THE PROSPERITY® CONSULTING GROUP, LLC
A WEALTH MANAGEMENT COMPANY

Summer 2016
www.prosperityconsult.com

THE WEALTH ADVISOR

# Four Retirement Planning Rules Of Thumb To Bend

The online Merriam-Webster dictionary offers two definitions for "rule of thumb":

- A method or procedure based on experience and common sense,
- A general principle regarded as roughly correct but not intended to be scientifically accurate.

In other words, although rules of thumb can be useful guidelines, they're not gospel on any particular issue. This is especially important to remember when you're trying to set aside enough money to last comfortably through your retirement years. And while some traditional rules of thumb that have been followed faithfully for decades may serve as starting points, they're not infallible. Consider these four examples:

**1. Save one million dollars for retirement.** How much will you and your spouse need to live on in retirement? That's the age-old question. In recent years, some people have seized on a million dollars as the magic number to strive for. It's a nice round figure and, after all, can't a millionaire afford an upscale lifestyle in retirement?

But a million dollars doesn't go as far as it used to. Suppose you take an income of 4% of your savings annually—another rule of thumb for using retirement savings (see below). That's just $40,000 a year, and there will be even less if you dig into your nest egg to buy a winter "snowbird" home, for example, or take a few exotic vacations. And people are living longer these days, so you may need money to sustain you for 25 or 30 years, not 20 or less.

Another option that can be used is to set aside an amount roughly equal to eight times your ending salary (or even higher). So, if you're pulling down $200,000 just before retirement, you should have $1.6 million (8 x $200,000) in your coffers. That may be a preferable goal—but even then, a 4% withdrawal will give you only $64,000 a year.

**2. Replace 80% of your pre-retirement income.** This rule of thumb has been amended to make some concessions for a higher cost of living. Previous estimates often were predicated on replacing 70% or 75% of your salary with savings from retirement plans at work and IRAs, investment earnings, Social Security benefits, and other sources. Again, this rule of thumb may work for some people, but not for everyone, and replacing 80% of a high salary could require very substantial savings. You want to have 80% of that $200,000 in income? That's $160,000 a year, and could require savings of $4 million or more.

Moreover, the 80% rule ignores certain variables, such as health-care needs, lifestyle choices, and family obligations. It may be more helpful to go beyond rules of thumb to estimate what your expenses really may be in retirement and work backward to figure

*(Continued on page 4)*

## *Linda Stapf Joins Our Team!*

We are pleased to announce that on July 31st, Linda Stapf, CPA from Stapf Financial Services, will be joining The Prosperity Consulting Group, LLC.

Linda is a graduate of Loyola University Maryland and is a licensed financial advisor and CPA. She has been providing comprehensive financial services to clients in the Howard and Carroll County areas over the last 20 years.

Linda will be maintaining her office in Sykesville, giving Prosperity an expanded presence in Maryland. "We are thrilled to have Linda and her team joining our firm. They are skilled professionals who perfectly complement and align with our core values. We look forward to expanding not only our presence, but our knowledge and expertise to continue to assist clients in achieving their financial goals," says Donald N. Hoffman, MS, CPA, President of The Prosperity Consulting Group, LLC.

In addition to keeping up with all the latest in investing, insurance, taxes, and accounting, Linda enjoys riding horses and spending time with her two grandchildren.

The Prosperity Consulting Group, LLC

# Market Timing Is An Inexact Science

The Standard & Poor's 500 (S&P 500), a leading stock market benchmark, was poised to record one of the worst Januarys in history before a late recovery occurred. Due in part to plunging oil prices and concerns over the global economy, stocks were slammed early in 2016. At one point, the S&P 500 was down 11%, before the index rose 2.48% on January 29, leaving it with a 5% decline for the month.

Clearly, this was more volatility than usual, which was both good news and bad news for market timers.

Market timing is the practice of selling stocks and mutual fund shares ahead of projected declines and buying back those investments when the investor expects the stock market to climb. It's a tempting proposition, and when it works, it can reduce losses and position a portfolio for future gains. However, it usually doesn't work, and getting the timing wrong can result in big losses, from selling shares that would have recovered or from being out of the market when prices rebound.

Market timing appeals to investors who think it can bring them the best of all possible worlds—letting them buy low and sell high. But it's not for inexperienced investors, and even those who know what they're doing and who have all of the resources to help them make intelligent, well-informed decisions are just as likely to fail as they are to succeed.

Not only is the stock market volatile, it is unpredictable. Unexpected events can have an impact, either positive or negative, on a company, industry, or sector. Market timers think they know better than others what's coming next. Although they may guess right sometimes, they're bound to be wrong, too. To compound the problem, those who are successful once may start to think they are invincible. Of course, they're not.

But just because market timing is generally a loser's game doesn't mean you always have to sit idly by while markets fluctuate. Tactical adjustments may be in order depending on what's in your portfolio, what your goals are, and your investing timetable. However, by investing for the long term and periodically rebalancing your portfolio, you can focus on specific objectives in a consistent manner. This could be especially important following a period of extreme volatility such as the one the markets experienced early this year. Working toward your long-term goals also takes emotions out of the investing equation.

