New Year, New Strategies: Rethinking Your Savings Plan

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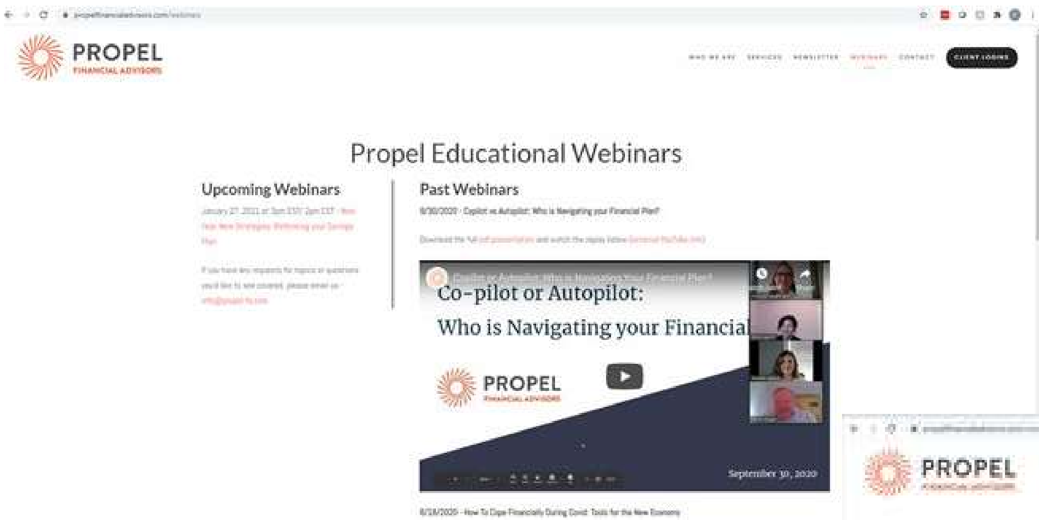
January 27, 2021



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Agenda

- Moving Beyond the 401(k): Danielle Woods, Attorney
- Incorporating Tax Planning: Emily Agosto, CPA
- Making Behavioral Finance Work For You: Amanda Vaught, Attorney
- Analyzing Restricted Asset Choice: David Vaught, CFA

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Danielle Woods

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Danielle is an attorney and advisor in her 23rd year of working with individuals, families and small businesses on their tax and financial planning needs.

She wants her clients to enjoy their lives and retire when they want to.   She lives near the Great Smoky Mountains National Park in East Tennessee with her family.

DW AGOSTO TAX PLANNING LLC

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MOVING BEYOND THE 401(k)

THE CONCEPT OF RETIREMENT

"...the entire concept of being entitled to retirement is, at most, two generations old. Before World War II most Americans worked until they died...The labor force participation rate of men age 65 and over was above 50% until the 1940s."

- **<u>The Psychology of Money: Timeless Lessons on Wealth, Greed, and Happiness</u> by Morgan Housel (9/8/2020)**

The average life expectancy in the United States in 1940 was 65.2 years for women and 60.8 years for men.

