IMA Hartford Chapter

"Making the Most of Your 401(k) Plan and When to Consider Roth Conversions"

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Morrissey Wealth Management LLC is a Registered Investment Advisor.

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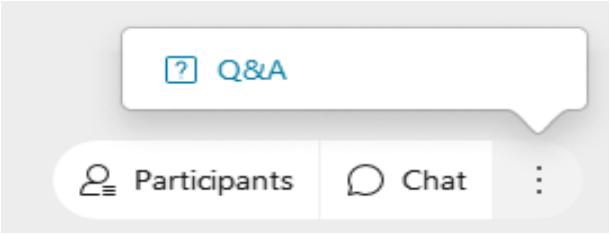

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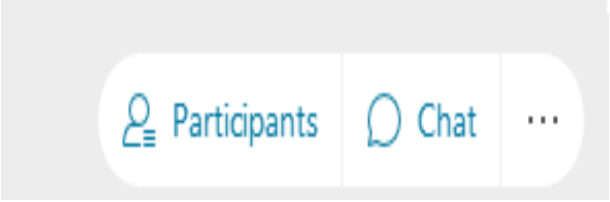

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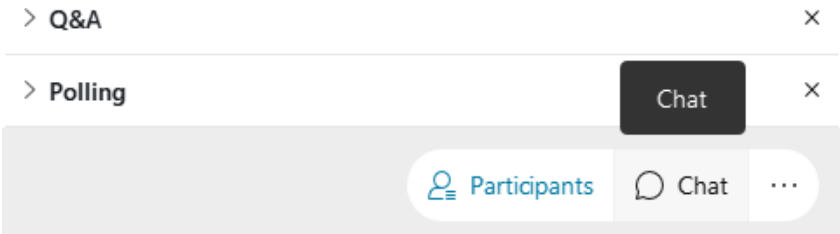

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Welcome Message

Claude-Helene McIntyre
IMA Hartford Chapter
President
2019-2021

Making The Most of Your 401(k) plan and When To Consider Roth Conversions

PRESENTED BY:

RYAN R MORRISSEY, CFP®, CLU®, CHFC®, CMFC®

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Ryan Morrissey's Background:

- Fee-only Fiduciary Financial Advisor
- We specialize in helping people who are within 5 years of retiring create a plan for retirement, implement that plan, see that plan through
- We provide Financial Planning Advice and Investment Management
- We receive no commissions from the recommendations we make and are compensated by client fees only
- Ryan's Credentials: Certified Financial Planner™ Practitioner, Chartered Life Underwriter®, Chartered Financial Consultant®, Chartered Mutual Fund Consultant®

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Introduction

Today, we will discuss:

- Company Retirement Plans: 401(k), 403(b), 457(b), SEP Plans, Simple Plans
- Self Employed Retirement Plans
- The benefits of these plans
- Roth Conversions
- Constructing your investment portfolio
- How to make the most of these plans
- IRA Rollovers
- The different types of advisors you can work with

Large Company Retirement Plans

Depending on your employer your many have access to a company retirement plan.

- For Profit Companies offer a 401(k) Plan (Possible Roth Option)
  - 2021 elective deferral contribution Limit of $19,500 with catch up contribution of $6,500 for those over 50
- Non Profit Companies offer a 403(b) or 457(b) Plan (Possible Roth)
  - 2021 elective contribution limit of $19,500 with catch up contribution of $6,500 for those over 50
  - Certain state of CT employees may be able to contribute the maximum to both 403(b) and 457 plan for a total of $52,000
- Future Contribution limits adjusted for inflation each year
- Employer and employee contribution limit of $57,000 plus catch up

Polling Question 1

What is the elective deferral contribution limit for a 401(k) plan for 2021?

A) $15,000
B) $18,000
C) $19,500
D) $30,000

Small Company Retirement Plans

Small employers may offer a different plan.

- Employers with less than 100 employees can offer a SIMPLE IRA
  - 2021 elective deferral contribution Limit of $13,500 with catch up contribution of $3,000 for those over 50
- Some Employers may offer a SEP Plan or Profit Sharing Plan
  - No employee elective deferrals (employee), employer deferrals only
  - Contribution limits of $57,000 plus catch up apply
  - Any tax deduction goes to the employers not the employee

Self Employed Retirement Plans

Anyone with self employed income can set up self employed retirement plan.

- Individual or Solo 401K
  - 2021 elective deferral contribution limit of $19,500 with catch up contribution of $6,500 for those over 50
  - Can include owner of the company and spouse
  - Can defer up to 100% of income up to deferral limits
  - Can tack on a profit sharing plan to contribute an additional 20% of self employed income up to $57,000 contribution limit plus $6,500 catch up
  - Plan limits apply across multiple plans of the same type, meaning multiple 401(k) plans
- You could also set up a SIMPLE, SEP, Profit Sharing, or Pension Plan
  - A pension plan could allow you to defer even more than the $57,000 limit and catch up

Why Contribute To These Plans

There are many benefits these plans offer:

- Pretax plans offer you a current tax deduction
  - Defer federal income tax until you withdraw from the plan by age 72
  - Defer state income tax and possibly avoid it if you move to a state with no income tax
  - This could also put you into a lower tax bracket from deferrals
- Tax deferred growth (offered with both pretax and post tax plans)
  - Any capital gains, dividends, and interest is not taxed while inside the retirement plan
  - This will allow your investments to compound at a faster rate
- Allows for automated savings
  - Money can be taken from your paycheck every pay period which helps with overspending and is a forced saving mechanism

401(k) or Roth 401(k)

Are you better off contributing to the traditional 401(k) or Roth 401(k) option?

Pay tax now or later? What is going to save you more in taxes?

- Depends on your age, income, and future tax rates
- If you believe tax rates will be higher for you in the future and you have some years until you'll use the money the Roth 401(k) may be better
- If you are in a higher tax bracket now (32% or higher) and you expect your tax rates to be lower in retirement than the traditional 401(k) is probably better
- If you have over 15 years until retirement than the Roth 401(k) may be better
- You can split your contributions between the two if you desire

Roth 401(k)

Roth 401(k) if you don't qualify for a Roth IRA

- Roth 401(k) could allow you to contribute to a Roth account if you don't qualify for a Roth IRA
- Capital gains, dividends, and interest grow tax deferred
- Distributions are tax free if taken out after age 59.5 and 5 years after the initial contribution
- They are subject to RMDs at age 72, so consider rolling them over before
- A new 5 year rule starts with the rollover if you don't have an existing Roth IRA
- Hopefully distributions will not become taxable in the future, such as when Social Security became taxable in 1983

Roth IRAs

Roth IRAs are often used to save for retirement if you:

- Are unable to deduct contributions to a Traditional IRA
- Are close to retirement and do not want to make withdrawals by age 72
- Are otherwise eligible based on tax status and adjusted gross income (AGI)
- Contribution limit for 2020 is $6,000 with an over age 50 catch up of $1,000

Roth IRAs

MAGI Income Limitations for Roth IRA Contributions 2020			
	Married Filing Jointly	Single Filer	Married Filing Separately
Full Contribution	Income less than $196,000	Income less than $124,000	None
Contribution Less than $6,000*	Income $196,000 to $206,000	Income $124,000 to $139,000	Income $0 to $10,000
Contribution not allowed	Income above $206,000	Income above $139,000	Income above $10,000

*Contribution limits for 2019. Catch-up provisions may increase these amounts for people over age 50; Source: Internal Revenue Service.

Roth IRAs

MAGI Income Limitations for Roth IRA Contributions 2021			
	Married Filing Jointly	Single Filer	Married Filing Separately
Full Contribution	Income less than $198,000	Income less than $125,000	None
Contribution Less than $6,000*	Income $198,000 to $208,000	Income $125,000 to $140,000	Income $0 to $10,000
Contribution not allowed	Income above $208,000	Income above $140,000	Income above $10,000

*Contribution limits for 2019. Catch-up provisions may increase these amounts for people over age 50; Source: Internal Revenue Service.

Back Door Roth Contribution

What if your AGI (Adjusted Gross Income) is over the threshold to make a Roth contribution? Can you still make one through a backdoor contribution?

