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How Flexible Is Your Financial Plan?

Flexibility in a financial plan is a delicate balancing act: it is important to maintain enough flexibility that your financial plan can accommodate unexpected events that are out of your control. On the other hand, a sound financial plan needs to be firmly grounded by factors you can control so that even in the face of unexpected events, following your financial plan gets you to where you want to be.

Be Flexible: There Are Assumptions You'll Have to Make about Factors You Can't Control

When you develop a financial plan, you have to make certain assumptions, many of which are out of your control:

Taxes — The notoriously complicated U.S. tax code will affect your financial plan in a number of ways. For one, your effective tax rate will change as your income changes. Also, changes to the tax code itself can affect your financial plan, often dramatically.

Income — We all hope our income will rise as we move forward in our careers. Typically, those kinds of income changes are predictable. More dramatic yet still predictable income changes can happen when one spouse voluntarily stops or starts working.

Health — Your health and your spouse's health is a significant factor in your financial plan for two reasons: first, because health is a big determinant of one's ability to earn income; second, because health care costs are often a large expense, especially for older people. As you age, it's important to think about changing your assumptions about your health. Maybe you reduce the income you expect because you won't be able to work such long hours anymore. Or you increase the health-care-related expenses you plan for.

Life — Beyond job losses and health events that can impact your financial plan, other major life events can have a big impact as well. Whether it's good or bad, expected or unexpected, events like the birth of a child, marriage or divorce, a

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Frankly Speaking

It's that time of year again for resolutions and turning over new leaves. But think back to last year… What resolutions did you make and how many did you keep? This year my suggestion is that you take it a little easier on yourself and only attempt attainable goals.

Budget your finances and time with your family equally. Nobody has moaned on their death bed, "If I had only been able to spend more time at work". Take care of those you love, and your health by eating well and sensibly. Remember to exercise and avoid a sedentary lifestyle as there will be plenty of time for that when you're dead.

Do things you've always meant to, but never got around to doing them. Stick to the retirement savings goals, review life insurance needs for your wife & family, and then make the investments.

May all your troubles last as long as your New Year's Resolutions. (Joey Adams). ❍❍❍

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How Flexible?

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spouse's death, or a relocation will impact your financial plan. Some you can plan for, some you can't; the point is to be aware that these kinds of events typically require a review of your financial plan.

Economy — For most of us, our financial plans are based on the assumption that our investments will earn a certain average return in the market. Those assumptions affect decisions we make about our plans; for example, the amount you need to save every month to retire at age 70 is larger or smaller the higher or lower your assumption about investment returns. The best way to make these assumptions is to base them on long-term historical returns in the relevant market indices.

That is not to say, of course, that these assumptions will always be correct; anyone with money invested in the stock market in the fall of 2008 understands that those assumptions can be turned on their heads in a single day. But given that we have to make assumptions, using historical returns is the best way to do it.

Be Grounded: Factors You Can Control to Keep Your Financial Plan on Track

Because there are so many factors affecting your financial plan that you can't control, it's critical to know the factors you can control and to stay on track with your plan in those areas.

Live within your means — When you keep your expenses (including savings and investments) less than your income, you give yourself more flexibility to accommodate unexpected changes that you can't control. If you have some breathing space in your budget every month, you can more easily accommodate, for example, a higher tax rate or economic downturn without having to alter your financial plan.

Have a rainy day fund — Have at least 3–6 months worth of living expenses in an easily accessible, liquid fund that you can draw upon in the event of an emergency or unexpected situation. This savings fund should be set aside from all other savings and investments and only used for true emergency expenses — like in the case of a job loss or illness. With an adequate rainy day fund, you can deal with unexpected events without having to dilute or erode your financial plan.

Revisit your plan regularly — The number one key to achieving your financial goals is to review and, if necessary, revise your financial plan regularly — at least once a year. That way you can make adjustments for all the factors out of your control that have changed, for better or worse. If you haven't revisited your financial plan in the last year, or if you need to develop one, please call. ❍❍❍

Why Teach Your Children about Investing?

Not convinced your children need to know how investing works? Here are four good reasons to teach your children about investing.

