

# Financial focus



SPRING 2021

## In This Issue



### Add a Ritual to Your Charitable Giving

-Zach Teutsch



### Choosing a College: Where to Start

-Rob Reed



### Sustainable Withdrawal Rates in Retirement up for Debate

- Tim Sullivan, CFP®, EA



### Ways to Weather Unexpected Needs for Emergency Cash

- Karen Folk, Ph.D., CFP®

Start the ritual in a way which distinguishes it from normal life (reading, candle, music, etc.), then do your decision-making and execution of to whom and how much to give. Bring it in for a close by creating a last part of the giving process before re-emerging into the everyday. Perhaps you light a second candle, play a different piece of music, read a different intention, sing a song, walk around the block, eat a special food, or make a certain movement. Whatever it is, it helps to demarcate the end of your giving ritual.

Bring creativity to designing your ritual. Use elements which you find meaningful whether from your family, your faith tradition, or something from your own story. We love helping clients identify something that fits into their family rhythms. For instance, some of our clients light shabbat candles every week so we helped them decide to take a moment before they light the candles to think about issues or suggestions of giving ideas that came up during the week. They then write them on a running list they kept nearby (but not too near!) the candles.

If you want to make decisions with a partner, friend, or family members, perhaps after the pandemic, schedule a nice meal at a restaurant to discuss it. Order dessert to associate the happy memories with the good work. Or during the pandemic, perhaps this is a good excuse for a phone or Zoom call with a little more content to help you connect one-on-one with people you care about.

Do you need a ritual for your charitable giving? Of course not! But it will probably help the experience be meaningful. If you don't have a ritual, that's okay too and it should definitely not keep you from starting your annual charitable giving. Start and then figure your ritual out in a future year.

Also, consider whom you want to engage with on these issues. If you have kids, you might consider how to include them. One of the best teaching tools is modeling what you hope your kids will learn. Ron Lieber, an exceptional finance writer, wrote *The Opposite of Spoiled* which covers many questions about how to talk about kids about money, including giving. It is well worth reading.

You might also consider the idea of a giving circle or other participatory philanthropy options. They can be structured in a lot of different ways. One way is that people come together, commit to giving money (different amounts or all the same), and work together on researching/deciding but then write their own individual checks along with a group cover letter. Another model is to pool money together and then decide as a group where to donate.

A third model is to work with groups like DC's Diverse City Fund, where donors delegate the actual decision-making to a grants team made up of people from directly impacted communities rather than the donors deciding who gets grants. There is a powerful idea built into this model. Our lived experience strongly influences which issues we know and care about. In this view, people who are part of the communities most impacted have lived experiences that better prepare them for making those decisions.

## Add a Ritual to Your Charitable Giving

By Zach Teutsch  
Washington, DC

When it comes to charitable giving, the exact amount of money we give does not necessarily define how meaningful it feels. However, the rituals we create around our giving can make a big difference.

If you do (or will start doing) most of your giving once a year, consider setting the context so you will be more mindful. Most good rituals have a beginning, middle, and end. You might start by reading an intention, for example: "Here I sit, in recognition that the world is broken and that I must help to repair it, that I have more than I need, and that others have less. I will do my duty to use what I have to repair the world and meet the needs of others as I can." You could listen to a piece of music or even eat a special food. What symbolizes the values you hope to reflect in your giving? Perhaps you have never articulated why you give, what problems you see, your capacity to address them, or why you think you should give. If not, maybe that is worth exploring. You can explore through conversation, reading, art, or some other way. Whatever way you choose, your giving will be more valuable as you develop a giving vision and consider its importance to you.

# Choosing a College: Where to Start

By Rob Reed  
Columbus, OH

Parents spend far too much time thinking about how to pay for college instead of what kind of college their child should attend. Yet the kind of school a student attends affects not only what parents pay but—much more importantly—their child's college experience and chance for success.

The issue is not how smart your child is but finding where your child can best succeed. Where can they flourish? Start the conversation with your student in their sophomore year. In what type of school will they likely be happier? Often, the relationship between a student and their professors is the basis for that success. A professor, like any employee, responds to incentives. Here, we will classify colleges according to what they pay professors to do.

NOTE: This list focuses on general education institutions offering undergraduate degrees. It excludes technical schools, military institutions, and strictly sectarian schools.

## Community Colleges

Professors are hired and promoted based on their teaching. An excellent start for students who feel they need extra preparation or who are unsure about attending college, community colleges are inexpensive and offer a solid grounding in college basics. They offer small classes and highly personalized instruction.

Advantages: if a student discovers they have little interest in a general college education, they can transfer directly into one of the school's vocational programs. This training offers a solid preparation for a well-paying career. If, on the other hand, a student discovers an aptitude for college-level academics, they can later transfer into a four-year college or a state university and save years of higher tuition cost.

