# Keep your retirement nest egg golden

## *Plan ahead to mitigate a decrease in your portfolio's value*


Imagine retirement is on the horizon. You have saved for years and invested in a mix of stocks and bonds. You've garnered a healthy return. And though you often cringe when the market nosedives, you stand firm and resist the temptation to panic.

Now you want to retire, but you're wondering what are the risks? One to consider is sequence risk (also known as sequence of returns risk). That's the risk your portfolio will suffer low or negative returns in the early years of retirement—right when you're beginning to withdraw funds from your nest egg.

For example, assume Jill and John each set aside $500,000 in tax-advantaged retirement accounts. For the sake of this example, assume all assets are invested in mutual funds tracking the Standard and Poor's 500 index and each person withdraws 4% annually.

1. John retires first, in January 2008. Over the next 12 months the S&P 500 index drops over 38%. By the end of his first retirement year, John's portfolio has dwindled to $290,000. Five years later, his retirement account balance has recovered to only $390,000.
2. Jill has the good fortune to retire later, in January 2013. Because of a booming stock market, her portfolio grows to more than $750,000 in the first five years of retirement.

Of course, your situation won't exactly mirror these extremes. But regardless of when you choose to retire, you can mitigate some of the detrimental effects of sequence risk by following these suggestions:

- **Withdraw your least volatile assets first.** Sequence risk tends to have less impact on safe and predictable investments like U.S. Treasury bonds and high-rated corporate bonds. Other more volatile investments—stocks and real estate, for example—tend to be hit harder during economic downturns. They also tend to pay higher returns and provide inflation protection over the long term. If possible, leave your more unpredictable accounts intact until later.
- **Re-balancing is key.** Every year look at your retirement portfolio and re-balance your investments according to your age, financial situation and willingness to take risk. While you cannot predict when large downturns occur, when they do, your sequence risk is somewhat reduced.
- **Keep tabs on your withdrawal rate.** If possible, leaving more money in retirement accounts can help keep sequence risk at bay. This strategy only works if you have alternative sources of income. Options for increasing income and lowering withdrawal rates might include working part-time or taking Social Security benefits earlier than planned.
- **Continue to diversify.** As the life expectancy of older Americans continues to climb, retirement savings must often last 30 years or more. Inflation, though historically low, can be expected to whittle away at retirement portfolios over those decades. So it's important to keep a portion of your savings in investments that have a good probability of outpacing inflation over the long term.

Even if sequence risk hammers your portfolio in the early years of retirement, take time to do your homework. Refuse to give in to panic. And, above all, ask for help from a qualified investment advisor. ❑





# TAX PLANNING INSIGHTS

Year-End 2020

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Dear clients and friends,

This year began with a record-high stock market and the prospects of continued economic growth. Now, millions of Americans are reassessing their financial health and attempting to make ends meet while the economy slowly tries to come back online.

This Tax Planning Insights newsletter can help you decipher your financial puzzle during these challenging times as you start looking ahead toward the 2020 tax filing season. With the prospect of higher taxes on the horizon, included here are some tips on what you can do before the end of 2020 to help keep your tax bill as low as possible.

Also read about how to get the most out of charitable contributions by donating stock instead of cash, and how to approach your investment portfolio which may have lost value this year.

Don't hesitate to call to schedule a discussion about any last-minute moves to ensure your 2020 tax liability is as low as possible.

As always, feel free to share this Letter with friends and associates who are interested in minimizing their tax obligations.



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# Be prepared for higher taxes

"Tis impossible to be sure of anything but death and taxes."

*The Cobbler of Preston* by Christopher Bullock (1716)

This old adage by Christopher Bullock is still true today, but there's actually a third certain thing in life - fluctuating tax rates!

The tax rate percentage has moved like a roller coaster, going up and going down, over the past 50 years. With another major election this fall, combined with plummeting state and federal revenue because of this year's pandemic, the roller coaster could be heading up again.

Now is the time to start strategizing to structure your finances around possible higher tax rates. Here are some issues you could encounter if tax rates increase along with some helpful suggestions.

**■ Higher income taxes.** Given increased government spending during the pandemic without corresponding tax receipts, most experts forecast an increase in overall income tax rates.

