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Chasing Excellence in Financial Planning

Luke Novak, JD

#IREMforward

Corporate and Individual Financial Planning Roadmap

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Corporate and Individual Discussions

1st Discussion

Corporate Responsibilities of Managing Retirement Plans

2nd Discussion

Individuals Managing Their Own Financial Assets and Future

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Corporate: Changing the Way You Think

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- Improving the Retirement Plan Committee Process
- Enhancing the Participant Experience
- The Dangers of Automatic Enrollment
- Understanding the Value of Roth
- Dissecting the Expense Ratio
- Final Thoughts

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Individual Discussion Topics

- Defining Financial Literacy
- Student Debt and Debt Management
- The Effects of Compounding
- Retirement Planning
- Retirement Distribution Strategies

Corporate: Initial Observations

- Complacency in 401(k) Plans?
  - Participants are not complaining
  - Ten straight years of strong investment markets
  - Across the board fee reduction
  - Corporate priority is usually healthcare
- If it’s not broken, why fix it?

Setting the Stage
Improving the Retirement Plan Committee Process

- How many times a year does the Plan Committee meet?
  - Quarterly
  - Semi-annually
  - Annually
  - When necessary
- Why we meet—to fulfill our Fiduciary responsibility

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Setting the Stage
Improving the Retirement Plan Committee Process

- Many companies do not have ERISA or investment expertise. Generally companies rely on service providers to guide them.

- What is the typical focus of a Committee meeting?
  - Investment Review
  - Fee Review

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Setting the Stage
Improving the Retirement Plan Committee Process

- Investments and fees are very important
- Regulators tend to focus on 401(k) issues unrelated to either investment performance or plan fees

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Consider This
Improving the Retirement Plan Committee Process

- From 2015 – 2018 there was a total of 201 lawsuits filed related to Retirement Plans

- 47 of those lawsuits were against financial firms for **self-dealing** (e.g., “using their own funds in a Plan”)

Source: DOL

Now Consider This
Improving the Retirement Plan Committee Process

- In 2018, the DOL recovered $1,600,000,000 from over 1,329 civil investigations
- In 2018, 65% of the DOL's cases resulted in monetary results
- Average monetary result: $1,200,000+

Source: DOL

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Improving the Retirement Plan Committee Process

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- **In 2018, companies self-reported violations to the DOL's VFCP and DFVCP systems**.
  - 1,414 VFCP filings
  - 19,937 DFVCP filings
- **For Context**:
  - Fidelity is the nation's No. 1 recordkeeper of 401(k) retirement savings plans and a leading provider of 403(b) retirement plans for not-for-profit institutions. Fidelity provides defined contribution, defined benefit, health and welfare and stock plan services to nearly 23,000 employers .*

*https://www.fidelity.com/about-fidelity/fidelity-by-numbers/corporate-statistics

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How did we get here?
Improving the Retirement Plan Committee Process

- **An Advisor's specialty tends to be what?**
- **Misunderstanding of service provider roles and responsibilities.**
- **Most companies do not have someone familiar with key provisions of the document.**
  - Do you know your definition of compensation?
  - How are bonus elections handled?

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Operational Blind Spots – Examples

- Definition of compensation – Bonuses
  - Can you defer on bonus?
  - Is bonus special election?
- Applying the incorrect eligibility for Rehires
  - Do you ever rehire employees?
  - Do you utilize 360 integration between payroll and your 401(k) provider?
- Problems with missing participants

Operational Blind Spots
Missing Participants

Establish procedures for tracking down missing participants*

- Certified Mail to last known address
- Related Plan and Employer Records
- Designated Plan Beneficiary
- Free Electronic search tools (e.g., Facebook, Whitepages, Google)

Always check with your legal counsel that you are in compliance with regard to personally identifiable information (PII) privacy law

**See*, Department of Labor Field Assistance Bulletin No. 2014-01 Required Search Steps

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Next Steps
Improving the Retirement Plan Committee Process

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Enhancing your Committee Process does not have to be complex or hard, there are easy steps companies may consider implementing.

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The Dangers of Automatic Enrollment

- **48% of Plans offer Automatic Enrollment**
  - 50% auto enroll all eligible employees
  - 50% auto enroll new/recent hires only
  - 97% auto enroll into a Target Date option

- **74% of Auto Enroll Plans offer an Annual Increase Program**
  - 19% utilize an automatic Annual Increase Program
  - 26% of active participants utilize the program

Source: Fidelity Q4 2017 Building Futures DC Trends Quarterly Fact Sheet

The Dangers of Automatic Enrollment

- Operational Failures
- Industry and Employee Demographics
- Communication

The Dangers of Automatic Enrollment

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Examples of Pitfalls:

- Rehires;
- Entering Participant Data Incorrectly
- Change of Employee Status
- Employer-chosen automatic enrollment rate may be lower than participant's chosen rate

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The Dangers of Automatic Enrollment

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Action Plan to Prevent Pitfalls

- Create an Administrative Quality Control Committee
  - Review process and procedures
- Cross-check Payroll and Recordkeeper reports
- Have a trained back-up administrator

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Enhancing the Participant Experience

- **What does a typical Education Meeting look like?**
  - How long is the presentation?
  - How often?
  - What kind of topics?
  - How many topics?
  - One-on-one meetings–are they offered?
  - Are key questions being addressed/answered?

Enhancing the Participant Experience

- **Is there a better way?**
  - Shorter meetings
  - 1-2 topics
  - Dynamic speaker
  - Discussion vs. lecture
  - One-on-one meetings
  - Pre-retirement seminars
  - Demos

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What is the Goal?

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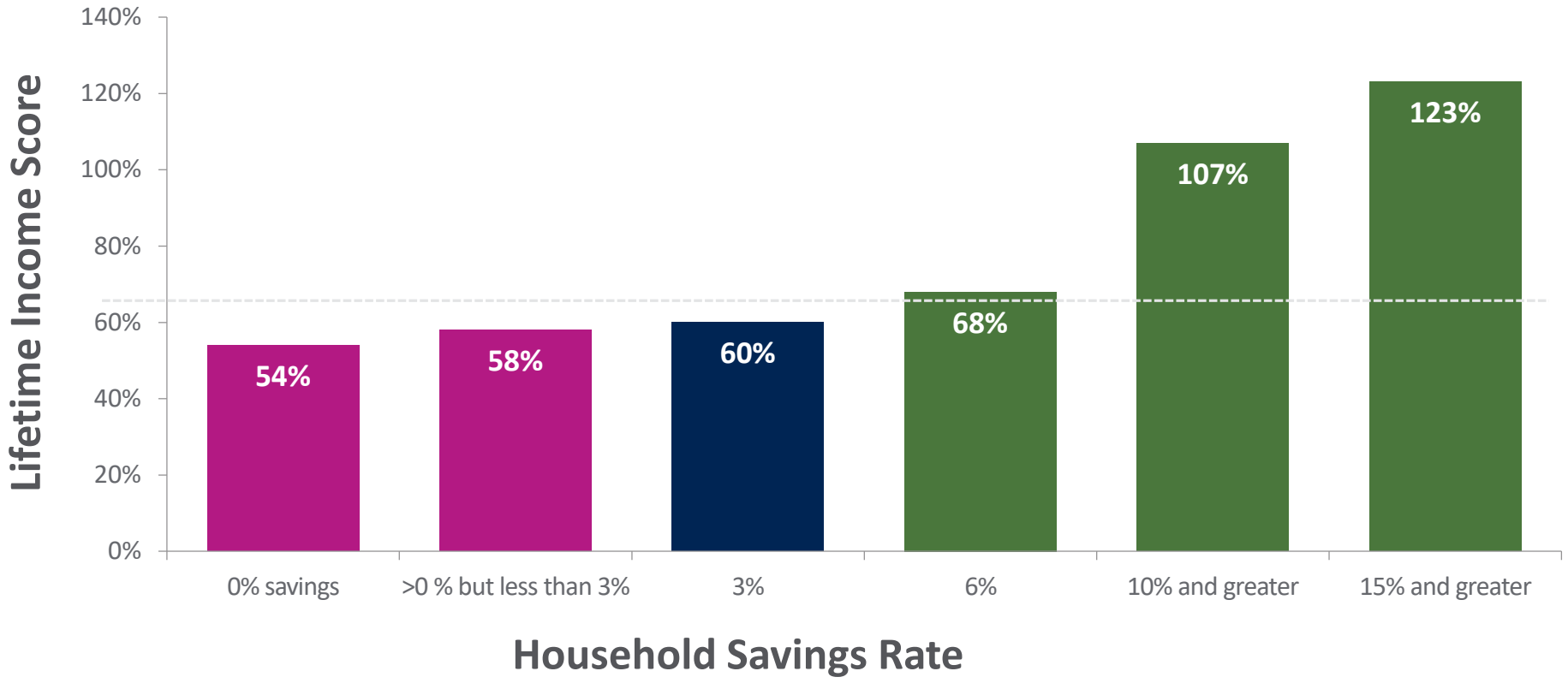
Savings rate: the dominant driver of success



Median Lifetime Income Score

62%

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What is the Goal?