## Four-Year Colleges

Professors are hired and promoted primarily based on their teaching, though they are expected to do published research. These mid-sized schools have mostly regional reputations and typically grant only undergraduate degrees. Most classes are small and taught by full-time faculty who are expected to personally mentor students. Good schools in this category have a close, nurturing academic atmosphere.

These are good schools for students who are ready for college but have not settled on a particular interest area. They are also good for students who need personal attention from professors or who feel overwhelmed by a massive campus. There are many schools in this category and consequently there is much variation in quality and character. Tuition reflects this variation.

## Large State Universities

Professors are hired and promoted primarily based on their research. With national reputations, campus populations of 20,000 or more, and topnotch faculty, your child will likely be taught by the professor's graduate students or be in classes of several hundred students taught by the professor during their freshman and sophomore years. University faculty have little time to actively seek out undergraduates to mentor. While this sounds grim, engaged undergraduates with initiative can easily find professors who are genuinely interested in working with them. Students, however, must be assertive enough to seek out professors.

Large state universities offer a great selection of courses and much more: the chance to work directly with first-class faculty, student organizations devoted to professional development, dozens of clubs to pursue personal interests, and a diverse group of students. These schools offer tremendous opportunities, but to take full advantage a student must be prepared to go beyond merely attending classes.

Many large state universities have branch campuses. These campuses offer the advantages of small class size, personalized professional instruction, and often a more relaxed admission policy. Later transfer to the main campus is typically straightforward.

## Elite Institutions

At elite institutions professors are paid and promoted based on outstanding teaching and research. These internationally known schools boast small classes taught by world-renowned scholars. This is the "best of both worlds" and tuition reflects this fact. Admission is highly competitive but, for many students, attendance is a life-altering experience. These schools are a serious commitment: both for the parents who pay the bills and for the student who strives to succeed in this high-pressure environment.

For bright students who cannot afford or gain admission to an elite institution, the honors program at a large state university is a cost-effective alternative. These programs are essentially mini-elite institutions set inside a larger university. Professors compete to personally teach these students who often have their own classes, dorms, and mentoring programs.

Keep in mind, this is only a general overview. Within each college type there are good and bad schools, better and worse bargains. This classification does not single out the "best" colleges; hopefully, it will help you identify the type of college that best fits your child.





# Sustainable Withdrawal Rates in Retirement up for Debate

By Tim Sullivan, CFP®, EA  
Columbia, MO

In his article “Determining Withdrawal Rates Using Historical Data,” published in the *Journal of Financial Planning* in 1994, William Bengen introduced what would become known as the “4% rule” which has since become standard industry—and consumer—parlance. Using historical returns dating back to 1926, he determined through this and subsequent research that an individual could have withdrawn a maximum of 4.5% annually from a balanced portfolio over any 30-year period without running out of money.

Bengen coined the term “SAFEMAX” to describe the maximum “safe” portfolio withdrawal rate for clients starting at the beginning of their retirement. This SAFEMAX rate assumes that money is held in a tax-advantaged account, withdrawals are adjusted annually for inflation, and the portfolio needs to last for at least 30 years. In a recent article in *Financial Advisor* magazine, he describes how the 4.5% figure “is based on a ‘worst case’ scenario—for the individual who retired on October 1, 1968 and suffered through years of poor stock market returns and high inflation.”

However, the individual who retired during the most optimal 30-year period could have withdrawn up to 13% of their portfolio annually without running out of money! In fact, according to Bengen’s article, the average SAFEMAX over the period 1926 to 1990 was a very healthy 7%—significantly higher than the low end 4.5%. Of course, when an individual retires, they do not know if they are retiring at a “good” time or a “bad” time. If market returns are “good” in subsequent years, they can have a higher SAFEMAX rate. Alternatively, retire at a “bad” time and withdrawal rates must be lower.

Determining an optimal SAFEMAX rate can have significant ramifications for a retiree. For example, if the rate is determined to be 4.5% and a client needs \$50,000 per year in retirement income, their portfolio would need to be just over \$1.1 million to support this cash flow. If instead the safe withdrawal rate was determined to be 7%, the portfolio would only need to be about \$714,000 or approximately 35% less than previously required. Lower SAFEMAX rates may lead to excessive savings requirements, delayed retirement dates, reduced cash flows in retirement, or some combination of all three.

Bengen goes on to describe his efforts to determine whether the SAFEMAX rate can be tailored to individuals based on market valuations at the start of retirement. Two key numbers he examined were the “Schiller CAPE” or “CAPE” and the current inflation rate. The CAPE is similar to the more widely known P/E ratio or price-to-earnings ratio. However, the CAPE ratio measures the stock price relative to the 10-year average earnings adjusted for inflation. Essentially, instead of looking at short-term company profitability, it looks at a company’s long-term performance. When the same ratio is applied against the entire stock market, it can be an indicator of an overall market that is expensive or cheap when compared to historical numbers.

