Tele(k)

A Short Webinar Series Presented By

SageRutty And Company, Inc.

1) Roth vs. Pre-Tax

a. Pre-Tax contributions avoid paying taxes when you put money into your 401(k). Your money then grows tax deferred. However, you will pay income taxes when you pull the money out in retirement.

b. Roth contributions go into your 401(k) after taxes have already been paid. Your money then grows tax-free and all that growth can be drawn in retirement tax-free.

c. If you are in the same tax bracket both now and in retirement, you end up paying the same amount in taxes and net the same amount of money.

d. If you are in a higher tax bracket now and expect to be in a lower tax bracket in retirement (i.e. have a lower income) pre-tax is the better option. It allows you to avoid paying taxes when your tax rate is higher now and pay them later when your tax rate is lower, saving you money.

e. If you are in a lower tax bracket now but expect to be in a higher tax bracket in retirement the Roth is typically the better choice. We find the Roth to be especially beneficial for people who are younger or are just entering the workforce, who may have a low income now but will have a higher income down the road.

f. It's important to keep in mind some things that might affect your tax rate in retirement.

   i. Social Security is taxable; however, it is taxed more favorably than ordinary income.

   ii. After age 65 the standard deduction increases by $1,300 per person, helping to reduce the amount of your money that is taxable.

   iii. New York State does not tax the first $20,000 per person from your retirement account each year as well as not taxing Social Security.

   iv. Not all states have the same income tax rates. If you plan on retiring in a state with no income tax it may change the decision whether a Roth or pre-tax deferral is more beneficial for you.

   v. Tax rates will change in the future. Make sure you are adapting your strategy for these changes.

2) Sequence of Returns Risk

a. What order in which the stock market experiences positive and negative returns might not matter for someone who is further away from retirement, but it can be critical for someone in retirement.

b. For example, Adam and Zack each started out with $1,000,000 and invested it for 10 years. Adam's account did poorly in the early years but had some good years at the end to earn an average rate of return of 5.1%. Zack's account on the other hand started off great but the last few years did had negative returns. He ended up with a 5.1% average rate of return as well. If neither Adam nor Zack touched their money during this time, they would both have $1,525,347. In this situation it did not matter what years the good and bad returns were because they did not touch the money at all.

c. Looking at an example in retirement, Adam and Zack begin with the same $1,000,000 and are withdrawing the same $50,000 each year. Again, Adam has bad returns first and good returns later, while Zack had good returns at the beginning and bad returns later on. This changes their situation completely. Zack's account continues to grow even though he is withdrawing money. Adam is withdrawing funds while his account is already lower from poor performance. Over the course of retirement even if they have the same average rate of return this would lead to Adam having significantly less money than Zack at the end of the 10 years by a factor of $444,000.

3) Actionable Steps

a. Put together a tax projection. How much will you make for the year and what tax bracket do you fall into? How does that change your strategies on where money is saved?

b. Consider whether Roth or pre-tax contributions will be better for you over your lifetime and not just right now. Do you see tax rates changing? Do you intend to retire in the same state you live in now?

c. Make sure you are adjusting your investments as you approach retirement. The strategy that got you to the point of being able to retire and the strategy you will use throughout retirement should be different.