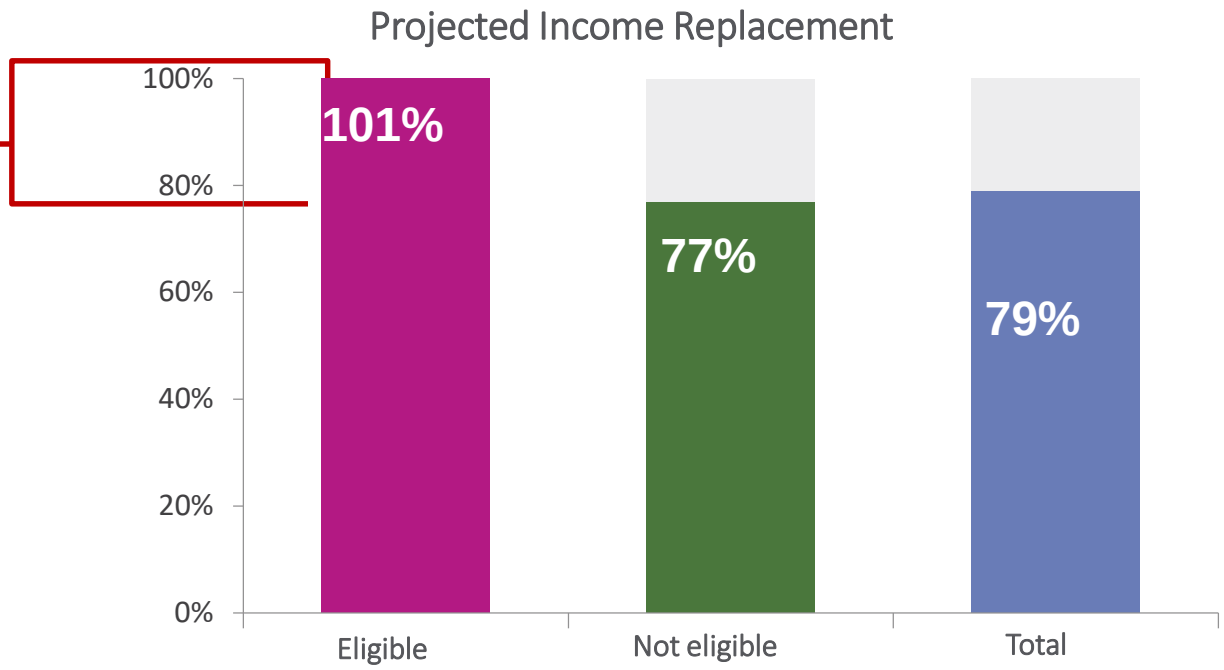
Effect of auto-escalation

Modern plan design positively affects

Nearly

25%

outcome



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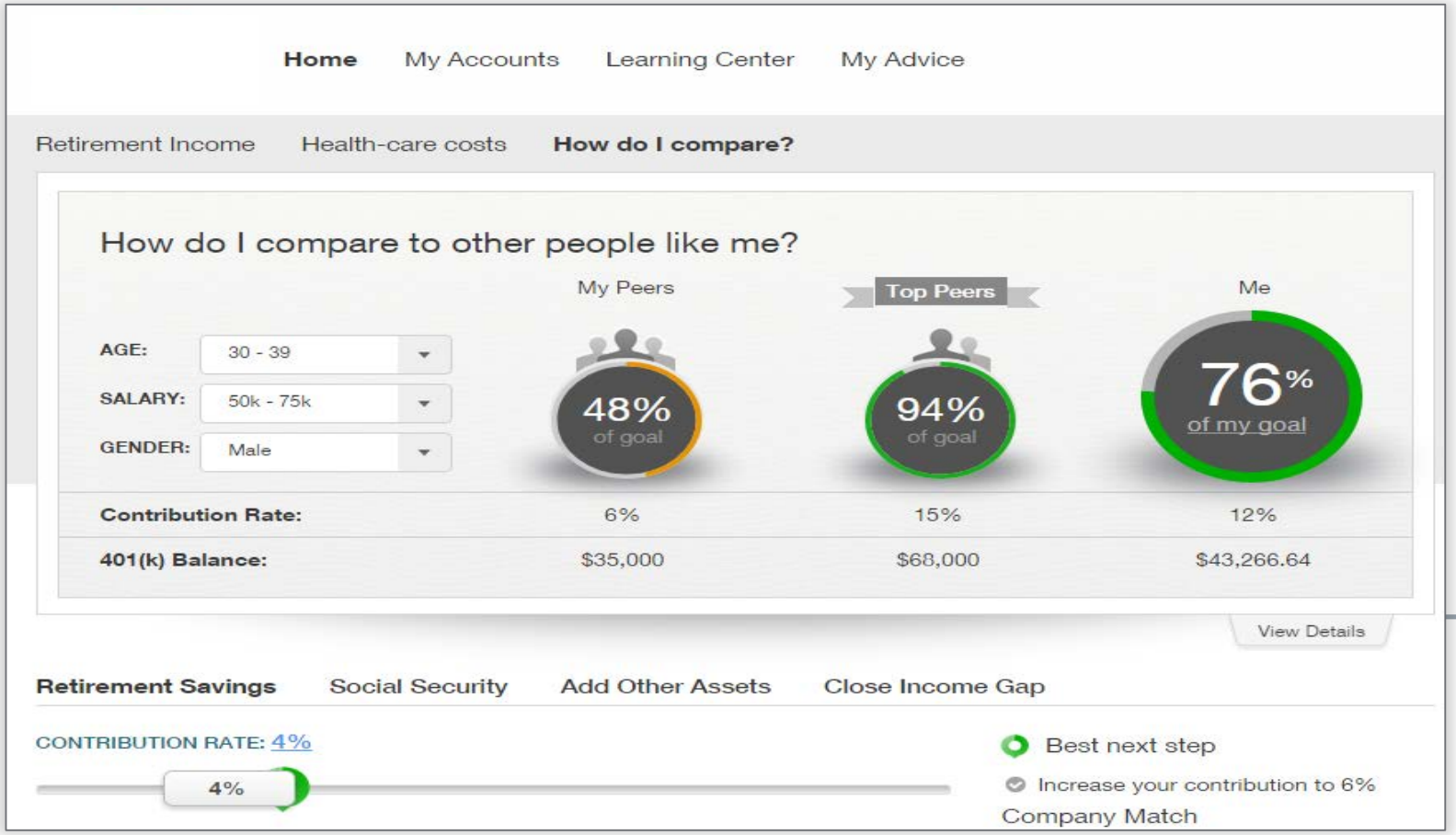
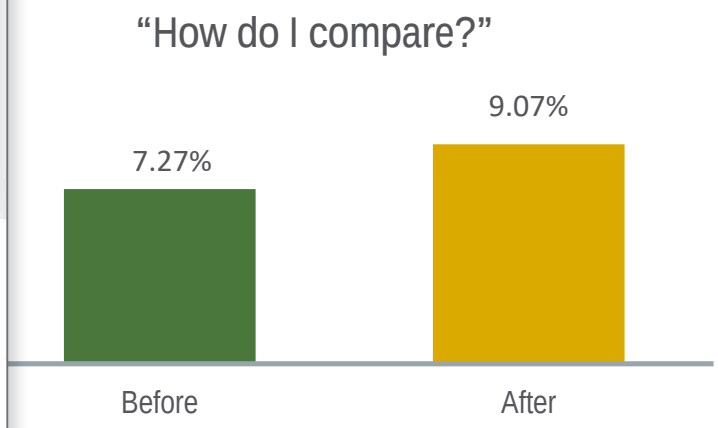
Peer comparison can motivate employees to save more





Based on Participant website usage data for the period 1/1/14-12/31/14; users are defined as participants who logged on to the website and accessed each of the referenced tools.

Enhancing the Participant Experience

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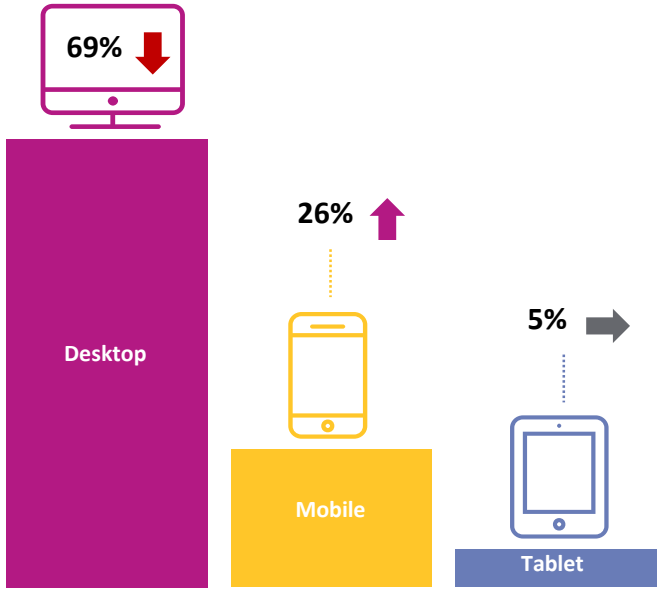
Participants Engage Trends

User Profile	Use by Device	Average Usage

97%

of customers use digital devices to engage with Fidelity



4:02
Average Visit Time

220M
Total Logins

*Source: Visitor Source Adobe Analytics XO Suite: includes NB Retail, Post Login & Device Type

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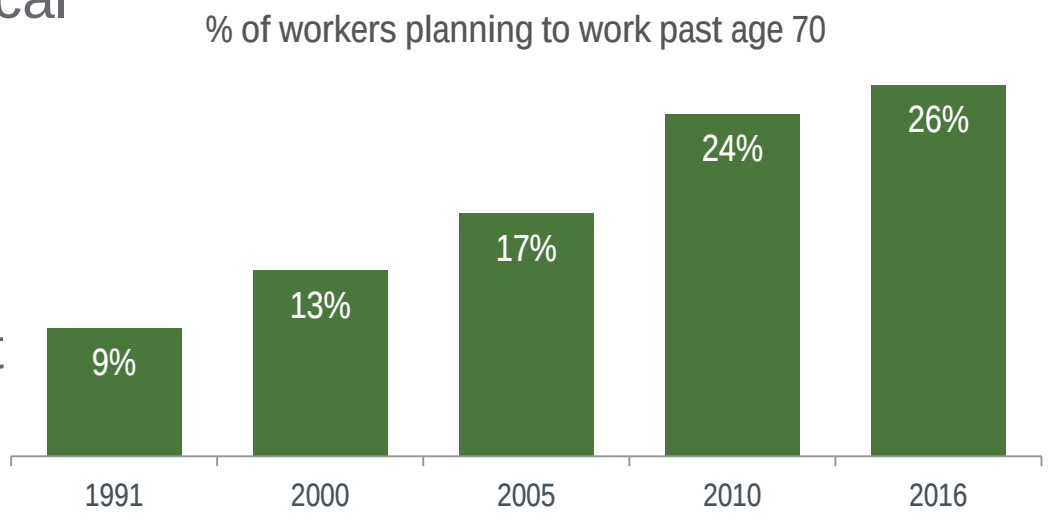
Healthcare and Retirement: lack of information can impact multiple benefit costs

Lack of confidence

- Less than half – 47% – of Baby Boomers are confident they will be able to cover their medical expenses in retirement.[1]

Working longer to get access

- A growing number of workers – 26% – expect to work past age 70.[2]
- 74% plan to do so to get access to healthcare.



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Dissecting the Expense Ratio

- What “Share Class” are your funds?
- What are hard-dollar fees?
- What are implicit (soft-dollar) fees?
- What is Revenue Sharing?

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Dissecting the Expense Ratio

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Morningstar's Formal Definition:

- The **expense ratio** is the annual fee that all **funds** or ETFs charge their shareholders. It expresses the percentage of assets deducted each fiscal year for **fund expenses**, including 12b-1 fees, management fees, administrative fees, operating costs, and all other asset-based costs incurred by the **fund**

Informal Definition:

- What Investors pay

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Dissecting the Expense Ratio

What is Revenue Sharing?

- A practice that directs a portion of the fund-management fee to a third party (e.g., a record keeper)
- In 2017, 27% of 401(k)s used revenue sharing to pay for plan administration, down from 38% in 2016 and 66% in 2012.
- Plans are turning to explicit dollar fees (e.g., $50 per year) or asset-based fees (e.g., 0.50% a year) to pay for plan administration — which are charged separately from the funds

Source: Investment News, 2018-05-03 *"7 investment trends in 401(k) plans"*

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What Could Go Into An Expense Ratio

- Management Fees
- Third Party Fees
- Other Shareholder Services

Takeaways

- Industry is moving towards Institutional Mutual Funds
- Retail Mutual Funds could be OK as long as the company understands the third party fee revenue sharing, and how much each party is receiving in compensation
- Where appropriate, consider minimizing or mitigating soft-dollar revenues

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Questions about Corporate Retirement Plans?

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Luke J. Novak, JD

Luke is a Vice President and member of Rothschild's Executive Committee, which handles all aspects of the firm's strategic direction. Luke oversees the firm's Retirement Plan Consulting Practice.

Since joining Rothschild in 2004, Luke's focus is helping employers and committees better understand and comply with their fiduciary responsibilities through a well-defined process. He is committed to keeping his clients updated regarding the practical impacts of new legislation, IRS and DOL regulations, and meaningful court decisions.

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Individual Financial Planning

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Brain Games

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Common Pitfall #1: Mental Shortcuts

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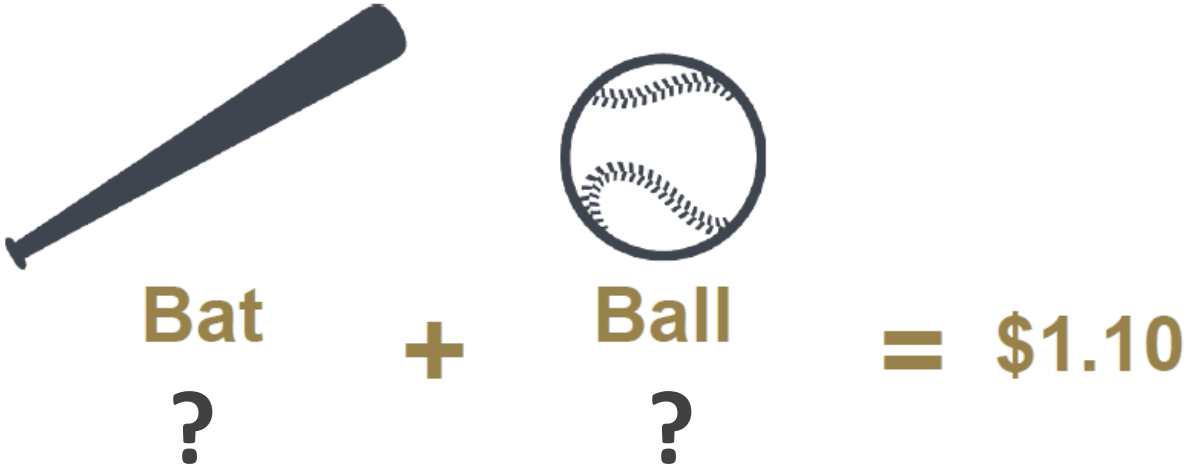
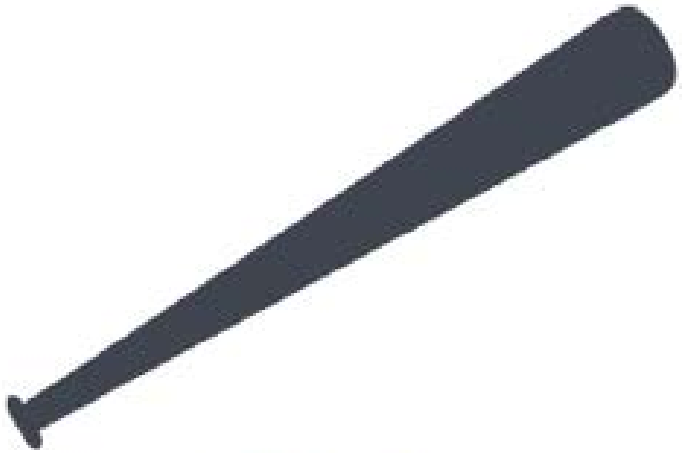
Mental Shortcuts

- Consider the following:
  - Together, a bat and a ball cost $1.10
  - If the bat costs $1 more than the ball, how much does the ball cost?



Mental Shortcuts



Bat
$1.05

+

Ball
$0.05

= $1.10

Common Pitfall #2: Loss Aversion

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Which Option do You Prefer?

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Option 1 – A gamble

80% chance of winning $4,000

Expected Value (80% x $4,000) = $3,200

Option 2 – A sure thing

Receiving **$3,000**

- The <u>rational</u> option is Option 1; the expected return is higher

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How About Now?

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Option 1 – A gamble

80% chance of losing $4,000

Expected Value (80% x -$4,000) = -$3,200

Option 2 – A sure thing

Losing **$3,000**

- The <u>rational</u> option is Option 2
- We are irrationally afraid of losing money

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Common Pitfall #3: Extrapolation

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Extrapolation

In 1977, at the time of Elvis Presley's death, there were 170 Elvis impersonators worldwide.

In 2000, there were 85,000 Elvis impersonators.

At this rate of growth, statisticians predicted that by 2019, Elvis impersonators would make up 1/3 of the world's population.

Extrapolation: Takeaway

- Investors tend to estimate the future based on the assumption that things will continue as they are now
- This type of thinking can be dangerous for our investment decisions
- During stock market declines, investors assume the market will continue to go down until their entire investment is wiped out

Investing Redefined

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Your Money Today Will Likely Buy Less Tomorrow

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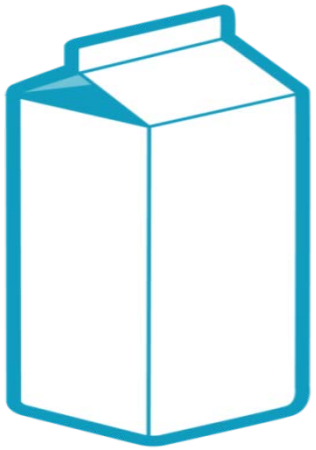
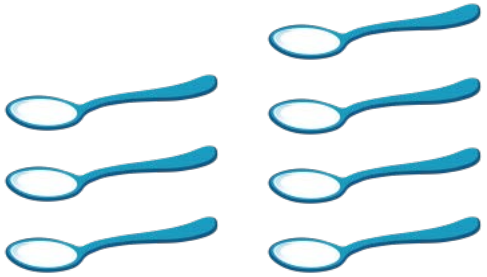
1916	1966	2016
		
$0.09 = Quart of milk	$0.09 = 1 Small Glass of milk	$0.09 = 7 Tablespoons of milk

In US dollars.

Source for 1916 and 1966: Historical Statistics of the United States, Colonial Times to 1970/US Department of Commerce. Source for 2016: US Department of Labor, Bureau of Labor Statistics, Economic Statistics, Consumer Price Index – US City Average Price Data.

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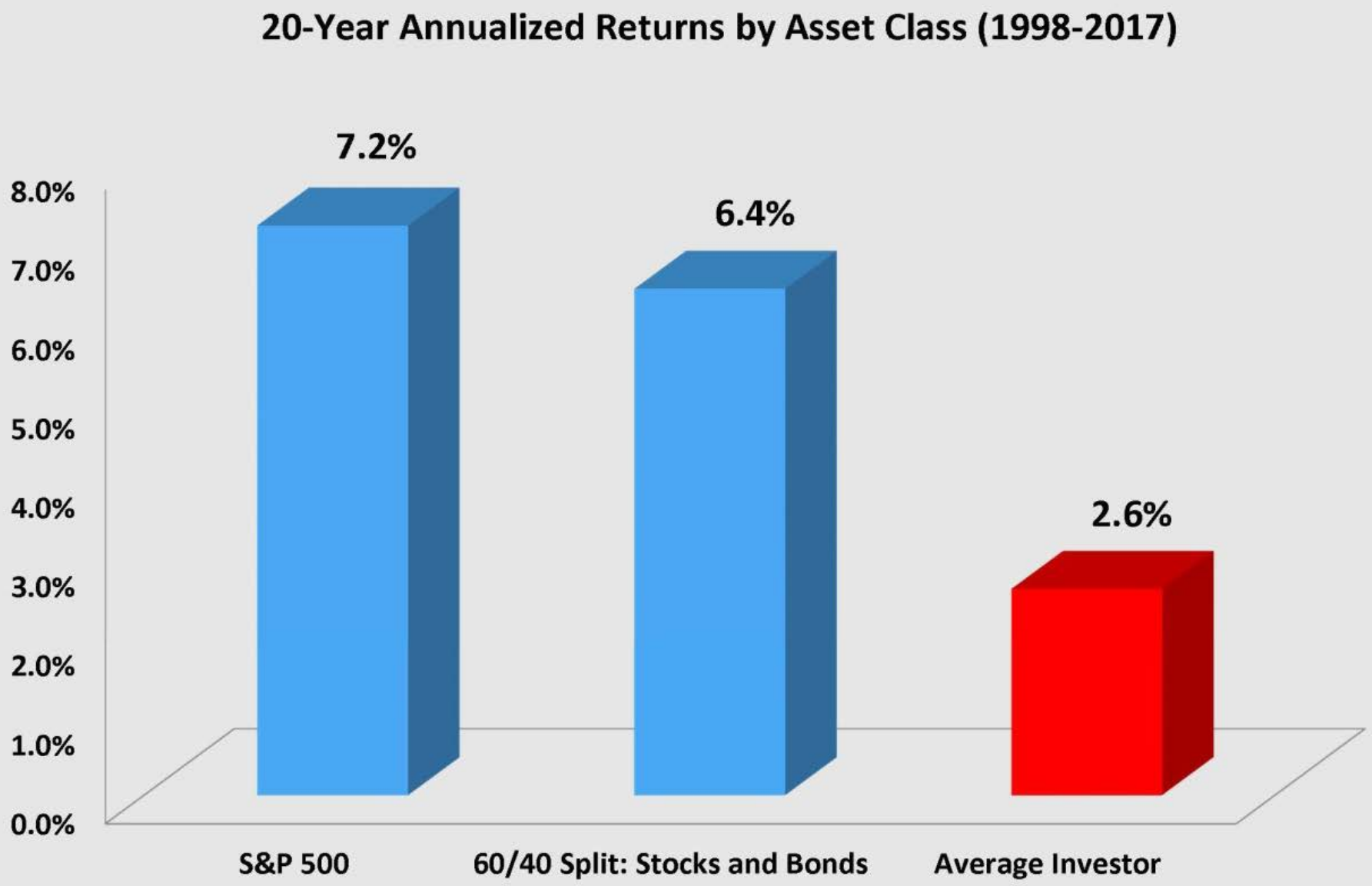
The Impact of Emotion on Investing



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The Real Cost of Emotional Mistakes

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Investor A

- 40 Year Old Investor
- $30,000 starting value
- $375 total monthly contributions ($4,500/year)
- Annual Return: 6.4%
- Balance at 67: $491,798

Investor B

- 40 Year Old Investor
- $30,000 starting value
- $375 total monthly contributions ($4,500/year)
- Annual Return: 2.6%
- Balance at 67: $236,377

Difference: $255,421

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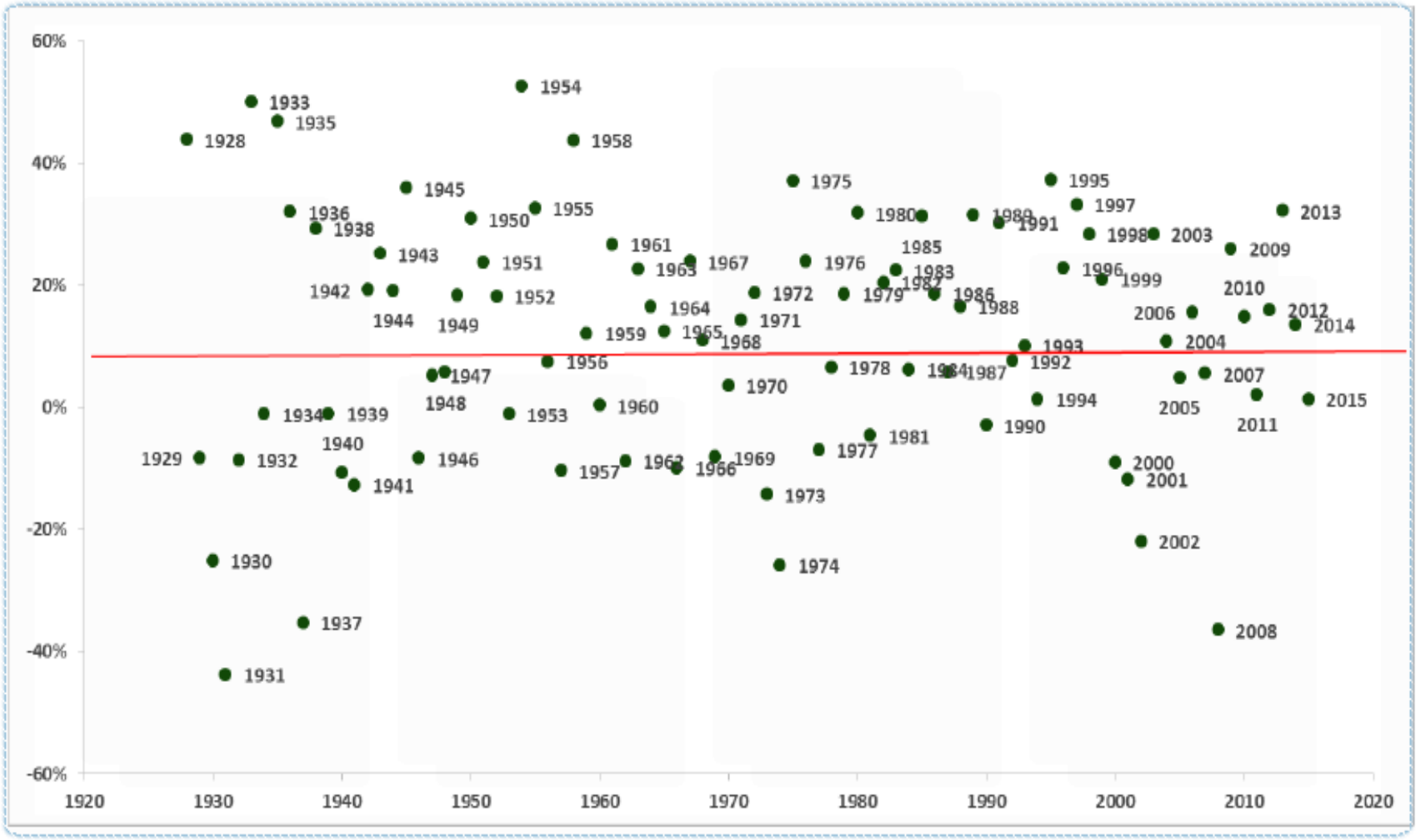
S&P 500 Annual Returns (1928 – 2015)



Average Annual Return

11.4%

Source: Prof. Robert Shiller data. http://www.econ.yale.edu/~shiller/data.htm. Past performance is not a guarantee of future results. One cannot invest directly in an index. The launch date of the S&P 500 Index was March 4, 1957. All information prior to the index launch date is back-tested. Back-tested performance is hypothetical and not actual performance. The back-test calculations are based on the same methodology in effect when the index was officially launched. Returns include dividends but do not reflect effects of taxes or fees.

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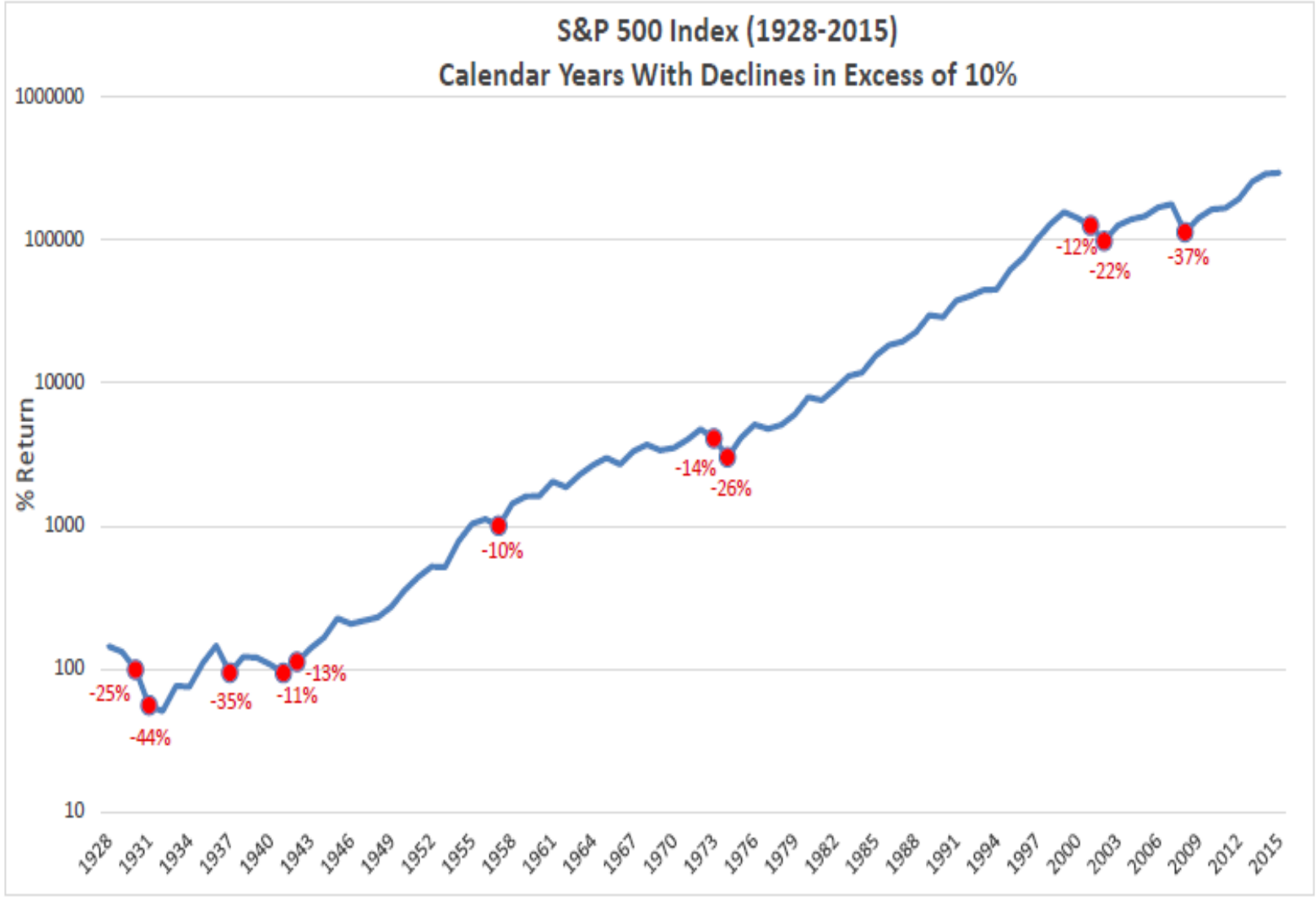
Risk Tends to Diminish Over Time…



Source: Prof. Robert Shiller data. http://www.econ.yale.edu/~shiller/data.htm. Past performance is not a guarantee of future results. One cannot invest directly in an index. The launch date of the S&P 500 Index was March 4, 1957. All information prior to the index launch date is back-tested. Back-tested performance is hypothetical and not actual performance. The back-test calculations are based on the same methodology in effect when the index was officially launched. Returns include dividends but do not reflect effects of taxes or fees. Does not represent all market declines of 10% or more.

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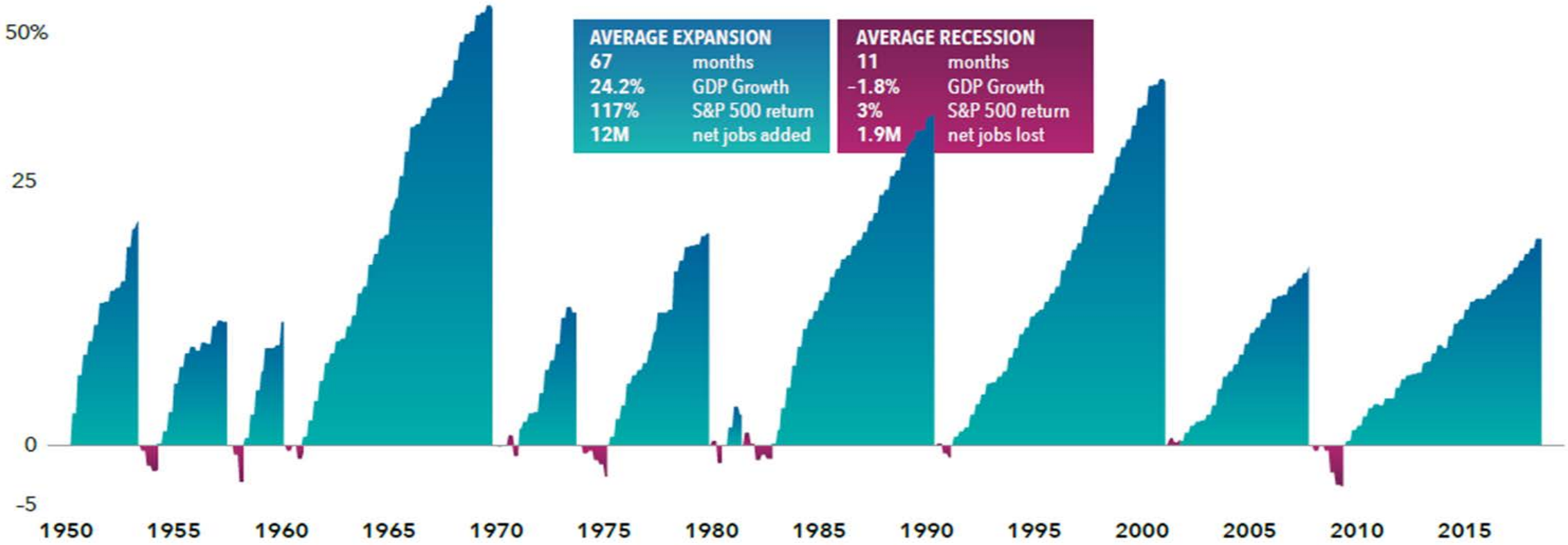
Recessions are painful but expansions have been powerful

Expansions have been considerably longer and stronger than recessions

Cumulative U.S. GDP growth for each expansion and recession (%)



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Time, not Timing

What would have happened if you made a one-time $10,000 investment in the S&P 500 right before the 2008 financial crisis?

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Time, not Timing continued

- Assuming you had invested $10,000 in an S&P 500 index fund at that time, it would now be worth approximately $23,100

- Since the beginning of the financial crisis (around 9/30/2007), the S&P 500 Index has grown 7.4% per year on average, or 131.3% overall!

*As of 5/31/2019

Where do you learn about investing or saving for retirement?

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Financial Literacy

The ability to effectively evaluate and manage one’s finances in order to make prudent decisions toward reaching life’s goals.

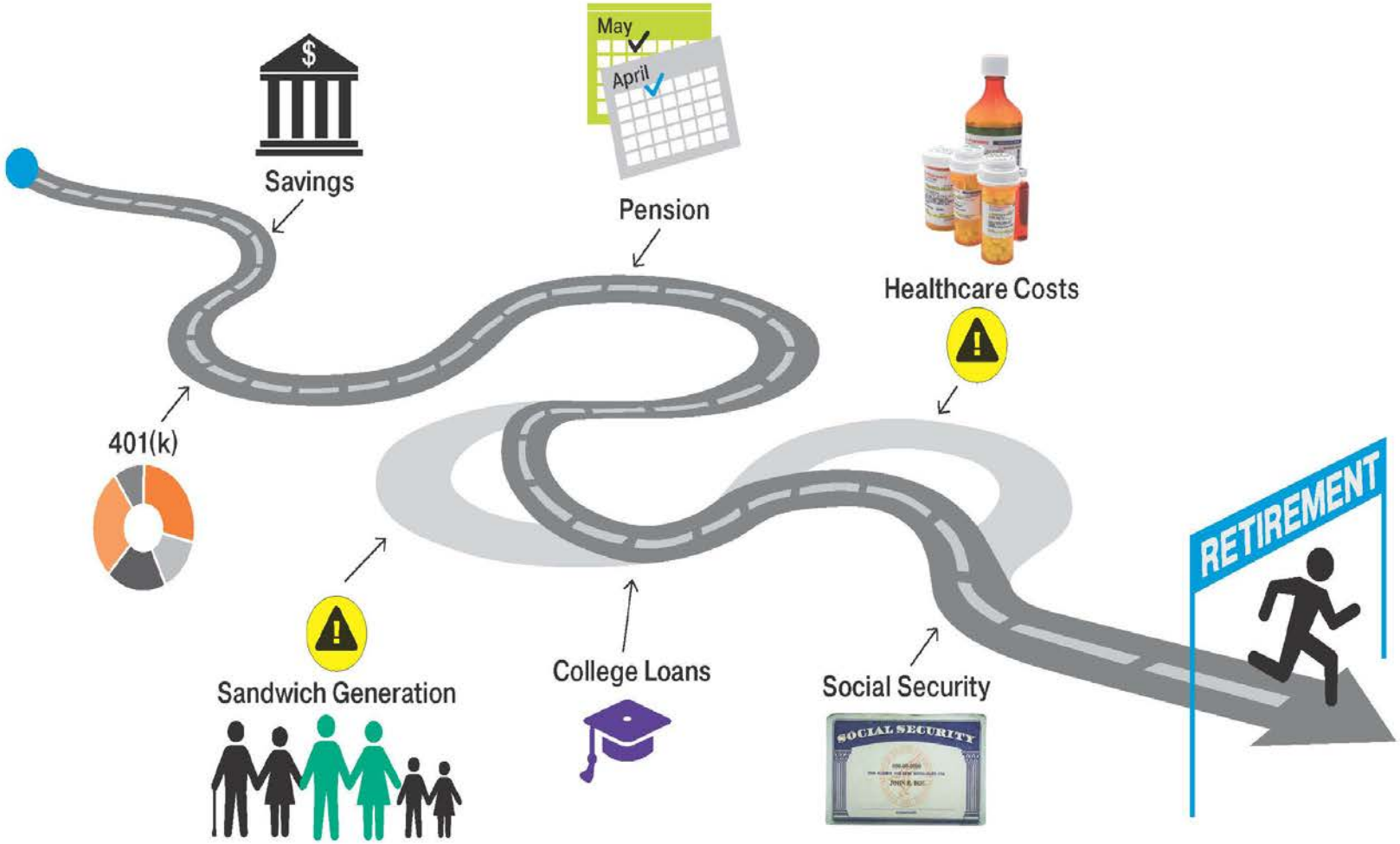
Achieving Financial Literacy

Five Key Areas of Personal Finance:

- Money and income
- Money management
- Spending and debt
- Savings and investments
- Risk management

Retirement Planning: Charting the Right Course

Factors that will impact your retirement.



Source: OppenheimerFunds, 2017.

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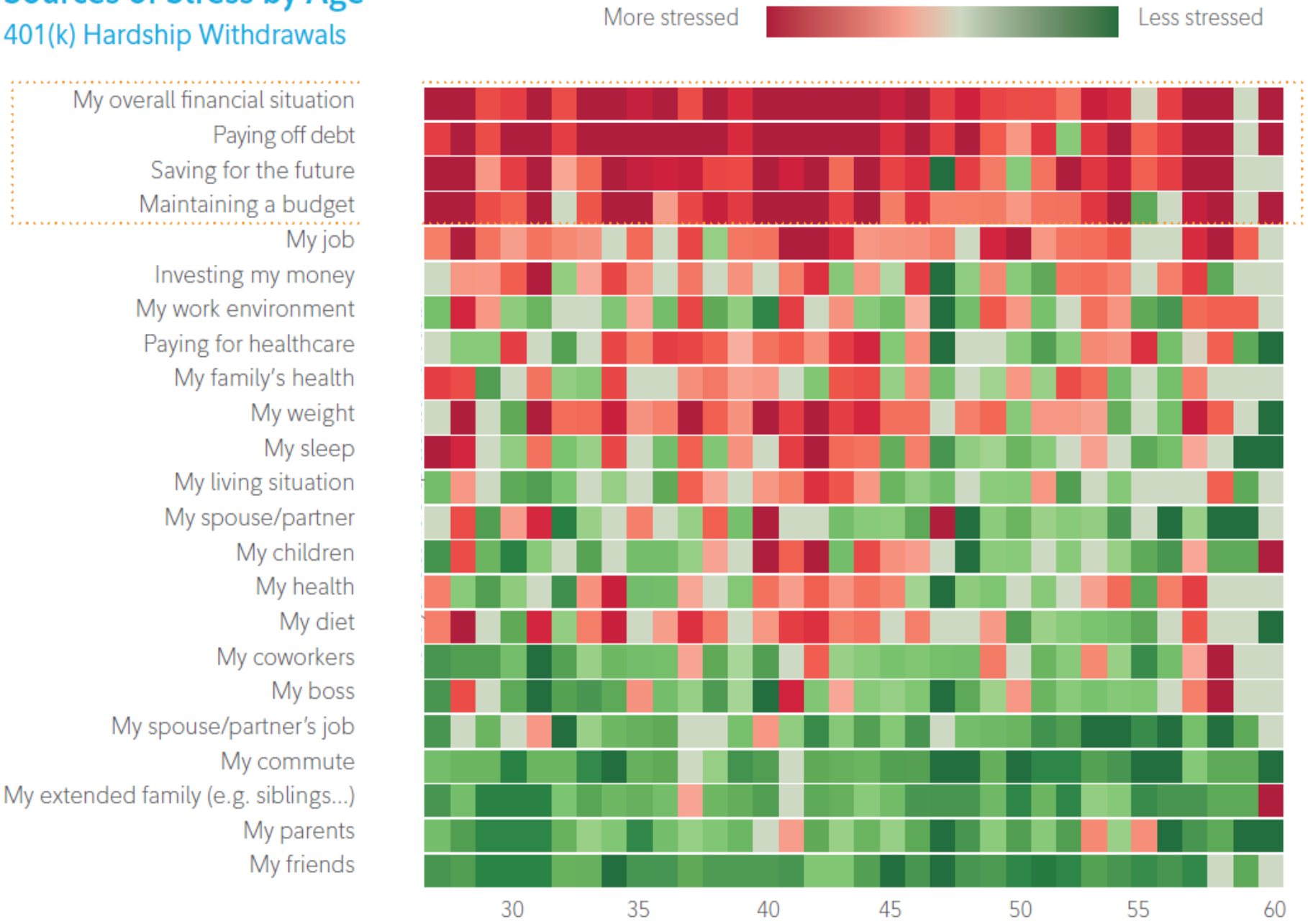
Sources of Stress by Age

401(k) Hardship Withdrawals



Source: Fidelity Investments, 2017 Total Well-Being Research online survey.

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“Where do I begin…?”

- Everyone had different starting points

- Determine what stage in life you are at
  - Beginning
  - Middle
  - End

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How do I start Planning My Financial Future?

- Evaluate your current financial situation
  - Family Balance Sheet
  - Family Income Statement
  - Creating a Budget
  - Student Debt
  - Taxes
  - Estate Planning

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The family balance sheet

Assets

Safe assets:
- Savings
- Checking accounts
- Certificates of deposit

Financial assets:
- Bonds
- Stocks

Non-financial assets:
- Residential property
- Business property
- Art
- Jewelry
- Furniture
- Cars

Entrepreneurial assets:
- Business
- Intellectual property

Liabilities

Mortgage debt/rent

Student loans

Credit card debt

Car loans

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The family income statement

Revenue	Expenses	
Wage and Salary	Housing	35.6%
Rental Income	Transportation	19.6
Interest Income	Dining Out	15.0
Transfer Payments (e.g., Social Security)	Insurance/Pensions	12.8
	Health Care	6.8
	Entertainment	5.1
	Apparel	4.1
	Education	2.7
	Personal Care	1.3
	Miscellaneous	1.3
	Alcohol	0.8

Revenue – Expenses = Net Income

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Emergency Savings

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- If you were to incur a $400 emergency payment, would you be able to cover it today?
- Have at least six months of cash on-hand or readily available in case of unexpected financial upsets such as a job loss.
- Available options include physical cash, traditional savings accounts, or money market funds.

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Read Your Pay Stubs and Understand What You Keep

"You don't pay taxes. They take taxes." —Chris Rock

Company Name
420 Sample Street
Anytown, MA, 08756

Earning Statement

Employee Name/Address	SSN	Reporting Period	Pay Date	Employee #
John Doe 123 Any Street Anytown, MA, 08756	XXX-XX-XXXX	01-11-2011 – 01-18-2011	1-19-2011	1357

Income	Rate	Hours	Current Pay	Deductions	Total	YTD Total
Gross Earnings	10.00	10.00	400.00	Statutory Deductions		
				FICA - Medicare	5.80	29.00
				FICA - Social Security	24.80	124.00
				Federal Tax	44.50	225.50
				State Tax	35.00	140.00

YTD Gross	YTD Deductions	YTD Net Pay	Total	Deductions	Net Pay

Company Name
420 Sample Street
Anytown, MA, 08756

Check Date	Check Number
1-20-2011	8649

This is not a check

Direct Deposit

Pay "425" Dollars and "65" Cents

Pay to order of John Doe
123 Any Street
Anytown, MA, 08756

Non-Negotiable

1 **Federal Income Tax**
Based on taxable income → ≈10% for single filers earning under $10,000 up to ≈39.6% for earnings over $415,050 annual income

2 **Social Security**
Deducted as a flat percentage based on taxable income up to a yearly maximum of $7,347 → ≈6.2%

3 **Medicare Tax**
Flat percentage (FICA) → ≈1.45%

4 **Other Deductions**
Insurance policies from employers → Varies

5 **State and Local Tax**
- Based on taxable income
- Not all states have income tax

→ Varies from 0% at state level for Texas and Florida up to 13.3% for California (highest in nation)

6 **Wage Garnishments***
Only if needed to pay off debt → Only occasionally applicable

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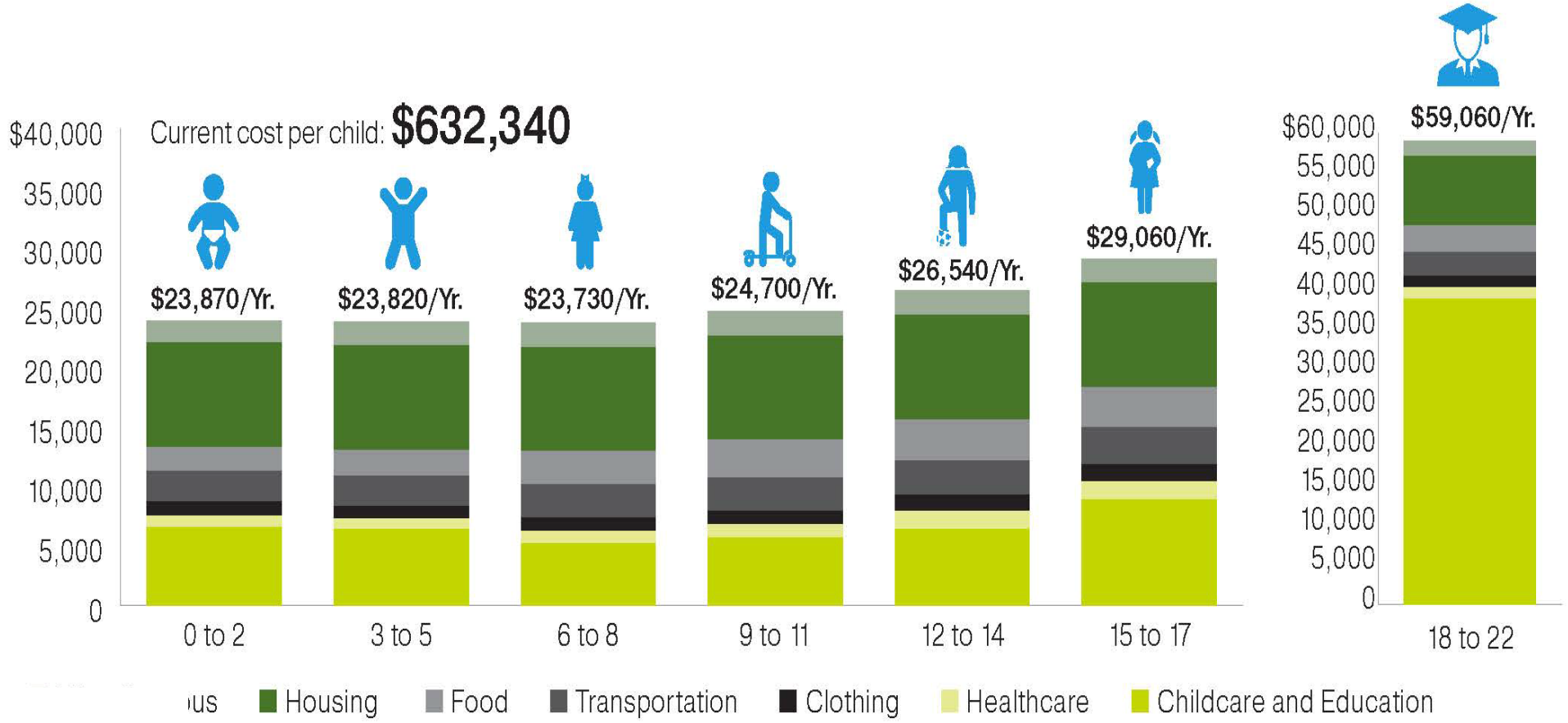
Now Determine Where You Want To Go

- Define Your Goals, Objectives, & Lifestyle
  - Pay off Debt?
  - Get Married?
  - Children?
  - Summer Home?
  - Saving for Retirement?

Cost of Raising Children

"...buying a house is the biggest purchase most Americans will ever make. Having a baby is like buying six houses. Except that they don't increase in value, you can't sell them and after 16 years they'll probably say they hate you." —Jonathan Last



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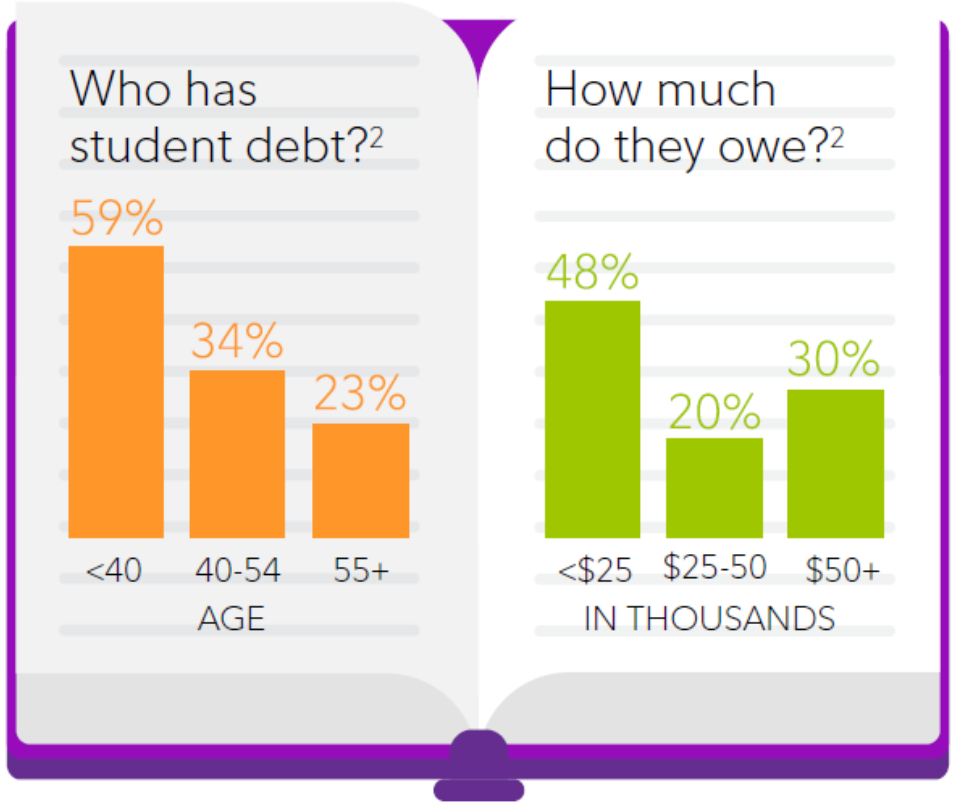
Student debt is growing, and not just in the millennial generation

DID YOU KNOW?

2 in 3 workers say debt is a problem

Source: ©2018 EBRI/Greenwald Retirement Confidence Survey



Student debt can have a significant impact on financial wellness

81% OF AMERICANS WITH STUDENT DEBT HAVE MADE FINANCIAL SACRIFICES AS A RESULT, INCLUDING:

50% DELAYED CONTRIBUTIONS TO A RETIREMENT ACCOUNT

46% DELAYED BUYING OR UPGRADING A CAR

40% DELAYED BUYING A HOUSE

Source: American Institute of CPAs, 2016.

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You are Not Alone

Consider:

44 million Americans collectively owe **$1.5 trillion** in student loans.

$37,172 is the **average** amount to repay.

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Not all debt is the same

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Step 1 Consider the interest rates of your student debt

Step 2 Consider any tax benefits from your loans

Step 3 Consider your debt as a part of your entire financial plan

Step 4 Know the interest rates on your other types of debt

Some debt may not be bad debt.

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Time is Money

Take Perspective

What is $10,000 worth invested one time on 12/31/1979 in the S&P 500?

Take Perspective

Over $750,000 which is doubling your money 6 times

Investor A: Start Early, Contribute for only 10 years

Expected annual return: 8%

Year	Age	Annual Contribution	Portfolio Value
1	30	$5,000	$5,410
5	34	$5,000	$31,865
10	39	$5,000	$79,121
11	40	$0	$85,608
20	49	$0	$174,005
30	59	$0	$382,679
38	67	$0	$718,874

	Contributions	Account Value
Total at Age 67	**$50,000**	**$718,874**

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Investor B: Start Late, Contribute every year until retirement

Expected annual return: 8%

Year	Age	Annual Contribution	Portfolio Value
1	30	$0	$0
5	34	$0	$0
10	39	$0	$0
11	40	$5,000	$5,410
20	49	$5,000	$79,121
30	59	$5,000	$253,126
38	67	$5,000	$533,466

	Contributions	Account Value
Total at Age 67	**$140,000**	**$533,466**

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Investor C: Start early, Contribute every year until retirement

Expected annual return: 8%

Year	Age	Annual Contribution	Portfolio Value
1	30	$5,000	$5,410
5	34	$5,000	$31,865
10	39	$5,000	$79,121
11	40	$5,000	$91,018
20	49	$5,000	$253,126
30	59	$5,000	$635,805
38	67	$5,000	$1,252,340

	Contributions	Account Value
Total at Age 67	**$190,000**	**$1,252,340**

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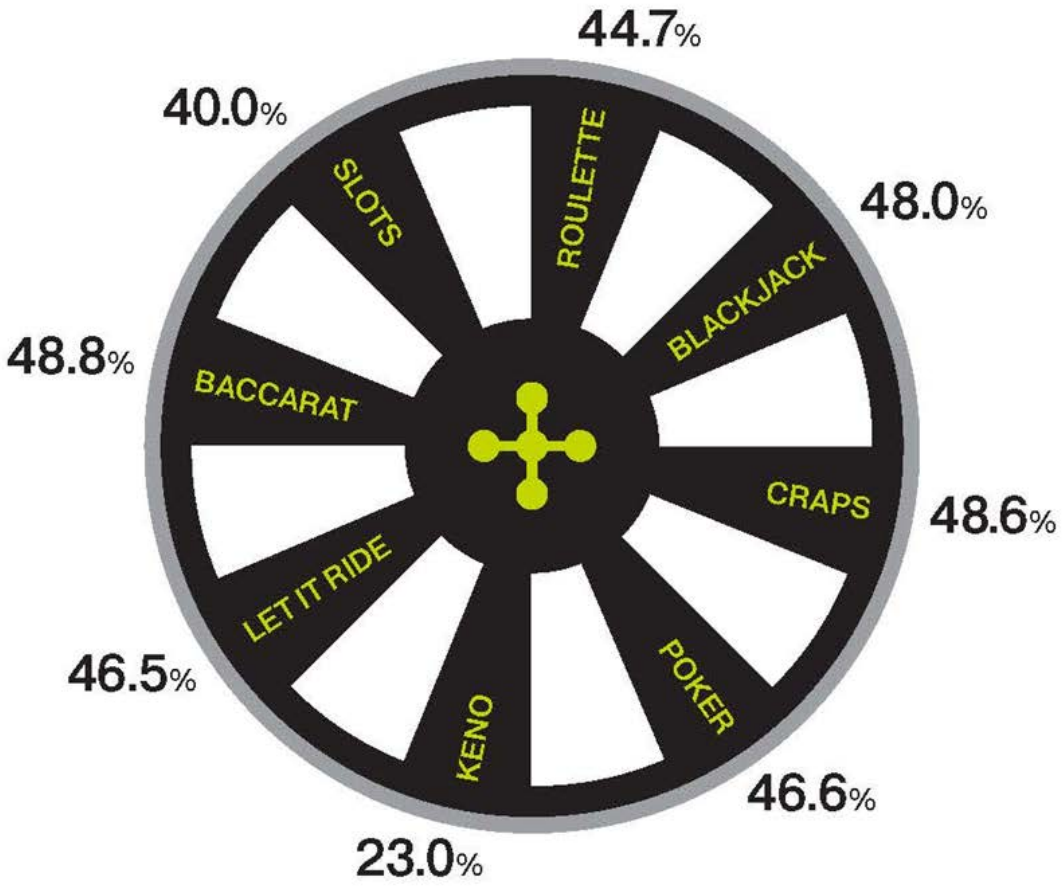
Investing vs. Gambling

Is the Market Like a Casino?

Is the Market Really Like a Casino?

Odds of Winning at Various Casino Games



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Is the Market Like a Casino?

- The odds of winning most casino games never reach 50%
- The odds of the stock market being up in any given month are 75.7%
- The odds of the stock market being up in any 15-month timeframe are 99.8%

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Traditional (Pre-Tax) vs. Roth (Post-Tax)

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Traditional Salary Deferral

- Assume $50,000 salary
- You defer $5,000
- You are taxed as if you earned $45,000
- Your investments grow tax-deferred
- In retirement your distributions are taxed at your individual tax bracket
- Example: $10,000 distribution, and your in the 25% tax bracket, you receive $7,500 after taxes

Roth Salary Deferral

- Assume a $50,000 salary
- You defer $5,000
- You are taxed as if you earned $50,000
- Your investments grow tax-free
- In retirement your distributions are NOT taxed
- Example: $10,000 distribution, and your in the 25% tax bracket, you receive $10,000, as the distribution is not a taxable event

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Who May Consider Roth as a Deferral Option?

- Generally speaking, there are two types of investors that often consider Roth as a deferral option:

  1) Investors that may be in a lower tax bracket now than in retirement

  2) Individuals that wish to reduce their future tax liability

- These are simply common considerations and not an exhaustive list of people who would make Roth contributions

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Retirement Planning

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Investment Strategies

- Money you need relatively soon
- Conservatively invested to preserve principal
- Money Market, Bond Funds

- Money that can be safely invested with a focus on growing your wealth
- A mixture of return-seeking investments (stocks) and income generators (bonds)

- Focus on long-term growth
- Return-seeking investments that help you regenerate your nest egg later into retirement

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What Retirement Planning Can Be:

- Easier than you think
- Small time commitments over many years
- Calming

Changing the Retirement Perspective

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- Most people's education has been focused on the "pre-retirement phase"
- Working career spent in that accumulation phase of retirement – saving retirement $, not spending it
- How does my investment strategy change in retirement?
- What new information should I consider?

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The Three Phases of Retirement Planning

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- **Phase 1: Pre-Retirement**
  - 10+ year before Retirement
  - Retirement Income Planning Phase
- **Phase 2: Early Retirement**
  - 1 – 10 years before retirement; fine-tune the plan
- **Phase 3: Late Retirement**
  - 5+ years of retirement; fine-tune the plan

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Pre-Retirement:
Retirement Income Planning Phase

- 10 years out from retirement
- Determining your income needs in retirement
- Evaluating Social Security collection strategies
- “4% Rule”

Making Your Money Last
Withdrawals can deplete your nest egg:

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6% WITHDRAWAL — YOUR MONEY WILL LAST 15 YRS.

5% WITHDRAWAL — YOUR MONEY WILL LAST 20 YRS.

4% WITHDRAWAL — YOUR MONEY WILL LAST 28 YRS.

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Early-Retirement

- 1-10 years into retirement
- Income sources include withdrawals from IRA's, Social Security, investment portfolios
- Investment allocation aiming toward wealth preservation versus return-seeking investments
- Using efficient strategies to minimize year-end tax liability

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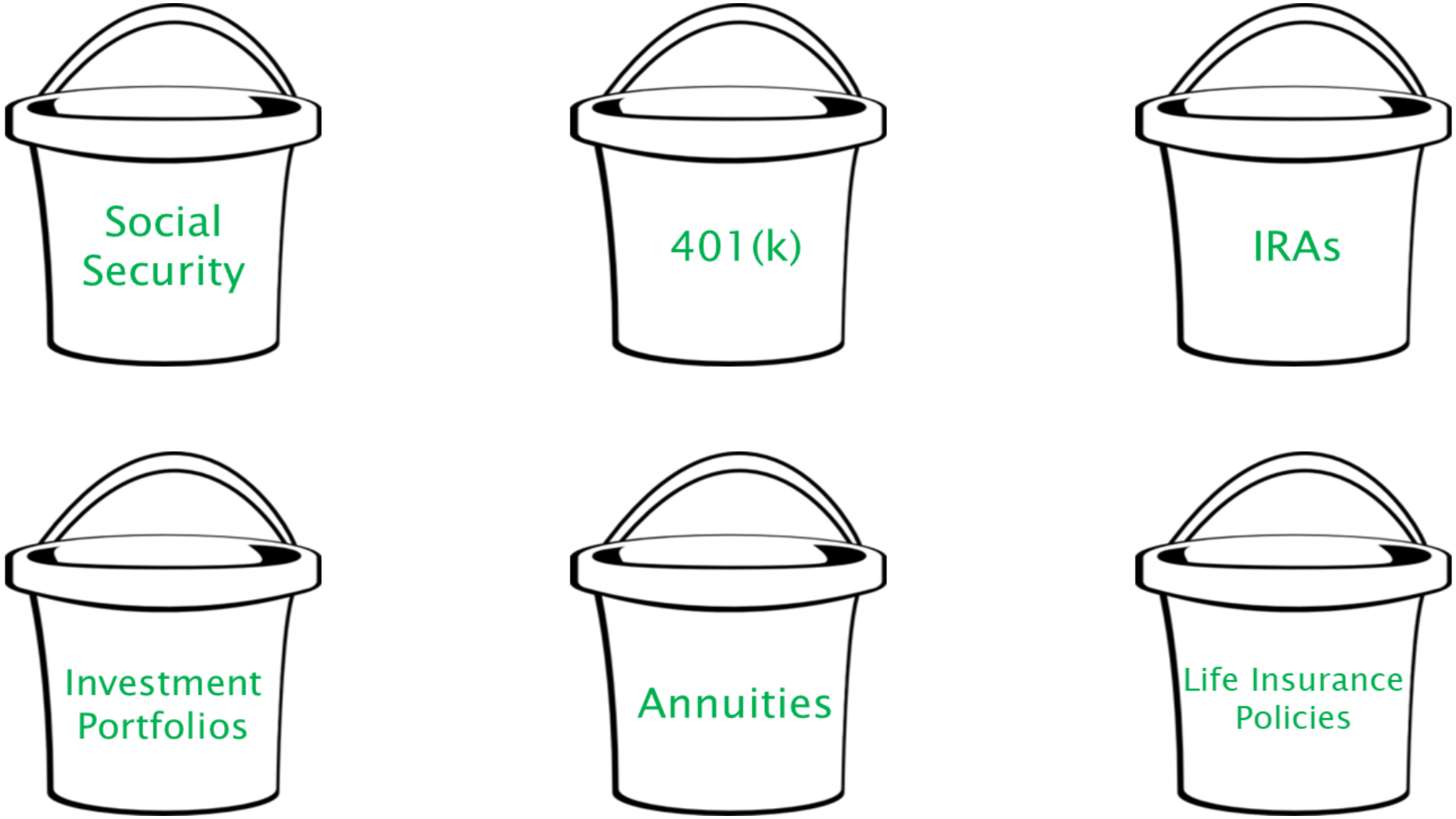
Creating a Paycheck in Retirement:



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Considering Retirement Income Sources

Late-Retirement

- 5+ years into Retirement
- Important to effectively plan the passing of your wealth onto your heirs
- Have the proper beneficiaries and Powers of Attorney in place for when you are incapable of making decisions alone
- Trusted family members / individuals to help you with decisions
- Income strategies

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Create Your Social Security Account

- www.ssa.gov/myaccount/
  - Create an Account

- Gives estimates based on your actual Social Security earnings record

- You can use the Retirement Estimator if:
  - You have enough Social Security credits at this time to qualify for benefits and
  - You are not:
    - Currently receiving benefits on your own Social Security record;
    - Waiting for a decision about your application for benefits or Medicare;
    - Age 62 or older and receiving benefits on another Social Security record; or
    - Eligible for a Pension Based on Work Not Covered By Social Security.

