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Helping You Create Financial Independence

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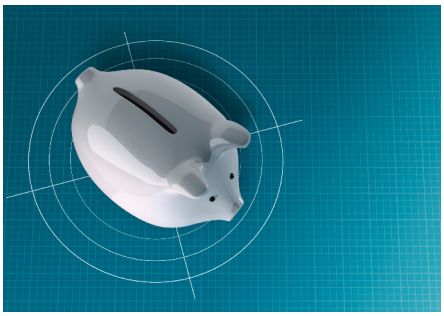
Should You Contribute to a Retirement Plan or IRA? Or Both?

If you're eligible to contribute to an employer-sponsored retirement plan, should you? Should you contribute to an individual retirement account (IRA)? How about contributing to both? The answers are: Yes, yes, and yes. If this comes as a surprise, it's probably because there are so many rules about eligibility for contributing to IRAs and workplace retirement plans that it's easy to become confused about what is allowed and what isn't.

One thing is never ruled out: you can always contribute to both a workplace retirement plan and an IRA, as long as you have earned income. What's open to question are how much you can contribute, to which type of account, and whether your contributions are tax deductible. Keep these three important points in mind:

Point 1: There are limits to your annual contributions. Every year, the IRS sets limits on how much you can contribute to retirement plans, and the amounts are different for various types of plans. The one rule common to them all is this: you can't contribute more than your earned income (except for contributions to a spousal IRA for a spouse who does not work).



Let's say your employer sponsors a 401(k) plan. If you participate in the plan by a) making contributions of your own, b) your employer makes contributions for you, or c) you and your employer both contribute to your account, then you can still contribute to your own IRA outside the workplace. If you're 49 or younger, in 2016, you can contribute $18,000 to the 401(k) plan and another $5,500 to an IRA, for a total of $23,500 in retirement plan contributions. If you're 50 or older, those numbers are $24,000 for the workplace plan and $6,500 for an IRA, for a total of $30,500.

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Changing Life Insurance Needs

Your life insurance needs will typically change over the years, based on changing individual circumstances:

Just starting out — Young, single adults may have little need for life insurance with no major debts and no one else counting on their income.

Married with no children — You may think you don't need insurance if both spouses work. However, if it takes both salaries just to make ends meet, you may want to purchase insurance to replace your income.

Two incomes with children — This is typically the time when your insurance needs are the greatest, since several family members are depending on your income. The death of either spouse can create a hardship.

Middle age with children — You should reassess your insurance again as your children approach college age, since you may need to increase coverage to fund their educations.

Children out of college — Your need for life insurance may decrease when your children become independent. On the other hand, you may find you now have different needs for insurance.

Since your life insurance needs can change drastically over the years, you should periodically assess that coverage. ❍❍❍

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Should You?

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Point 2: Your income can affect the tax treatment of IRA contributions. Originally, there was only one kind of IRA: the kind that enabled you to reduce your taxable income by the amount of your contributions when you file your income tax return. Today, it's referred to as a traditional IRA to distinguish it from a Roth IRA, to which you can only contribute after-tax money.

There are good reasons to choose either the traditional or Roth IRA, but if you participate in a workplace retirement plan *and* have income above the IRS limits, your ability to take the tax deduction for a contribution to a traditional IRA is limited. In 2016, tax deductibility begins to phase out if you are a single filer and earn more than $61,000, and disappears altogether at $71,000. For joint filers, the range is higher: $98,000 to $118,000.

Take note, however: if you make too much to be eligible for the up-front income tax benefit in the year you contribute to a traditional IRA, you can still make contributions to it *and* to your workplace retirement plan. In this case, you might want to consider contributing to a Roth IRA instead. Here as well, you might be limited by income: for 2016, eligibility to contribute to a Roth IRA phases out for single filers above $117,000 and joint filers above $184,000 and disappears completely for those earning more than $132,000 and $194,000, respectively.

Step 3: Doing either can build assets faster — both, faster yet. The complexity of the rules regarding whether IRA contributions are tax-deductible has obscured the most important benefit of qualified retirement plans: they compound free of annual taxes. This gives them a distinct advantage over taxable savings accounts, because at the same rate of return, assets grow faster when returns are not taxed.

