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left to right: Brenda C. Bolander, Joe Bowie, Randy Thurman, Carol Ringrose Alexander, Chad Rudy, and Andrew Flinton

Financial Briefs

MAY 2021

Retirement Planning Assumptions

To enjoy your retirement without financial worries, make sure you have enough money saved when you retire. This calculation can be a daunting task, since a variety of factors affect your required amount and inaccurate estimates for any factor can leave you with way too little in savings. Some of the more significant factors include:

What percentage of your preretirement income will you need? You can find various rules of thumb indicating you need anywhere from 70% to over 100% of your preretirement income. On the surface, it seems like you should need less than 100% of your income. After all, you won't have any work-related expenses, such as clothing, lunch, or commuting costs. But look carefully at your current expenses and how you plan to spend your retirement before deciding how much you'll need. If you pay off your mortgage, stay in good health, live in a city with a low cost of living, and engage in inexpensive hobbies, then you might need less than 100% of your income. However, if you travel extensively, pay for health insurance, and maintain significant debt levels, even 100% of your income may not be enough. You need to take a close look at your expenses and planned retirement activities to come up with a reasonable estimate.

When will you retire? Your retirement date determines how long you have to save and how long investment returns can compound. You want to make sure your retirement savings and other income sources, such as Social Security and pension benefits, will support you for what could be a very lengthy retirement. Even extending your retirement age by a couple of years can significantly affect the ultimate amount you need.

How long will you live? Today, the average life expectancy of a 65-year-old man is 81 and of a 65-year-old woman is 84 (Source: Social Security Administration). Most people use average life expectancies to estimate this, but average life expectancy means you have a 50% chance of living beyond that age

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Pension Plans vs. 401(k) Plans

A pension plan has become exceedingly rare, or at least that's the conventional wisdom. But that doesn't mean pensions are not still an important retirement planning tool for many people. While it's true that few private sector employers offer pension benefits for new hires, they are still common for people who work in the public sector. Many older people also have some pension benefits, perhaps from a previous employer. So, although pensions aren't available to everyone, they are still an important part of the retirement planning mix for millions of Americans.

Whether you have a pension, a 401(k) plan, or a combination of the two, you may be wondering which is better. The answer is it depends.

The Difference Between Pensions and 401(k) Plans

What separates a pension plan from a 401(k) plan? A pension is a defined-benefit retirement plan. Your employer contributes money throughout your working years in a pot with all other employees' money. The money is then invested on behalf of you and your coworkers. When you retire, you receive a predetermined monthly benefit based on your length of service, salary, and age. Your benefit is guaranteed, but you don't have any control over how the money is invested.

With a defined-contribution plan, like a 401(k) plan, you (and your employer if they offer match-

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Assumptions

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and a 50% chance of dying before that age. Since you can't be sure which will apply to you, it's typically better to assume you'll live at least a few years past that age. When deciding how many years to add, consider your health as well as how long other family members have lived.

What long-term rate of return do you expect to earn on investments? A few years ago, many retirement plans were calculated using fairly high rates of return. Those high returns don't look so assured now. At a minimum, make sure your expectations are based on average returns over a very long period. You might even want to be more conservative, assuming a rate of return lower than long-term averages suggest. Even a small difference in your estimated and actual rate of return can make a big difference in your ultimate savings.

Have you considered inflation? Even modest levels of inflation can significantly impact the purchasing power of your money over long time periods. For instance, after 30 years of just 2% inflation, your portfolio's purchasing power will decline by 45%. When estimating an inflation figure, don't just look at the historically low inflation rates of the recent past. Also consider long-term inflation rates, since your retirement could last for decades.

What tax rate do you expect to pay during retirement? Especially if you save significant amounts in tax-deferred investments that will be taxable when withdrawn, your tax rate can significantly affect the amount you'll have available for spending. You may find your tax rate is the same or higher after retirement.

Once you've estimated these factors, you can calculate how much you'll need for retirement. Please call if you'd like help with this calculation.

Is Your 401(k) Plan Enough?

If you work at a company that offers a 401(k) plan, especially if the plan offers matching contributions, it may be the most important part of your retirement investment plan. But should it be the only part?

In 2021, the maximum annual 401(k) contribution is $19,500, not including employer-matching contributions. If you are at least 50 years old, you can contribute an additional $6,500 in 2021, if permitted by the plan. Your plan may impose lower limits to ensure that it complies with nondiscrimination rules.

