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PRIZM PERSPECTIVE SUMMER 2014

Retirement Derailers

In a February 2013 survey of 1,000 employed and retired Americans aged 50–70 with $100,000 or more in investable assets, 90% of respondents said they had experienced a "retirement derailer" — a specific circumstance that seriously impacted their retirement plans or reduced their retirement savings (Source: Ameriprise Financial, February 2013). Approximately 37% of respondents had experienced five or more such circumstances. The top 10 derailers cited by survey respondents were:

- ❍ Supporting one or more grown children or grandchildren
- ❍ Receiving pension benefits that are lower than expected or not getting an anticipated pension at all
- ❍ Losing some retirement savings because of unsuccessful investments
- ❍ Taking Social Security benefits before reaching full retirement age
- ❍ Experiencing a job loss
- ❍ Not getting an anticipated inheritance
- ❍ Having to spend a lot of money on home repairs
- ❍ Taking care of an aging parent or other family member
- ❍ Paying for significant medical bills that aren't covered by insurance
- ❍ Using retirement savings to pay bills

To make sure your retirement isn't derailed, consider these tips:

1. Start saving now. When asked what they would have done differently, 57% of survey respondents said they wished they would have started

Continued on page 2

Don't Forget about Catch-up Contributions

If you're 50 years or older, make sure you take advantage of the catch-up options for contributions to IRAs, 401(k)s, and other tax-advantaged, defined-contribution retirement plans.

For IRAs — both traditional and Roth — you can contribute an extra $1,000 a year beyond the standard limit of $5,500. But for workplace qualified plans, the catch-up provisions are even more generous. For 401(k) plans, the catch-up allowance is $5,500 — raising the total limit for the older age group to $23,000 in 2014.

You can do even better if you take advantage of the catch-up provisions in both an IRA *and* a workplace plan. If you're 50 and work until you're 70 (at which time your Social Security benefits reach their maximum), contributing the maximum in an IRA and a 401(k) at a steady 7% annual return could potentially add more than $265,000 to your nest egg.

Where do you find the money to contribute these extra amounts? That's an entirely different subject, but you can start by reducing the luxuries in your lifestyle: dining out less frequently, buying a cheaper car, taking less extravagant vacations, canceling some subscriptions, cutting back on the premium cable TV channels, or using a cheaper data plan for your cell phone. You could also consider refinancing your mortgage (rates are near historic lows), making your home more energy efficient, and ensuring you take advantage of every tax break you can find on your tax return. If you're not sure how to put the right action plan together, please call to discuss. ❍❍❍

Retirement Derailers

Continued from page 1

saving earlier. Indeed, because of the power of compounding, starting to save for retirement just a few years earlier can make a huge difference in the end.

2. Save now to spend later. About 33% of survey respondents said that if they had spent less on discretionary expenses like dining out and vacations during their working years, they would be better prepared for retirement. This is where it's critical to make a budget for current expenditures, a retirement budget, and a plan for how to make retirement work. That plan may involve trimming current expenditures, scaling back retirement expectations, or both.

3. Prepare a retirement plan. Unless you plan to work until the day you die, a retirement plan should be an integral part of your overall investment plan — and no matter what your circumstances, an investment plan is a very important way to decrease the likelihood that your life plans will be derailed by unexpected circumstances that inevitably arise.

Think seriously about things for which you might want to spend money before or during retirement — like helping out grown children or grandchildren — and then build that into your retirement plan.

Obviously, unexpected circumstances do arise; but if you can anticipate that your children or grandchildren might need help and you are willing to help them, put that into your investment plan.

4. Review the implications of taking Social Security benefits before reaching full retirement age. For people who were near retirement age when the Great Recession hit and lost their jobs, taking Social Security at age 62 probably seemed like a far better idea than trying to get a new job at that age. But it's important to understand that while the government will allow you to start taking benefits at age 62, it will penalize you for it: for an individual born in 1960 or later who retires at age 62 instead of age 67 (full retirement age), monthly benefits will be reduced by 30%.

