FinancialConnections
A Bridge To Your Future

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THE FALLACY OF LIVING OFF THE INCOME

It is a common theme that someone will say, "I want to keep my principal and live off the income." Unfortunately, unless you have a lot of principal, this is an unrealistic expectation.

History (www.multpl.com)

1873 – a basket of large-cap stocks (predates S&P 500 but similar concept) provided 7.5% dividend yield

1917 – dividend rate peak 10.2%

Late 1980s – range was 3.5% – 6%

Current circumstances

Bond interest is at historical lows. The U.S. Aggregate Bond Index is 1.82% at the time of this writing.

Today, companies are stingy with dividends. Since 1990 the rate declined and today is at an historic low of 1.28%. It is unrealistic to think that this type of dividend can support anyone in retirement.

On a portfolio of $1,000,000, the annual amount distributed based on this yield is $12,800. Unlikely to fund retirement expenses. What are the options?

1. Have more principal if you want to stay within the dividend rate
2. Withdraw based on total return. Dividends plus interest plus capital gains equal total return. If your million-dollar portfolio has dividends of 1.28% (12,800) and capital gains (rise in stock price) of 4.5% (45,000), your withdrawal would be $57,800.

When clients establish ongoing distributions, total return is how we design our approach to funding withdrawals.

Inside Financial Connections Newsletter

JILL PLANS TO RUN AWAY AND JOIN THE CIRCUS

Bonnie and Jill decided to get away in December. They are taking a Princess cruise from San Francisco (no plane necessary) down the California coast and to Cabo San Lucas. They plan to come back refreshed and ready to meet the challenges and opportunities in 2022.

WANTED – TAX PREPARERS

We regularly get asked if we can refer a tax preparer to a client. If you like your tax preparer, will you share their contact information with us? Just email Jill or Brian. Thanks.

LOANS TO A FAMILY MEMBER

Over the decades, some clients have loaned their adult children money for a down payment on a home. While it is logical to say this is my family, I'll loan you some money, the IRS actually has rules surrounding this activity.

If you loan money without going through the process of setting up a loan including length of time, payment terms, etc. the IRS assumes you made a gift. If this "loan" is more than the annual exclusion of $15,000, a tax return is required. Most likely there are no taxes due.

Each person has a lifetime gift exemption. At this writing, it is over $11,000,000. If you were to loan a child $200,000, that amount is subtracted from the $11,000,000. However, you must file the tax return for $200,000 as it is the documentation you provided a gift against the lifetime exemption.

If it is indeed a loan, the IRS sets up inter-family loan rates. Based on the interest rate environment, the IRS calculates a minimum applicable federal rate (AFR) for loans covering different time frames.

Up to three years is considered short-term. The rate, as of September 2021 is 0.17%; loans up to nine years at 0.86%. Over nine years is 1.71% – 1.73% depending upon the frequency of interest payments.

CAUTION: Lenders view an inter-family loan as additional debt and might deny or reduce the mortgage available. Frequently, in order to obtain the mortgage needed, the down payment from the parents becomes a gift.

SOCIAL SECURITY – SAME OLD - SAME OLD

Almost every year the media sounds the alarm on Social Security's pending shortfall. We have written about it regularly; most recently discussed in our podcast #12 (12/20/2020).

This problem is not new – and will continue until the politicians decide to do something about it. So far, they just "kick the can down the road."

Brief History

What's in a number? The belief was that older people should give jobs to the next generation. Otto von Bismark is frequently credited for establishing a German pension. The eventual agreed upon starting age was 65. The problem? Life expectancy in Germany for a newborn male was 37.7 years and newborn female 41.4 years. Not hard to keep a pension system running with so few people participating.

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SOCIAL SECURITY – SAME OLD - SAME OLD (continued)

When Social Security was created in the U.S., the life expectancy for both sexes was 61.7. Full Retirement Age for benefits, age 65.

<u>Current</u>

You can see that the original systems assumed a low percentage of the population would be alive to collect benefits. The average life expectancy in 2021 for females is almost 83 years and for males 78 years (lifeinsurancehoppingreviews.com).

Almost 40 years ago Social Security was going to have a shortfall. The Full Retirement Age (FRA) was raised over a period of years from 65 to 67. The age increase is taking 22 years to implement.

Social Security reserves are currently expected to run out in 2033. This date changes each time they review the numbers – at least annually. It does not mean you will not receive your benefit. What it does mean is that unless something is done, the benefit will be 76% of your normal payment.

Listed below are just a couple of suggestions if the politicians had the courage to deal with the problem.

- Raise the annual wage ceiling subject to Social Security taxation. Current maximum is $142,800.

- Increase the age to apply for Social Security – we live longer, why not start benefits later? The age suggested: 69 or 70. This would be over time – not for the immediate group of benefit recipients.

The latest data indicates that 16.5% of the U.S. population is retired (statista.com) with an increase expected to be 22% by 2050. That's a lot of votes. Imagine how relieved this voting bloc would be to know Social Security was secure!

WHAT'S IN A PRONOUN?

We all know the adage that nothing stays the same, things are always changing. It certainly applies to society. It used to be that personal pronouns were she/her/hers or he/him/his. That is changing. As part of diversity commitments, more and more companies recognize that beyond she/he, some people identify as neither male or female or both male and female. They may prefer they/them/theirs.

In retail, some employers encourage employees to identify their pronouns on their name badge. Other companies encourage employees to list their preferred pronouns under their email signature.

It is important to the staff at Financial Connections that all clients feel comfortable and are heard and seen. In fact, one of our specialties is working with non-traditional individuals and couples.

We redesigned our financial planning questionnaire to reflect pronoun preferences for new clients. If you are already a client and would prefer something other than she/he, please contact us.

REFRESHER ABOUT DOWN MARKETS

We've been lulled into complacency since the COVID bear market last year. The volatility has been minimal until this month. We thought it would be a good time to recall how markets usually work.

Stock market corrections and bear markets are a normal part of investing. Unfortunately, they aren't predictable (maybe in hindsight) and they aren't regular. Let's define our terms.

Correction is defined as more than 10% (but less than 20%) from the market high (peak) to the market low (trough). Since 1950, there have been 38 declines of more than 10% (Yardeni Research). It averages to one every 1.87 years. The reality of course is we go years without a correction and then may have more than one in a calendar year (2018).

Bear markets are defined as over 20% from peak to trough. The average bear market since 1929 is 39.9%; occurs on average every 56 months and lasts 21 months (Kiplinger May 4, 2020).

But don't forget the market is up more than it is down. And you can't predict when a market downturn starts or ends. This is why we believe in a diversified portfolio that stays the course based on your financial plan and risk profile.

We are available if you'd like to discuss your portfolio.

SCHWAB/TD AMERITRADE UPDATE

Schwab offered a three-day webinar called Solutions that highlighted the various tools offered for advisors and their clients. Kai Bogdanovich, our Operations Manager, and Jill attended the virtual event.

We were impressed. They are not giving "lip service" when they say they are looking at both the TD Ameritrade and Schwab platforms and building out something new that uses the best of both. They showed us the template for the new dashboard Financial Connections would see when we login each morning. We could actually see what they took from TD Ameritrade and combined with Schwab.

Another area that was impressive was Schwab's website for clients. You will be able to change your address or approve transfers. There will be several steps required to maintain security but nevertheless, what we've seen looks good.

They are now projecting the transition to take place between April – October 2023. They continue to anticipate we will not need to complete new applications so conversion will be done electronically over a weekend. You will have new account numbers but the history from TD Ameritrade also transfers.

Stay tuned. We'll update you as the process moves along.

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