- **<u>Life expectancy in the USA, 1900-98 (u.demog.berkeley.edu)</u>**

Moving Beyond the 401(k): SAVINGS OPTIONS AND IMPACT OF SECURE ACT

1. Tax-Deferred 401(k)s & IRAs
2. The SECURE Act
3. Roth IRAs
4. Taxable Savings
5. Connecting the Dots

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TAX-DEFERRED 401(k)s & IRAs

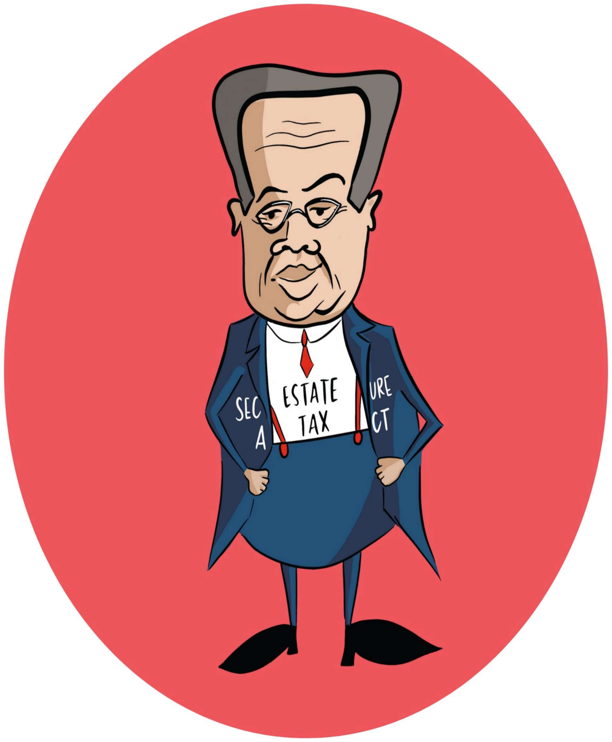
- Personal IRA's were first created in 1974, and 401(k) plans for employees were created in 1979 (effective in 1981).
- Tax-deferred does not mean Tax-Free.

Fun Fact: 401(k) plans were created by accident and first used in 1981. By 1983, half of all big companies offered them to their employees. In 1990, more than $380 billion of personal wealth were in 401(k) plans and more than $1 trillion by 1996. It was hoped that these plans could replace pension benefit plans, but they have fallen far short due to low savings rates, high fees, and poor investment discipline.

The SECURE ACT & TAX DEFERRED SAVINGS

Before 1/1/20, non-spouse beneficiaries could:

- Take small annual withdrawals each year
- Could own it their entire lives
- Could pass it on to their own beneficiaries



After 1/1/20, non-spouse beneficiaries must:

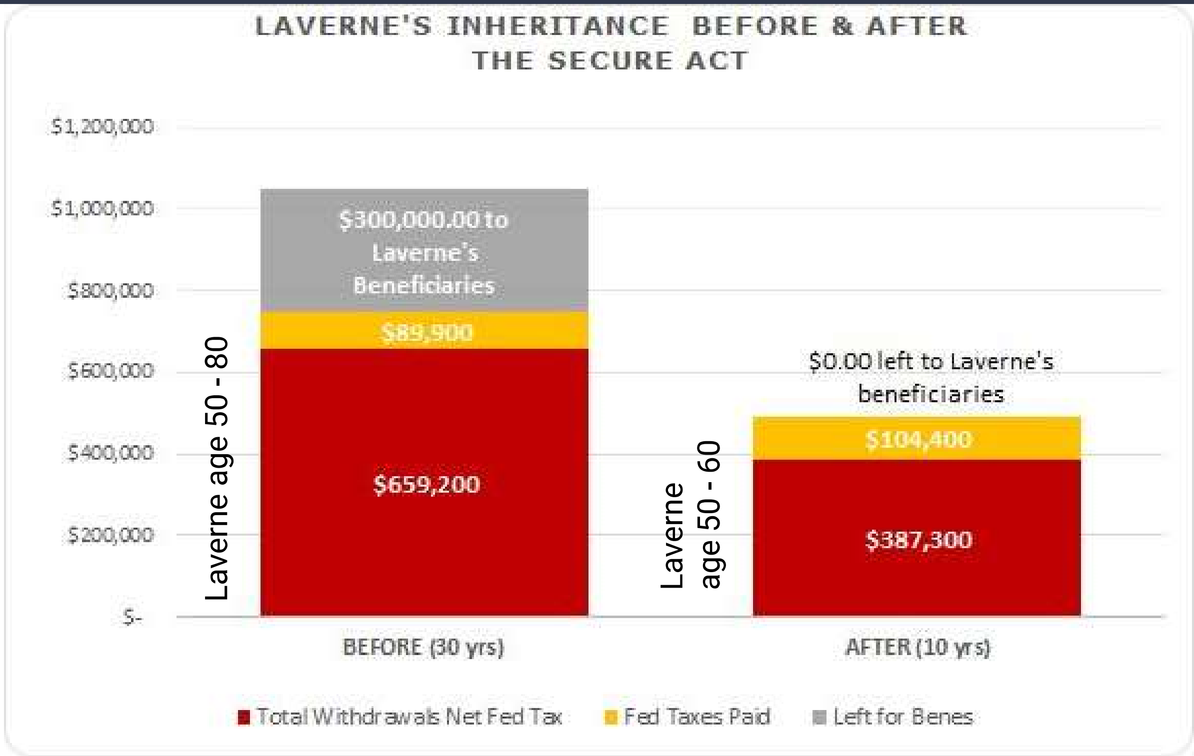
- Withdraw 100% of the account value within 10 years of the original owner's death

MOVING BEYOND THE 401(k)

The SECURE ACT = AN ESTATE TAX

Laverne is 50 years old and earns $35k per year when she inherits a $400k IRA from her friend, Shirley.

