The Thoughtful Investor

Second Quarter 2020

Time to Rethink Your Retirement Plan Strategy

December 20, 2019, the passage of the SECURE Act - **Setting Every Community Up for Retirement Enhancement Act** set in motion the most substantial rule changes for retirement accounts in 13 years. Designed to expand retirement plan access and increase lifetime income options in retirement plans, the SECURE Act also changed required distribution rules for retirement plans. These changes will dramatically impact estate plans for individuals with substantial IRA balances who were looking forward to providing children and grandchildren with funds for their future retirement.

Any retirement accounts inherited prior to January 1, 2020, are grandfathered under the pre-SECURE Act rules. The changes discussed below only impact accounts inherited AFTER December 31, 2019.

The following is a brief summary of some key changes that will impact retirement account holders.

Benefits for Retirement Account Holders

The age at which account holders are required to begin making required minimum distributions (RMDS) increases to 72 for those who had not reached the RMD age of 70½ prior to December 31, 2019. This also applies to required minimum distributions to spouses, who inherit an IRA where the deceased owner was under 70½ on December 31. As with the old rules, account owners must take their first RMD by April 1 of the year following the year in which they turn 72.

Accountholders who continue working and have earned income can continue to make contributions to their retirement accounts regardless of how long they live. Before, one was not able to make contributions after age 70½ with the exception of Roth IRAs.

The SECURE Act allows retirement accountholders to withdraw up to $5,000 from tax-deferred retirement accounts following the birth or

continued on page 2

The Reality of Stock Market Declines

1. No one can predict consistently when market declines will happen.
2. No one can predict how long a decline will last.
3. No one can consistently predict the exact right time to get in or out of the market.
4. Not having a plan to minimize the impact of market downturns guarantees your funds are vulnerable to loss.

At the most basic level, stock market prices are a function of supply and demand. Too much supply or too little demand and prices decline. Too much demand and not enough stock to satisfy that demand will push prices up.

But then it gets messy, because the factors that influence demand can defy logic. And markets can remain

continued on page 4

Have You Set Account Alerts?

Financial fraud is alive and doing quite well in our increasingly digital society. It seems as soon as we anticipate one problem, a new scam springs up. While you may not be able to keep up with all the ways your accounts are threatened, you can make certain you are alerted early to any problems in your accounts. Every financial institution has their own approach to security alerts so you will need to set up each according to their procedures.

At a minimum, use two-factor authentication to log into financial accounts and credit cards. A code will be sent to your personal phone to authenticate that you are the one accessing the account.

Brokerage and Retirement Accounts

- Set up your cell phone to received text account alerts.
- If appropriate - place your accounts into secure lockdown mode, blocking the ability to electronically move money out of your accounts.

Banking and Savings Accounts

Set alerts to notify you of:

- Withdrawals over a specified amount
- Notice of upcoming automatic or scheduled payments
- Deposits
- New linked accounts
- Low balance alerts
- Unusual activity

Credit Cards Alerts

- Transactions over a specified amount
- Transactions without a card
- International transactions
- High balances
- Approaching payment dates
- And other red flag events

adoption of a child without paying the 10% early-withdrawal penalty. Income tax is still owed on the distribution. Married couples can each take a $5,000 withdrawal from his or her own account, penalty free.

Inherited Retirement Accounts Must Be Distributed in 10 Years

Up until December 20, individuals could count on the ability to "stretch" the value of their retirement assets out over future generations. Withdrawals from an account left to a child or grandchild could be distributed over the expected lifetime of the individual. With the exception of four specific categories, retirement accounts inherited after December 31, 2019 **must be distributed within 10 years**.

Exceptions to the 10-year Rule:

1. A surviving spouse
2. A beneficiary under the age of majority
3. A chronically ill or disabled beneficiary
4. A beneficiary no more than 10 years younger that the decedent

As under current law, surviving spouses can defer distributions until their deceased spouse would have reach the age of minimum required distributions. Once a minor beneficiary reaches the age of majority as defined by her or her state of residency, the 10-year rule takes effect.

Because 401K and IRA withdrawals (with the exception of Roth accounts) are taxed at the individual's personal tax rate, distributions from an inherited account could occur during the individual's highest earning years and push their tax rate into a higher bracket. For minors, a substantial inheritance could become available when they are least prepared to manage a sudden influx of money.

The Trust Trap

To counter having a young beneficiary receive access to considerable money when they may have minimal experience handling money, some estate plans set up trusts as the beneficiary. Under the new rules this can backfire. The income tax brackets for trusts and estates are narrower than those of individuals. In 2020, the top 37% tax rate for trusts and estates begins at $12,950. Because the trust would have to recognize as income all of the inherited IRA within 10 years, much of the inheritance could be lost to taxes before the individual reaches his or her majority.