If you have no assets in Traditional IRAs, SEPs, or SIMPLE IRA's then yes

- Here is how it works:
  - You open a Traditional IRA and Roth IRA with the same provider
  - You then make a non-deductible contribution to a Traditional IRA $6,000 or $7,000
  - Next you immediately submit a request to that provider to convert that money from the Traditional IRA to the Roth IRA
  - Now you have money in the Roth IRA with no tax on the conversion
  - You'll have to fill out IRA form 8606 when you file your taxes that year
  - You've now completed a back door Roth IRA

Back Door Roth Contribution

If you have assets in Traditional IRAs, SEPs, or SIMPLE IRA's when you do the conversion be aware of the pro-rata rule

- Here is how it works:
  - The pro rata rule is the total after-tax money in all IRAs divided by the total value of all IRAs multiplied by the amount converted
- Here is an example:
  - You make a $6,000 non-deductible IRA contribution and you have a traditional IRA worth $94,000.
  - You want to convert the $6,000 to a Roth
  - You would divide $6,000/$100,000 (total value of your IRAs) which equals 6%
  - That means only 6% of the conversion would be tax free. The rest you would owe tax on
- You would want to transfer the IRA money to a 401(k), 403(b), or 457(b) plan in the tax year you are doing the conversion for. Balances are as year end.

IRA to Roth IRA Conversions

TO CONVERT OR NOT TO CONVERT?

What about converting pre-tax money to a Roth account? When does it make sense?

If you convert your Traditional IRA to a Roth IRA, you:

- Pay income taxes at your current tax rate (tax rate for that year)
- Receive tax-free withdrawals during retirement
- Have no required minimum distributions

Important Consideration: Traditional IRA account owners should consider the tax ramifications, age and income restrictions in regards to executing a conversion from a Traditional IRA to a Roth IRA. The converted amount is generally subject to income taxation.

Should you Convert to a Roth IRA?

Do you have a large retirement account you may not use all of?

Do you want to leave a legacy potentially tax free?

Do you believe tax rates will be higher in the future?

- You don't have to convert all at once, you can convert a bit at a time
- Convert in years where you have little income up to the 12% Tax Bracket
- Start conversions before you reach age 72, to minimize Required Minimum Distributions

Important Consideration: Traditional IRA account owners should consider the tax ramifications, age and income restrictions in regards to executing a conversion from a Traditional IRA to a Roth IRA. The converted amount is generally subject to income taxation.

Income Tax Rates

2020 Federal Taxable Income Rates		Ordinary Income (Interest, earned income, non-roth retirement distributions)	Qualified dividends & Long-term capital gains *
Single	Joint Return		
$0 +	$0 +	10%	0%
$9,876 +	$19,751 +	12%	0%
$40,126 +	$80,251 +	22%	15%
$85,526 +	$171,051 +	24%	15%
$163,301 +	$326,601 +	32%	15%
$207,351 +	$414,701 +	35%	15%
$518,401 +	$622,051 +	37%	20%

*Qualified dividends are from domestic corporations and certain foreign corporations but don't include dividends from certain preferred stock and most REITs. The current maximum tax rate on long-term capital gains (excluding unrecaptured Section 1250 gain and gain from sales of collectables and qualifying small business stock) is 20%.

IRA to Roth IRA Conversions

Conversion Example:

Steve is 62, married to Sue age 62, and retired. He has a 401K worth 1.2 million. They also have 500k in cash from an inheritance and are planning to live off that money until they collect social security at 67 of $57,000 per year.

- He could convert up to $105,050 and pay $9,235 in federal taxes. State taxes would also apply if he lived CT. $105,050-$24,800=$80,250 taxable income
- He could do this for 5 years until he and Sue begin collecting social security. If he paid the taxes from their cash, he could convert $525,250 to his Roth IRA
- Assuming 5% compound growth, if he didn't covert to a Roth and waited until 72 for his first distribution the IRA would be worth 1.9 mill and RMD $71,338
- Assuming 5% compound growth, after the conversion the IRA would be worth 1.2 mill at 72 and his RMD would be $45,095

The Investors Decisions

An Investor Has 5 Decisions to Make with their Portfolio

1. The Asset Allocation Decision
2. The Diversification Decision
3. The Active versus Passive Decision
4. The Rebalancing Decision
5. The Do-It-Yourself Decision

The Investors Decisions: Asset Allocation

WHAT IS ASSET ALLOCATION?

- Asset allocation is a technique that can be used to reduce many types of risk
- It refers to the process of diversifying a portfolio among several different asset classes, with the objective of reducing risk and increasing returns
- It is the single most important decision an investor makes
- It is often considered the only “free lunch in investing”

The Investors Decisions: Asset Allocation

The Asset Allocation Decision: How should you allocate your investments across the asset classes?

An asset class are a group of securities that exhibit similar characteristics

There are 5 Asset Classes:

- Cash
- Fixed Income (Bonds)
- Equities (Stocks)
- Real Estate (REITs)
- Commodities

Polling Question 2

How many asset classes are there?

A) 1
B) 3
C) 5
D) 15

Cash Accounts

One category of loan investments is cash accounts. Examples include:

- Savings accounts
- Certificates of deposit (CDs)
- Money market accounts
- Money market mutual funds*

*An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the fund seeks to preserve the value of your investment at $1 per share, it is possible to lose money by investing in the fund. See prospectus of money market fund for full disclosures.

Bonds

Another common type of loan investment is bonds

- A bond is basically an IOU sold by the government, a company, a municipality or an individual in order to raise money
- In return for the loan, the bond investor is promised a return of principal and periodic interest payments
- Bonds are often purchased by investors to generate income or preserve principal

Bond Interest Rates

LENGTH OF TERM

- Longer terms may involve higher risk and usually offer higher interest
- Short-term bonds have a term of one to five years
- Intermediate-term bonds have a term of five to ten years
- Long-term bonds have a term of over ten years