Yet, if you're over 40 and haven't started saving for retirement, even these large annual contributions may not be enough to reach your retirement goals. Here are five questions to help you decide whether your 401(k) plan is the only plan you'll need for retirement:

- **What kind of lifestyle do you want to fund in retirement?** You'll find general rules of thumb indicating you need anywhere from 70% to over 100% of your preretirement income during retirement. How much you'll need depends on your individual circumstances. For example, if your mortgage will be paid off and you plan to stay home and watch your grandchildren during retirement, 70% of your preretirement income may be sufficient. On the other hand, if you plan to travel extensively, 100% may be a better number.
- **How much can you count on from Social Security?** Social Security benefits were never designed as the sole source of retirement income, but they still are a valuable source of income. Those with lower incomes will find that Social Security replaces a higher percentage of their preretirement income than those with higher incomes.
- **How much does your employer contribute to your 401(k) plan?** The $19,500 maximum contribution to your 401(k) plan does not include employer contributions. Employer matching contributions vary by plan, but a typical match is 50 cents for every dollar contributed, up to a maximum of 6% of your pay. However, in recent times, many employers have reduced or eliminated matching contributions. If your employer offers a match, make sure you take full advantage of it. A generous matching contribution can contribute substantially toward your retirement.
- **What are the average returns on your 401(k) investments?** You can only choose from the investments offered by your 401(k) plan. But within those parameters, select investments that match the long-term nature of your plan and will help grow your retirement funds over time.
- **What other sources of income can you count on in retirement?** If you already have other retirement assets, you might not need to rely as heavily on your 401(k) plan. Other potential sources of retirement income might include a defined-benefit pension plan, individual retirement accounts (IRAs), an inheritance, or other investments.

If you contribute the maximum possible to your 401(k) plan and still aren't sure you'll have enough for retirement, please call for a review. There are a variety of other options you can use for saving for retirement.

Pension Plans

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ing contributions) set aside money in a special account. You can then invest that money in options available in the plan. Unlike a pension, the amount you receive when you retire depends on the amount you save and the investment returns you receive.

Pros and Cons: Pensions

At first glance, pensions seem superior to defined-contribution plans. After all, you get a guaranteed benefit that lasts for the rest of your life after you stop working. A pension eliminates the risk of outliving your money or losing all your savings because of a market crash or an investing mistake. Overall, pensions also have slightly better returns over time than 401(k) plans.

But pensions have their downsides too. One of the biggest is that you can't control the investments. That means that if you're a savvy or aggressive investor, you could be missing out on possible gains. Another drawback? If you leave your employer before a certain time (called your vesting period), you lose access to all or a portion of your benefit. Finally, if your employer runs into financial distress or goes out of business, your benefit may be far less than you anticipated.

Pros and Cons: 401(k) Plans

Employers love 401(k) plans since they take the responsibility for managing employees' retirement off of the employer and put it onto the workers. Many employees like 401(k) plans too, since they can control how much they save for retirement and how it is invested. And the money you contribute is yours — you won't lose it if you change jobs (although you may lose matching contributions, depending on how long you've worked for your employer) or face the possibility of reduced benefits if your employer goes bankrupt. Finally, you can pass on any money left in your 401(k) plan to your heirs. That's not the case with a pension, where the benefits end after the pensioner or the pensioner's spouse dies.

But 401(k) plans have their disadvantages as well. First, you need to be motivated enough to set aside money from your paycheck — money you could be spending today — for retirement. Many people struggle with this, either putting off saving or not saving enough. Another problem? Many people don't take enough risk with their retirement savings. If you stick with cash or low-interest bonds, your returns likely won't be high enough to generate the income you need in retirement.

Defined benefit and defined-contribution plans each have their pros and cons. Whatever type of retirement plan you have access to, it's essential to understand how it works and what your responsibilities and options are. Please call if you'd like to discuss this in more detail.

Don't Touch Your 401(k) Plan

If you leave your employer, be careful about what you do with your 401(k) funds. Your worst option is to take a distribution, pay taxes and a penalty on it, and then spend the money on something other than retirement. By doing so, you use retirement funds and forego any further tax-deferred growth on those assets. In addition, you may incur a large tax bill, since withdrawals are subject to ordinary income taxes and a 10% federal income tax penalty if you are under age 59 ½ (55 if you are retiring).

You have three options to keep your 401(k) funds in a tax-deferred vehicle until retirement:

Leave the funds in your former employer's 401(k) plan. Generally, you can leave the funds in your former employer's plan if your balance is at least $5,000. However, most plans will not allow you to borrow from your account once you leave the company. Until you consider all your options, you might want to at least temporarily leave the funds with your former employer's plan.