For someone with an effective federal tax rate of 25%, an annual contribution of $5,500 to a taxable account that returns 6% a year grows to almost $226,000 in 25 years. But that same contribution to an IRA, at the same rate of return, grows to more than $301,000 — a difference of more than $75,000, regardless of whether the contributions were tax deductible. Increase the contribution to $20,000 a year, and your retirement fund grows to nearly $1.1 million after 25 years — and the advantage over a taxable account exceeds $200,000. *These examples are provided for illustrative purposes only and are not intended to project the performance of a specific investment vehicle.*

The bottom line: you should contribute as much as possible to tax-advantaged retirement plans. For many people who work, there are multiple retirement savings options available. There are even IRA options open for nonworking spouses. To make sure you're taking full advantage of the options open to you, please call. ❍❍❍

Keeping Score of Financial Progress

Keeping score is important in finances. You only know if you're making progress toward your goals if you've created a plan that tells you where you need to be and when.

Essentially, there are two numbers to focus on: your total net worth and your liquid net worth. The distinction comes chiefly from the fact that most of the average American's net worth rests in their home. If you own it, under normal circumstances, you can't readily sell it to raise money.

Liquid net worth, on the other hand, refers to the assets owned that can readily be converted into cash to meet expenses. These are the kinds of assets people normally draw upon to meet their monthly expenses, both anticipated and surprise, in retirement.

In both cases, the basic formula is the same: Net Worth = Assets minus Liabilities

Assets are what you own, and liabilities are what you owe — essentially debt of any and all kinds. Again, your liquid net worth is a more accurate measure of how much you can spend without altering your lifestyle, especially in retirement.

A sound financial plan defines several important data points. These include the date you need to fund a future expense or expenses, how much cash you will need to generate to meet them, and by how much your current resources need to grow each year to meet that principal value. It's from this information that you can generate a series of annual interim goals. These are the scores you'll need to meet or beat to achieve your goals.

To do this annual review properly, you need to determine the current value of your assets. In some cases, such as the value of your savings and investment accounts and cash-value life insurance policies, this is relatively easy to do. In the case of less-liquid assets (and sometimes this can even refer to some assets in your investment accounts), establishing the current market value can be difficult. Things like collectibles, a business you intend to sell, or vacant land fall into this category. To the extent that you are relying on these to meet your long-term goals, it's worth securing professional appraisals every few years and then more frequently as you approach the date you'll need to convert them into cash. ❍❍❍

Saving and Life Planning

We are all unique, so there's no one financial plan that will suit everyone. But that doesn't mean there aren't some broad guidelines to fit common situations.

So when it comes to your savings, here are some benchmarks to indicate whether you're following the right priorities and are on track for meeting your financial goals:

In your twenties. Typically, this is the age when you're likely to have the lowest income in your working life, but also the fewest dependent-related expenses. At this stage, you should have two top priorities: First, you should concentrate on building an emergency fund equal to three to six months of living expenses held in short-term savings vehicles.

Second, you should begin putting money into an individual retirement account (IRA) or 401(k) retirement plan. The advantage of beginning to save for retirement at this age is time: in a tax-deferred account, even relatively small amounts can grow into significant assets when you have 35 to 40 years to harness the power of compounding.

For example, if you contribute just $2,000 a year to an IRA and it grows by 8% a year, after 30 years, it could be nearly $227,000 and more than $518,000 after 40 years. *This example is provided for illustrative purposes only and is not meant to project the performance of an actual investment.*

You may have a third priority: saving for a down payment on a house. It's best if you can accumulate 20% of the price of the house to avoid having to pay private mortgage insurance, but whatever you can accumulate will help keep your mortgage payments lower.

In your thirties and forties. If you have children, it's a good idea to be saving for their educations. Consider a tax-advantaged 529 college savings plan that you can invest in the stock market. The principle here is that if you have more than five years before college bills start coming due, you can afford to take some risk to potentially achieve a higher rate of return than you might from bonds or other safer investments.

Now you should begin to increase contributions to your retirement accounts. The more you can put aside now the better, as you still have 25 to 30 years of compounding. Your emphasis should still be on the stock market; although by your late forties, you might consider increasing your bond investments to guard against losses due to market shocks.

In your fifties. This is normally the time when people make their largest contributions to their retirement accounts because their incomes are close to the highest of their careers; and if they have any children, they're typically out of college and on their own.

Federal limits on annual contributions to retirement plans are more generous at this age, too. For example, as of 2016, below age 50 there's a ceiling of $5,500 for contributions to IRAs and $18,000 to 401(k) plans; but at age 50, those limits increase to $6,500 and $24,000, respectively.