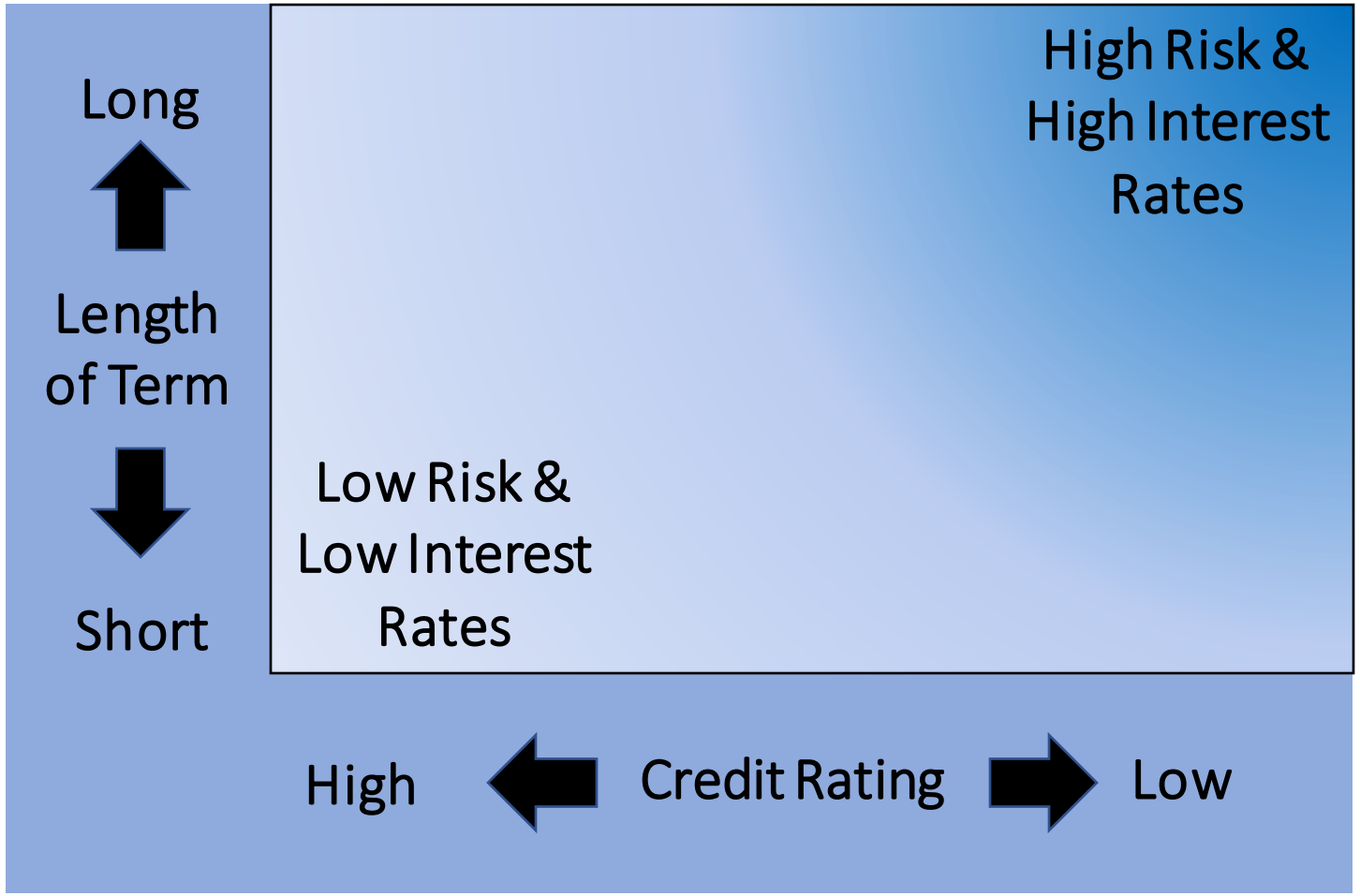
CREDIT OF ISSUER

- Lower credit ratings involve higher risk and usually offer higher interest
- Investment Grade is BBB or higher

Bond Ratings

Moody's	Standard & Poor's	Grade	Risk
Aaa	AAA	Investment	Lowest Risk
Aa	AA	Investment	Low Risk
A	A	Investment	Low Risk
Baa	BBB	Investment	Medium Risk
Ba,B	BB,B	Junk	High Risk
Caa/Ca/C	CCC/CC/C	Junk	Highest Risk
C	D	Junk	Highest Risk

Bonds & Risk


Long
Length of Term
Short
High Risk & High Interest Rates
Low Risk & Low Interest Rates
High
Credit Rating
Low

Bond Categories

Corporate Bonds	
Subcategories	Details
There are three types of corporate bonds:	• Taxable • Pay a higher yield than government bonds • More risk than federal bonds
Asset-backed bonds are secured by collateral or physical assets.	
Debentures are unsecured loans backed only by credit or the promise to pay.	
Convertible bonds offer investors the option of converting their bonds into stock (subject to restrictions). Investors are not required to exercise this exchange option.	

The market value of corporate bonds will fluctuate, and if the bond is sold prior to maturity, the investor's yield may differ from the advertised yield

Bond Categories

Municipal Bonds	
Subcategories	Details
There are two types of bonds issued by states, cities, or other local governments	• Federal tax-exempt* • Only exempt from state and local taxes if you buy bonds issued by the state or city where you live* • Pay a lower yield than similar corporate bonds or U.S. Treasuries • More risk than federal bonds
General obligations are backed by the full faith and credit of the issuer	
Revenue bonds are backed by earnings of the particular project the bond is financing	

*Municipal bonds may be subject to the alternative minimum tax (AMT).

Municipal bonds are subject to availability and change in price. They are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise. If sold prior to maturity, capital gains tax could apply.

Bond Categories

U.S. Treasuries	
Subcategories	Details
Treasury Notes are issued with terms of 2, 3, 5, 7 or 10 years. They may be purchased at face value and pay fixed-rate interest every six months until maturity.	• Interest income is subject to federal tax but not state or local tax* • Very low-risk
Treasury Bonds are issued with terms of 10 to 30 years. They may be purchased at face value and pay fixed-rate interest every six months until maturity.	

*Government bonds and Treasury bills are guaranteed by the US government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value.

Bond Categories

Agency Bonds	
Summary	Details
Agency Bonds are issued by federal, state, and local agencies.	• May be subject to federal, state, and local taxes • Slightly more risk than treasury bonds • Pay a higher yield than treasury bonds

Stocks

- When you buy stock in a corporation, you own part of the business including any assets such as buildings and inventory
- Corporations divide their ownership into shares of stock
- Companies may be publicly traded or privately held
- This section will focus exclusively on publicly traded stock that may be purchased by anyone

Stock Categories

Common Stock	Preferred Stock
• Greater potential for share price appreciation • Have voting rights • Last to receive any investment back if the company goes out of business • Directly participates in the success or failure of the company	• Usually offers greater price stability but less potential for appreciation • Do not receive voting rights • After creditors and bondholders but before common stockholders to receive a portion of investment back if the company goes out of business • Dividends are fixed regardless of how the company performs and are paid before any dividends on common stock • If company is unable to pay dividends, they will be repaid in the future before any dividends are paid to common stockholders

Stock Categories

Use of Corporate Earnings	
• Growth and Value stocks are classifications referring to how they use any corporate earnings and their PE valuation • Some companies may fall into both categories since they reinvest in their companies but also pay out dividends to shareholders	
Growth Stock	Value Stock
• Reinvest earnings in order to grow their business • Purchased with the primary objective of capital appreciation • Have a high PE ratio	• Pay dividends to shareholders • Purchased with the primary objective of generating current income • Value stocks are often larger, more established companies • Low PE, fallen on hard times

Stock Categories

Company Size	
• The size of the company is often categorized by its market capitalization • This can be calculated by multiplying the price of one share by the number of outstanding shares • While the calculation remains the same, the exact market capitalization amounts and how they are labeled vary with different brokerage firms over time.	
Small Cap Stock	Large Cap Stock
• $2 billion and less • May be less stable during a bad economy • More potential for growth but also may pay dividends	• $10 billion and greater • May be more stable during a bad economy

The prices of small cap stocks are generally more volatile than large cap stocks

Stock Categories

Company Location	
• The exchange the company is located on • Is it a US based company or is it traded on a foreign exchange. 60% of all stocks trade outside of the U.S. • U.S. companies have led the markets since 2008 but foreign and emerging stocks are beginning to outperform	
Foreign Stocks	Emerging Markets Stocks
• Listed on a foreign exchange • In more established and stable countries • Have to be concerned with foreign exchange rates	• The main block of these countries are known as BRIC (Brazil, Russia, India, and China) • There are other emerging countries outside of BRIC • Large upside and downside

The prices of small cap stocks are generally more volatile than large cap stocks

Real Estate Investment Trusts (REITs)

WHAT IS A REIT?

- It is a company that owns, operates, or finances income producing real estate. These companies have to meet a number of requirements to qualify.
- REITs offer trade on major exchanges, provide income, and liquidity in real estate. However, some REITs are non-traded and not as liquid.
- REITs, by law, must payout 90% of their income and be invested in 75% real estate, cash, or US Treasuries. They can own both property and mortgages.
- Most REITs specialize in a specific real-estate sector, for example, multi-tenant retail or health care.
- REITs fluctuate in value like stocks and can be bought individually, through ETFs, or mutual funds

Commodities

WHAT IS A COMMODITY?

- A raw material or primary agricultural product that can be bought and sold such as gold or coffee. They are often used as inputs in the production of other goods or services
- They can also be used as a store of value or a hedge against inflation
- Gold for example is often a haven when stock prices decline. However, there have been times when gold and stock prices decline at the same time
- They are another way to diversify your portfolio. They are best purchased through an ETF. Most mutual funds don't invest directly in them but in the stocks of companies that produce them. Trading futures contracts is another way to get exposure to them but is highly risky and requires extensive knowledge.

