REFLECTIONS

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WINDGATE
WEALTH MANAGEMENT

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WHICH ACCOUNTS SHOULD YOU DRAW DOWN FIRST IN RETIREMENT?

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When we meet with near-retirees, there is often a single question that cuts right through any discussion on economic outlook or investment strategy: "How will I replace my monthly paycheck, so I can pay all my bills in retirement?"

"Well, we can help turn your portfolio into a paycheck," is typically our answer. Fortunately, strategic income planning not only brings retirees comfort and peace of mind, but it can also result in more assets. In fact, according to Vanguard, retirees working with an advisor can expect around a 3% performance increase per year.[1]

Why?

Because financial advisors help you build a plan and stick to it. We draw on the right accounts at the right times. We aim to maximize growth and minimize taxes. That said, in addition to working with an expert, it's also important to know why you're doing what you're doing. Read on to understand a few general guidelines for retirement withdrawals.

[1] https://advisors.vanguard.com/iwe/pdf/FASQAAAB.pdf

INSIDE THIS ISSUE

1. Taxable Brokerage Accounts

The first places you should generally withdraw from are your taxable brokerage accounts—your least tax-efficient accounts subject to capital gains and dividend taxes. By using these first, you give your tax-advantaged accounts (IRA, Roth IRA) more time to grow and compound. Brokerage accounts will never grow as quickly as tax-advantaged accounts because they are subject to the annual drag of taxation on interest, dividends, and capital gains.

2. Traditional IRA And 401(k)

A second lever to draw from are your Traditional IRA or 401(k) accounts. From a tax perspective, it doesn't matter which you start with. Keep in mind that once you turn 70½ years old, you'll be required to take minimum distributions (RMDs) from both accounts.

3. Roth IRA

Your Roth IRA should remain untouched for as long as possible. Roth IRAs are tax-free, which in retirement are two words you will always be happy to hear. Unlike traditional IRAs and 401(k)s, you are never required to take minimum distributions from your Roth. That means your portfolio can continue compounding tax-free as long as you want (unless future laws change).

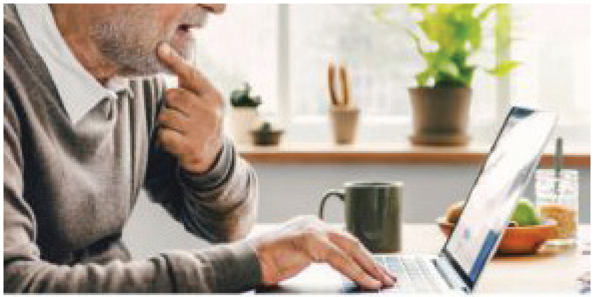
Easy as 1-2-3… Not So Fast

If you really want to maximize your portfolio's retirement longevity, it's not as easy as pulling from the above types of accounts one-two-three. It is beneficial to allow your IRAs to grow tax-deferred as long as possible, but with a significant caveat: if your IRAs grow too large, you may be subject to higher tax rates in the future.

Remember that every dollar you take from a Traditional IRA is included as taxable income. This means if you simply spend down your brokerage accounts to zero and then plan to begin living off your IRA completely, all your withdrawal income will be taxed in this second phase of your plan, potentially pushing you into a higher tax bracket.

In addition, leaving your Traditional IRA to compound untouched in early retirement can result in larger RMDs at age 70 – so large in some instances that RMD income alone can push you into higher tax brackets. Your first year's RMD will be about 4% of the account value, meaning a $2 million IRA could produce enough required income alone ($80K) to nearly double your tax bracket, before even counting Social Security, pension, or other retirement income. So much for low tax rates in retirement!

Filling the Buckets with Partial Roth Conversions



An ideal retirement income strategy will maximize tax-advantaged growth, while maintaining the flexibility to fund some portion of your retirement expenses with non-taxable income. Good news, this is doable; it's called a Roth Conversion strategy.