When you engage in market timing, you effectively have to be right twice—getting out of the market at the right time, before a downturn, and then getting back in before the market rallies. That's much less likely to pay off than staying in the market over the long haul—which also happens to be a lot easier on the nerves. ●

# DOL Approves Final Fiduciary Rule

At long last, the controversial "fiduciary rule" for retirement accounts has been approved, with some modifications, by the Department of Labor (DOL).

The fiduciary rule drew a firestorm of criticism when it was first proposed in 2015. After lengthy hearings and thousands of comment letters from the public, the DOL went back to the drawing board. The final rule that has emerged takes into account some concerns that were raised, but keeps the basic framework intact.

Under the final rule, firms providing investment advice pertaining to retirement plans and IRAs must put their clients' "best interest" before their own. Essentially, financial advisors can't receive compensation without qualifying under the Best Interest Contract Exemption (BICE). Otherwise, their actions may constitute "prohibited transactions."

The new final rule clarifies the rules for the BICE by establishing a contractual fiduciary duty between investors and financial advisors. To qualify under the BICE, fiduciary standards of conduct must be acknowledged in a written contract.

In that contract, advisors must state that the advice they offer is based on a client's particular needs. This includes recommendations relating to a retirement plan, a plan participant or beneficiary, a plan fiduciary, or an IRA owner in exchange for fees or other compensation—for buying, holding, selling, or exchanging investments. It also covers advice on rollovers, transfers, and distributions from plans and IRAs. The fiduciary standards also cover disclosures on reasonable compensation, costs of providing advice to clients, and conflicts of interests.

The final rule also establishes what is ***not*** advice for these purposes. General communications such as financial newsletters, marketing

# Study These Six Higher Education Tax Breaks

Paying for college can be daunting, but federal tax rules provide some relief. With enhancements from the Protecting Americans from Tax Hikes (PATH) Act of 2015, you may benefit from one or more of these six tax provisions:

1. Section 529 Plans, available from all 50 states and the District of Columbia, encourage families to set aside savings for future education expenses. Most states set contribution limits at $300,000 or more. Generally, the investment grows without current taxes and distributions to pay for most college expenses — including tuition, fees, books, supplies, equipment, and room and board for full-time students — are completely tax-free.

You can choose a 529 plan from any state, and although college-savers often choose to save in the plan of their home state, you might be better off establishing a plan elsewhere. Still, more than half of the states offer state tax deductions or credits for Section 529 plan contributions by residents. That could be a compelling reason to stay home when choosing a plan.

2. The American Opportunity Tax Credit (AOTC) became a permanent tax break when the PATH Act became law in December 2015. The maximum annual credit is $2,500. You can get separate credits for each qualified student in your family. For example, if you have three kids in school this year, your maximum credit is $7,500. Also, under another recent tax law change, you now can claim the AOTC for up to four years of school for each child, up from two years previously.

However, the AOTC phases out between $80,000 and $90,000 of modified adjusted gross income (MAGI) for single filers and $160,000 to $180,000 for joint filers. Once you exceed the upper limit, you can't claim the AOTC.

3. The Lifetime Learning Credit (LLC) also is a permanent part of the tax code, but the maximum credit of $2,000 applies per taxpayer rather than per student. So even if you have three kids in school at the same time, the maximum credit is still $2,000.

And eligibility for the LLC also phases out, at levels lower than the AOTC. The current range is between $55,000 and $65,000 of MAGI for single filers and from $110,000 to $130,000 for joint filers.

4. Tuition deductions also permit some parents to claim deductions for tuition and related fees paid to colleges and universities. This tax provision, also made permanent by the PATH Act, provides a deduction of either $4,000 or $2,000, depending on MAGI. For single filers, the $4,000 deduction is available for a MAGI up to $65,000 and $2,000 between $65,000 and $80,000. Joint filers can deduct $4,000 for a MAGI up to $130,000 and $2,000 if a MAGI is between $130,000 and $160,000. Above those limits you don't get a deduction.

Taxpayers may claim either higher education credit – the AOTC or the LLC – or the tuition deduction, but not more than one of these three tax breaks.

5. Student loan interest deductions allow you to deduct the annual interest you pay on a student loan, up to a maximum of $2,500. This deduction applies only to the taxpayer who's actually repaying the loan. And the deduction for student loan interest is phased out based between $65,800 and $80,000 of MAGI for single filers and between $130,000 and $160,000 of MAGI for joint filers.

6. Coverdell Education Savings Accounts (CESAs) allow annual contributions of up to $2,000. This is on the low side, especially when compared to Section 529 plans that let you make six-figure contributions. And the ability to put money into a CESA in the first place is phased out between $95,000 and $115,000 of MAGI for single filers and between $190,000 and $220,000 of MAGI for joint filers. But if you qualify, these accounts, too, shield you from current taxes on earnings and you can withdraw money tax-free to pay for tuition and fees, room and board, uniforms, transportation, books and supplies, academic tutoring, and computers.

One bonus with a CESA: those who qualify to contribute to the accounts can use the money to cover costs from kindergarten through 12th grade as well as for college.