Transfer your funds to your new employer's plan. Find out if your new employer's plan accepts rollovers. If so, you can typically make the rollover even before you are eligible to make contributions. However, first check out the investment options to make sure the new plan has options that will fit your investment goals. Once the funds are in your new employer's plan, you'll be able to take loans if permitted by the plan. Also, if you work past the age of 72, you won't be required to take distributions from the 401(k) plan until you retire. With traditional individual retirement accounts (IRAs), you must take withdrawals once you turn age 72, even if you are still working. If you decide to transfer the funds to your new employer's plan, get the appropriate paperwork from your new employer so the funds can be transferred directly to the new plan's trustee. Otherwise, if the funds go directly to you, your former employer will be required to withhold 20% for taxes. You must then replace the 20% with your own funds within 60 days or the 20% withholding will be considered a distribution, subject to income taxes and the 10% federal income tax penalty.

Roll the funds over to a traditional IRA. Again, you should have your former employer transfer the funds directly to the IRA trustee to avoid the 20% withholding described above. Once the funds are rolled over to an IRA, you can invest in a wide variety of investment alternatives. With a 401(k) plan, you typically have a limited number of options. If you plan on leaving part of your 401(k) balance to your heirs, an IRA usually has more flexible options than a 401(k) plan. After the funds are transferred to a traditional IRA, you can then convert the balance to a Roth IRA.

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News and Announcements

From the Flinton Household

"The price of anything is the amount of life you exchange for it."

~ Henry David Thoreau

When I was a kid, I used to walk to school in the snow, uphill both ways. That's a true story about my life. Rain, sleet, snow; it did not matter, my brother Joseph and I walked to school every day. Growing up in Piedmont in the 80's and 90's was a kids' dream. From the time I was in 2nd grade, we had free run of the town. Summertime was unstructured freedom to explore the fields, abandon buildings, or finding an open window at the school so we could unlock the gym and play basketball with the usual crew. Life was good. We would ride our bikes to friends' houses that lived 6-7 miles away. We would walk it if the tires were flat. I even drove a riding lawn mower across town about 5 miles to mow my girlfriend's lawn one day.

We didn't have summer camps, vacations to exotic locales, summer curriculum to get ahead for our next school year, or any of the accoutrements that now accompany my own children's lives. We had mountains of manual labor, gardens to weed, acreages to be mowed, and general work that a parent would assign to you if you happened to be within eyesight. Our natural defense was to get out of the house as soon as possible and not be seen. My appreciation for "Small Town America" wasn't to be known until later in life, but I have such an appreciation now that I'm removed from it. At times I feel that one day I will find another remote "Small Town America" and give it a go once more.

Wishing you cherished memories,

Andrew Flinton, CFP®

From the Alexander Household

My parents held on to a lot of papers, which can be a blessing and a curse. Last night as I was going through boxes of documents from their medical clinic in Guthrie, I found the birth certificates for my paternal grandparents from 1900. Then I discovered my medical chart from the Ringrose Clinic. The treasure was in the back of my chart. They were the R.F. Ringrose, M.D. file cards that served as medical charts in my Grandfather's day. All of the notes of my vaccinations are written by my Grandfather, who started his medical practice in Guthrie in 1928. My father joined him in practice in 1970 and they worked together until my grandfather was 90. There are so many memories of the time I spent both growing up and working in the Ringrose Clinic that you wouldn't expect from finding a few file cards. I am grateful for the memories and all of the skilled, compassionate doctors who provide care for all of us.

Carol Ringrose Alexander,
CFP®, AIF®, CEPS, CDFA™

From the Rudy Household

Over the years, we've rented boats a few times each summer. It was something the whole family enjoyed, and we always looked forward to our boat day. Although I always claimed we would continue to rent rather than buy, as of last August, we now have a pontoon boat on Lake Lewisville.

With only a few months of warm weather remaining, our family and friends spent as many days out on the lake as possible. One of the highlights was getting to celebrate our daughter's 14th birthday with some tubing and swimming. We loved spending the day with Tatum and her friends. With all the fun in the sun, it's almost as if these teens didn't notice that parents were at the party as well.

Once it started getting cooler, I wasn't sure how frequently we would make it out on the boat. However, there were plenty of sunny days when Amy and I would put on jackets and take out the boat for a quick ride. We would often drive just outside of the marina, where we'd talk, read, listen to music, or just sit quietly listening to the sound of the water.

With summer quickly approaching, we are ready for a full summer on the lake and can't wait to make some great memories.

Chad Rudy, CFP®