- If Shirley had died in <u>2019</u>, Laverne could have taken the required minimum amount each year, lived to be 80, and still left an account valued at more than $300k to her beneficiaries.
- But Shirley dies in <u>2020</u> from COVID. Laverne chooses to withdraw 20% of the IRA market value each year until completely distributed in Year 10.



* The example assumes a 5% net return in the IRA each year. The Distributions are net, after taxes are paid.

MOVING BEYOND THE 401(k)

ROTH IRAs

- Created in 1997 as an alternative to tax-deferred retirement savings.
- Roth IRAs can be funded with contributions and conversions from Traditional IRAs. They are more flexible than pre-tax 401(k)s and IRAs.
- Earnings will never be taxed and distributions will not impact reportable income if the rules are followed.

Fun Fact: William Roth, Jr. who co-sponsored the legislation to create Roth IRAs spent his political career fighting wasteful spending in government and overtaxation of US citizens.

In 1983, he decorated a **Christmas Tree** with spare parts (such as nuts and bolts) from government defense contracts. The decorations cost a whopping $101,000. Roth noted that the same supplies would have cost $110 at the local hardware store.

TAXABLE SAVINGS

- Not limited to checking, savings, and bank CD's.
- Brokerage accounts allow for investment in a variety of assets with post-tax dollars. Income tax is charged against income and capital gains only. This may be the most underused form of savings.

Fun Fact: Some taxpayers (single taxpayers with less than $40,000 in taxable income, and married taxpayers with less than $80,000 in taxable income) will pay NO tax on long-term capital gains.

Most taxpayers are in the 15% bracket, which is lower than nearly all current income tax rates.

MOVING BEYOND THE 401(k)

SO MANY RULES...

TAXES ON
EARNED INCOME

CONTRIBUTION
LIMITS

TRACKING
ACTIVITY FOR
FUTURE YEARS

TAXES ON
RETIREMENT
INCOME

WITHDRAWAL
REQUIREMENTS

ESTATE
PLANNING
CONCERNS

WHICH WAY IS THE RIGHT WAY?

CONNECTING THE DOTS

ACTIVE INDIVIDUAL PORTFOLIOS - NO MODELS

IN-HOUSE RESEARCH AND DUE DILIGENCE ON ASSETS

ACCESSIBLE ADVISORS AND EDUCATION OPPORTUNITIES

TAX EFFICIENCY

A FOCUS ON LIQUIDITY AND FLEXIBILITY

PROACTIVE ADVICE, NOT REACTIVE PROBLEM SOLVING

WITH A PROACTIVE, FULL SERVICE APPROACH

MOVING BEYOND THE 401(k):

Poll Question

What's your biggest takeaway from this presentation?

1. I feel more comfortable with my current accounts and my tax situation.
2. I think I am overweight in traditional 401(k)/IRA accounts.
3. I need to increase my Roth value.
4. I need to begin a Taxable account.
5. The SECURE ACT is going to really mess up my estate planning.

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As a CPA and financial advisor, Emily enjoys helping families and small business owners stay organized and focused on saving for retirement and tax planning.

Emily lives in the Irving Park neighborhood of Chicago with her husband and Bruce the cat.

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Incorporating Tax Planning with your Retirement accounts

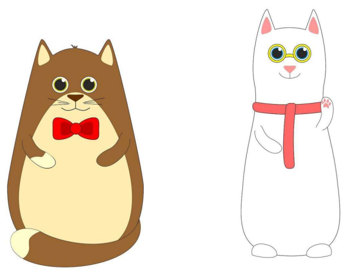
Assumption: Pre tax/tax deferred savings in 401(k)s and traditional IRAs are the best choice for me because I will be in a higher tax bracket when I'm working and a lower tax bracket when I retire.