The Investors Decisions: Asset Allocation

Asset Allocation Should Be Based On:

1. YOUR TIME HORIZON

This refers to the amount of time your money will be invested before you need it. Your time horizon is important because:

- A longer time horizon may allow you to take more risk and potentially achieve a greater rate of return
- A shorter time horizon may create a need for some of your retirement investments to become more conservative
- Don’t count on good market conditions if you are working within a short time horizon
- Once you have a plan in place, you may need discipline to stick to it over an extended time horizon

The Investors Decisions: Asset Allocation

Asset Allocation Should Be Based On:

2. YOUR RISK TOLERANCE

- How much fluctuation can you tolerate in your portfolio?
- Fluctuation is another term for volatility. Can you tolerate a 10% decline in your portfolio? How about a 20% decline in your portfolio? How much fluctuation are you willing to accept for higher long-term returns?
- Unfortunately, there are no low risk/high expected return investments
- Pursuing greater return will come with greater fluctuation
- You should know your portfolio's potential fluctuation or standard deviation

The Investors Decisions: Asset Allocation

Hypothetical Portfolios

Capital Preservation	Defensive Growth	Conservative Growth	Moderate Growth	Growth	Aggressive Growth
100% Bonds	80% Bonds 20% Stocks	60% Bonds 40% Stocks	40% Bonds 60% Stocks	20% Bonds 80% Stocks	100% Stocks

There is no assurance that the models and allocations shown will be suitable for all investors or will yield positive outcomes.

Sample Asset Allocation Performance 1-1-2007 to 10-30-2019

Allocation*	Maximum Drawdown	Average Annual Return
100% Stocks	-43.28%	8.39%
90% Stocks/10% Bonds	-38.96%	8.15%
80% Stocks/20% Bonds	-34.59%	7.87%
70% Stocks/30% Bonds	-30.17%	7.55%
60% Stocks/40% Bonds	-25.71%	7.18%
50% Stocks/50% Bonds	-21.19%	6.78%
40% Stocks/60% Bonds	-16.63%	6.34%
30 % Stocks/70% Bonds	-12.02%	5.86%
20% Stocks/80% Bonds	-7.4%%	5.36%
10% Stocks/90% Bonds	-4.68%	4.82%
100% Bonds	-3.49%	4.25%

*Bonds represented by Vanguard Total Bond Index (VBTLX), stocks represented by Vanguard S&P 500 Index (VFIAX) and annually rebalanced. Does not include MWM Annual Management Fee.

The Investors Decisions: Asset Allocation

CREATING YOUR OWN ASSET ALLOCATION

- Completing a risk tolerance questionnaire to determine your asset allocation is a good idea
- Your 401K provider may have a questionnaire you can fill out
- A Financial Advisor can be very helpful in determining your tolerance for risk and helping you constructing your asset allocation
- Once you determine your allocation you apply it across all your investment accounts

The Investors Decisions: Diversification

WHAT IS DIVERSIFICATION?

- Diversification means not having all of your money in one or a few investments in one asset class (such as stocks)
- The intent behind this strategy is that if one or some investments don't perform well (single security risk), they will be offset by others that perform above average*
- Research has show that you must own a portfolio of at least 30 different individual securities to eliminate single security risk
- Negatively correlated investments can reduce your overall fluctuation

*While diversification may help reduce volatility and risk, it does not guarantee future performance.
There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk

The Investors Decisions: Diversification

GROWTH OF VALUE STOCKS

The Investors Decisions: Diversification

LARGE CAP OR SMALL CAP STOCKS

The Investors Decisions: Diversification

STOCK SECTOR RETURNS

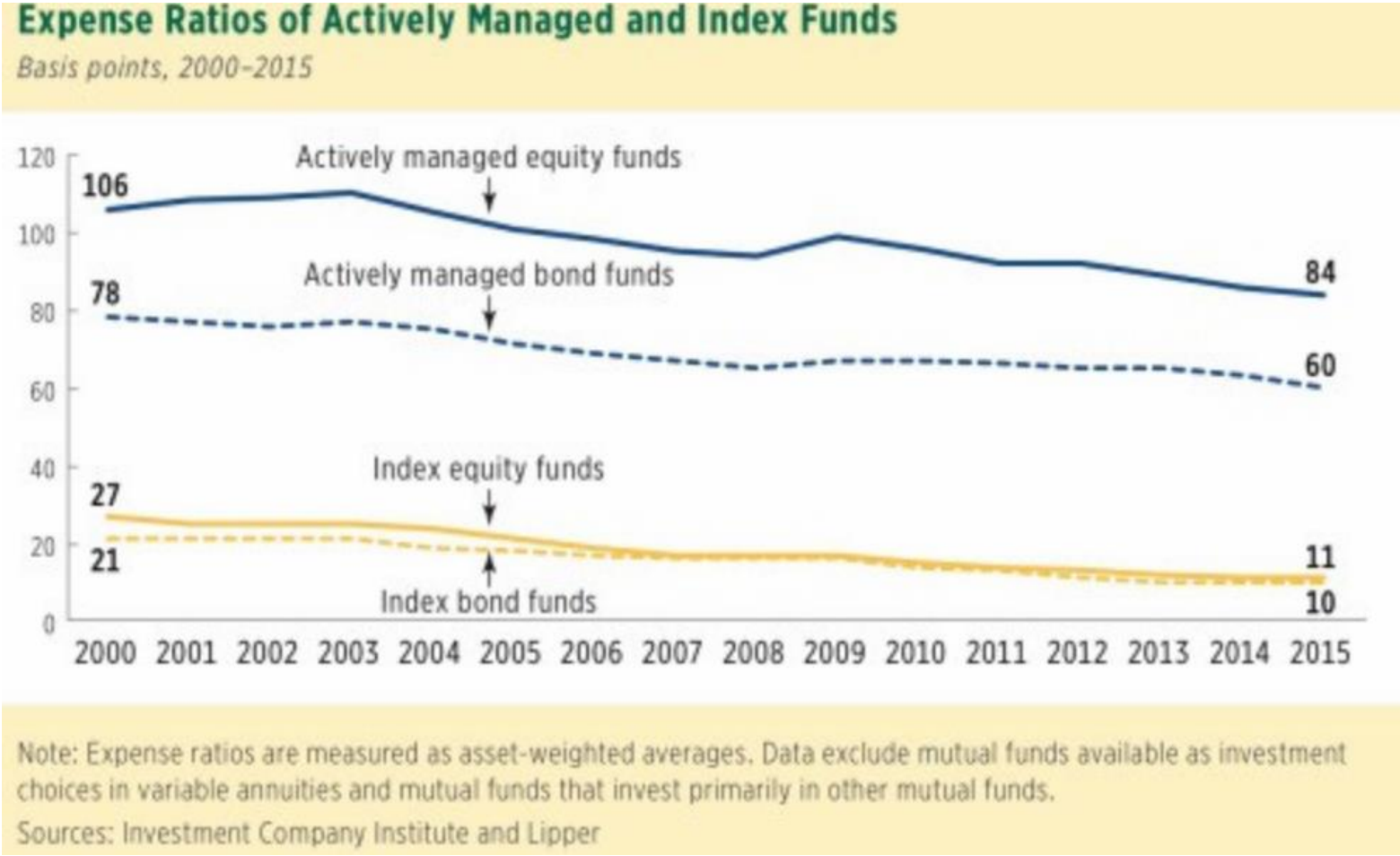
2015	2016	2017	2018	2019
Large Growth 3.17%	Small Value 24.65%	Emerging Mkt 31.11%	Large Growth -1.51%	Large Growth 36.39%
International -.19%	Large Value 16.75%	Large Growth 27.65%	Small Growth -6.15%	Mid Growth 35.47%
Mid Growth -1.03%	Mid Value 15.11%	International 26.40%	Mid Growth -3.76%	Small Growth 28.48%
Large Value -1.04%	Emerging Mkt 11.55%	Small Growth 21.78%	Large Value -8.27%	Mid Value 27.06%
Mid Value -1.91%	Small Growth 10.61%	Mid Growth 21.72%	Mid Value -13.04%	Large Value 26.54%
Small Growth -2.64%	Mid Growth 6.62%	Large Value 16.99%	International -13.79%	Small Value 22.39%
Small Value -3.78%	Large Growth 5.99%	Mid Value 16.91%	Emerging Mkt -14.58%	International 22.01%
Emerging Mkt -15.47%	International 2.45%	Small Value 11.67%	Small Value -18.7%	Emerging Mkt 18.42%

Large Growth, Large Value, Mid Growth, Mid Value, Small Growth, Small Value measured by the Russell Indexes. International measured by the MSCI EAFE Index and Emerging Markets measured by the MSCI Emerging Markets Index.