Because Someday They'll Need to Do It on Their Own — Once your children are on their own and have jobs, they'll have to make decisions about investing for retirement and other goals. If they come armed with good lessons from childhood, they're more likely to make smart decisions.

Because Good Money Habits Start Early — Children's core money habits may be ingrained as early as seven years old. You can start to teach children about concepts related to investing, like the idea that wealth builds over time. One way to do this is by having children open a savings account that earns interest, or you could reward their saving on your own, perhaps by matching a certain percent of their savings, just like your employer matches your 401(k) contributions.

So They Can Make Mistakes — Making mistakes is a part of the learning process. Most people have to make their investing mistakes as adults, when losing money often hurts a bit more. But by exposing your children to investing at a young age — and by letting them make their own decisions when it's appropriate — they'll learn valuable lessons now, when losing money hurts less. So let your child invest a small amount in that questionable stock. When it tanks as you expect it will, he/she will have learned a valuable lesson.

So They Can Start Building Wealth Early — Consistent, focused investing is one of the best ways for most people to build wealth. If your children start young, you'll be giving them an important leg up for their financial future. Even if you aren't prepared to give children the reins yet when it comes to managing their money, you can show them how you're giving them a solid foundation by putting their birthday cash and other gifts in an investment account like a Roth IRA. As long as a child has earned income from a job, he/she can put money in a traditional or Roth IRA. Even if it's just a few hundred dollars, by starting early, their money will have decades to grow. If they continue those good habits as adults, by the time they reach retirement, your child could accumulate a significant sum.

If you're ready to teach your children about investing but aren't sure where to start, please call. ❍❍❍

Your 401(k) Plan When Changing Jobs

If you are considering changing jobs, make sure you fully understand the impact it may have on your retirement plan. If you are not aware of your employer's retirement plan rules, you could lose thousands of dollars in matching funds, taxes, and potentially a large penalty.

Here is what you need to know about your 401(k) plan if you are thinking of changing jobs.

Your Vesting Schedule and Status

Assuming your company offers an employer match to your 401(k), it can significantly increase the size of your retirement account. The money you contribute to the account is always yours, even if you leave the company. The money your employer contributes to the account, however, will have a vesting schedule that defines when those contributions legally become yours.

Companies can have an immediate vesting schedule, a cliff schedule, or a gradual vesting schedule. Sometimes, staying an extra month or a year can make a big difference in what you get to take with you when you leave the company. If you leave the company before you are completely vested, you are aware that you will lose a portion of the matching funds, but the timing could make a big difference.

Your Retirement Account Options

Once you have decided to change jobs, you will need to decide what to do with your 401(k). When you leave your employer, you have four options for your 401(k), which are cashing it out, leaving the money in the plan, rolling the money over to your new employer's qualified retirement plan, or rolling it over to an IRA.

Cashing Out Your 401(k)

If you plan on rolling over the funds into another retirement account, but you have the money directly paid to you, you have 60 days to put the money into a qualified retirement account or you will have to pay income taxes and a penalty. If you intend on putting the money into a retirement account, it is better to set up a direct rollover to the new plan administrator to avoid this.

If your intention is to cash out the account and keep the money, you need to understand the financial impact. For example, let's say you have $50,000 in your 401(k) account. The plan administrator is required by law to take out 20% for taxes; now your account is valued at $40,000. If you are under the age of 59½, you'll also have to pay a 10% penalty on the original amount in the account, which is another $5,000. Now you have $35,000.

It doesn't end there. The $50,000 distribution will most likely put you in a higher tax bracket than the 20% that your administrator withheld. Let's say you are in a 31% tax bracket; you will have to come up with the difference, which is an additional 11% or $5,500. Your original $50,000 in retirement savings is now down to $29,500. Now you have to deduct any state and local taxes, which could take another $5,000 or so depending on where you live. You could be giving up almost half of your retirement savings in income taxes and penalties.

Leave the Money in the Plan

If you have at least $5,000 in your 401(k) plan, most employers will allow you to leave the funds in their plan. This can be a good option if your new employer doesn't offer a 401(k) plan.

