Investing Well at Every Life Stage

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In this presentation, we’ll share strategies for the following life stages

- Young Accumulators: People in their 20s who are just getting started
- Multitaskers: People in their 30s and 40s who are simultaneously saving for college for their kids and their own retirements
- Pre-Retirees: People in their 50s and 60s who are strategizing about retirement
- Retirees: People in their 60s and 70s who are already retired
Young Accumulators (20s): Key Priorities

- Get out of debt
- Stay out of debt
- Kick-start the retirement plan
- Save for near-term goals
Get Out of Debt

- Pay off credit card debt--cards with highest rates should take priority.
- Pay off college loans--pay down highest rates first, or consider consolidation.
- Do a monthly budget to familiarize yourself with your spending habits (Quicken, Mint.com), identify places to cut back.
Stay Out of Debt

- Establish an emergency fund that can cover at least 3 months worth of living expenses, or up to 6 months if you think it would take longer to find a job if you became unemployed.
- Keep emergency savings liquid by using a bank money market or regular savings account.
- Build up credit history.
- Having multiple credit cards won’t hurt you, unless you overuse them.
- If you can’t pay off the balance on your credit card(s) each month, a debit card may be a better choice.
- Pay your bills on time.
- Keep it simple: Don’t spend more than you take in each month.
Kick-Start the Retirement Plan

For most people just starting out, the following accumulation sequence will make sense:

- Contribute enough to 401(k) to earn company match
- Contribute to a Roth IRA (if within income limit; $5,500 annual limit for either Roth or traditional IRA)
- Max out contributions to 401(k), 403(b), 457 plan: $17,500 for Roth or traditional contributions
- Roth or traditional: If you expect to pay higher or the same tax rate later, use a Roth; if you expect to pay a lower rate later, use traditional; if not sure, use both.
Kick-Start the Retirement Plan

- Investment mix of retirement assets for accumulators should skew heavily (or entirely) toward stocks, be diversified globally.

Source: Morningstar’s Lifetime Allocation Indexes
Save for Near-Term Goals

- Buying a car
- Down payment on a home
- Wedding/honeymoon
- Starting a family
- Additional education/training
- Any money you will need within the next 5 years should not be invested in stocks; instead use money markets, CDs, short-term bond funds.
Multitaskers (30s and 40s): Key Priorities

- Maximize contributions to company retirement plans and IRAs
- Retain emphasis on long-term growth through stocks
- Save in taxable accounts
- Save for college
Maximize Contributions to Company Retirement Plans and IRAs

- Continue to aim for maximum allowable IRA and 401(k) contributions
  - $5,500 for IRAs
  - $17,500 for 401(k)s, 403(b)s, and 457 plans
- Contribute to IRA on behalf of non-earning spouse
  - "Spousal" IRA allowable as long as earning spouse has enough income to cover contribution amount.
Begin to Shift Retirement Assets into Safer Securities

- For people in their 30s and 40s, equity allocations remain high but portfolio begins to be slightly less global.

Source: Morningstar’s Lifetime Allocation Indexes
Build Assets in Taxable Accounts

► Use for additional retirement savings once 401(k) and IRA are maxed out.
► Use to grow money for near- or long-term needs; only long-term money should be invested in stocks.
► Keep taxes and expenses low by investing in low-cost funds and funds that don’t trade a lot, such as index funds.
► Individual securities give you greater control over capital gains, but watch transaction costs.
Save and Invest for College

- 529 college savings plan: Provides tax-free growth and distribution; contributions may be deductible on state income taxes.
- 529 prepaid plan: Locks in tuition payments at today’s rates.
- Coverdell Education Savings Account: Can also be used for K-12 educational expenses; $2,000 annual limit.
- UGMA/UTMA: Assets belong to child; may hurt financial aid.
- Understand the role financial aid plays in your college planning.
Review 529 Savings Plan Options

- If your state offers a tax deduction for 529 contributions, look there first.
- Visit Morningstar.com’s 529 Plan Center
- Top-rated 529 plans, according to Morningstar analysts:
  - Alaska (T. Rowe Price)
  - Maryland (T. Rowe Price)
  - Nevada (Vanguard)
  - Utah (Vanguard)
- Illinois 529 plans:
  - Bright Start--direct-sold, rated Bronze (Oppenheimer, Vanguard)
  - Bright Directions--advisor-sold, rated Bronze (multiple managers)
  - Bright Start--advisor-sold, rated Neutral (Oppenheimer, Amer. Cent.)
Pre-Retirees (50s and 60s): Key Priorities

- Continue to save aggressively for retirement
- Gradually reduce risk in the portfolio
- Pay off debt, including “good” debt like mortgage debt if you intend to stay in your home
- Assess retirement readiness by looking at income needs, withdrawal rates, and portfolio sustainability
- Develop a Social Security and retirement date strategy
- Formulate a long-term care, estate plan
Continue to Save Aggressively for Retirement

▶ “Catchup contributions” available for 401(k)s, 403(b)s, 457s: $23,000 total contribution limit for investors over 50.
▶ “Catchup contributions” available for IRAs: $6,500 total contribution limit for investors over 50.
▶ Spousal IRA contributions available for non-earning spouse as long as earning spouse has enough income to cover contribution amount.
▶ Saving in taxable accounts also valuable to provide control over taxes in retirement.
Gradually Reduce Risk in the Portfolio

- Bond stake increases at the expense of stocks; foreign weightings continue to decline.
- Inflation protection plays a greater role.

Source: Morningstar’s Lifetime Allocation Indexes
Pay Off Debt (Can Any Debt Be ‘Good Debt’ in Retirement?)