In the view of the SECURE Act authors, retirement accounts were designed to help individual savers, not future generations. Plus, shortening the period of time in which inherited assets must be distributed increases taxes over the short-term, providing financing for the act's other features.

Education Savings Account Changes

The use of 529 education savings accounts was expanded to cover costs associated with registered apprenticeships; homeschooling; up to $10,000 of qualified student loan repayments (including those for siblings); and private elementary, secondary, or religious schools. State tax treatment of withdrawals varies for private elementary, secondary or religious schools and withdrawals may be subject to specific state taxes.

Government Employees Have a Two-Year Window to Comply

403(b) and 457 plans for government workers and the Thrift Savings Plan for federal employees are subject to the same changes, however, these account holders have two extra years in which to comply with the new law's Stretch IRA elimination.

Rethinking Your Estate Plans

If you fully anticipate spending all of your retirement account funds before you die, these changes may have little, if any impact. If you have accumulated substantial tax-deferred retirement plan assets that you had expected to include in your estate, it may be beneficial to sit down with your financial advisor and rethink your estate plans.

1. Do you need to change your retirement plan beneficiaries?
2. If passing retirement account assets on to future generations is no longer as desirable, should you adjust the amount you currently contribute to IRA and 401k plans?
3. Is it more beneficial to spend down retirement plan assets on living expenses and charitable contributions and leave taxable accounts to your heirs, where value will be stepped up to current market value at your death?
4. Should you delay beginning distributions from your retirement accounts until age 72 or continue adding contributions after age 72?
5. If your goal is to provide heirs with long-term income, should your estate feature more investments based on cash flow?
6. If you inherit a retirement account after January 1, 2020, what is the best way to allocate your distributions to minimize taxes and maximize the amount you receive? Unlike under earlier law, you are not required to begin distribution upon inheriting the account or within five years. Distributions can be made in years when taxable income will at its lowest (i.e. offsetting a loss) as long as the account is emptied within 10 years of inheriting.

There are a number of additional SECURE Act changes to retirement plans, most aimed at increasing access to retirement account investing on both individual and employer levels… but these need to be the subject of another article.

The preceding information is intended as a limited overview of the "Division O: Setting Every Community Up For Retirement Enhancement" of the "Further Consolidated Appropriations Act, 2020." It is not intended as investment or tax advice. Consult with your tax advisor and/or financial consultant before making any changes in your estate plan or retirement accounts.

Your Brain – Better with Age!

"Of all the self-fulfilling prophecies in our culture the assumption that aging means decline and poor health is probably the deadliest." ~ Marilyn Ferguson

Everything you have been told about how your brain changes as you grow older may be wrong. As more people reach their senior years, researchers have started asking why many people remain highly functional into their late 90s, and the answers they are finding are changing our ideas of aging.

Most studies of how the brain changes look at the early years, from 1 to 25. By age 40, it is assumed that your brain is mature and there won't be much in the way of changes, barring disease or strokes, until you begin losing brain cells and cognitive abilities with age.

Far from declining, it turns out that the brain is far more resilient, adaptable and capable than previously thought. Older brains have had more time to learn more than younger brains. They hold a much larger vocabulary and collection of memories and experiences, know the names of far more people (which may be one reason why we occasionally misfile a name or two), and are physically different from younger minds.

As we learn and create memories, we develop connections between the neurons in our brain that trigger identification and response to different stimuli. The more memories, the denser the networks of neurons and the more intricate the connections within the brain become. While we do lose brain cells as we age, older minds are proving capable for growing new brain cells, storing new memories and continuing to evolve.

Among the interesting changes taking place is that older brains increasingly use both left and right sides of the brain to make decisions and perform tasks. That's a huge change from our younger minds where either the right or left side of the brain dominates responses to outside

information. Older minds literally think differently. Researchers believe this change may contribute to being able to see from someone else's point of view, anticipating change, considering multiple possible results, acknowledging uncertainty, and searching for compromise. Older brains also appear to react less to negative information and remember positive experiences better than negative ones.

Over time, areas of our brains that we use more frequently continually grow and rewire themselves for greater efficiency. Musicians have significantly increased functioning in the areas of the brain that respond to hearing and discrimination of tone and pitch and are noticeably enlarged in those areas. By challenging our brains, we seem to be able to influence neuron connections, stimulate their growth and make new cellular material for thinking.

Some brains clearly go bad. Diseases such as Parkinson's disease and Alzheimers, as well as strokes are clear culprits. But poor physical health and a lack of ongoing stimuli also impact mental health.

