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Investing Before and During Retirement

There are two phases in the life cycle of a retirement portfolio: the time when you're contributing to it and the time when you're using it to cover your living expenses. During each phase, the basic challenge is deciding how to invest your nest egg, and for that there are three common approaches:

✔ **Going with your comfort level.** Most people have some idea as to what investments are appealing, either because of the rate of return associated or how much safety they seem to offer. Whichever it is, people tend to pile their retirement funds in one place — which can cause problems if there is a significant decrease in that investment.

✔ **Using a one-size-fits-all formula.** There are at least several of these formulas. On the theory that the closer you get to retiring the more conservative you should become, one says you should subtract your age from 100, treat the result as a percentage, and put that portion of your portfolio in stocks and the rest in bonds. Another follows the same method, but suggests you subtract your age from 120. The appeal of this approach is that it's simple and unambiguous. The downside is that the results don't take into account the details of your circumstances, the state of the economy and inflation, or the cyclical nature of market returns.

✔ **Using a financial plan.** A plan includes all the details that the other two methods leave out. It's by far your best bet for achieving your retirement goals since it takes your circumstances and the state of the economy into account. The plan should be split into before-retirement and during-retirement strategies.

Before You Retire

The key factor is to determine what rate of growth you need to achieve in your portfolio to retire with a nest egg capable of supporting you for the rest of your life once you no longer earn a paycheck. It's a balancing act between how much you can afford to put aside every year, how much growth will maximize your nest egg, and how much risk you feel comfortable taking.

By analyzing these factors, a

Continued on page 2

Frankly Speaking

The debt limit is a cap on how much the Treasury Department can borrow to fund federal operations. Congress sets the debt limit, as required by federal law and consistent with the Constitution, which gives Congress the "power of the purse." Since 1960, Congress has raised or re-defined it 78 separate times.

Question: Can you spend money you don't have? Answer: Not for long.

Sadly, our politicians seem to feel spending other peoples' money is OK. But you & I must work within a personal spending plan or budget. Ronald Regan once accused 'Congress of spending like drunken sailors, but that would be unfair to drunken sailors because the sailors are spending their own money!'.

If you would like an Excel template of a personal spending plan, please call, or email me and manage your money wisely. ❍❍❍

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Investing

Continued from page 1

good financial plan produces a recommended asset allocation strategy that specifies how much of your portfolio should be invested in stocks, bonds, cash, commodities, and real estate. The mix you invest in aims at a target rate of return and risk level that both meets your goals and makes you comfortable.

In general, the younger you are, the more risk you can afford to take. It's not unheard of for someone in his/her 30s or 40s to invest up to 70% or 80% of his/her assets in stocks. Conversely, younger people who are risk-averse may be able to take less risk and put more of their assets in bonds, as long as they have more modest retirement goals.

It's generally true that the closer you are to retiring, the more conservative your portfolio ought to be. But this doesn't suggest the precise proportions that you ought to put into each asset class, nor does it take into account the opportunities or challenges that current market conditions present. Those answers will come only when you get into the details of your current situation and your future goals.

After You Retire

Before you retire, your asset allocation strategy is driven largely by the goal of creating the largest possible retirement portfolio within the limits of your tolerance for risk. After you retire, the goal shifts to keeping your retirement portfolio large enough to continue generating the supplemental income you need for the rest of your life.

While this shift means your strategy aims for less growth and risk than in the accumulation stage, it's usually a mistake to revert to the most conservative strategy possible. That's because your portfolio gets eroded over time by:

- ✔ Inflation, which means the real value of your portfolio (as well as the buying power of the income it throws off) gets smaller every year.
- ✔ Taxes on income and capital gains in taxable accounts and withdrawals from non-Roth IRAs.
- ✔ Withdrawals that you make to support your lifestyle.

Because of this constant shrinkage, some portion of your portfolio needs to be invested in stocks, which is a riskier asset class but typically stays ahead of inflation, taxes, and reasonable rates of withdrawals.

Please call if you'd like to discuss your situation. ❍❍❍

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. ❍❍❍

Bonds: Not Just for Retirement

Bonds can be a good investment alternative at all stages of your life, not just when you retire.

During Childhood

Savings bonds can be a way to teach children the importance of savings and growth. Though these bonds might not have the initial thrill of toys or cash, they can provide a unique opportunity to instill in young people the basics of saving and investing and even increase the probability that you'll raise financially savvy adults. The gift that keeps on giving, savings bonds will not only provide children with intermittent interest payments to either invest, save, or spend, but a sizeable return once their bonds mature during their college years and beyond.

In Your 20s

Once you enter your 20s, bonds may no longer hold the appeal they might have afforded you as a child, but they're still useful in a more grown-up way: retirement. Though most of your growth-centered retirement account will likely be in stocks, you might also consider a small allocation of bonds as an anchor that can provide some stability to your investments. After beginning your retirement contribution plan, focus on paying off student loans and building a savings account for emergencies. If you still have extra money to work with and you have a specific goal down the road, such as graduate school or saving for a down payment on a home, annual payments from a fixed-income investment such as bonds can help you reach your goals with minimal risk. Depending on the type of bond you purchase, bonds don't come with early withdrawal penalties should you run into an emergency.

In Your 30s and 40s

Though it may seem a lifetime away, you're now a decade or two closer to retirement, so it's time to rethink your asset allocation. Even though you're more likely to be serious about investing and retirement — perhaps opening an IRA or increasing your 401(k) contributions with raises or bonuses — you may want to rethink your risk tolerance, even if you're just getting started in the investment arena. Should the market happen to take a downturn and you're still entirely invested in stocks, you no longer have as much time to recover, particularly if you plan on retiring younger. Bonds can lend more security to your portfolio, allowing you to work toward financial goals in a less risky way.