You can change (or "convert") any portion of a Traditional IRA into a Roth IRA in a given tax year. The cost is simply that you must pay income tax on the amount converted. By systematically moving some of your Traditional IRA assets into a Roth IRA during your early years of retirement, you can create a future where a Roth IRA is available to fund a good portion of your retirement expenses. Since Roth IRA accounts are tax-free, any dollars put into to a Roth can compound without any tax drag and be later taken out without paying additional taxes. This is a great situation for retirees to be in.

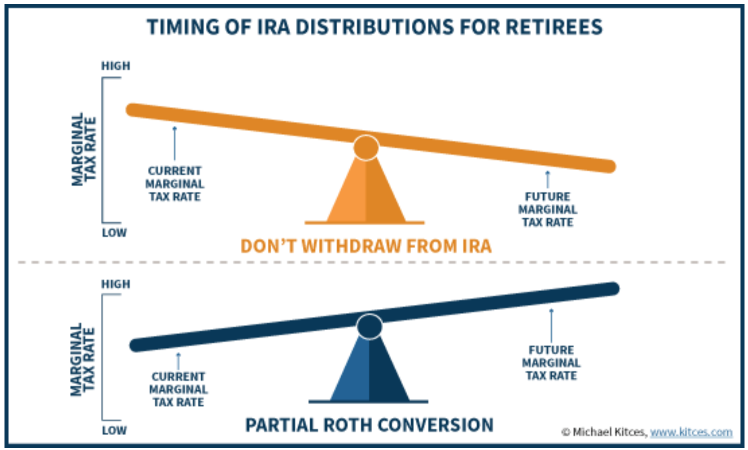
Implementing a partial Roth Conversion strategy is different for each family, as everyone has their own unique circumstances. As a general example, it may be possible to simply "fill up" the lower tax brackets with Roth conversion income each year while building your Roth accounts. For example, the 12% tax bracket begins at about $80K of income for joint filers. Let's say that after adding up any social security, pension, or other retirement income and accounting for deductions your taxable income lands at $40K. Here, doing a $40K Roth conversion will bring your income right up to the top of the 12% bracket, allowing you to build a Roth account without paying higher rates in taxes.

Don't Forget Social Security

So where does Social Security fit into your retirement income? Like most things in personal finance, it depends. Every situation is unique. One easy recommendation: start drawing when you need to—no sooner, no later.

Every month you delay taking Social Security, your income increases. Your survivor benefit will also increase, creating an increased insurance payment for your spouse. However, there may be health or other reasons why you'd want to draw early. Social Security payouts are based on life expectancy. So, if you live to an average age, you'll receive the same total amount regardless of when you start drawing. Tap in early, and you'll receive more checks for a smaller amount. Wait to draw, and you'll receive fewer checks for a greater amount.

As you can see, there's no one right answer. You must factor in your personal (and family) health, financial situation, and other individual needs.



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MARKETS COMPLETE ROUND TRIP

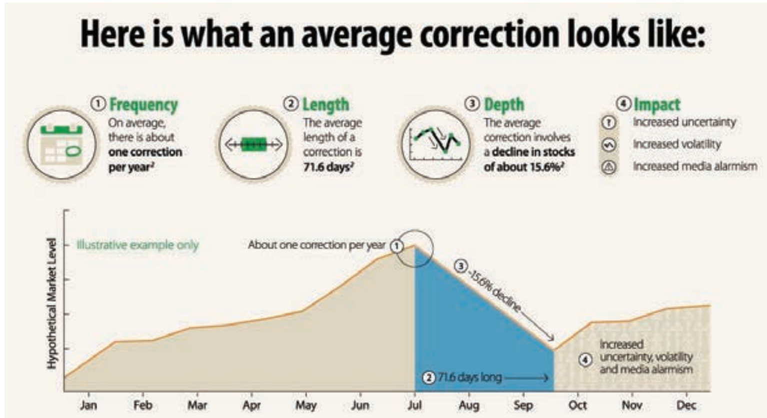
Seven months later, the S&P 500 climbed back to where it started before its collapse late last year. It took 14 weeks to fall and 17 weeks to recover, making one of the fastest market turnarounds in history. For investors, if you managed to never sell during the market tantrum, you were likely made whole before the recent pullback..