- As your investment portfolio becomes more conservative, its return potential also declines.
- That makes it less likely that you’ll be able to out-earn the interest rate on any debt you have.
- Consider prepaying your mortgage if you intend to stay in your home because:
  - The return on your investment is guaranteed (good luck earning 3%, 4%, or 5% on your CDs!)
  - Your mortgage interest deduction may not be saving you much if the bulk of your payments go toward principal
Assess Retirement Readiness

- Multiple online calculators can help you determine whether you can safely retire without running out of money:
  - T. Rowe Price Retirement Income Calculator
  - Fidelity Retirement Quick Check
- You can also crunch the numbers on your own, using the 4% rule:
  - Start with desired annual income in retirement
  - Subtract steady sources of annual income such as Social Security, pension
  - The amount left over is what your portfolio will need to replace
  - If it’s less than 4% of your balance, you’re on solid footing
The 4% Rule in Action

- Couple wants $60,000 in annual income during retirement
- Social Security supplies $30,000
- Portfolio needs to replace the other $30,000
- Their portfolio value is $800,000.
- Using the 4% rule, they could withdraw $32,000 per year in retirement, assuming a 60% stock/40% bond portfolio and a 30-year time horizon.
- The initial withdrawal amount ($32,000) is inflation-adjusted annually.
- Year two withdrawal = $32,960 (assuming 3% inflation)
Develop Social Security, Retirement Date Strategy

- Deciding when to retire, take Social Security are two of the most important decisions retirees can make.
- For people in good health who don’t have to take care of others, delaying both can deliver a tremendous payoff.
- Delaying retirement has a triple benefit:
  - Can continue to add to investment portfolio
  - Reduces demands on portfolio
  - Increases Social Security payments by 8% per year for every year past full retirement age (no benefit for waiting past 70)
- Tools for Social Security decision-making include:
  - ssa.gov
  - T. Rowe Price Social Security Benefits Calculator
Formulate a Long-Term Care, Estate Plan

- Long-term care insurance can be prohibitively expensive, but there are a few ways to save.
  - Investigate whether your company offers a group plan for long-term care.
  - Buy a minimal amount of coverage rather than 100% (average long-term care stay = 18 months).
  - Opt for less of an inflation benefit (3% versus 5%).
- Estate planning isn’t just for the wealthy. Regardless of income level, everyone needs:
  - A will
  - An advance directive (i.e., living will)
  - Power of attorney for medical, financial matters
Retirees (60s, 70s, and Beyond): Key Priorities

- Continue to reduce risk in investment portfolio
- Segment portfolio by time horizon
- Liquidate investments in a tax-efficient manner
- Regularly revisit withdrawal rate to make sure it’s sustainable
Continue to Reduce Risk in Investment Portfolio

- In the years leading up to and in retirement, it’s essential to shift assets to safe securities: cash and bonds.
- Inflation protection also increases to help protect purchasing power.

Source: Morningstar’s Lifetime Allocation Indexes

- U.S. Stocks: 31%
- Non-U.S. Stocks: 10%
- U.S. Bonds: 34%
- Non-U.S. Bonds: 5%
- Treasury Inflation-Protected Securities: 12%
- Commodities: 6%
- Cash: 3%
The “bucket” approach can help you figure out how much of your retirement portfolio to hold in cash, bonds, and stocks, based on your time horizon for the money.

Bucket 1: Years 1 and 2
Holds: Cash
Goal: Funds Living Expenses

Bucket 2: Years 3-10
Holds: Bonds, Balanced Funds
Goal: Stability with Income, Growth

Bucket 3: Years 11+
Holds: Stocks, Higher-Risk Bonds
Goal: Growth, Inflation Protection
Sample Portfolio Using the Bucket Approach:
$750,000 portfolio, $30,000 annual income needs

**Bucket 1: Liquidity Portfolio for Years 1 and 2: $60,000**
$60,000 in CDs, money market accounts/funds, other cash

**Bucket 2: Intermediate Portfolio for Years 3-11: $240,000**
$65,000 in T. Rowe Price Short-Term Bond PRWBX
$75,000 in Harbor Bond HABDX
$50,000 in Harbor Real Return HARRX
$50,000 in Vanguard Wellesley Income VWELX
Sample Portfolio Using the Bucket Approach: $750,000 portfolio, $30,000 annual income needs

Bucket 3: Growth Portfolio for Years 11 and Beyond: $450,000
$200,000 in Vanguard Dividend Growth VDIGX
$100,000 in Harbor International HAINX
$50,000 in Vanguard Total Stock Market Index VTSMX
$65,000 in Loomis Sayles Bond LSBDX
$35,000 in Harbor Commodity Real Return HACMX
Liquidate Investments in a Tax-Efficient Manner

- Taxes can be a big expense for retirees, especially those with big shares of their portfolios in traditional IRAs and 401(k)s.
- Properly sequencing those withdrawals can result in a big savings over time.
- The following sequence will make sense in many situations
  - Taxable assets
  - Traditional tax-sheltered assets
  - Roth assets
Regularly Revisit Withdrawal Rate

As much as a steady income stream is desirable, it’s worth revisiting your withdrawal rate regularly to make sure it’s sustainable.

Factor in:

- Market performance: Lower withdrawals in poor markets, may be able to increase in bad
- Your asset allocation: If you’re more conservative, lower withdrawal rate
- Your age: Depending on portfolio performance, you may be able to take more as you age
- Inflation: If your personal inflation rate is low, forego inflation adjustment
- Unplanned expenses
Questions?

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