

RETIREMENT PLANNING



a portion of that raise to your investment program. One of the most seamless ways to do it, if you are also contributing to a 401(k), is to bump up your company retirement plan contribution at the same time you anticipate that raise. That way you don't get used to that higher paycheck because you're steering at least a portion of it into your 401(k) plan right away.

Because this is such a beneficial way for workers to increase their savings rates, a lot of companies employ a feature in their 401(k) plans called "auto-escalate." It's just a box that you've got to check on your 401(k) plan website, or whatever system you use to enroll; you're telling your employer to automatically steer a predetermined portion of every raise you receive into your 401(k). That can be a nice way to say, I'm going to continue to increase my contributions and do so with a lot of discipline.

**Stipp:** Another area where people sometimes are able to free up some cash is by refinancing, and investing some of that money could be a way to bump up your savings.

**Benz:** One silver lining we've seen with low interest rates right now is that mortgage rates are still quite low. We've seen a lot of people queue up to refinance. Of

course, standards are still pretty stringent on refinancing, so not everyone who wants to has been able to refinance. But for those who qualify, refinancing can be a nice way to free up some extra income in the household that you in turn can shuttle into your retirement savings plan.

When you think about someone refinancing from, say, a 4.5 percent 30-year loan into a 3.75 percent 15-year loan, assuming a \$200,000 mortgage, that can free up an extra \$100,000 into the household that otherwise would have gone to mortgage payments over the life of the loan. That money, in turn, can be steered into an IRA or some such savings vehicle.

Here again, I think that idea of enforced discipline to invest those mortgage savings can be valuable. Any fund company or brokerage firm will let you turn on automatic contributions. They really like when investors invest this way, so they make it easy. Think about using one of those automatic investment programs, whereby you're just saying take this amount out of my checking account every month, and do it until I tell you to stop. Most investors, if they do set up a plan like this, don't stop it. They tend to stick with it. So, it's a nice way to increase your savings rate and keep

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# YOUR PORTFOLIO

important ones. For example, you can make sure that distributions from your income-producing securities get spilled directly into your bank account, thereby providing cash for near-term living expenses. You can also automate your required minimum distributions from your IRAs and 401(k)s, and use the auto-payment feature on your online banking platform to ensure that you don't miss your most important bills. If you pay quarterly estimated taxes, and most retirees do, you can make those payments electronically via the IRS' website (irs.gov).

## Begin building your team

If your partner has no interest in or aptitude for financial matters, it's unrealistic to expect he will know how to identify an appropriate financial advisor. The financial-advisory landscape is a jumble of designations, and business models and can be off-putting. As a result, people without a lot of financial knowledge often choose advisors based on their interpersonal skills rather than making an objective assessment of the individual's financial acumen and whether the business model is a good fit. Even if your plan is to not hire an advisor right away, the onus is on you to vet some advisors for your spouse to ensure their investment approach is palatable, their fee structure is fair, and that you can meet the minimum initial investment amount. I'm a believer in

asking for referrals from related professionals—such as your accountant or your estate-planning attorney—rather than relying on the friends and family network for recommendations.

## Simplify

Do all of the above steps make your head hurt? If so, the best way to reduce your succession-planning workload—and the potential workload of your spouse—is to streamline your portfolio. You can reduce the number of moving parts by collapsing multiple accounts of a given type into a single account at one firm—for example, merge multiple joint taxable accounts into a single one and purge your portfolio of so-called onesies, which are small pools of assets held here and there. True, there's no single firm that's the absolute best at every investment type, but a handful of firms (such as Vanguard and T. Rowe Price) field solid options in all of the major asset classes. In addition to streamlining the number of accounts you hold, it's also wise to switch to lower-maintenance options, such as index funds, and away from higher-maintenance options, such individual stocks and bonds, as you get further into retirement. In so doing, you'll reduce your own portfolio-oversight obligations and simplify life for your spouse if he eventually inherits those duties.

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# TIPS TO AVOID IRA HEADACHES

## Common pitfalls that can trip up newbies and seasoned investors alike

For a vehicle with an annual contribution limit of just \$6,000 (\$7,000 for those over 50), investors sure have a lot riding on IRAs. Assets across all IRA accounts topped more than \$7.3 trillion dollars during the third quarter of 2014, making the vehicle the top receptacle for retirement assets in the U.S., according to data from the Investment Company Institute. In addition to direct annual contributions, much of the money in IRAs is there because it has been rolled over from company retirement plans of former employers.

Opening an IRA is a straightforward matter — pick a brokerage or mutual fund company, fill out some forms, and put money into the account. Yet there are plenty of ways investors can stub their toes along the way. They can make the wrong types of IRA contributions — Roth or Traditional — or select the wrong types of investments to put inside the tax-sheltered wrapper. And don't forget about the tax code, which delineates the ins and outs of withdrawals, required minimum distributions, conversions, rollovers and recharacterizations. Rules as byzantine as these provide investors with plenty of opportunities to make poor decisions that can end up costing them money.

Here are 12 common mistakes that investors can make with IRAs, as well as some tips on how to avoid them:

### 1 Waiting until the 11th hour to contribute

Investors have until their tax-filing deadline — usually April 15 — to make an IRA contribution if they want it to count for the year prior. Many investors take it down to the wire. Those last-minute IRA contributions have less time to compound — even if it's only 15 months at a time — and that can add up to some serious money over time. Investors who don't have the full contribution amount at the start of the year are better off initiating an auto-investment plan with their IRAs, investing fixed installments per month until they hit the annual limit.