IN THE CURRENT BULL MARKET THERE HAVE BEEN EIGHT CORRECTIONS SO FAR

Source: Visual Capitalist

You have also had the good fortune to experience a market shock and recovery in a fraction of the time that it usually takes to endure and learn from.

For some perspective, below we offer a longer-term reminder of how corrections are a normal part of investing. The average correction and recovery, though generally much lengthier than what we have just experienced, still demonstrates the wisdom found in the tried and true philosophy: invest for the long term, don't panic, and avoid the news.



Source: Visual Capitalist

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[1] MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of 23 developed countries.

[2] https://www.marketwatch.com/story/what-to-expect-from-the-next-market-correction-2013-02-19

HOW BUSINESS OWNERS CAN CATCH UP FOR RETIREMENT

Owning your own business can give you great freedom and power in life, but it also comes with responsibility. One of the responsibilities business owners struggle with is creating a plan to convert their successful business into long-lasting personal wealth. As a business owner, you know how difficult it is to prioritize saving for retirement when you are focused on growing your business. For most small business owners, 70% of their wealth is tied up in their business[1] and according to a Manta research study, 34% of business owners don't have a retirement savings plan.[2] Since your retirement is just as important as the success of your business, take a look at these four steps that will help you catch up for retirement in a hurry.

1. Find the Right Plan For You

Unfortunately, you don't have access to an employer-sponsored 401(k) account with matching contributions at your fingertips. That doesn't mean you are out of luck when it comes to building a nest egg. Here are some savings options to consider.

Traditional & Roth IRA

A Traditional IRA is like a 401(k) in that you can contribute pre-tax dollars to an investment account that grows tax-deferred. A Roth IRA is the reverse: your contributions are not tax-deductible like Traditional IRAs; instead your earnings grow tax-deferred and your withdrawals are all tax-free (subject to IRS guidelines). For 2019, you can contribute up to $6,000 to IRAs, or if you're over age 50, a total of $7,000. There are income limits to these strategies, however, so higher earners may have to get more creative to take advantage.

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[1]https://www.cnbc.com/2014/08/19/cnbcfinancial-planning-association-survey-finds-small-business-owners-are-too-focused-on-their-business-to-plan-for-their-own-financial-futures.html
[2]https://www.manta.com/resources/small-business-trends/small-business-retirement-savings-plan/?dest=%2Fresources%2Fsmall-business-trends%2Fsmall-business-retirement-savings-plan%2F

SEP IRA

A SEP IRA, also known as a Simplified Employee Pension, is a good option for those seeking a retirement plan with higher annual limits than the $6,000 ceiling imposed on IRAs, but without the administrative responsibilities of a 401(k). As an employer of yourself, you can make contributions on your own behalf of up to 25% of your self-employed income or $56,000 per year (whichever is the greater amount). Perhaps the most attractive feature of a SEP IRA is that annual contributions are completely discretionary: a business owner can provide a maximum $56,000 contribution one year and no contribution the following year if business is slow.

Solo 401(k)

A Solo 401(k) is ideal for business owners with no employees (other than a spouse). It can offer an advantage over the SEP IRA because it allows you to contribute in two separate capacities: both as an employee and as an employer. Wearing your employee hat, you can defer up to $19,000 (or $25,000 if age 50 or older). As the employer, you can also contribute up to 25% of compensation as defined by the plan. Combined, you can contribute up to $62,000 if you're over the age of 50. If you earn $225,000 or less, a solo 401(k) will generally allow you to contribute more than a SEP IRA.

Adding A Defined Benefit Plan

A defined benefit plan such as a cash balance plan will allow you the greatest amount of tax-deferred retirement savings. They are such a powerful retirement savings tool, we even made a video explaining how they work (https://www.windgatewealth.com/how-to-contribute-far-more-than-18500-to-your-401k/). These plans are complex but can be designed to fit the needs of almost any business. Depending on your age and income, a defined benefit plan allows you to set aside up to hundreds of thousands of dollars annually to fund your retirement, making it possible to save a lot, even if you have little time.