5. Have a candid conversation with your parents or other family members whom you might be caring for in old age. Talk about how they'll want to be cared for and the means they have to pay for such care. Urge them to consider long-term-care insurance, which can greatly ease the financial burden of paying for their care in a world in which the average cost for an assisted-living facility is nearly $42,000 a year and is more than $90,000 a year for a nursing home (Source: *The Wall Street Journal*, October 12, 2012).

If you have already been impacted by one or more of the detailers listed above — or any other circumstance that has impacted your retirement plans, here are five ways you can get back on track:

1. Take advantage of catch-up provisions. If you are 50 or older, you can contribute more tax-deferred income to a 401(k) or IRA (these are called catch-up contributions). In 2014, you can contribute $5,500 more to a 401(k) or 403(b) and $1,000 more to an IRA.

2. See where you can trim expenses to save more. Boosting your savings to get back on track for retirement might be easier than you think: most of us spend more than we realize on discretionary things like meals out, clothing, travel, and other personal expenditures. Take a hard look at your budget and see where you can cut back — even $100 per month can make a difference in your retirement savings.

3. Evaluate your investment choices. Review your current asset allocation. Many individuals close to retirement pulled money out of the stock market during the financial crisis; and if you haven't since reassessed your asset allocation, you're probably missing out on significant investment opportunities as the equity market rebounds. That said, you want to ensure that your asset allocation is appropriate (not too heavy in equities) given your age and target retirement date.

4. Reevaluate your retirement lifestyle. Most financial advisors recommend that you be able to replace at least 70% of your preretirement income during retirement. So if you planned to spend 85% of your current income in retirement, you might be able to scale back and still retire comfortably.

5. Work longer. When Social Security was created in 1935, the average American 65-year-old man could expect to live to age 78 and the average American woman to 80. Today, the average American 65-year-old man can expect to live to 84 and the average American 65-year-old woman to 86 (Source: Social Security Administration, 2013).

In that context, working five more years might not be such a sacrifice — and it can make a big difference in the retirement lifestyle that you can afford. For a 60-year-old who has a retirement account balance of $250,000 today and contributes $2,000 a year, pushing retirement back from age 65 to age 70 would yield an additional $158,410 in total savings (not counting Social Security) — adding $300 per month to the individual's retirement income.

No matter where you are on the path to retirement or whether you've been derailed or not, please call to discuss this in more detail. ❍❍❍

Have You Assessed Your Risk Tolerance?

While investors want the highest returns possible, they compensate you for the risks you take — higher risks are generally rewarded with higher returns. Thus, you need to assess how much risk you are willing to take to obtain potentially higher returns.

However, this can be a difficult task. It is one thing to theoretically answer questions about how you would react in different circumstances and quite another to actually watch your investments decrease significantly in value. What you are trying to assess is your emotional tolerance for risk, or how much price volatility you are comfortable with.

Some questions that can help you gauge that include:

❍ **What long-term annual rate of return do you expect to earn on your investments?** Your answer will help determine the types of investments you need to choose to meet that target. Review historical rates of return as well as variations in those returns over a long time period to see if your estimates are reasonable.

Expecting a high rate of return may mean you'll have to invest in asset classes you aren't comfortable with or that you may be tempted to sell frequently. A better alternative may be to lower your expectations and invest in assets you are comfortable owning.

❍ **What length of time are you investing for?** Some investments, such as stocks, should only be purchased for long time horizons. Using them for short-term purposes may increase the risk in your portfolio, since you may be forced to sell during a market downturn.

❍ **How long are you willing to sustain a loss before selling?** The market volatility of the past several years will give you some indication of how comfortable you are holding investments with losses.

❍ **What types of investments do you own now and how comfortable are you with them?** Make sure you understand the basics of any investments you own, including the historical rate of return, the largest one-year loss, and the risks the investment is subject to. If you don't understand an investment or are not comfortable owning it, you may be tempted to sell at an inopportune time. Over time, your comfort level with risk should increase as your understanding of how risk impacts different investments increases.

❍ **Have you reassessed your financial goals recently?** Due to the significant market volatility of the past few years, your financial plan may need to be revamped. Otherwise, you may find you won't have sufficient resources in the future to meet your goals. Based on your current investment values, determine what needs to be done to meet your financial goals. You may need to save more, change or eliminate some goals, or delay your retirement date.