The Investors Decisions: Passive vs Active

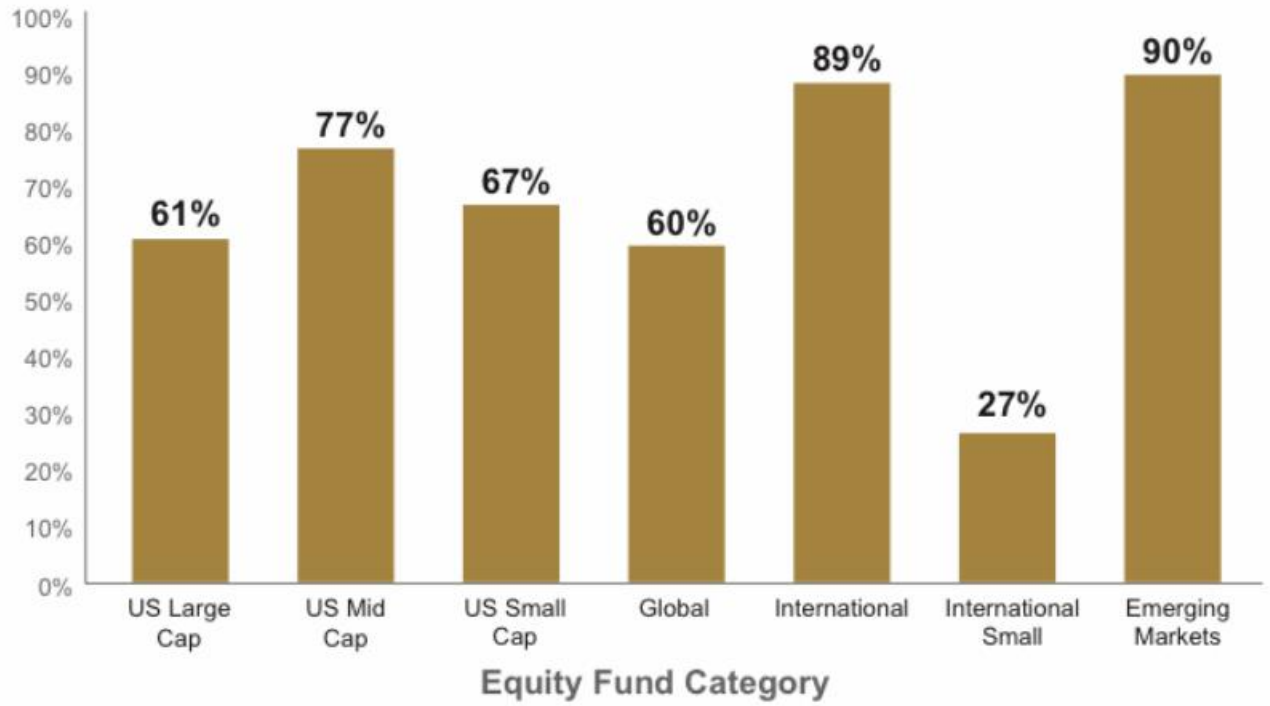
Passive Investment Management	Active Investment Management
• Seeks to track a benchmark (Example S&P 500) • Also known as indexing • Goal is to track the benchmark and not outperform the market • There is an index for every area of the market you can think of • Cost of passive funds is low because there is very little trading and no active management • Think exchange traded funds (ETFs) • Pros: Low cost, tax efficiency, predicable results, transparency • Cons: Lack of variance, no downside protection, less potential upside	• Seeks to outperform a benchmark (Example S&P 500) • There is a portfolio manager(s) who's job is to buy securities that they feel will outperform their particular benchmark • Cost of active funds is almost always higher than passive because of trading, research, and management costs • Think mutual funds • Pros: Flexibility, hedging (downside protection), larger potential upside • Cons: Higher cost, under performance (compared to their index), lack of transparency

The Investors Decisions: Active vs Passive Costs



Active Managers Failing to Beat Their Benchmark (%)

January 1, 2005 – December 31, 2009



Source: Standard & Poor's Indices Versus Active Funds Scorecard, March 30, 2010. Indicies used for comparison: US Large Cap—S&P 500 Index, US Mid Cap—S&P Mid Cap 400 Index, US Small Cap—S&P Small Cap Index, Global Funds—S&P Global 1200 Index, International—S&P 700 Index, International Small—S&P Developed ex.-US Small Cap Index, Emerging Markets—S&P IFCI Composite. Data for the SPIVA study is from the CRSP Survior-Bias-Free US Mutual Fund Database. Results are net of fees and expenses. Indices are not available for direct investment.

The Investors Decisions: Active vs Passive

ABOUT MUTUAL FUNDS

- Mutual funds are designed with specific objectives which help you to narrow your choices
- There are both actively managed and passively managed funds
- The funds prospectus details the strategy of the fund and costs
- There are an estimated 9500 actively managed funds in the US
- There are an estimated 2000 index mutual funds in the US

Note: Fund share values fluctuate in accordance with market and economic conditions. It is possible to lose money by investing in mutual funds.

The Investors Decisions: Active vs Passive

Load Versus No-Load Mutual Funds

Load Funds (Commission)	No Load Funds (Non-Commission)
Sold by Stockbrokers	No sales charge paid
Load mutual funds charge a sales commission.	Can be purchased directly from the investment company
-Class A- up front sales charge up to 5.75%	Usually have lower internal expenses than load funds
-Class B-no up-front charge but higher annual internal expenses than Class A	Used by Registered Investment Advisors Managing Portfolios (RIA's)
-Class C- no up-front charge but higher annual internal expenses than Class B. Pay 1% fee if sold in the first year	Also available through many discount brokers such as Fidelity, TD Ameritrade, Vanguard.

The Investors Decisions: Active vs Passive

ACTIVELY MANAGED MUTUAL FUNDS

An active mutual fund is only as good as its portfolio manager and its costs.

- The manager is the person making investment decisions with your money
- Investors often look at past performance of a fund without investigating how long the current manager has been responsible for performance*
- If the manager is new to that fund, try to find out what fund they managed previously and how it performed during their tenure
- If your fund hires a new portfolio manager, investigate their previous track record
- www.Morningstar.com good place to research mutual funds

*Past performance is no guarantee of future results.

The Investors Decisions: Active vs Passive

STOCK FUNDS

Each fund has an objective and certain stocks that it is permitted to hold. This can be found by reading the funds prospectus.

You can choose from:

- Growth or Value Funds
- Large Cap, Mid Cap, Small Cap
- Domestic, International, Emerging Markets
- Global Funds
- Active or Passive (Index Funds)

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The Investors Decisions: Active vs Passive

BOND FUNDS

These funds buy and sell certain types of bonds in order to generate current income for investors. Unlike an originally issued, individual bond, these funds may experience either capital appreciation or depreciation due to an actively managed portfolio.

You can choose from:

- Treasury Bonds Funds
- Corporate Bond Funds
- Municipal Bond Funds
- High Yield Bond Funds
- Strategic Bond Funds

The Investors Decisions: Active vs Passive

ABOUT EXCHANGE TRADED FUNDS

- An ETF is a group of securities that provides a diversified portfolio with one purchase
- They are traded on exchanges like stocks, so you can buy and sell throughout the day
- Most ETFs are passive but there are some actively managed options
- Typically, ETFs try to imitate market indexes or sectors by investing in all or a representative sample of the stocks or bonds in that index or sector
- They often have low annual management fees

The Investors Decisions: Active vs Passive

ABOUT EXCHANGE TRADED FUNDS

- ETFs are tax efficient. Unlike an actively managed mutual fund that sells securities for a gain, to meet shareholder redemptions or when the fund manager changes, an ETF sells securities to reflect the index or sector. Most capital gains are delayed until you sell the fund.
- The transaction fee to buy or sell an ETF has a small impact on larger investments and a large impact on smaller, ongoing investments
- ETFs provide financial transparency with daily portfolio disclosure
- However, not all ETFs costs are the same and must investigate them before purchasing

