withdrawal rate is considered sustainable except in cases where inflation creeps above 5%. But withdrawal rates of 5% or higher are risky, especially when inflation approaches 4%.⁶ Depending on the size and health of your nest egg and the growth rate of your expenses, you may be able to adjust this rate in future years.

Order of withdrawals can make a difference

Deciding which of the “three legs of the stool” to spend first depends to a great extent on tax laws. Most people know that delaying taking Social Security payments until age 70 can mean higher payments later; they may not realize that a portion of Social Security income is taxable at ordinary tax rates, which currently is set at a maximum 37%.

Discretionary Expenses – “Nice to Haves”
Eating out
Entertainment
Travel
Sports and hobbies
Gifts
Shopping

Remember that tax issues and IRS rules on qualified plan distributions can be very complicated. For example, although your money can grow tax-deferred inside a 401(k) or pension account, once you take a withdrawal, the entire distribution is hit with your ordinary-income tax rate and possible penalties if you're under age 59½.

On the other hand, selling stocks you hold in a taxable account means that only your capital gains will be taxed at the current maximum of 20% (depending on your income). Some think it's best to take money first from regular taxable investment accounts and let tax-deferred accounts continue to grow.

Not everyone agrees with this strategy, though. Depending on your circumstances, some think it makes sense to withdraw money from your IRA and 401(k) before spending down your taxable assets. “The idea is to let the assets that will be taxed at the lowest rate accumulate for the longest time,” says Robert Carlson, author of *The New Rules of Retirement: Strategies for a Secure Future*. For example, if you think income tax rates will be higher in the future, you may want to spend down your taxable assets sooner. Consider enlisting the assistance of online tools or retaining a financial planner to tailor the order of withdrawals to your specific needs and tax situation.



⁵ Withdrawals from qualified plans prior to age 59½ may be subject to a 10% IRS penalty. Account values are subject to income tax upon distribution. This discussion is not intended to show the performance of any fund for any period of time or fluctuations in principal value or investment return. Periodic investment plans do not ensure a profit nor protect against loss in declining markets.

⁶ Gerstein Fisher, “What’s a Sustainable Withdrawal Rate for a Retirement Portfolio?” Seekingalpha.com, May 1, 2018. <https://seekingalpha.com/article/4168085-sustainable-withdrawal-rate-retirement-portfolio>

Retirement in Motion

TIPS AND RESOURCES THAT EVERYONE CAN USE

First-time Home Buyers Rely More on Family for Mortgage Help

The way that people are financing their first home purchase is changing. More than 26% of mortgage borrowers who used FHA-insured loans received help from a relative to make the down payment, according to 2018 FHA data reported by the *Wall Street Journal*. That number is up from 22% in 2011. Rising home prices and interest rates made it difficult for buyers to save enough for down payments — not to mention generally higher debt loads from college loans.⁷ Further adding to borrower stress is the fact that the gap between owning and renting continues to widen, according to Freddie Mac.⁸

Q&A

How can I include funds that consider ESG in my portfolio?

The companies you choose to invest in can matter to you just as much as the financial results. Many 401(k) plans offer funds that incorporate environmental, social and governance (ESG) criteria as well as financial fundamentals in their investment process. Studies show that a growing number of

investment managers consider ESG factors when selecting companies for investment. To learn how to incorporate more ESG exposure into your portfolio, talk to your plan administrator or HR department.

Quarterly Reminder

With changes in the new tax law, you may have decided to lower your federal tax withholding so that you're taking home more pay. It may be very tempting to use a fatter wallet to buy more things. But if you are falling short of your retirement goals, consider increasing your 401(k) contribution instead.

Tools & Techniques

Investment concepts you should understand

Fraud is a rapidly growing risk for all Americans, not just the elderly. The AARP Fraud Watch Network has useful tips to avoid credit card scams, get scam alerts delivered to your phone and offers a scam-tracking map to see (and report) what's been perpetrated in your local area — and much, much more: <https://www.aarp.org/money/scams-fraud/>.

⁷ Source: "More First-Time Home Buyers Are Turning to the Bank of Mom and Dad," *Wall Street Journal*, Jan. 4, 2019. https://www.wsj.com/articles/more-first-time-home-buyers-are-turning-to-the-bank-of-mom-and-dad-11546597800?cx_testId=16&cx_testVariant=cx&cx_artPos=3&cx_tag=collabctx&cx_navSource=newsReel#cxrecs_s

⁸ Freddie Mac Multifamily Research Center, 2019 Outlook, Jan. 2019. <http://www.freddiemac.com/research/pdf/2019-Outlook.pdf>



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