By now, you may have also inherited money from a grandparent, great uncle, or even parent. If you'd like to invest this money for a specific goal down the road, such as your children's college education or a kitchen remodel, individual bonds can provide you with semiannual interest payments, and depending on the bond type and grade, a guaranteed total return.

Approaching Retirement

Now that you're inching closer to retirement, it may be time to take a more conservative approach with your investments rather than exposing them to the volatility of the stock market. Whereas before you might have been more aggressive with your portfolio growth, you may want to consider protecting what you've worked so hard to establish by transitioning a larger portion of your portfolio to bonds.

Beyond retirement planning, bonds can help you reach specific goals, such as funding a grandchild's college education down the road or achieving your dream of a vacation home in the tropics. Because bonds come with a variety of maturity dates — whether your goals are approaching in 20, 10, or even five years — bonds can help achieve them, with less risk than stocks but most likely a better return than the savings account at your credit union.

Your Golden Years

Collecting your Social Security benefits is one thing, but you may not be as thrilled about taking distributions that might dip into your retirement principal. This can be an ideal time to begin focusing predominately on bonds, which can offer numerous advantages throughout your retirement years. At this point in your life, the goal is to retain your principal as long as possible, since it's impossible to predict how long you'll live. Additionally, the more you can preserve in the long run, the more you can leave to loved ones when you die. You'll need an investment plan that maximizes your retirement accounts by affording you with enough interest to live comfortably without liquidating your principal. Because your income is likely entirely dependent on Social Security benefits and investments, it may not be prudent to expose your retirement funds to the volatility of the stock market. A bond fund can provide enough interest to subsidize your income while preserving enough of your principal to outperform inflation. Furthermore, tax-exempt municipal bonds can help shelter you from a higher tax bracket.

Please call to discuss this in more detail. ❍❍❍

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Overcoming a Fear of Investing

Many Americans are nervous about investing. While investing does come with risks that you need to be aware of, that's no reason to avoid it entirely. Here are three steps you can take to overcome that fear.

Start from a Position of Strength — If you have a mountain of credit card debt and no emergency savings, investing any of your money is likely to be a bit nerve-wracking. Before dipping a toe into serious investing, work on paying down high-interest credit card debt and establishing an emergency fund with at least six months' living expenses. The exception to the above suggestion? Investing in your retirement plan at work. If you get a company match, you may want to invest just enough in your 401(k) plan to get that money.

Get Educated — Familiarizing yourself with how markets work and with the basic principles of sound investing will help you understand that though investing comes with risk, it's hardly the same as playing the lottery. There may be no sure things when investing, but if you proceed with a smart strategy and stick with it over time, there's a good chance you'll come out ahead.

Set a Goal — By knowing what you want to achieve before you make any specific decisions about where to put your money, you'll be more likely to invest in a way that will get you to where you want to be. If your goal is to buy a house in five years, that means that investing in potentially high-return yet also high-risk stocks is not so smart — the risk that you could lose your down payment savings is simply too great. Stashing that cash in a certificate of deposit probably makes more sense. But if you're investing for retirement that's three decades away, you can afford to take on more risk with your investments, since you have more time to make up any losses, and you'll benefit from the potentially greater returns of high-risk investments. In that case, higher-risk stock investments make a lot of sense. The key is to keep your goal in mind and let that drive your decisions about how to invest.

Being a little nervous about investing is normal, but you shouldn't let it keep you from achieving your financial goals. Please call if you'd like to discuss this in more detail. ❍❍❍

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Consider a Bond Tent

An important strategy to consider is building a bond tent before you retire. This strategy increases the allocation of bonds during the 10 years or so prior to retirement, and then the bonds are sold from this portion of your portfolio during the first 10 to 15 years of retirement, providing you with an income stream.

This strategy is called a bond tent because if you were to look at it on a line graph, the bonds in the portfolio steadily rise until it reaches a peak at retirement and then falls as the bonds are sold, which makes a tent shape.

The strategy works by reallocating a traditional 60/40 mix of stocks and bonds to an allocation of 50% or 60% in bonds by the time you retire. The bond holdings are then sold during the first half of retirement until the original mix is once again reached. This provides portfolio protection against major losses due to a market downturn during the first half of retirement. The portion of your portfolio that is still in stocks will continue on the path for long-term growth to fund your later years of retirement as well as provide protection against inflation. ❍❍❍

Financial Thoughts

In a recent survey of the impact of the COVID-19 pandemic on personal finances, women have been disproportionately affected. They are more likely to be the primary caregivers for children at home and are heavily concentrated in healthcare and other frontline service work that exposes them to the coronavirus and puts them more at risk of related business closures. Given those uncertainties, only 33% of women feel optimistic or in charge of their finances while 44% of men do. Also, 31% of women reported feeling they barely have their head above water, while only 19% of men did. Only 55% of women felt confident in their ability to build emergency savings, as opposed to 69% of men. And fewer women, 54%, felt confident they could retire when they wanted, compared to 67% of men (Source: *Financial Advisor Magazine*, March 2021).

Respondents to the same survey are vowing to take charge of their finances in 2021 — 83% said they want to minimize worrying about their finances, mainly by increasing savings, and 70% indicated they are saving more (Source: *Financial Advisor Magazine*, March 2021) ❍❍❍