Reality:

1. Tax brackets are not set in stone
2. Expenses don't stop at retirement
3. What if you need to access funds prior to retirement?

Tax Planning & Retirement accounts:
Case Study

Bruce and James are the same age and earn the same salary at the same job. They both want to save 9% of their salary for retirement. Their employer matches 3% of their 401(k) contributions.



	Bruce	James
Annual Income	$55,000	$55,000
Annual 401(k) contribution (tax deferred)	3% of salary = $1,650	9% of salary = $4,950
Annual Roth IRA contribution	3% of salary = $1,650	$0
Annual contribution to Taxable Savings	3% of salary = $1,650	$0

Tax Planning & Retirement accounts:

Case Study: 2020 Taxes, Year 1

Bruce and James are 25 years old. After subtracting the standard deduction ($12,400) and contributions to their 401(k), their tax owed is below.

	Bruce	**James**
W2 Income	$55,000	$55,000
Taxable Income	**$40,950**	**$37,650**
Tax owed	**$4,805**	**$4,324**
2020 Tax Bracket/Effective Rate	**22% / 11.73%**	**12% / 11.48%**
Difference	Pays $481 more in 2020	

Tax Planning & Retirement accounts:

Case Study: 2020 Taxes, Year 15

Bruce and James are 40 years old. This year they both had an unforeseen expense of $5,000. Bruce took the funds from his Roth IRA and James took the funds from his 401(k).

	Bruce	**James**
W2 Income	$55,000	$55,000
401(k) withdrawal (tax deferred)	$0	$5,700 (to net $5,000)
Roth IRA withdrawal	$5,000	$0
Taxable Income	**$40,950**	**$42,650**
Tax owed	**$4,805**	**$5,333 + $570 early withdrawal penalty**
2020 Tax Bracket/Effective Rate	**22% / 11.73%**	**22% / 12.30%**
Difference		Pays $1,098 more in 2020

Tax Planning & Retirement accounts:

Case Study: 2020 Taxes, Year 40

Bruce and James are 65 and retired! Both receive Social Security of $2k/month. To replace their income, Bruce withdraws $10k each from his Roth IRA, 401(k) and taxable savings while James withdraws it all from his 401k.

	Bruce	James
Social Security Income	$24,000	$24,000
401(k) withdrawal (tax deferred)	$10,000	$34,000 (to net $30,000)
Roth and Taxable Savings withdrawal	$20,000	$0
Taxable Income	**$10,000**	**$36,300**
Tax owed	**$0**	**$3,964**
2020 Tax Bracket/Effective Rate	**10% / 0%**	**12% / 11.47%**
Difference		Pays $3,964 more in 2020

Over half, $14,050, of James' social security income is taxable because the $34k of retirement funds withdrawn counts as income. James needs to withdraw $34k in order to net the same take home pay as Bruce.

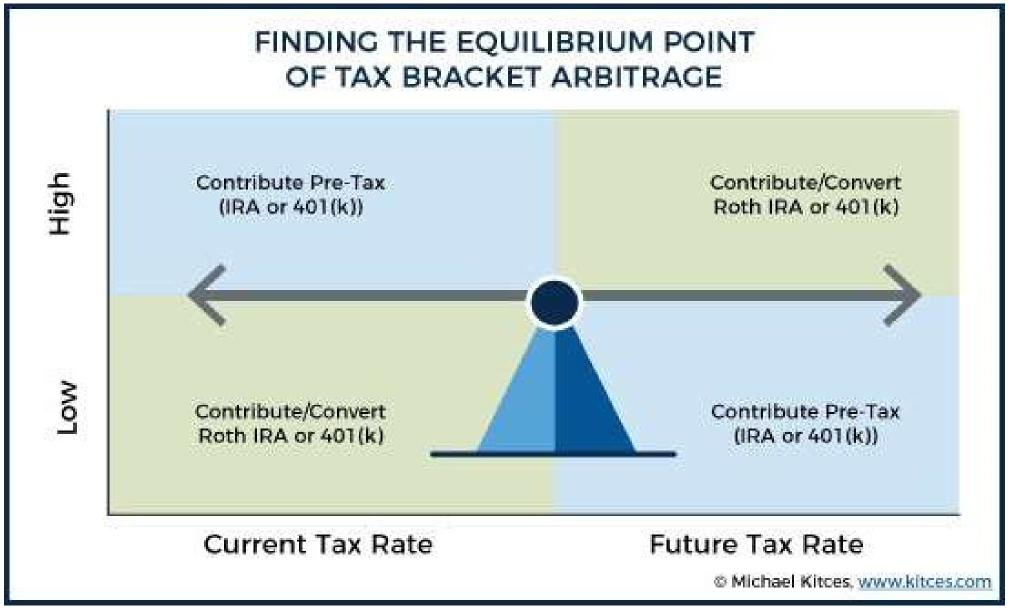
Tax Planning & Retirement accounts:

Case Study: Final Thoughts

Something as simple as diversifying the types of retirement accounts you contribute to could help add flexibility to your investments and save on taxes.

Tax Planning & Retirement accounts:

The Importance of Tax planning



For a lot of people, income is not a linear progression. Depending on your sources of income and situations beyond your control (hello, 2020!) your "current tax rate" could vary drastically year to year.

Tax Planning & Retirement accounts:

Poll Question

Based on this presentation, are you motivated to do any of the following?

1. Yes. I want to talk to an advisor about tax planning.
2. Yes. I will start thinking about how I might benefit from tax planning.
3. No. I'm already tax planning on my own or with an advisor.
4. No. I don't think I need tax planning.

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Amanda Vaught loves helping young families work towards achieving their unique financial goals.

Before working as a financial advisor, Amanda was a chemist and practiced law. She lives in Brooklyn, NY, with her husband and two small children.

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Behavior is major key to success

Ronald Read

First in his family to graduate high school. Worked as a gas station attendant and janitor.

Passed away in 2014 worth $8 million.

Ronald Read breakfasting at the American Legion in VT.
https://www.cnbc.com/2016/08/29/janitor-secretly-amassed-an-8-million-fortune.html

Richard Fuscone

Dartmouth, MBA from Chicago. Retires early after amassing a fortune in financial industry.

Loses everything in 2008 after being over-leveraged expanding his 11-bedroom mansion in Westchester, NY.

Fuscone's Westchester home: foreclosed before he declared bankruptcy
https://www.wsj.com/articles/SB10001424052702304198004575172303998670976

401(k)s Force Good Financial Behavior

- Forced savings with regular deposits out of your paycheck.
- Difficult to withdraw funds

  → Replicate this behavior with your savings accounts.
  → Focus on the steps to achieve your goal - not the end result.