### 2 Assuming Roth contributions are always best

Investors have heard so much about the virtues of Roth IRAs — tax-free compounding and withdrawals, no mandatory withdrawals in retirement — that they might assume that funding a Roth instead of a traditional IRA is always the right answer. It's not. For investors who can deduct their traditional IRA contribution on their taxes — their income must fall below the limits — and who haven't yet saved much for retirement, a Traditional deductible IRA may, in fact, be the better answer. That's because their in-retirement tax rate is apt to be lower than it is when they make the contribution, so the tax break is more valuable to them now.

### 3 Thinking of it as an either/or decision

Deciding whether to contribute to a Roth or traditional IRA depends on your tax bracket today versus where it will be in retirement. If you have no idea, it's reasonable to split the difference: Invest half of your contribution in a traditional IRA (deductible now, taxable in retirement) and steer the other half to a Roth (after-tax dollars in, tax free on the way out). This can also be a strategy for 401(k) contributions, if you have the option to contribute to either a Traditional or Roth 401(k).

### 4 Making a nondeductible IRA contribution for the long haul

If you earn too much to contribute to a Roth IRA, you also earn too much to make a traditional IRA contribution that's deductible on your tax return. The only option open to taxpayers at all income levels is a traditional nondeductible IRA. While investing in such an account and leaving it there might make sense in a few instances, investors subject themselves to two big drawbacks — required minimum distributions and ordinary income tax on withdrawals. The main virtue of a traditional nondeductible IRA is as a conduit to a Roth IRA via the "backdoor Roth IRA maneuver." With a backdoor Roth IRA, the investor makes a contribution to a nondeductible IRA and then converts those monies to a Roth shortly thereafter. (No income limits apply to conversions.) Note that the clock on backdoor Roth IRAs could be ticking: President Obama proposed closing the backdoor Roth IRA loophole in his most recent budget proposal. For now, though, it's a viable maneuver for affluent retirement savers.

### 5 Assuming a backdoor Roth IRA will be tax free

The backdoor Roth IRA should be a tax-free maneuver in many instances. After all, the investor has contributed money that has already been taxed, and

if the conversion is executed promptly (and the money is left in cash until it is), those assets won't have generated any taxable investment earnings, either. For investors with substantial traditional IRA assets that have never been taxed, however, the maneuver may, in fact, be partially — even mostly — taxable.

### 6 Assuming a backdoor Roth IRA is off-limits

Investors with substantial traditional IRA assets that have never been taxed shouldn't automatically rule out the backdoor IRA idea, however. If they have the opportunity to roll their IRA into their employer's 401(k), they can effectively remove those 401(k) assets from the calculation used to determine whether their backdoor IRA is taxable.

### 7 Not continuing to contribute later in life

True, investors can't make traditional IRA contributions after age 70 1/2. They can, however, make Roth contributions, assuming they or their spouse have enough earned income (from working, not from Social Security or their portfolios) to cover the amount of their contribution. Making Roth IRA contributions later in life can be particularly attractive for investors who don't expect to need the money in their own retirements but instead plan to pass it on to their heirs, who in turn will be able to take tax-free withdrawals.

### 8 Not gifting with IRAs

Speaking of earned income, as long as a kid in your life has some, making a Roth contribution on his or her behalf (up to the amount of the child's income) is a great way to kick-start a lifetime of investing. Per the IRS' guidelines, it doesn't matter whether the child actually puts his or her own money into the IRA (there are, after all, movie tickets and Starbucks beverages to be purchased). What matters is that the child's income was equal to or greater than the amount that went into the account. The IRA contribution can come from you.

### 9 Forgetting about spousal contributions

Couples with a non-earning spouse may tend to short-shrift retirement planning for the one who's not earning a paycheck. That's a missed opportunity. As long as the earning spouse has enough earned income to cover the total amount contributed for the two of them, the couple can make IRA contributions for both individuals each calendar year. Maxing out both spouses' IRA contributions is, in fact, going to be preferable to maxing out contributions to the earning partner's company retirement plan if it's subpar.

### 10 Delaying contributions because of short-term considerations

Investors — especially younger ones — might put off making IRA contributions, assuming they'll be tying their money up until retirement. Not necessarily. Roth IRA contributions are especially liquid and can be withdrawn at any time and for any reason without taxes or penalty, and investors may also withdraw some of their traditional IRA money without penalty under very specific circumstances, such as a first-time home purchase or college funding. While it's not ideal to raid an IRA prematurely, doing so is better than not contributing in the first place.

### 11 Running afoul of the 5-year rule

The ability to take tax-free withdrawals in retirement is the key advantage of having a Roth IRA. But even investors who are age 59½ have to satisfy what's called the five-year rule, meaning that the assets must be in the Roth for at least five years before they begin withdrawing them. That's straightforward, but things get more complicated if your money is in a Roth because you converted traditional IRA assets. Check with an advisor if this applies to you.

### 12 Thinking of an IRA as 'mad money'

Many investors begin saving in their 401(k)s and start to amass sizable sums there before they turn to an IRA. Thus, it might be tempting to think of the IRA as "mad money," suitable for investing in niche investments. Don't fall into that trap. While an IRA can indeed be a good way to invest in asset types that aren't offered in a company retirement plan, ongoing contributions to the account, plus investment appreciation, mean that an IRA can grow into a nice chunk of change over time. It makes sense to populate it with core investment types, such as diversified stock, bond and balanced

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