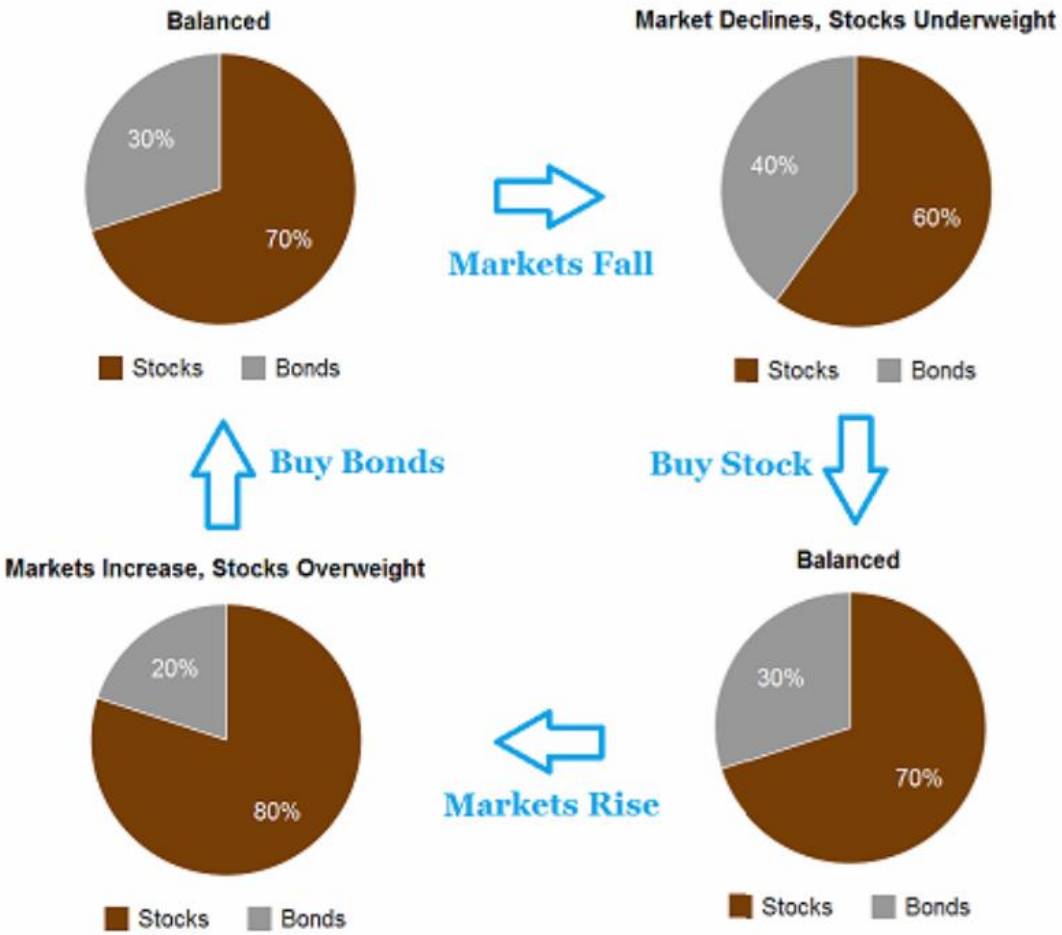
The Investors Decisions: Rebalancing

WHAT IS YOUR REBALANCING STRATEGY?

- It allows you to manage the risk in your portfolio
- Rebalancing is counter-intuitive and difficult for many investors
- It involves selling your winners and buying more of your losers
- Rebalancing is an automatic way to buy low and sell high, without your emotions getting in the way

The Investors Decisions: Rebalancing

REBALANCING EXAMPLE:



The Investors Decisions: Rebalancing

REBALANCING METHODS

- Can be done on a schedule, such as monthly, quarterly or annually
- Can be done when your portfolio is out of balance by a certain percentage such a 5%
- Whatever your rebalancing plan it is important that you have one in place

Target Date Funds

Many plans offer target date dates. Those are funds that have a date in the name of the fund, such as Vanguard Target Retirement 2030 Fund.

- The are life cycle funds that offer preset asset allocations. The date refers the year a plan participant would turn 65 and presumably retire.
- For example, if you turn 65 in 2030 then the 2030 plan in your fund could be a fit for you.
- Over time the fund is designed to become more conservative by adding more money into bonds the closer you get to your retirement year.
- It's an easy way to have a preset asset allocation and rebalancing strategy
- You can pick any fund year but the further out date you pick, generally the more aggressive the allocation (more in stocks and real estate)

Target Date Funds

However, there are some negatives to consider with target date funds:

- Most target date funds are single company funds. For example Fidelity only. Meaning that company is only picking from their available funds and there might be better funds to select from.
- Your asset allocation may not align with the target date fund for when you turn 65. Meaning you may need a more aggressive or conservative allocation.
- Each target date fund approaches asset allocation differently one fund may have less diversification than another and might completely ignore some asset classes such as real estate.
- If you can put in some time and research, many times you can put together your own “target date fund” that will be better suited for your needs

Review Your Plans Participant Fee Disclosure

This document is available from your retirement plan provider and will tell you the following:

- What the annual costs of the investment options in your plan are
- Any provider fees or asset based fees you may be paying
- Any additional fees that may apply
- You should review this anytime there is a change in your plan
- You can get a copy of this by logging into your plan or requesting a copy

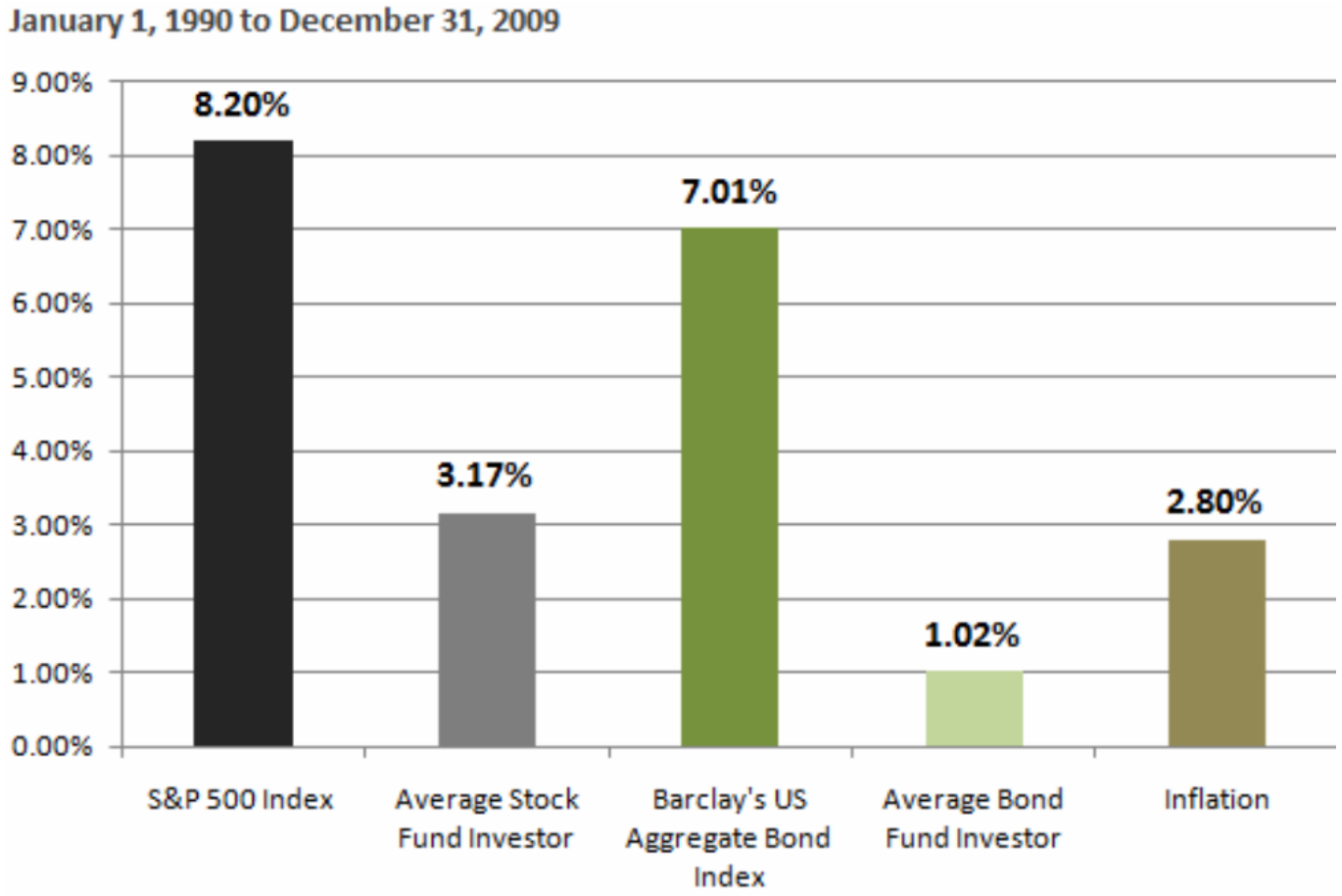
The Investors Decisions: Do-It-Yourself Decision