What he found was a correlation between SAFEMAX rates, the CAPE rate, and the most recent 12-month inflation rate. For example, if the inflation rate was moderate (2.5–5%) and the beginning Schiller CAPE was between 8 and 10, the SAFEMAX rate was 9%. On the other hand, if the Schiller CAPE range was greater than 22, the SAFEMAX was only 4.5%. Some of these results seem intuitive. If stocks are cheap at retirement, it stands to reason that a higher withdrawal rate could be supported based on above average market returns in the future. On the flip side, if stocks are expensive already, it is unsurprising that the safe withdrawal rate would be significantly lower. However, the effect that inflation had when combined with the CAPE rate was less intuitive and needs to be studied further.

Perhaps all this historical data is irrelevant and even 4.5% is too high given the current CAPE rate of 33.4 is nearly double its long-term average and interest rates are extremely low. Nevertheless, Bengen’s research further highlights a dilemma in the financial planning community. Clients often need or desire higher withdrawal rates, but no advisor wants to see a client run out of money because they recommended a higher withdrawal rate than what ultimately proved sustainable.

There is no “one size fits all” approach, but as pensions become less and less common, sustainable withdrawal rates will be at the forefront of tomorrow’s retirement planning.



# Ways to Weather Unexpected Needs for Emergency Cash

By Karen Folk, Ph.D., CFP®  
Champaign, IL

Newly married, with my husband in school and no credit, we turned to the “Bank of Mom and Dad” several times to pay unexpected expenses, mostly related to car repairs or replacing our worn-out clunker with a more reliable one. Out of school, and fully employed, we switched from relying on relatives to credit and savings to cover those unexpected expenses. Where do you get the cash you need to pay for unexpected emergencies?

Having adequate emergency funds is one of ACP’s Five Fundamentals of Fiscal Fitness. We recommend building two types of emergency funds. The first fund provides enough to cover those unexpected expenses that inevitably crop up. A 2015 survey found that 60% of households have some type of unexpected expenses each year. The median expense in that survey was \$2,000 (Pew Research Center).

How much do you need in your fund for those inevitable unexpected expenses? For those with steady wage income, we recommend aiming for 10% of annual income in ready cash savings. For those with variable income or the self-employed, we recommend 20% of income, as unexpected expenses invariably crop up when income is low. Setting up an automatic transfer to savings from each paycheck is the best way to start building a fund, no matter how small your initial monthly amount. You can boost your unexpected emergency fund with windfalls such as tax refunds. If you are just starting a fund, you could aim to first save enough to cover your insurance deductibles, and once that goal is met, continue to build up to the recommended 10% of income.

The second type of emergency fund, designed for periods with loss of income, needs to be larger—to replace lower income during months of job loss, reduced hours, or an accident with a lengthy recovery period. I like to call this your “dire” emergency fund and we recommend that it be twice the size of your unexpected expenses emergency fund. Such events will be rare, but the consequences can be devastating. The top two causes of bankruptcy in the US are medical bills and loss of employment. With the COVID pandemic, income loss has hit many. An April 2020 survey found that 43% of US adults said that they or someone in their household had lost a job or taken a cut in pay due to the outbreak (Pew Research Center). And, that same survey found that only 48% of middle-income households had “rainy day” funds that would cover living expenses for three months.

The good news is that accumulating that larger “dire” emergency fund can sometimes be accomplished by setting aside part or all of an inheritance, cash value of life insurance, or by reallocating

to less risky investments within existing accounts. Retirement accounts (IRAs, or employer 401k, etc.) are good places for this larger emergency fund. Setting up an automatic monthly contribution can start building this loss of income fund, and, once your goal is reached, continued contributions build retirement investments. While the conventional wisdom is to invest a good portion of retirement accounts in the stock market for long-term growth, keeping the amount needed for “dire” loss of income emergencies in safe interest-earning investments provides the needed cushion that could be withdrawn or borrowed during periods of loss of income.

When clients come to us for comprehensive financial planning advice, we can often find ways to immediately fund their “dire” emergency fund in full by shifting the needed funds from stock investments to safer bond or other interest-earning options within their retirement accounts. This provides protection from the “triple whammy” that you hope never happens: your partner is laid up for six months with a broken leg, your hours at work are reduced, and the stock market plummets. While there are penalties for early withdrawals from retirement accounts, periods with loss of income also come with lower income tax rates. Longer-term CDs are another safe place to accumulate funds to be tapped in “dire” emergencies. Longer-term CDs pay higher rates of interest until maturity. If they are needed to replace income, you pay the early withdrawal penalty. If not needed, they earn the higher rate of interest and grow to cushion future income emergencies.

Starting small, increasing over time, and making the savings process automatic are all proven strategies to build funds that will tide you over until the emergency need is met, without threatening your long-term financial security. You can do this! There is no better time to start than now.

All content provided by members of:

