

reinventing retirement

Your Retirement Planning Newsletter

Fourth Quarter 2014

Saving and Investing in Your 30s: Plan for the Long Road Ahead

Our last issue focused on the top financial planning themes facing workers in their 20s. This quarter we turn our attention to 30-somethings—and how making good choices today may help your financial well-being decades from now.

Life's responsibilities increase in your 30s. Maybe you're becoming more established in your career path, or are thinking about marriage and raising a family. Whatever your goals, it's important to begin to build a financial infrastructure to support them. Here are five elements of a plan:

- 1. Pay down school loans** – Americans are awash in \$1 trillion in education debt, and in 2012 the average student loan debt was \$27,253.¹ The problem is that outstanding loan balances may cause you to delay other life decisions, such as buying a home or starting a business. There's a straightforward approach to retiring school debt. Look at all forms of outstanding debt (student loans and credit-card debt) and assess whether you're on track to paying it off in a desired time frame. You might also consider consolidating the debt or refinancing if it reduces the interest rate you pay each month or accelerates your repayment schedule.
- 2. Protect your loved ones** – Even when you're in the prime of life, misfortune may strike. If you are married, you may want to set up a living will and/or a revocable life insurance trust. A living will specifies what actions should be taken for your health if you are no longer capable of making decisions for yourself because of illness or incapacity. A revocable life insurance trust allows you to specify that life insurance benefits be paid into a trust for the benefit of your loved ones. This is often recommended for younger families with relatively modest assets but substantial insurance policies to pay down debts, fund education or accumulate wealth.
- 3. If you have dependents, consider buying term insurance** – Term life insurance pays a fixed amount of benefit for a certain period of time (the relevant term).



Parents with dependent children often purchase term life insurance policies as the least expensive way to provide for those children's livelihoods in the event of their death.

- 4. Save for a down payment on a house** – But only if you have no credit-card debt and you've set up a six- to eight-month emergency fund. The emergency fund needs to be an account that you can access relatively quickly, without penalty, such as a bank savings account or money market fund. Many financial advisors do not recommend purchasing a home with less than a 20% down payment.

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¹ "\$1 Trillion Student Loan Problem Keeps Getting Worse," Forbes.com, February 21, 2014, <http://www.forbes.com/sites/halahtouryalai/2014/02/21/1-trillion-student-loan-problem-keeps-getting-worse/>

Don't Leave It to Your Ex: Update Your Beneficiary Designations

One of the most important pieces of information on your retirement account is also one of the most overlooked—your beneficiary designation. If you've been married or divorced, had children, started a business, or suffered the loss of a spouse since setting up your retirement accounts, read on.

Similar to a will, a beneficiary designation on your 401(k) or IRA legally defines how your assets will be distributed upon your death. The rules governing beneficiaries are different for 401(k) accounts and IRAs (as the sidebar demonstrates).

Not naming a beneficiary on your account generally means that your assets will be paid to your estate and will be subject to probate. Some people name their spouse and children as beneficiaries, while others choose a charity or other entity, such as a trust. You should regularly review your beneficiary designation to ensure it is up-to-date, and share any changes with

anyone who is helping you with estate planning to ensure that it meshes with your will. If you don't know who you've named, review your current plan agreement, contact your plan administrator, or call your financial advisor or legal/tax professional.

Case Study: The Cost of Not Updating Your Beneficiary

John and Maura, husband and wife, want to leave a bequest to each other. Maura decides to leave 50% of her 401(k) to John upon her death and 25% each to her two children. She designates all three as her beneficiaries. Upon her death, John will receive 50% of the value of her retirement account, and her children will split the remaining 50%. John's will specifies that Maura is to receive his assets upon his death, and designates her as a 100% beneficiary of his IRA.

John and Maura divorce 10 years later. John remarries Trudi. Although John updates his will to leave Trudi his assets, he neglects to update his IRA beneficiary designation. When he dies, surprise! The plan will send a check for all proceeds to Maura. Even though Maura is no longer named a beneficiary in John's will, she is the legal beneficiary of his IRA. Only if John names Trudi as a successor beneficiary on his IRA can he be certain that she will receive the proceeds as he intended.



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5. Keep saving – A rule of thumb is to save about 15% of your salary for retirement, including IRAs, employer-sponsored plans and any matching employer contributions.

While taking charge of your finances is not especially difficult, it does take time and attention. Consider working with a financial advisor to create a plan that takes into account your specific circumstances and goals.



Eye on the Market: What to Do if the Market Corrects

Practical guidance to keep in mind during the next market downturn



If you haven't already noticed, the U.S. stock market has more than doubled in value since March 2009, with the S&P 500® Index pacing an annualized return of more than 16% through July 31, 2014. Over the past 50 years, however, the S&P 500 has returned 10% a year on average. Although we've enjoyed a recent period of outstanding results coming out of a deep recession, the returns of the past few years are likely not sustainable.

What sorts of expectations should you have going forward as an investor? The short answer is that markets go up and down, rarely in a straight line. If you are decades away from needing to take money from your retirement account, it may be best to just do nothing if the market corrects by 10% or 20%. Although there are no guarantees in investing, including when markets will recover or whether they will recover at all, most market corrections since 1900 have fully recovered within an average of 10 to 20 months.²

How should you prepare for the next market correction?

Check your emotions

Emotions have a huge impact on investor decision-making. The most common problem, documented in a 2013 DALBAR study, is that the average investor tends to make poorly timed investment decisions. Reacting to the constant drumbeat of market "news," investors tend to buy when prices are high, and sell at the bottom. When you react emotionally to short-term market fluctuations rather than focusing on your long-term goals, you can fall into a

trap of worry about "hanging on" in a falling market. The best way to keep your emotions from interfering with your decision-making is to prepare for a correction before it occurs. You're less likely to make snap decisions that way.

Invest for the long term

What "long term" means is different for everybody, but for the purposes of this discussion we generally mean the amount of time you have until you retire. That will give you some indication of how long you have until you need to start taking money out of your savings. If you have 20 years or more to go, it may not be productive to panic over how a short-term 10% market correction will impact a 20-year investment goal. On the other hand, if you have less than five years until you stop working, you may want to position your savings more defensively by allocating a greater percentage of your assets to more conservative investments.

Rebalance your portfolio

With the strong run-up in stock prices over the past four years, your savings may have more exposure to stocks than is appropriate for your goals. (Stocks may fluctuate in value more frequently and to a greater degree than other types of investments, making them riskier to investors with shorter time horizons.)

It may be a good idea to sell some of your better-performing stock funds and reallocate them into more conservative investments, such as bonds and cash.³



² Market declines are based on price declines in the S&P 500 Index (without dividends reinvested), with the index fully recovering its value between declines. The S&P 500 is an unmanaged index. One cannot invest directly in any index.

³ Asset allocation and portfolio rebalancing do not ensure a profit or protect against loss.

retirement in motion

Tips and resources that everyone can use

Q&A: Common Questions Plan Participants Ask

How do I choose the right mortgage?

For most people, plain vanilla, fixed-rate mortgages are best. The interest rate remains the same for the life of the loan, which means the monthly principal and interest payments never change. Adjustable rate mortgages (ARMs) can be riskier, because the rate adjustments can increase the borrower's monthly payments by hundreds of dollars, depending on the size of the loan and the rate. Still, the going-in rate can be less than available fixed-rate mortgages, which can be attractive to borrowers who expect to be in their homes for less than 10 years.

Tools and Techniques: Resources to Help Guide Your Retirement Plan

Create a tax-free nest egg for your lifetime

Rolling part of your 401(k) into a Roth IRA has a number of advantages, not the least of which is that withdrawals will be free from federal income taxes. You will pay income tax on the rollover amount, but the principal and earnings left in the Roth IRA will accumulate tax-free. Possibly best of all, the Roth IRA will not be subject to required minimum distributions (RMDs) during the owner's lifetime. A

401(k) account holder must start taking RMDs in the year following the year in which he or she turns 70½.

Boomers on the Brink: Issues Affecting Participants as They Approach Retirement

Immediate annuities

Thousands of Americans are retiring each day, and immediate annuities—investments that offer guaranteed income payments—are attracting greater interest.⁴ In exchange for collecting a one-time payment, an insurer makes a predetermined payout to the annuity holder each month for a specified period (10 years, say, or for life). The insurer guarantees the payments, so it's important to buy from companies that receive the very highest ratings from agencies such as Standard & Poor's and A.M. Best. Consider buying several annuity contracts over a number of years, so that you protect your income against currently low interest rates. There are a number of inflation-indexed annuities that may also protect against rising prices. However, there can be no assurance that spreading out such purchases will protect against declining interest rates or rising inflation. (Source: <http://www.aaii.com/journal/article/the-role-of-inflation-indexed-annuities.touch>)

Quarterly Reminder

Charitable deductions and your taxes

If you itemize deductions, you can deduct qualified charitable donations so long as you maintain the right records. Even if you make a tiny cash gift, get proof—such as a canceled check or bank or credit-card statement. If you give more than \$250 to a qualified organization, make sure the charity sends you documentation for your contribution. And remember, you cannot deduct contributions made to specific individuals, political organizations or candidates. (Source: <http://www.irs.gov/uac/Eight-Tips-for-Deducting-Charitable-Contributions>)

Corner on the Market: Basic Financial Terms to Know

In-service withdrawal

This is a withdrawal of funds from a qualified plan account before the account holder separates from service or reaches a certain age. Some plans permit in-service withdrawals for certain needs, such as a first-time home purchase or funding a child's education. In most instances, though, an in-service withdrawal is subject to a 10% IRS penalty.

⁴ Walter Updegrave, "Using Immediate Annuities to Guarantee Retirement Income," (Source: The Wall Street Journal, July 4, 2014), <http://online.wsj.com/articles/using-immediate-annuities-to-guarantee-retirement-income-1404482404>

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