Compounding: Warren Buffet’s secret

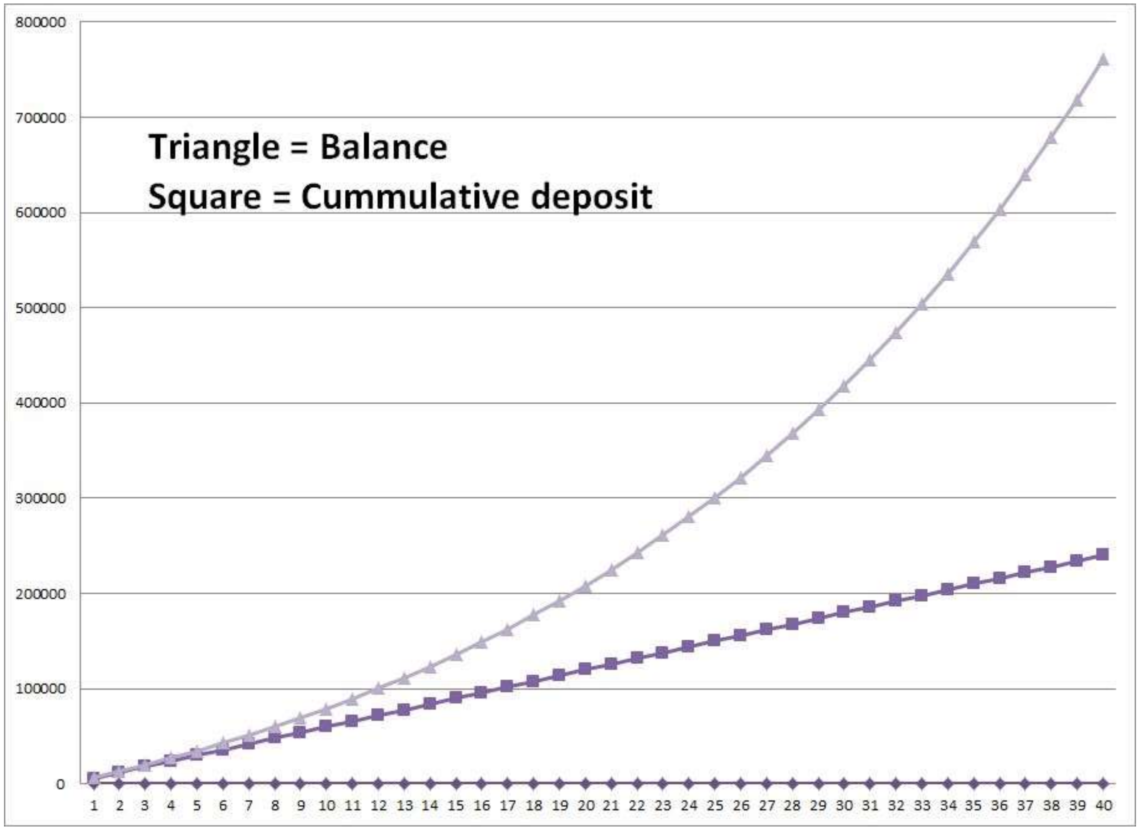
$81.5B of Warren Buffett’s $84.5B net worth came after his 65th birthday. (That’s 96.4%)

Began investing at age 10 and earned 22% per year.

A skilled investor, but his secret weapon is time.

Numbers via The Psychology of Money, Morgan Housel, Kindle edition p. 40.

Compounding: It's not intuitive



Deposit $6,000 per year in a Roth for 40 years.

Assume 5% return per year every year.

In Year 40, you have deposited $240,000 but your total balance is $761,038.58 for a 217% return.

Behavioral steps to financial success

It's not what you know, it's what you do

Which of these steps could you do today?

- Open a Roth or taxable savings account
- Increase your savings deposits every year
- Conscious consumption
- Invest excess cash - inertia is not your friend
- Evaluate your budget
- Be aware of lifestyle creep

Be Patient.

Making Behavioral Finance Work for You

Poll Question

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Do you increase your savings contributions every year?

1. Yes
2. No

Making Behavioral Finance Work for You

Poll Question

Do you increase your savings contributions every year?

1. Yes
2. No

Giving yourself a 1% raise every year increases your final balance from $761,038.58 to $874,302 - a 15% increase.

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David likes working with Danielle, Amanda, & Emily to help our clients achieve their goals.

When he is not working on the computer in Naperville, IL, or Fort Myers, FL, he likes flying the new flying club Cessna 182, traveling in his Pleasure Way Lexor RV out West, or visiting with his eight grandkids.

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Analyzing Restricted Asset Choice in 401(k) Plans:

PROPEL'S Priority for Retirement Savings

- First, contribute enough to your 401 k to earn the available employer match.
  (If you're in a higher tax bracket, it might make sense to max out your pre-tax 401(k) contribution regardless of match.)
- Then, add to your Individual Roth IRA
  (you can contribute to both a 401(k) and a Roth)
- Finally, add regularly to a taxable brokerage account. Cash pays nothing.
- Balance the three approaches to meet your objectives.

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Analyzing Restricted Asset Choice in 401(k) Plans

- Most 401(k) plans offer a narrow investment universe.
- Accounts with larger asset opportunity sets increase diversification benefits and, thus, the possibility of higher returns.

*** Some 401(k) plans allow participants to hire their own advisors! Ask your HR Dept. (i.e. Fidelity Brokerage Link)**

Analyzing Restricted Asset Choice in 401(k) Plans

401(k) plans often limit the participant's ability to invest in subsets of the global market, such as Healthcare, ESG funds, and <u>quality international holdings</u>. In fact, many 401(k)s only offer 1-2 international options.