Exercise and challenging our minds through games and puzzles as well as new interests and social involvement appear to have the most influence on how well we think, recall past memories and are open to new experiences as we grow older.

Psychologist and aging specialist Gene D. Cohen, M.D., Ph.D., put forward an interesting theory that many people attribute aging and mental decline to what are natural stages of the maturing mind. Just as children and adolescents go through developmental stages, so do older individuals, he explains. Understanding these changes and exploiting them is not only good for our minds, but results in happier lives.

Phase 1 – *Mid-life reevaluation* typically occurs in one's early 40s to late 50s. Lost your interest in your job? Finding it hard to get enthusiastic about old interests? Dissatisfied with your life? Welcome to phase 1.

Phase 2 – This is the *"if not now, when?"* phase, where experimentation and innovation take priority. This phase usually occurs in one's late 50s to early 70s and can be characterized by a sense of freedom to speak one's mind, and a desire for novelty.

Phase 3 – *Summing up.* Late 60s through the 80s is often a time of looking for meaning in life, a desire to share wisdom, and increased capacity for autobiographical expression. It may also be a time of resolving unfinished business or unresolved conflicts.

Phase 4 – *Encore!* A time of reflection and celebration and the desire to live well to the very end.

The four phases can be very disturbing to people who have lived their lives up to that point with the expectation that they will always have the same goals, the same work ethic, and the same interests. Instead of viewing the change as natural evolution, it is viewed as signs of decreased mental vitality. By losing your interest and your ability to focus, you must be losing your mind. Understanding that your mind itself is changing can be transformational.

For a new, positive outlook on aging, take some time to read Dr. Cohen's book, The Mature Mind: The Positive Power of the Aging Brain. It may be just what your mind needs!

The Thoughtful Investor

The Reality of Stock Market Declines—*continued*

illogical on both the up and downside far longer than may make sense.

In a purely logical market, **FUNDAMENTAL factors** determine price. Fundamental factors are typically measurable, such as consumer purchasing power, earnings per share, cash flow ratios, PE ratios, debt to equity, product demand, book value and many more, both straightforward and esoteric measures of value.

TECHNICAL factors attempt to anticipate price changes based on historical patterns, human behavior and the tendency of trends to persist over different time periods. This may include moving averages, chart patterns, momentum, relative strength, incidental transactions such as the buying or selling behavior of "smart money," behavioral factors of traders and investors, and more.

EMOTIONAL factors, such as market sentiment, are the most difficult to anticipate or predict, both in their timing, intensity and duration. Sentiment has been described as obstinate, biased and subjective. And it has the capacity to overrule logical decisions.

It would be nice to think that when investing on a long-term basis, fundamental factors are all that matter. Is the market or company growing and creating value? For the most part, this can work, but there's still that pesky reality of market sentiment. Technical factors work, until they don't. Patterns that have repeated in the past can run up against an emotional headwind and fail.

But the biggest threat to the market is the threat no one is expecting – the Black Swan. Black swans are those rare and unpredictable outlier events that have an extreme impact on financial markets, according to author and former options trader Nassim Nicholas Taleb in The Black Swan: The Impact of the Highly Improbable. Taleb coined the term Black Swan based on the European belief that black swans did not exist, until they were discovered to be quite common in southeast and southwest regions of Australia.

Financial markets are inevitably susceptible to the unexpected and the emotional response of investors to outlier events. Past performance may provide clues to the future based on past human behavior, but it cannot predict the future. Tomorrow is always unknown territory.

As investors, how can we make our peace with that uncertainty? One response may be to avoid financial markets altogether. But cash has its own risks, mainly the risk that you run out of money because your funds are not keeping up with the impact of inflation and taxes. Diversifying your sources of income can help, but in a severe market downturn most asset classes become correlated and head the same direction. Which brings us back to active management.

Active management is the willingness to move to a defensive position when asset classes or the market begins to lose value, and back to a more aggressive investment stance when the market is trending up. To work, active management must be a very carefully designed, systematic approach that removes emotion from the decision as much as possible and accepts that not every buy or sell will be profitable.

The unpredictable, emotional nature of the financial markets assures there will never be the one right way to invest. But over time, minimizing the impact of market declines has the potential to reduce portfolio negative volatility, lower the risk of investing and produce competitive returns. We can't guarantee our investment approach will succeed, but it gives us the parameters to work with the uncertainty of investing over the long run. And time is often the most important element of investment success.

Past performance does not guarantee future success. Inherent in any investment or investment approach is the potential for loss as well as profit. There can be no assurance that active management or any other investment approach will prove successful.