It takes in-depth calculations to determine how much your retirement portfolio should be and whether you're on track to meet the accumulated value of the nest egg you'll need to retire.

That said, it's not unusual for people who are in their fifties to have accumulated only about half of what they'll need by age 65, yet still be on track for a well-funded retirement. (If your account balances are considerably less than half of what you'll need, you might have some catching up to do, or it might be necessary to consider retiring at an older age.)

In your sixties. This is the home stretch of the period during which you acquire assets for retirement. As you enter this decade of your life, you should still be contributing more than you ever have to your retirement accounts.

With less than five years before you retire, you should consider reshaping your portfolio to include greater percentages of lower-risk investments.

It's never too early to create or update your financial plan, so please feel free to call. ❍❍❍

Overcoming 5 Retirement Fears

We've all heard stories about people losing all of their retirement money in a stock market crash, outliving their money, or incurring unexpected medical expenses. Are these fears likely to become realities? Probably not, but here's how to prepare.

1. Outliving your money — There's a rule of thumb to decrease the odds of outliving your money over a 25-year retirement: by the time you're ready to retire, you should have saved eight times your annual salary. Of course, the amount of money you need to have saved by the time you're ready to retire depends on a huge range of very individual factors. So to truly decrease the odds that you'll outlive your money, work with a financial advisor to develop a plan.

2. High inflation — What if inflation went up to 12–14% as it did in the 1970s? It's probably not likely inflation would spike like that again. However, because it has happened before, you'll want to be prepared. This is where an annual review of your investments can be wise. That is the point of diversification: if you are properly diversified, your portfolio should include investments that move opposite of each other — so when one asset class is down, another is up.

3. Unexpected medical expenses before retirement — Unexpected medical expenses that you may incur while you are still working could totally derail your retirement. It's important to have insurance in place, such as disability and life insurance. Disability insurance will ensure that if you do lose your income due to a disability. Life insurance will protect your family in the event of your death.

4. Unexpected medical expenses during retirement — There are a few ways to prepare for medical emergencies: private health insurance to fill the gaps in Medicare, long-term-care insurance, and rainy day savings. For today's retirees, Medicare takes care of most medical expenses, however, you need savings to cover copays and expenses exceeding your insurance limit.

5. Market crash — As with high inflation, the key to surviving a market crash is diversification. (There is no way to insulate yourself completely from the effects of economic turmoil. But you can take steps to ensure it doesn't completely ruin your retirement plans.) As you get closer to retirement, you should be invested less in equities and more in bonds. ❍❍❍

Pat Kummer

Why Do Interest Rates Fluctuate?

The factors that cause interest-rate fluctuations include:

✔ **Economic conditions** — The volume of business activity affects interest rates. In periods of economic growth, businesses require large amounts of debt, which puts pressure on interest rates to rise. As the economy contracts businesses and consumers cut back on their borrowing, and interest rates start to fall.

✔ **Monetary policy** — The Federal Reserve attempts to assist the economy in growing at a stable rate with low inflation. Their actions impact the level of interest rates.

✔ **Expected inflation** — The market interest rate on a risk-free security has two components — the real rate of return plus an inflation premium. Investors' expectations about inflation impact the level of interest rates.

✔ **Federal deficit** — Since the federal government is such a large borrower in our economy, significant changes in the amount being borrowed can impact overall interest rates. ❍❍❍

What's New at Kummer Financial

Happy Spring, and thank you for your continued business and support! We appreciate your referrals, and we always welcome the opportunity to help those you know. Please do not hesitate to let us know of any changes in your world so we can keep your plan current.

Taxes are an important part of your plan, so please send us a copy of your 2016 tax return, which you may provide an electronic copy through the client portal, mail, or drop off a copy to us. If you do not have a secure client portal established through KFS, please contact us for access to www.clientwealthcenter.com. This is a secure place to upload or receive confidential information.

We also have a Client Only section on our website **www.kummerfinancial.com** for information pertaining to our Dynamic Allocations. Please check that out by clicking **Client Center** then **KFS Client Access Only**. Contact us for the passcode.

Please help us welcome Chelsea Lobato, paraplanner, to the team. She will be assisting with client plans and meetings.

Be sure and stay current with our economic updates posted to our website and Facebook. Watch for the Newsflash for current events and the weekly market updates.