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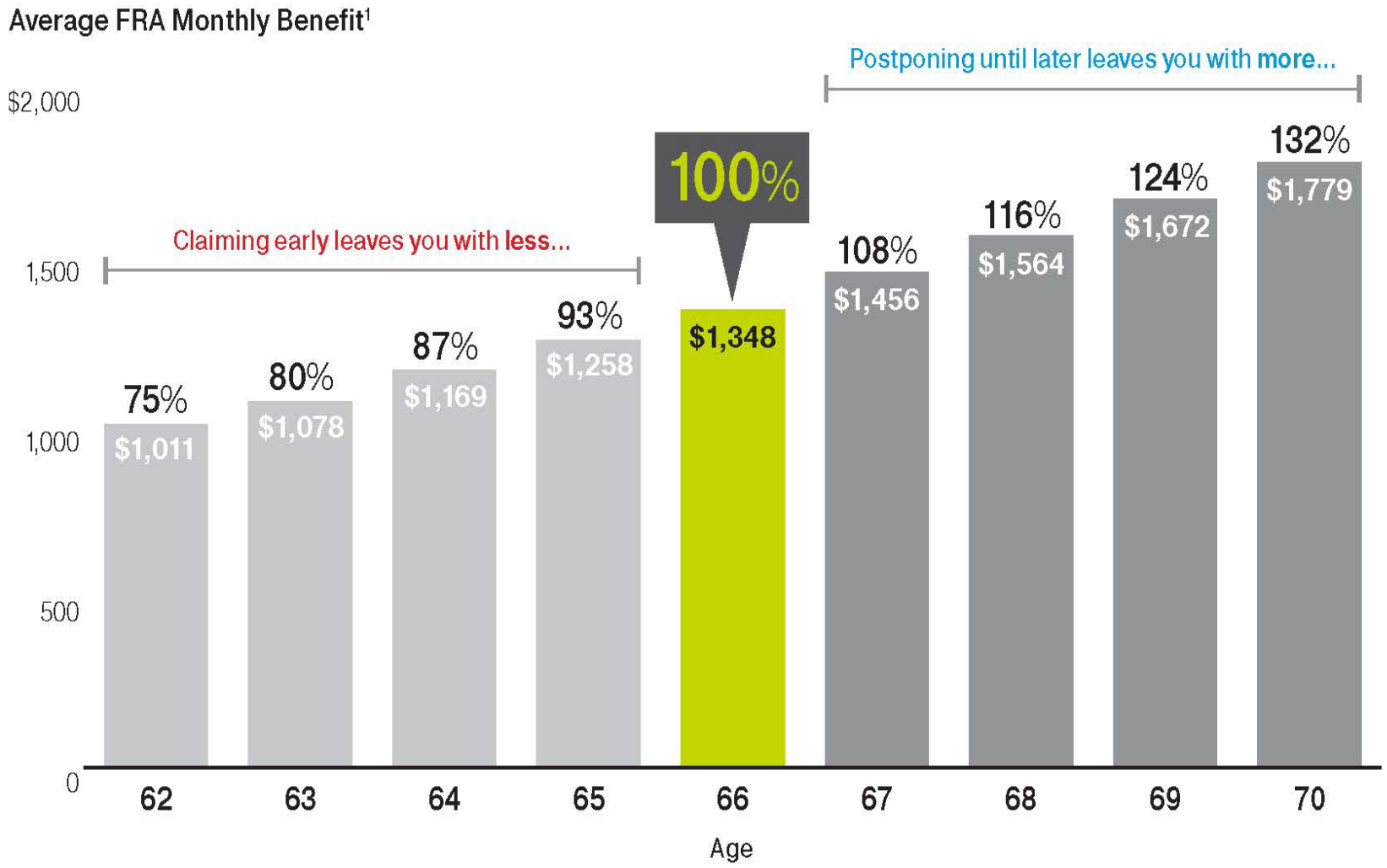
Social Security Monthly Payments by Claiming Age



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What is Estate Planning?

Wills

To ensure that money and property go to the intended parties on the death of the owner.

Trusts

Put conditions on how assets are distributed

Type of trust selected depends on:

- Goals and circumstances of the donor or grantor
- Who is providing the money and property to fund the trust
- Circumstances of the person who is to benefit from the trust.

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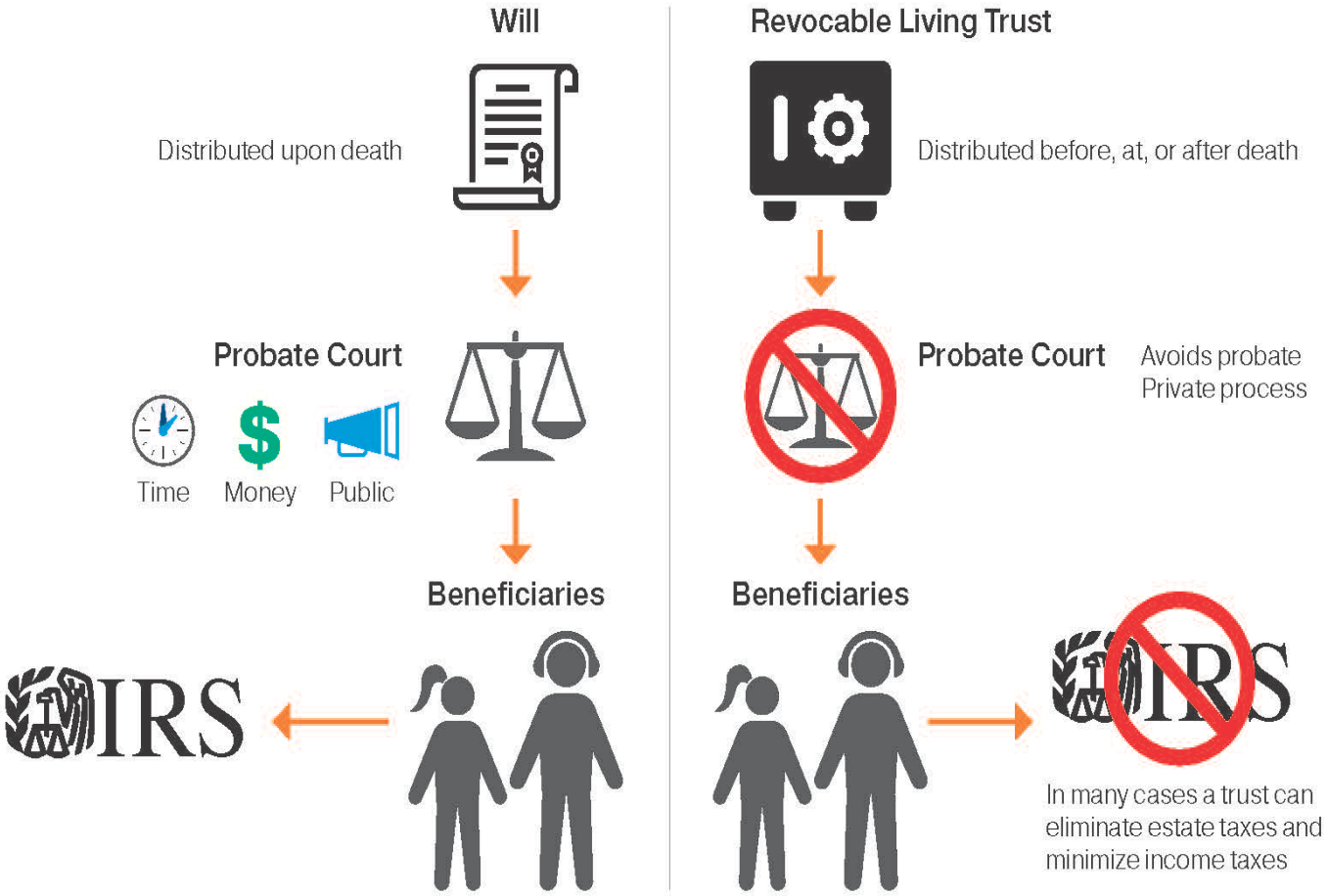
Will or a Trust?

"We don't own our family history. We simply preserve it for the next generation." —Rosemary Alva



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Have you updated your Beneficiary?

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Who Gets What?

"The acceptance of death gives you more of a stake in life, in living life happily, as it should be lived." —Sting

Large Estates with No Named Beneficiaries

Howard Hughes
$3.8 billion

Michael Jackson
$825 million

Pablo Picasso
$500 million

Elvis Presley
$400 million

Kurt Cobain
$400 million

Prince
$300 million

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Individual Discussion

- You may include your significant other/trusted associate in the discussion
- Typical conversation is 10-15 minutes
- Define your goals and objectives
- Review of household spending and retirement assets
- Actionable “next steps” to your financial strategy
- Annual checkups on your financial progress

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Luke J. Novak, JD

Luke is a Vice President and member of Rothschild's Executive Committee, which handles all aspects of the firm's strategic direction. Luke oversees the firm's Retirement Plan Consulting Practice.

Since joining Rothschild in 2004, Luke's focus is helping employers and committees better understand and comply with their fiduciary responsibilities through a well-defined process. He is committed to keeping his clients updated regarding the practical impacts of new legislation, IRS and DOL regulations, and meaningful court decisions.

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