*** We typically recommend rolling over old 401(k) plans to an IRA when you terminate employment to take advantage of a larger asset universe.**

The Problem with Limited Choice:
Assumes Domestic Outperformance Will Continue

Big Picture Reasons to Increase International Investment in 2021

- U.S. Dollar has come down from its high, allowing other currencies to increase in value.

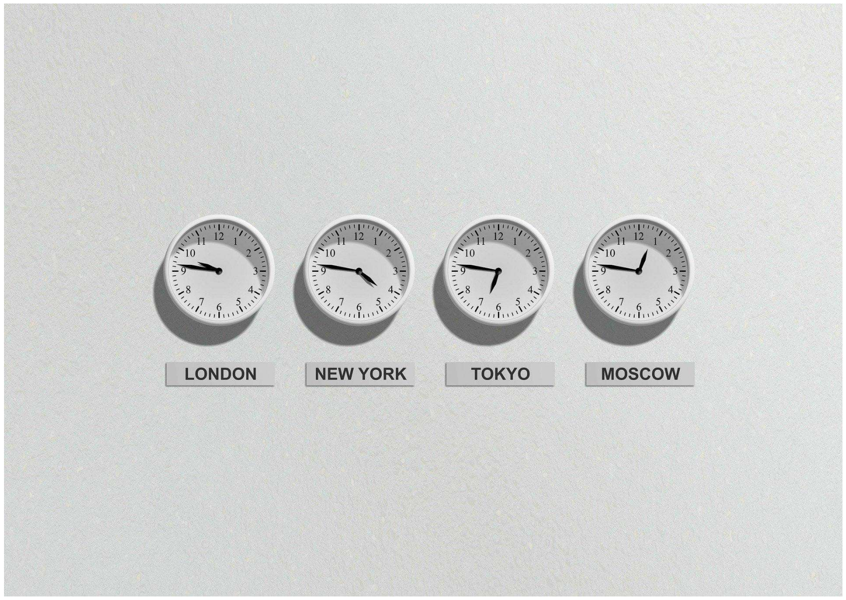
- International company valuations were trading at about 14% below U.S. companies over the past several years. According to Anjali Balani, VP of Asset Management at JP Morgan, international valuations as of 12/1/20 were trading at 24% of comparable U.S. companies. U.S. Companies are simply more expensive.

Specific Reasons for Cyclical Changes in International Performance in 2021

1. European stimulus deal that includes all European countries.
2. Brexit completion proves that other countries could leave EU, which promotes more economic independence.
3. European countries are pioneering green technology, which will increase exports.
4. China has a new trade deal with the EU, which excludes the United States.
5. Emerging market economies are growing by selling to their own increasing middle class, rather than relying on exports.

Not all International Funds are the Same

Do Your International Investments Include All of This?



- ★ Developed Country Large Cap Growth
- ★ Developed Country Large Cap Value
- ★ International Small Cap
- ★ Emerging Markets (Domicile)
- ★ Emerging Markets (Not Domicile-Specific)
- ★ Global Investment in ESG factors

Analyzing Restricted Asset Choice:

Poll Question

When it comes to your portfolio, what do you think about international investments after hearing this presentation?

1. Keep my investments at home in dollars by investing in only US companies.

2. Diversify my investments to include up to 20% in international investments.

3. Spread my international investments between large cap growth and value, small cap, and emerging markets.

4. Increase my international investments above 30%.

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Final Thoughts

All of these concepts intertwine.

- ➔ Use a variety of accounts to maximize tax efficiency and increase liquidity.
- ➔ Proactive financial and tax planning will save you money in the long run.
- ➔ Money does not grow by magic; you must contribute to the process with discipline and active savings.
- ➔ Asset choice, both domestically and globally, is a key element in both your understanding of your assets and in the long-term growth of your portfolio.

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What makes us different?

Experienced Team that understands the relationship between taxes and investments.

Personalized Advice to help you meet your financial goals, no cookie cutter models.

Competitive Fees for investment management and financial planning. Also, we don't believe in account minimums and prefer working with a variety of clients.

Frequent Communication between you and the team about investing, general market concerns and important tax updates.

Accountability - You always have access to our team to help you navigate financial decisions and answer questions.

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We'd love to hear from you!

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Thank you for attending!