***Action:*** *An old standby in tax planning is shifting income and expenses. If you're the owner of a private business, consider negotiating contracts with customers to move income from 2021 into 2020. On the expense side, try to do the opposite by pushing as many deductions as possible from 2020 into 2021. For example, you could wait until 2021 to make any major capital acquisitions. Finally, remember your tax-deferred accounts. If planned correctly, you may have time to pay income tax on accounts now and then move them into a tax-free Roth account.*

**■ Capital gains tax rate goes up.** In 2020, the highest long-term capital gains tax rate is 23.8% (20% capital gains tax rate plus a 3.8% surtax as part of the Affordable Care Act.) In 2005, the highest rate was 15%. Congress could see the sales of long-term securities and other assets as a valuable source of tax revenue by eliminating this preferential tax rate and instead using ordinary income tax rates (currently as high as 37%).

***Action:*** *Use investment gains against losses. Consider trading in 2020 any assets that have appreciated and that you intend to sell in the near future to avoid a potential capital gains tax rate increase.*

**■ Estate tax problem.** The federal estate tax rate for 2020 is 40% of the value of estate assets which exceed $11,580,000 ($23,160,000 for a married couple). There are discussions to drastically lower the $11.58M ($23.16M) Federal threshold to tax more of your wealth when you die. The estate tax rate may also increase above the current 40% rate.

***Action:*** *Consider gifting money or securities to family, friends or a foundation. Individual gifts in 2020 of $15,000 or less ($30,000 for married couples) don't count against the lifetime gift-giving limit.*

The bottom line? Consider your situation now and create a tax strategy so that if or when tax rates go up, you will be as prepared as possible. ❑





# Donating stock to charities can yield bigger tax savings

Scrolling through your inbox, you come across an e-mail from your favorite charity asking for a donation. You've been meaning to make a contribution for a while now, but just never got around to sending them a payment. You're ready to do it now, and you're cyber smart, so you avoid the e-mail and go directly to the charity's web site.

Regardless of how you make your payment - credit card, debit card, EFT, or mailing a physical check - your donation is considered a cash contribution.

Instead of making a cash contribution to a charity, you could instead make a stock contribution and see a potentially larger tax deduction.

To illustrate, assume you purchased stock in 2015 for $10,000 and donate the stock in 2020 with a fair market value of $15,000. Here are three different scenarios and their tax implications assuming your marginal income tax rate is 37% and your long-term capital gain rate is 20%.

**1. Donate cash instead of selling stock.** Donating $15,000 in cash to the charity decreases your taxes by $5,550 if you itemize deductions. You get a charitable contribution tax deduction equal to the cash contributed. Your income tax savings is 37% of $15,000, or $5,550.

**2. Sell stock and donate the proceeds.** Selling the stock and then donating the cash proceeds reduces your tax liability by $4,550. Here's why:

- Income tax savings = $5,550
- Capital gains taxes paid = $1,000. Selling the stock first means that you have to pay taxes on the gain. Your tax liability is 20% of $5,000.

**3. Donate the stock directly to the charity.** Donating your stock directly to the charity cuts your tax bill by $6,550! Here's how it works:

- Income tax savings = $5,550
- Capital gains tax savings = $1,000. By donating the stock, you do not owe long-term capital gain taxes. This saves 20% of the $5,000.

As you can see, directly donating stock to a charity can potentially save you $6,550 in taxes, compared to $5,550 if donating cash and $4,550 if selling the stock and then donating the proceeds. ❑

**STOCK DONATION VS. CASH DONATION**

| | Donate Appreciated Stock | Sell Stock, Donate Cash | Donate $15,000 Cash |
|---|---|---|---|
| Charitable Deduction | $15,000 | $15,000 | $15,000 |
| Income Tax Savings (a) | $5,500 | $5,500 | $5,500 |
| Capital Gains Taxes (b) | $1,000 saved | $1,000 paid | n/a |
| Total Tax Savings | $6,550 | $4,550 | $5,550 |

(a) Assumed income tax rate of 37%
(b) Assumed capital gains tax rate of 20%