The do-it-yourself (DIY) approach is increasingly popular in some industries: home repair and renovation, decorating, gardening, and fashion. However I don't believe it's prudent when it comes to investing for the following reasons:

- Extensive knowledge and experience is required to be successful
- Finance is complicated and the odds are stacked against you, the stakes are very high: your entire financial future
- Our own natural instincts can be our worst enemy when it comes to investing

The Investors Decisions: Do-It-Yourself Decision

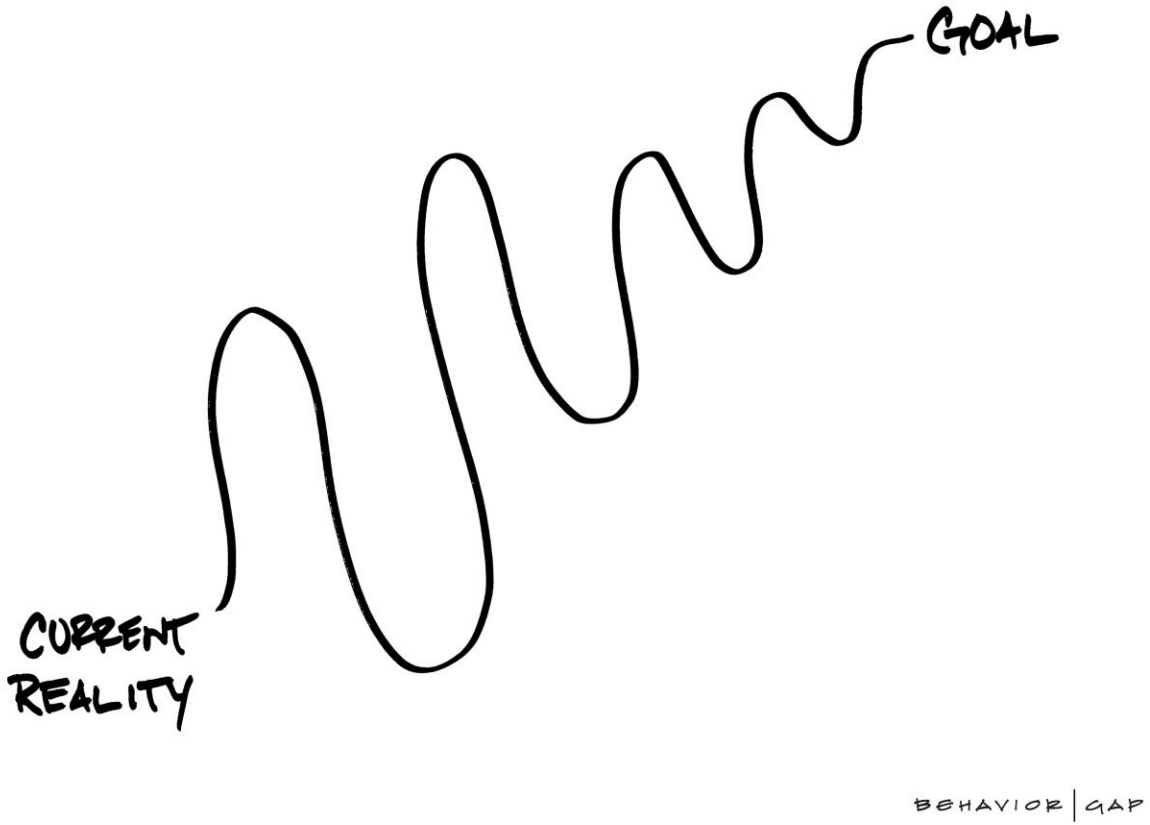
AVERAGE INVESTOR VS THE MARKETS



Average stock and bond investor performances were used from a DALBAR study, Quantitative Analysis of Investor Behavior (QAIB), 03/2010.

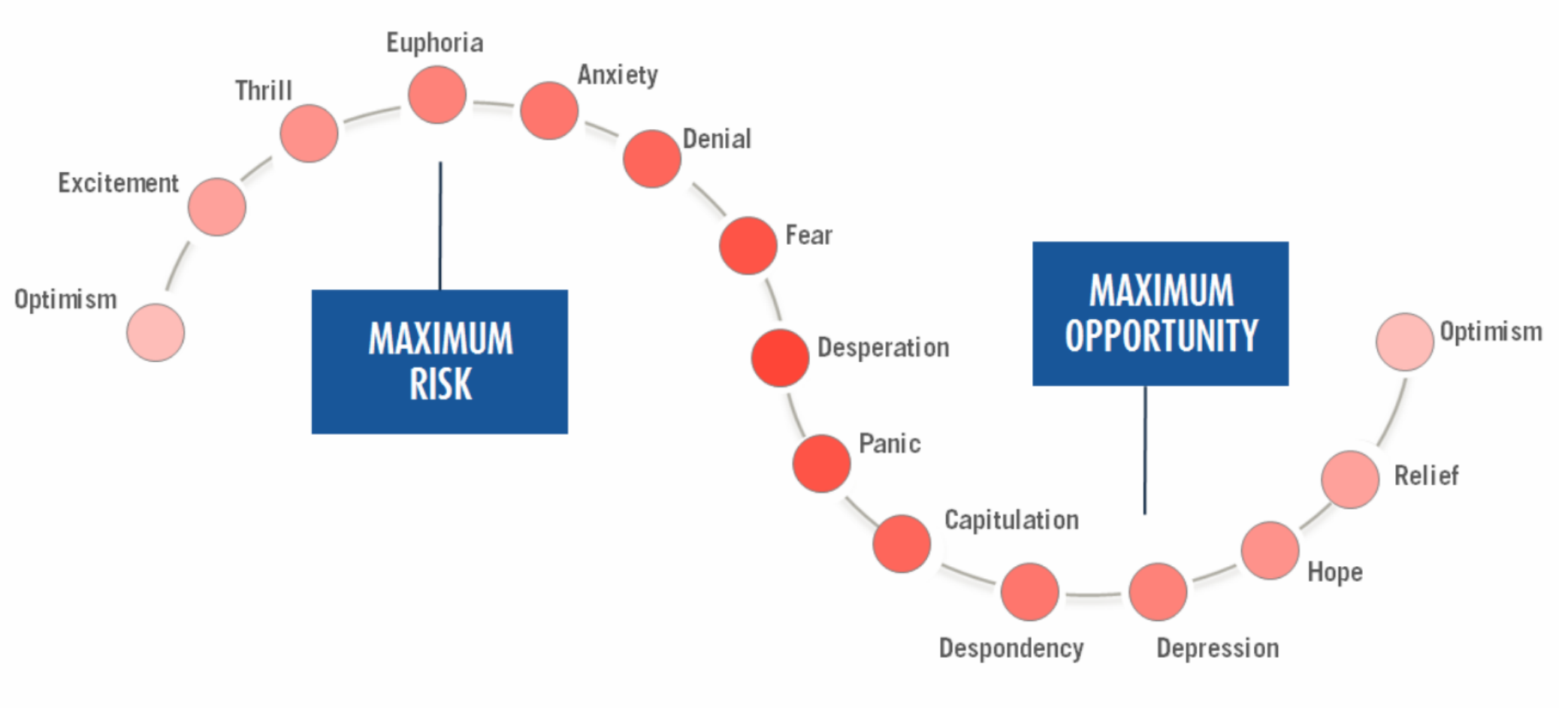
The Investors Decisions: Do-It-Yourself Decision

ACTUAL INVESTOR EXPERIENCE



The Investors Decisions: Do-It-Yourself Decision

THE EMOTIONAL CYCLE OF INVESTING



Types of Advisors Who Can Help

Brokers	Registered Investment Advisor
◦ They are salespeople	◦ They are fiduciaries
◦ They could be insurance brokers or stockbrokers	◦ Required to put clients' interest in front of their own
◦ Their obligation is to their broker or employer	◦ Held to the Investment Advisors Act of 1940
◦ The have no requirement to put your interest in-front of their own	◦ They are required to disclose any conflicts of interest
◦ They don't have to disclose conflicts of interest or commissions they may make off you	◦ Are compensated on an hourly, fixed fee, or % of the assets they advise/manage
◦ Any advice they give is incidental	◦ The percentage of fee generally declines as your account size increases
◦ They are not held to a fiduciary standard	◦ They do not receive commissions from the investments they recommend
◦ People can call themselves "financial advisors" and still be brokers	
◦ Compensated for more sales and turnover	

The Investors Decisions: Do-It-Yourself Decision

HOW TO GET HELP

A different way to receive professional money management is by hiring a Registered Investment Advisor to manage your portfolio for you. This approach is designed to pursue a diversified portfolio and work towards achieving specific, personalized objectives.

