April 2021

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Mallard Advisors LLC

Comprehensive Financial Planning & Wealth Management Solutions

The Quarterly Mallard Call

Retirement Accounts for Strong Savers

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Supporting your lifestyle over a 35-year retirement will be the most expensive goal you will have, and the burden is squarely on you. Because of its cost, you must prioritize your retirement savings - even in the face of college costs or other goals. Unlike these other goals, retirement is not optional and it can't be financed. This is true regardless of income level. Even high-income earners must have very strong savings rates since they generally have high lifestyles. Therefore, strong savings will be required in order to maintain this high lifestyle into retirement.

So, this is a massive goal that requires laser-like focus to build savings habits and maintain your savings rate as your income rises over time. If you are both motivated and have prioritized saving, where do you put your hard earned savings? Naturally, you want to leverage the dollars you set aside by putting them in the best places for long-term savings, but what are the options?

High-income earners or anyone with a strong savings rate face a dizzying array of choices including:

+ Bank Savings Account
+ 401(k) or Roth 401(k)
+ Health Savings Account (HSA)
+ Variable Annuity
+ Deferred Compensation Plan
+ Paying Down Debt
+ IRA or Roth IRA
+ 529 College Savings Plan
+ Taxable Investment Account
+ Employee Stock Purchase Plan (ESPP)

Some of these choices result in tax savings now. Others have no tax savings now, but get a tax benefit on the back-end. Some are liquid, and others are locked-up for a while. Some have significant fees, and others are very low cost. Some have forced distribution requirements, and others don't. Some are created for a specific purpose, while others can be used for anything. Savers must weigh the tax benefits, the liquidity, the costs, purpose, and distribution requirements to make the best decisions.

For our clients who are typically high-income earners, income taxes are one of the single largest expense over a lifetime. Therefore, leveraging retirement savings is best done by making decisions based upon the potential lifetime tax savings. Retirement accounts can provide one of three types of tax benefits. First is an *up-front tax deduction*. The most common example is a 401(k) or IRA which is a great savings vehicle because you get to reduce your taxable income when you put money into the account. However, all funds are taxable upon withdrawal. The second is a back-end tax benefit where the savings go into the account with no tax deduction. At a later date the savings (and the earnings) come out of the account with no tax liability - in other words, *back-end tax-free withdrawals*. The most common example here is a Roth IRA. The

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Notices

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When completing TD Ameritrade paperwork, please ensure each form has an *original* signature. TD Ameritrade will not accept photocopies of the same signature, even if you are completing multiples of the same form.

Use ShareFile

When sending confidential information to us, please remember to use the secure *ShareFile* link contained at the bottom of each of our email signatures. This link is also located at the top of every page of our website.

Mallard E-Mail Update

We strongly encourage all clients to read our E-Mail Updates (which are different from this newsletter). They may contain important information that is relvent to your situation. Just call us if you think something may apply to you so that we can discuss it.

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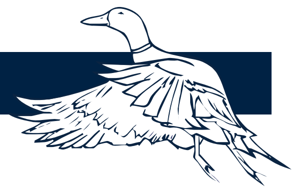


third type of tax benefit that these account types have is tax-deferral.

That means while your money is invested, the earnings do not get taxed which would otherwise chip away at the value of the account. These accounts would all be considered “Double-Tax-Preference Retirement Accounts”.

What if I told you there is an account that combines the up-front *tax deduction* of an IRA/401(k) with the *tax-free* withdrawals of a Roth IRA? This is an amazing double tax benefit within one account. Further, it too has tax-deferral and earnings are not taxed and they can build up inside the account (just as the IRA’s and Roth IRA’s do). In other words, with this special type of savings account, you get triple tax savings! This type of account is called a Health Savings Account (HSA). The Health Savings Account (HSA) is the ultimate savings machine as it is the only type of account with these triple tax benefits. To learn more about HSA's see our blog post on the subject.

