4 Common Mistakes in Retirement Planning

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1. Vast majority of savings are in pre-tax traditional 401(k) and IRA's.

For many years, people have lived under the belief that they would find themselves in a lower tax bracket at retirement and that the most important thing they can do is put as much money as they possibly can into pre-tax vehicles like 401(k) plans to get the deduction in the current year. The problem that creates is that they are forced to take distributions from those accounts at age 70 ½ whether they need the money or not. For example, in 2016 someone who has $2.5m in that type of account, would need to take out over $90k as a required minimum distribution for that year[1], or potentially pay a 50% tax on that amount[2]. All the income that comes out is subject to income tax and so is 85% of social security benefits. If we have to withdraw that amount of money from accounts that are taxable, we could wind up in a tax bracket that's higher than our working years. For those that have a few years of runway before retirement, there are some interesting strategies that we look at for our clients that help them create some other buckets that are not taxed later so that we can diversify how things are taxed later in the same way we diversify between different asset classes.

2. There isn't a sufficient cash reserve or bucket of safer dollars at retirement to ensure that assets don't have to be sold in a downturn.

The good news about investing in equities is that over the last 200 years or so, they have typically exceeded the rate of inflation. The challenge is that many people don't have sufficient cash or safer dollars in other places to provide income during retirement to last 2 years or so. Having these safer reserves gives our clients the confidence to know they don't need to sell their investments during a down turn and that confidence allows them to not worry as much during periods of volatility because they know their plan is built to help withstand those conditions.

3. They haven't set in motion tax advantaged vehicles in addition to their 401(k).

When we meet with people, in many cases when the topic of retirement planning comes up, we get responses like "well, I'm maxing out my 401(k)…" as if that is all there is to do. When we put together retirement plans for clients and show them what it looks like to arrive at retirement having maxed out their 401(k) every year from now until then, they are often surprised that having that along with social security may not provide enough income at retirement to support their lifestyle. This is particularly true for those that live in high cost areas like San Francisco or New York. Along with the high cost of living they are facing, our clients also tend to be paying significant income taxes that have risen in recent years. Once people realize the need to save in places beyond their 401(k), the question then becomes, what are some things I can do that are tax efficient?

It also occurs to people that they don't want to have all their money invested in equities for the reasons stated above.

4. They don’t have a clear plan in place for distribution of all their buckets and haven’t created guaranteed income.

For many years, the financial services industry was almost exclusively focused on accumulation of dollars without much thought to the distribution phase. As people are living longer and therefore having a longer retirement, 30 years in many cases, it has become important to have a clear plan for distribution. What we have found is that those clients who have sources of guaranteed income from pensions, social security, and annuities, tend to worry less about running out of money. They also worry less about gyrations in the stock market because they know that no matter what happens in the equity markets, they are going to have a certain amount of income each month. When we create financial plans for our clients, a big focus of these plans is finding ways to match fixed income with fixed expenses so that we know we aren’t going to need to sell as many of our other investments during a down turn. Our clients find this approach to be very comforting and they like knowing that they have equities in their portfolio to keep up with the rising costs we will all face during a 30 year retirement and that they also have guaranteed sources of income so that the ups and downs don’t bother them as much. Because most of our clients do not have pension plans, and they need more income on a monthly basis than social security can provide, they look to other sources to create this income and they want to be as tax efficient as possible in doing so. In working with our team, we make sure they have a plan in place to accomplish exactly that.

[1]Source: Financial Industry Regulatory Authority’s (FINRA) Required Minimum Distribution Calculator http://apps.finra.org/Calcs/1/RMD.

[2]Source: Internal Revenue Service (IRS), Required Minimum Distributions (RMDs) https://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Retirement-Topics-Required-Minimum-Distributions-(RMDs).