These tax breaks may offer parents help in saving for the high cost of higher education. We can help you sort through your options and navigate the arcane rules to find the best path in your situation. ●

materials, and educational materials don't count.

A main difference between the final rule and the earlier proposed version is that additional financial products, including variable annuities and private placements, are now included under the BICE. The final rule also eliminates a requirement for financial advisors to give clients an annual transaction disclosure on costs. Another key change wipes out the need for advisors to provide regular projections of fees over one, five, and 10 years.

Finally, the process of implementing the BICE is streamlined. Now a contract can be completed when a client opens an account.

For most advisors and clients, the final rule takes effect on April 10, 2017, although in some cases the effective date will be January 1, 2018. More details will be forthcoming. ●

# Still Time To Save $1 Million?

The Mazzellis are a typical couple. They married young, saved to buy a nice home, and helped put their children through college. But now, Victor and Debra, both 50 years old, have saved only $80,000 for retirement.

Supposing both spouses retire at age 66, when they will have reached full retirement age (FRA) for Social Security benefit purposes, that gives them just 16 years left to sock away enough for retirement. If the couple's goal is to have $1 million saved by then, what will they need to do?

It will be difficult, but not impossible. Victor and Debra still can secure a comfortable retirement by following a few basic strategies:

- **Ramp up retirement plan contributions.** If Victor participates in a 401(k) plan he can increase his annual contributions, especially now that he and Debra no longer have to pay the kids' college expenses. If he has been contributing 5% to the plan each year, Victor might double that to 10%, while Debra could do the same. Suppose that the Mazzellis boost their annual contributions from $10,000 to $20,000. If they earn a 7% annual return over the next 16 years, they'll have $578,692 when they turn 66. (This figure is hypothetical and not indicative of any particular investment.).

- **Figure out Social Security benefits.** The Social Security Administration (SSA) provides a benefits calculator at www.ssa.gov/retire/estimator.html. It can help you estimate how much you'll receive in retirement at FRA or if you wait longer to apply for benefits. Benefits increase by 8% for each year after FRA until age 70. For example, if Victor is entitled to $25,000 annually at FRA, that would increase to $33,000 if he waits until age 70 to start taking benefits. He'll need to weigh that larger delayed benefit against the $100,000 (4 years x $25,000) that he would get if he starts taking benefits at 66.

- **Work past FRA and invest more.** Regardless of whether Victor or Debra delays Social Security benefits, they might decide to work a few extra years. That helps in two ways—by letting them save more and by reducing the length of time their savings must last during retirement. For simplicity, let's say that this strategy provides $250,000 more in retirement savings for the couple by the time they're 70.

Making other changes, such as downsizing to a smaller home, cutting back on luxuries, and possibly moving to a less expensive area will provide additional savings. Without even taking those factors into account, the other strategies can enable Victor and Debra to build a nest egg of $1,008,692 ($80,000 + $578,692 + $100,000 + $250,000).

Bottom line: The $1-million goal isn't a pipe dream for this couple—and it doesn't have to be for you either. But the sooner you get started, the better. ●

## Rules Of Thumb To Bend

*(Continued from page 1)*

out how much you will have to accumulate and earn annually to meet your objectives.

**3. Save at least 10% of your income for retirement.** The old belief is that you should pay yourself first before you pay anyone else. This rule of thumb mandates that you set aside at least 10% of your salary each year no matter what is happening in your life. For a simplified example, if you earn $150,000 a year and thus set aside $15,000 a year in a tax-deferred vehicle such as a 401(k) plan, you will have $1,470,081 after 30 years if you earn an annual 7% return. (This example is hypothetical and not indicative of any particular investments.)

There are two problems here. First, there's no guarantee that saving 10% a year will give you what you need in retirement. The second is that it may be difficult to maintain that discipline, especially if you're raising a family during your peak earning years. If your saving lags during those years or if you can't start saving until later in life, the 10% rule is very likely to give you less than you need.

**4. Withdraw no more than 4% annually from your nest egg.** At first blush, this principle makes perfect sense for anyone planning on a long lifetime in retirement. In theory, if you withdraw 4% a year and earn more—say, 7% or 8%, as a hypothetical example—you should be able to sustain your nest egg throughout retirement as long as inflation remains relatively low.

But there are no guarantees of what interest rate you will earn, and you might have to use more than 4% some years. Furthermore, during a sharp market downturn, taking out even the minimum 4% could put you in a deeper hole that could be hard to dig out of.

Where do you stand? Although these four guidelines can be helpful, a better idea is to work out a comprehensive plan for your future. We would be glad to provide the retirement planning assistance you need. ●


Securities offered through Triad Advisors Member FINRA, SIPC. Advisory Services offered through The Prosperity Consulting Group LLC. The Prosperity Consulting Group, LLC is not affiliated with Triad Advisors. The articles and opinions expressed in this document were gathered from a variety of sources, but are reviewed by The Prosperity Consulting Group, LLC prior to its dissemination. All sources are believed to be reliable but do not constitute specific investment advice. In all cases, please contact your investment professional before making any investment choices. Any articles written by The Prosperity Consulting Group, LLC will include a 'by line' indicating the author. ©2016 API