- **The RIA is held to a fiduciary standard and any conflicts must be disclosed.**
- Portfolio's can contain stocks, bonds, mutual funds, or ETF's depending on the strategy and amount invested.
- The account is generally managed for you on a discretionary basis.
- There is full fee transparency and you pay a percentage of assets or a flat fee for this service. No commissions.

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The Investors Decisions: Do-It-Yourself Decision

Researching Brokers:

Google brokercheck or go to brokercheck.finra.org

- Type in the brokers name under individual and view their report
- You will be able to see the brokers licenses and who they work for
- You can also see any disclosures of client complaints and outside activities

Researching Registered Investment Advisors:

Google iapd or go to advisorinfo.sec.gov

- Type in your advisors name and view their report
- You will be able to view their history, licenses, disclosures, and outside activities
- You type in their firm name and review their firms ADV (disclosures) and their part 2 brochures

In-Service Distributions

In most cases, you must leave money in your retirement plan unless you experience a triggering event (such as termination or retirement).

However, some plans allow you to transfer a portion of the money in the plan to an IRA even if you are still working.*

*Any in-service distributions will reduce the value of the benefits you will receive when you retire. You should consult with your tax advisor regarding the implications of withdrawing money from a retirement plan.

In-Service Distributions

Why would you want to explore this possibility:

- If you are unhappy with limited investment choices in the plan
- If you feel your portfolio is overweight with employer stock in the account or you are concerned about the company's future

To determine if your plan allows in-service distributions, consult the summary plan description. If in-service distributions are allowed, this information will most likely be found in the plan distributions section.*

*Any in-service distributions will reduce the value of the benefits you will receive when you retire. You should consult with your tax advisor regarding the implications of withdrawing money from a retirement plan.

Plan Rollovers

When you are separated from a company you and have a former retirement plan your options are the following:

- Leave the money in the plan
- Transfer the money to your new employers plan
- Take the money out in cash and pay tax on it
- Annuitize your balance, meaning turn it into monthly installment payments
- Rollover the money to an IRA
- Be aware of NUA (Net Unrealized Appreciation) before doing the rollover

Depending on your situation your will want to review these options thoroughly to review the pros and cons of making any decisions.

*You should consult with your tax advisor regarding the implications of withdrawing money from a retirement plan.

Polling Question 3

You may rollover a retirement plan from a former employer:

A) Any time you want
B) When you receive a promotion
C) When you no longer work for that company
D) When you turn 65

Company Securities in Retirement Plans

Net Unrealized Appreciation (NUA), allows you to pay long-term capital gains tax on part of your account when you change jobs or retire[1].

Here is how it works:

- You have the company securities distributed in kind to your taxable brokerage account as part of a total distribution from the plan[2]
- You pay ordinary income tax on the original cost of the securities[3]

[1] The Net Unrealized Appreciation rule is found in Internal Revenue Code 402(e)(4)(a)-(c) and discussed in IRS Notice 98-24 and PLR200410023.

[2] To qualify as a total distribution, all assets must be withdrawn during the same calendar year, but can include multiple transactions. For example, the total distribution rule is satisfied if the company securities are taken as a taxable distribution in kind and the other assets in the account are transferred to a Traditional IRA during the same calendar year.

[3] The ordinary income tax is owed in the year that the distribution is made from the plan. Early withdrawal penalties may apply.

Company Securities in Retirement Plans

NET UNREALIZED APPRECIATION EXAMPLE

Let's illustrate the tax benefits of NUA with an example:

- 401(k) plan balance of $300,000
- $100,000 of the total is company stock (matching employer contributions) with a cost basis of $10,000

Upon retirement, the employee tells the 401(k) plan administrator to:

- Transfer the shares of company stock to her brokerage account as a taxable transaction*
- Transfer the other assets into her Traditional IRA account

*Early withdrawal penalties may apply.

Company Securities in Retirement Plans

The table below shows how her company stock will be taxed:

Taxable Amount	Tax Treatment	Tax Due
$10,000	Ordinary Income	When Distribution is Received
$90,000	Long-term Capital Gains	When Stock is Sold
Change in Value After Stock is Received	Long- or Short-term Capital Gain (or Loss)	When Stock is Sold

Company Securities in Retirement Plans

	Taxable Amount	Federal Income Tax[1]	
Income Tax Bracket[1]		24%	35%
Tax on Company's Cost Basis	$10,000	$2,400	$3,500
Tax on NUA Gain When Securities are Sold[2] (15%)	$90,000	(15%) $13,500	(15%) $13,500
Tax on IRA Transfer when Withdrawn[3]	$200,000	$48,000	$70,000
Total Income Tax		$63,900	$87,000
Total Income Tax when Withdrawn if Entire Account Transferred to IRA[3]	$300,000	$75,000	$105,000
NUA Income Tax Savings		$11,100	$18,000

[1]Current long-term capital gains tax rates are 0% for joint filers under $80,000, 15% for joint filers under $496,600 and 20% for joint filers under $496,600. 3.8% additional tax applies on the less of capital gains or income over $250,000. [2]Assumes securities are sold at the distribution price. [3] Assumes no increase in value.

Company Securities in Retirement Plans

REQUIREMENTS TO QUALIFY FOR NET UNREALIZED APPRECIATION:

1) The employer stock must be distributed in-kind:
   - The stock must be distributed to you in shares or transferred to a brokerage account electronically
   - You can't sell the stock before transferring it
2) The employer retirement plan must make a "lump sum distribution"
   - Must distribute the entire account by the end of the tax year (shares & cash)
   - Any previous partial rollovers will disqualify you
3) The lump-sum distribution must be made after a "triggering event"
   - Death, disability, separation from service qualify
   - Reaching age 59.5 will not qualify due to "lump sum distribution" requirement

*Early withdrawal penalties may apply.

Your Next Steps

Go through the 5-step investor decision process and come up with your own investment portfolio:

- Decided if you're going to be a passive or active investor
- Determine your asset allocation
- Decide if you need to make changes to your portfolio and make them
- Decide whether you're going to manage it yourself or get some professional help
- Review your retirement plan to see what costs you are currently paying and determine if you can lower them in the current plan or if you should seek another option such as a rollover

Questions:

Please now type your questions in the Q&A box and I will do my best to answer them.

Hartford Chapter News

The Hartford Chapter will continue it's virtual events for the remaining events through May.

Beginning with the February virtual event, our webinars will be hosted on the ON24 Platform, in accordance with IMA Global's guidance. More information will be provided as it become available.

Upcoming Hartford Chapter Events

FEB 16 6 pm EST	Virtual – on ON24 Platform - "Local Government Management" presented by Kevin Delaney – Finance Director, Town of Berlin ➢ Advance registration is required, watch your email for details
MAR 16 6 pm EST	Virtual – on ON24 Platform - "Nonprofits Driving Inclusive Economic Growth" presented by Jay Williams – CEO & Bonnie Malley – CFO Hartford Foundation for Public Giving ➢ Advance registration is required, watch your email for details
APR 20 6 pm EST	Virtual – on ON24 Platform - "Property & Casualty Insurance – Developments and Trends in Times of COVID" presented by Craig Parrow – Sr. V.P, Marsh & McLennan ➢ Advance registration is required, watch your email for details