MADISON PLANNING GROUP, INC.
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NEWSLETTER

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Madison News

Gary recently attended the Ed Slott Elite IRA Advisor Workshop from May 12 – 14 in Atlanta Georgia.

Ed Slott, who has been named "The Best Source for IRA Advice" by the Wall Street Journal led a three day workshop educating Gary and some of the best Financial Advisors, CPA's, Accountants and Tax Professionals in America.

To find out more about Ed Slott and what Gary learned at this workshop, please **CLICK HERE** to read our recap!

DATES TO REMEMBER

June 14th – Flag Day

June 19th – Father's Day

June 20th – Summer Begins

Gary (Centered) with Ed Slott (To the left of Gary) & fellow colleagues at Workshop

I. Projecting a Happy Retirement

A 2015 study found that 41% of households headed by someone aged 55 to 64 had no retirement savings, and only about a third of them had a traditional pension. Among households in this age group with savings, the median amount was just $104,000.[1]

Your own savings may be more substantial, but in general Americans struggle to meet their savings goals. Even a healthy savings account may not provide as much income as you would like over a long retirement.

Despite the challenges, about 56% of current retirees say they are very satisfied with retirement, and 34% say they are moderately satisfied. Only 9% are dissatisfied.[2]

Develop a realistic picture

How can you transition into a happy retirement even if your savings fall short of your goals? The answer may lie in developing a realistic picture of what your retirement will look like, based on your expected resources and expenses. As a starting point, create a simple retirement planning worksheet. You might add details once you get the basics down on paper.

Estimate income and expenses

You can estimate your monthly Social Security benefit at ssa.gov. The longer you wait to claim your benefits, from age 62 up to age 70, the higher your monthly benefit will be. If you expect a pension, estimate that monthly amount as well. Add other sources of income, such as a part-time job, if that is in your plans. Be realistic. Part-time work often pays low wages.

It's more difficult to estimate the amount of income you can expect from your savings; this may depend on unpredictable market returns and the length of time you need your savings to last. One simple rule of thumb is to withdraw 4% of your savings each year. At that rate, the $104,000 median savings described earlier would generate $4,160 per year or $347 per month (assuming no market gains or losses). Keep in mind that some experts believe a 4% withdrawal rate may be too high to maintain funds over a long retirement. You might use 3% or 3.5% in your calculations.

Now estimate your monthly expenses. If you've paid off your mortgage and other debt, you may be in a stronger position. Don't forget to factor in a reserve for medical expenses. One study suggests that a 65-year-old couple who retired in 2015 would need $259,000 over their lifetimes to cover Medicare premiums and out-of-pocket health-care expenses, assuming they had only median drug expenses.[3]

Take strategic steps

Your projected income and expenses should provide a rough picture of your financial situation in retirement. If retirement is approaching soon, try living for six months or more on your anticipated income to determine whether it is realistic. If it's not, or your anticipated expenses exceed your income even without a trial run, you may have to reduce expenses or work longer, or both.

Even if the numbers look good, it would be wise to keep building your savings. You might take advantage of catch-up contributions to IRAs and 401(k) plans, which are available to those who reach age 50 or older by the end of the calendar year. In 2016, the IRA catch-up amount is $1,000, for a total contribution limit of $6,500. The 401(k) catch-up amount is $6,000, for a total employee contribution limit of $24,000.

Preparing for retirement is not easy, but if you enter your new life phase with eyes wide open, you're more likely to enjoy a long and happy retirement.

[1] *U.S. Government Accountability Office, "Retirement Security," May 2015*

[2] *The Wall Street Journal, "Why Retirees Are Happier Than You May Think," December 1, 2015*

[3] *Employee Benefit Research Institute, Notes, October 2015 - See more at:*

II. Common Financial Wisdom: Theory vs. Practice

In the financial world, there are a lot of rules about what you *should* be doing. In theory, they sound reasonable. But in practice, it may not be easy, or even possible, to follow them. Let's look at some common financial maxims and why it can be hard to implement them.

Build an emergency fund worth three to six months of living expenses

Wisdom: Set aside at least three to six months worth of living expenses in an emergency savings account so your overall financial health doesn't take a hit when an unexpected need arises.

Problem: While you're trying to save, other needs--both emergencies and non-emergencies--come up that may prevent you from adding to your emergency fund and even cause you to dip into it, resulting in an even greater shortfall. Getting back on track might require many months or years of dedicated contributions, leading you to decrease or possibly stop your contributions to other important goals such as college, retirement, or a down payment on a house.

One solution: Don't put your overall financial life completely on hold trying to hit the high end of the three to six months target. By all means create an emergency fund, but if after a year or two of diligent saving you've amassed only two or three months of reserves, consider that a good base and contribute to your long-term financial health instead, adding small amounts to your emergency fund when possible. Of course, it depends on your own situation. For example, if you're a business owner in a volatile industry, you may need as much as a year's worth of savings to carry you through uncertain times.

Start saving for retirement in your 20s

Wisdom: Start saving for retirement when you're young because time is one of the best advantages when it comes to amassing a nest egg. This is the result of compounding, which is when your retirement contributions earn investment returns, and then those returns produce earnings themselves. Over time, the process can snowball.

Problem: How many 20-somethings have the financial wherewithal to save earnestly for retirement? Student debt is at record levels, and young adults typically need to budget for rent, food, transportation, monthly utilities, and cell phone bills, all while trying to contribute to an emergency fund and a down payment fund.