2. Banish Debt

The less debt you have when you enter retirement, the better. Whether it's personal debt in the form of credit cards, car loans, a mortgage, or business debt in the form of bank loans or equipment purchases, reducing your debt before retiring will lower your monthly expenses and enable your savings to grow and last longer. Review all current debts you face and compare interest rates and balances. This can help you decide which to pay off first.

3. Planning for a Profitable Exit

Do you have an exit plan? Even if you are just in the beginning stages of your business, it's imperative to have a plan for the future of your company because it will likely become one of your largest assets. Around 78% of small business owners plan to sell their businesses to fund their retirement, with the sale profits funding 60% of their retirement needs.[3]

If you are heavily relying on the sale or succession of your business to take care of your future financial needs, it's critical that you start thinking about what you can do now to prepare so you receive the highest price possible. Having a strategic transition plan will make your company more appealing to buyers who want assurance that it will continue to thrive without you. A thorough understanding of tax ramifications of selling your business can save you millions. Even if you're passing the business on to family members, you need a plan in place to ensure that it continues to prosper and all family members are treated equally.

4. Build A Support Team

It's no secret that being a business owner complicates life and finances. On top of saving for retirement and taking care of your family, you also have employees to think about and tax considerations. You are in a unique situation and would benefit from working with someone who specializes in serving business owners.

At Windgate Wealth Management, we specialize in serving small business owners and providing unique services to take care of all their financial needs. We even help design and manage company retirement plans, including 401(k)s, cash balance plans, and SEP IRAs, to help you provide for your employees, grow your personal wealth, and reduce your tax liability.

To learn more about how we can help you catch up for retirement quickly, call (844) 377-4963 or email windgate@windgatewealth.com.

A thorough understanding of tax ramifications of selling your business can save you millions.

[3] https://www.cnbc.com/2015/04/13/ew-small-biz-have-an-exit-plan.html

WHAT WE'VE BEEN READING

There's plenty to see, read, and listen to online. Here are some of our recent favorites for when you have time.

Do this Important Task: Check Your Paycheck Withholdings.

Shocked by your tax refund? Next year could be worse unless you act now.
https://www.nytimes.com/2019/04/14/your-money/tax-refund-paycheck-withholding.html

How to Tip

In case you need a tip.
http://www.grubstreet.com/2019/04/how-to-tip.html

How to Pay Attention

20 ways to survive the war against seeing.
https://medium.com/re-form/how-to-pay-attention-4751adb53cb6

Podcast: The ETF Story

The creation story of the first exchange-traded fund is the best way to understand how they work.
https://www.bloomberg.com/podcasts/the_etf_story

The World's Worst Boss

Guess what, it's you!
https://seths.blog/2010/12/the-worlds-worst-boss/

Your Life in Weeks

Are you making the most of your weeks?
https://waitbutwhy.com/2014/05/life-weeks.html

Invest Like the Best: An Interview with Eric Maddox

The incredible story of the military interrogator who located Saddam Hussein. His methods can even be applied in our personal and professional lives.
http://investorfieldguide.com/maddox/

Jim O'Shaughnessy – Things I Think I Know

30 years of investment experience, success and failure in 26 tweets.
https://twitter.com/jposhaughnessy/status/994631936181264384

The Perfectly Fried Egg – José Andrés

Cooks in under a minute, it did take us five tries.
https://www.nytimes.com/slideshow/2012/09/12/dining/20120912-SPANISH.html

How to Find a Financial Advisor You Can Trust

Gigantic infographic guide on how to find someone that will serve your best interests.
https://www.visualcapitalist.com/find-financial-advisor-can-trust/

For 2019, Invest in Adventure

Three steps to take the challenge.
https://www.nytimes.com/2019/01/07/your-money/2019-self-improvement-adventure.html

Any opinions in this article are general in nature and cannot be guaranteed to be suitable for every individual; individual needs and situations vary. Talk to your financial advisor to help consider what options might be right for you.

The information provided herein represents the opinion of Windgate Wealth Management and is not intended to be a forecast of future events, a guarantee of future results, nor investment advice.

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