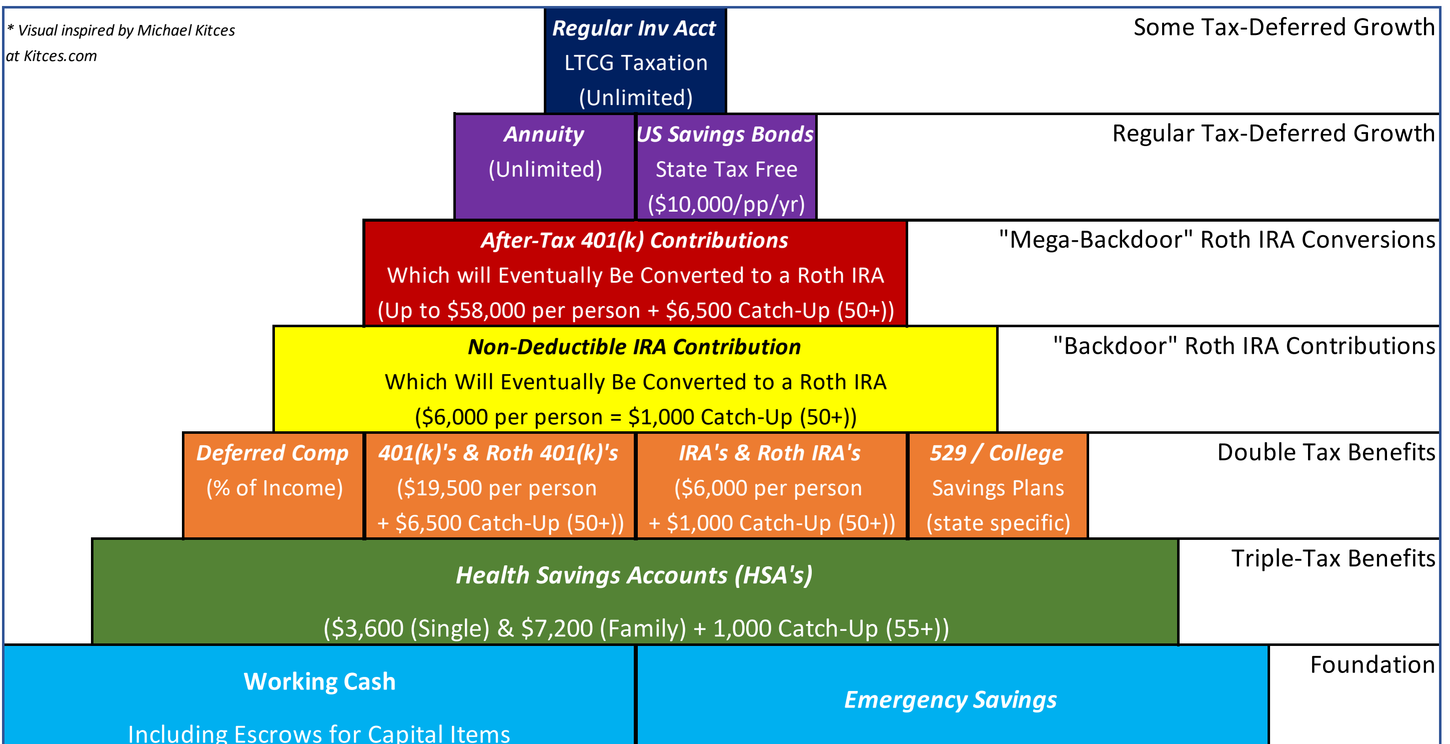
A major question becomes "Do I want to save money on taxes now or later?". Well, this depends on your tax rate now versus later. This is easily determined for our clients as we projected their taxable income over multi-decade time periods. If, like most income earners, you are in a high tax rate now, the front-end tax savings will be more attractive than the back-end tax savings.