One solution: Track your monthly income and expenses on a regular basis to see where your money is going. Establish a budget and try to live within your means, or better yet *below* your means. Then focus on putting money aside in your workplace retirement plan. Start by contributing a small percentage of your pay, say 3%, to get into the retirement savings habit. Once you've adjusted to a lower take-home amount in your paycheck (you may not even notice the difference!), consider upping your contribution little by little, such as once a year or whenever you get a raise.

Start saving for college as soon as your child is born

Wisdom: Benjamin Franklin famously said there is nothing certain in life except death and taxes. To this, parents might add college costs that increase every year without fail, no matter what the overall economy is doing. As a result, new parents are often advised to start saving for college right away.

Problem: New parents often face many other financial burdens that come with having a baby; for example, increased medical expenses, baby-related costs, day-care costs, and a reduction in household income as a result of one parent possibly cutting back on work or leaving the workforce altogether.

One solution: Open a savings account and set up automatic monthly contributions in a small, manageable amount--for example, $25 or $50 per month--and add to it when you can. When grandparents and extended family ask what they can give your child for birthdays and holidays, you'll have a suggestion.

Subtract your age from 100 to determine your stock percentage

Wisdom: Subtract your age from 100 to determine the percentage of your portfolio that should be in stocks. For example, a 45-year-old would have 55% of his or her portfolio in stocks, with the remainder in bonds and cash.

Problem: A one-size-fits-all rule may not be appropriate for everyone. On the one hand, today's longer life expectancies make a case for holding even more stocks in your portfolio for their growth potential, and subtracting your age from, say, 120. On the other hand, considering the risks associated with stocks, some investors may not feel comfortable subtracting their age even from 80 to determine the percentage of stocks.

One solution: Focus on your own tolerance for risk while also being mindful of inflation. Consider looking at the historical performance of different asset classes. Can you sleep at night with the investments you've chosen? Your own peace of mind trumps any financial rule.

Everyone has a story...

What's yours?

III. Debt Optimization Strategies

As part of improving your financial situation, you might consider reducing your debt load. A number of strategies can be used to pay off debt. However, before starting any debt payoff strategy (or combination of strategies), be sure you understand the terms of your debts, including interest rates, terms of payment, and any prepayment or other penalties.

Understand minimum payments (a starting point)

You are generally required to make minimum payments on your debts, based on factors set by the lender. Failure to make the minimum payments can result in penalties, increased interest rates, and default. If you make only the minimum payments, it may take a long time to pay off the debt, and you may have to pay large amounts of interest over the life of the loan. This is especially true of credit card debt.

Your credit card statement will indicate the amount of your current monthly minimum payment. To find the factors used in calculating the minimum payment amount each month, you need to review terms in your credit card contract. These terms can change over time.

For credit cards, the minimum payment is usually equal to the greater of a minimum percentage multiplied by the card's balance (plus interest on the balance, in some cases) or a base minimum amount (such as $15). For example, assume you have a credit card with a current balance of $2,000, an interest rate of 18%, a minimum percentage of 2% plus interest, and a base minimum amount of $15. The initial minimum payment required would be $70 [greater of ($2,000 x 2%) + ($2,000 x (18% / 12)) or $15]. If you made only the minimum payments (as recalculated each month), it would take you 114 months (almost 10 years) to pay off the debt, and you would pay total interest of $1,314.

For other types of loans, the minimum payment is generally the same as the regular monthly payment.

Make additional payments

Making payments in addition to your regular or minimum payments can reduce the time it takes to pay off your debt and the total interest paid. The additional payments could be made periodically, such as monthly, quarterly, or annually.

For example, if you made monthly payments of $100 on the credit card debt in the previous example (the initial minimum payment was $70), it would take you only 24 months to pay off the debt, and you would pay total interest of just $396.

As another example, let's assume you have a current mortgage balance of $100,000. The interest rate is 5%, the monthly payment is $791, and you have a remaining term of 15 years. If you make regular payments, you will pay total interest of $42,343. However, if you pay an additional $200 each month, it will take you only 11 years to pay off the debt, and you will pay total interest of just $30,022.

Another strategy is to pay one-half of your regular monthly mortgage payment every two weeks. By the end of the year, you will have made 26 payments of one-half the monthly amount, or essentially 13 monthly payments. In other words, you will have made an extra monthly payment for the year. As a result, you will reduce the time payments must be made and the total interest paid.

Pay off highest interest rate debts first

One way to potentially optimize payment of your debt is to first make the minimum payments required for each debt, and then allocate any remaining dollars to the debts with the highest interest rates.

For example, let's assume you have two debts, you owe $10,000 on each, and each has a monthly payment of $200. The interest rate for one debt is 8%; the interest rate for the other is 18%. If you make regular payments, it will take 94 months until both debts are paid off, and you will pay total interest of $10,827. However, if you make monthly payments of $600, with the extra $200 paying off the debt with an 18% interest rate first, it will take only 41 months to pay off the debts, and you will pay total interest of just $4,457.

Use a debt consolidation loan

If you have multiple debts with high interest rates, it may be possible to pay off those debts with a debt consolidation loan. Typically, this will be a home equity loan with a much lower interest rate than the rates on the debts being consolidated. Furthermore, if you itemize deductions, interest paid on home equity debt of up to $100,000 is generally deductible for income tax purposes, thus reducing the effective interest rate on the debt consolidation loan even further. However, a home equity loan potentially puts your home at risk because it serves as collateral, and the lender could foreclose if you fail to repay. There also may be closing costs and other charges associated with the loan.