Rollover to the New Employer's Plan

Most employers will allow rollovers from other qualified retirement plans. You will want to understand when you will be eligible to participate in your new employer's plan, because there is typically a waiting period for participation. You should consider leaving the money in your old employer's plan until you are eligible to participate in the new plan.

To ensure you will not have to pay any taxes or a penalty, the rollover should be a trustee-to-trustee transfer, so make sure the rollover check is made out to the new plan administrator and not to you. If it is not a direct rollover, you could be in jeopardy of having to pay the taxes as well as the penalty.

Rollover the 401(k) to an IRA

You can open a rollover individual retirement account (IRA) at most financial institutions. Rolling your 401(k) into an IRA is a great option because you will have more investment options. Most employer retirement plans offer limited investment options to keep down costs; however, they often have higher administrative fees that impact the value of your account. ❍❍❍

Assess Your 401(k) Plan

At least annually, you should thoroughly review your 401(k) plan. Some items to consider include:

Have your goals or objectives changed? Most people use their 401(k) plan to fund retirement, although it can also be used for other things. Take time to reassess your goals and objectives, which can impact how much you contribute and how you invest those contributions. Calculate how much you'll need at retirement as well as how much you should save annually to meet that goal.

Are you contributing as much as you can to the plan? At a minimum, make sure you are contributing enough to take full advantage of any matching contributions made by your employer. In 2023, the maximum contribution to a 401(k) plan is $22,500 plus an additional $7,500 catch-up contribution, if permitted by the plan, for individuals age 50 and older.

Are the assets in your 401(k) plan properly allocated? Some of the more common mistakes made when investing 401(k) assets include allocating too much to conservative investments, not diversifying among several investment vehicles, and investing too much in the employer's stock.

Do your investments need to be rebalanced? Use this review to ensure your allocation still makes sense. Also review the performance of individual investments, comparing the performance to appropriate benchmarks. Review your allocation annually to make sure it is close to your desired allocation. If not, adjust your holdings to get your allocation back in line. Selling investments within your 401(k) plan does not generate tax liabilities, so you can make these changes without any tax ramifications.

Are you satisfied with the features of your 401(k) plan? If there are aspects of your plan you're not happy with, such as too few investment choices or no employer matching, take this opportunity to let your employer know. ❍❍❍

Encourage Estate Planning

Even when your children are grown, there will probably be lessons you'll want to teach them, such as the need for estate planning. Some items to include in that lesson are:

Explain why estate planning is important. Your role is not to dictate what they should do with their estate, just to emphasize the need for estate planning. When your children encounter major life events, such as marriage, divorce, or a child's birth, remind them to review their estate plans.

Make sure all important estate-planning documents are in place. At a minimum, every adult should have a will, a durable power of attorney, and a health care proxy. A durable power of attorney designates an individual to control financial affairs if one becomes incapacitated, while a health care proxy delegates health care decisions to a third person when one is unable to make those decisions.

Coordinate estate planning across generations. If you have a substantial estate, you may want to coordinate your estate planning efforts with those of your children. A coordinated effort can help minimize estate taxes. ❍❍❍

Financial Thoughts

Recently, companies are spending more on buybacks than dividends. The S&P sectors that were most aggressive in repurchasing their stock (by percentage of all stock repurchased) were information technology (28%), communication services (14.4%), financials (10.9%), and energy (10.4%) (Source: *AAII Journal*, March 2023).

With value and growth stocks tending to move in cycles, investors are taking renewed interest in value investing after its outperformance in 2022. Value stocks are generally cheaper to buy, and growth stocks cannot sustain their momentum indefinitely. Some tech giants like Microsoft and Amazon are considered both value and growth stocks. As interest rates normalize, investors will tend to pay closer attention to fundamental factors of company operation such as price multiples, which tend to identify undervalued stocks (Source: *Kiplinger's Personal Finance*, May 2023).

Only 4% of children born in the lowest economic quintile rise to the top quintile. However, 40% of people born in the highest quintile remain there. People born in the middle quintiles have a 50-50 chance of moving to a higher or lower quintile (Source: Pew Charitable Trusts, 2023). ❍❍❍