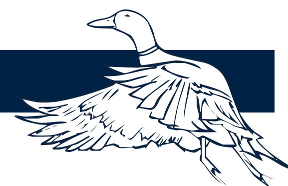
Everyone is different so for this article, we will focus on some common rules of thumb for the high saver who is in a high tax bracket now. There are nuances to the use of several of these saving strategies, so be certain to speak with a financial or tax professional. Also, I am excluding potentially valuable savings strategies (such as an employee stock purchase plan, or paying down debt) as they are less tax relevant.

First, it is assumed the foundation is covered with an appropriate amount of cash for monthly needs, emergencies, capital items (e.g. home improvement).

The visual at the bottom of the page will be our reference tool in helping to prioritize among the different types of retirement accounts. The bottom of the pyramid has more tax favorability (other than the foundation), and less as you move up towards the top.

After securing a foundation of liquid safe cash, the strong saver with a desire to lower lifetime taxes will max out their HSA (if available). As mentioned earlier, this is the only retirement savings account with triple-tax benefits. However, only a high-income earner can truly take advantage of the triple tax bene-





fits of an HSA. This is because they have the ability to both fund the account each year yet *NOT USE* the account until retirement. This would require that you not only fund the HSA, but that you also pay your current medical expenses out of your own pocket instead of using the HSA. This can be hard, but it works for those with the cash flow (or other assets) to do so. In doing so, they can take investment risk with the expectation of higher returns. This is the only way to take advantage of the back-end tax benefits: tax-free growth. In fact, this is the ideal scenario: **fund the account; avoid withdrawals; invest the balance; and let it grow tax-free for your future retirement medical expenses.**

The next accounts that a strong saver would fully fund are those with the double-tax benefits such as a 401(k) with an up-front tax deduction. Again, the up-front deduction of a 401(k) or IRA is generally preferable to the back-end tax-free nature of a Roth 401(k) or Roth IRA due to the saver's high tax rate. Many executives also have access to a Deferred Compensation Plan. This too has the same double tax benefits of a 401(k), but with different distribution requirements and much higher contribution limits. The downside is that these plans are subject to the claims of the employers' creditors. Most strong savers as a result of their high income are not eligible to contribute to a deductible IRA or Roth IRA.

If saving for college is a goal, then the 529 college savings plans are ideal. While they do not provide the up-front tax deduction high-income earners desire, the high contribution ceilings and tax-free growth (just like a Roth IRA) are still quite valuable especially when saving for a young child.

The next level in the pyramid refers to a "Backdoor" Roth IRA Contribution. Since the high income earner does not qualify to make a deductible pre-tax IRA contribution or a Roth IRA contribution, they still contribute to the IRA without the benefit of the tax deduction. This is known as a non-deductible IRA contribution. However, once funded, the account can eventually be converted to a Roth IRA (as there is no income limit on Roth Conversions)! It is called a "back-door" because you can't go in the front-door with a direct contribution to a Roth IRA, but you can still get there via this strategy.

The next savings vehicle for the strong saver would be the "Mega-Back-Door" Roth Conversion. This is similar to the previously described strategy, but in this case, you are making non-deducible (after-tax) contributions to a 401(k). This option is not available to everyone with a 401(k), but if it is, allows contributions beyond the up-front deductible contributions up to the $64,500 contribution limit (if age 50 or older) for total contributions to a 401(k). In other words, if you are already contributing the pre-tax maximum of $26,000 (age 50+), you still are potentially able to contribute another $38,500 to meet the overall limit of $64,500. These contributions can eventually be converted to a Roth IRA—either while still working (if the plan allows) or at retirement. Imagine making $20,000 of annual after-tax contributions for 5 years prior to retirement, and being able to convert the total $100,000 to a Roth IRA—with no tax cost!

There are accounts that do not provide up-front tax-deduction, or tax-free earnings, but do provide some sort of tax-advantaged growth over time. For example, U.S. Savings Bonds grow over time with complete tax-deferral of the earnings. In other words, the earnings are not reported to the IRS each year. Instead, they grow tax-deferred without erosion from annual taxation. Once you cash them in, while you will have interest taxed by the IRS, the interest is state tax free. There are also insurance accounts which fall in this category such as annuities and cash value life insurance.