❍ **Do you understand ways to reduce the risk in your portfolio?** While all investments are subject to risk, there are some risk reduction strategies you should consider for your portfolio. These strategies include diversifying your portfolio, staying in the market through different market cycles, and using dollar cost averaging to invest. ❍❍❍

What Kind of Retirement Do You Want?

Retirement is no longer viewed as a time to slow down, but is now considered a new beginning in life. To help you visualize your retirement so you can estimate retirement expenses, consider these questions:

❍ When do you want to retire? Will you realistically have the resources to retire at that age?

❍ Do you plan to stay in your current home, trade down to a smaller one, or move to a different city? If you plan to move, is the cost of living there more or less expensive?

❍ Will your mortgage be paid off by retirement? What about other debts?

❍ Will you continue to work after retirement? If so, will you work part-time or full-time? Where will you work and how much can you expect to earn? Do you have any hobbies or interests that can be turned into paying jobs?

❍ How will you spend your free time? What hobbies will you pursue? How much and where will you travel? How much will all these activities cost?

❍ How will you pay for medical costs? Will your employer provide health insurance, or will you need to purchase insurance to supplement Medicare coverage?

❍ Do you have any medical conditions that are likely to impact your quality of life in retirement? What would you do if you became physically disabled? How will you provide for long-term-care costs?

❍ How much of your income will be provided by personal investments? Are you confident you can invest so those investments will last your entire retirement?

❍ What would happen financially if your spouse dies? If you die, would your spouse be able to support himself/herself financially? ❍❍❍

A Retirement Account Is Not a Retirement Plan

A retirement plan is like a road map. It shows you how to get from where you are to where you need to go. The vehicle that gets you there could be a bike, a car, a train, a plane, a boat, or in some cases, a combination of all these vehicles. In retirement planning, your vehicles are your accounts: they transport you from point A to point B.

Just as a road map keeps you from getting lost on the road, a retirement plan keeps you from getting lost on your way to retirement.

A retirement account is simply a vehicle to save for retirement, while a retirement plan includes many factors — when you want to retire, how much you will need every month, your assets and investments, your debts, Social Security benefits, health care, emergency fund, and more.

Some factors to consider include:

Are you contributing enough? If you're like most Americans, the answer is probably no. In 2012, on average, Americans contributed about $2,700 to their 401(k) plans; even if matched at 100%, $2,700 a year is not enough for most people to make it through retirement. There is a lot of room to contribute far more than average before hitting the annual 401(k) contribution maximum of $17,500 (that's the limit in 2014 per IRS rules; it typically increases a bit each year). But if you don't have a plan — if you don't know how much you'll need to have saved when you retire — you won't know how much you need to contribute every month. For most people, not knowing results in not contributing enough.

Are your investment allocations right for you? How you allocate your money — the types of investments you have — should depend on where you are on the path to retirement. Stocks involve more risk but typically yield a higher return, while bonds carry potentially less risk but typically yield a lower return.

Generally, the further away you are from retirement, the more money you should have in stocks and the less money you should have in bonds. As you get closer to retirement, you should reallocate your funds toward more bonds and less stocks. Why?

Because if you are too conservative when you're young (not invested enough in stocks), your investments won't grow like you need them to. But if you're too aggressive as you near retirement (invested too much in stocks), market volatility could derail your retirement plans.

Have you strategically chosen your accounts? The government incentivizes us to save for our retirement by giving certain types of tax advantages to qualified retirement accounts. But those advantages vary.

For some, you may contribute pretax dollars (but that money is taxed when you take it out in retirement). For others, you can take out money tax free in retirement, but contributions are made after taxes.

So you need to think strategically about how and where you are investing for retirement. In addition to the tax implications associated with different investment vehicles, you also need to look at fees associated with the account. And beware, if you're planning to retire early, many types of retirement accounts will penalize you heavily for early withdrawals.

If your employer offers a 401(k) plan and matches contributions, it always makes sense to contribute at least as much as your employer will match. But for most Americans, that 401(k) plan alone is not sufficient.

To ensure that you are saving enough to retire when and how you want to, you need to have a road map to get from here to there. Please call if you'd like to discuss this in more detail. ❍❍❍ FR2014-0219-0009

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