Finally, we reach the top of our pyramid which provides some tax-deferred growth. This is the regular old taxable brokerage investment account. If purchasing tax-efficient assets such as a large-company U.S. index funds, these investments are essentially tax-deferred in that the capital gains are not taxable until the investment is sold. When there are investment losses, you are able to deduct those losses (subject to some limitations).

As a strong saver, you can save in a variety of accounts using different strategies in order to minimize lifetime taxation. Hopefully, it is now easier to prioritize your savings in order to leverage the options available to you.

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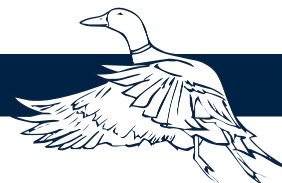
Market Commentary



What a difference a year makes! Unlike the situation in the first quarter of 2020, since the start of this year, U.S. stocks posted healthy gains and one-year returns that are simply shocking in light of the year we have had. **I will let the table below speak for itself**. Recent returns reflect optimism about the impact of government checks to individual consumers and how this will give the economy a shot in the arm. However, the best stimulus at this time is the COVID vaccine which gives people confidence to return to more normal life.

With the recent ***American Rescue Plan (ARP),*** the government has now committed in excess of $5 Trillion in total fiscal support since the pandemic began. Even before the ***ARP***, the economy was expanding, and Americans were holding upwards of $2 trillion in "excess savings". Now add to that the recent stimulus checks and refundable tax credits and you have a pool of pent-up demand that probably has no recent precedent. This is good in the short-term, but what are the long-term effects? ***At some point***, one would reasonably expect there might be negative consequences: consumer inflation, a falling dollar, rising interest rates.

It is impossible to predict when stocks will take a break, but they will. However, don't let that fear allow you to bet against the stock market with possibly the strongest economic environment since the 1990's underway.

If the global pandemic has taught us anything it is that we live in an uncertain world, and that maintaining a globally diversified portfolio in the face of the uncertainty is the winning strategy.

Summary of Asset Class Total Returns (as of 3/31/2021)

Asset Class*	Ticker	One Month	YTD	12 Months	Annualized 3 Year	Annualized 5 Year	Annualized 10 Year
GLOBALLY DIVERSIFIED BALANCED PORTFOLIO**							
60% Equity / 40% Bond	DGSIX	2.4%	5.0%	39.1%	9.3%	9.6%	7.3%
STOCKS							
Larger-Cap	VFINX	4.4%	6.2%	56.2%	16.6%	16.1%	13.8%
Smaller-Cap	NAESX	1.6%	10.2%	87.5%	14.8%	15.5%	12.0%
International - Developed Mkts	VGTSX	1.7%	3.9%	52.7%	6.5%	9.9%	5.2%
International - Emerging Mkts	VWO	(1.0%)	3.6%	58.3%	6.4%	11.4%	3.3%
Real Estate	VGSLX	5.1%	8.6%	36.4%	10.8%	6.0%	8.8%
Inflation Hedges	*	3.8%	12.2%	92.5%	8.5%	11.5%	2.3%
BONDS							
U.S. Investment Grade Bonds	VBMFX	(1.4%)	(3.6%)	0.4%	4.5%	3.0%	3.3%
Global Bonds	VTABX	0.0%	(2.3%)	2.0%	4.0%	3.3%	-

** Each asset class is represented by a relevant Vanguard Index fund except for Inflation Hedges where the Morningstar Category average for* ***"Natural Resources"*** *is used. All data is provided by Morningstar and includes reinvested dividends.*

** All returns are net of (i.e., after) fund fees, and include reinvested dividends.*

** Past performance is not indicative of future results.*

*** This portfolio is represented by the DFA Global Allocation Fund (60% Equity / 40% Bond) - DGSIX*