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In this Issue:

2018 Yearend Tax Planning

Setting an Appropriate Retirement Spending Guideline

Health Insurance Coverage for Pre-Retirees

Implications of Longevity on Wealth Management

2018 Yearend Tax Planning

It's that time of year again – the end of the year where individuals start to think about yearend tax planning. However, 2018 is different from past years. This is the first full year operating under the new Tax Cut and Jobs Act rules. The theme behind the new law is fewer deductions, but lower tax rates. Following is a short list of yearend tax planning actions that still may help you lower your 2018 tax bill:

- Consider selling securities, mutual funds or exchange traded funds on or before December 31 to harvest any unrealized capital losses that may be used to offset any 2018 realized gains or long term capital gain distributions. Be careful to avoid wash sale rules if you wish to reacquire the harvested security within 30 days.
- For charitably-oriented retirees who are taking retirement plan minimum distributions from their IRA, prior law rules remain intact. You may still transfer up to $100,000 per year from your IRA directly to a qualified charity (called a Qualified Charitable Distribution). This counts toward your RMD requirement and reduces the taxable amount of your IRA distribution.
- Beginning in 2018, most itemized deductions are replaced with a higher standard deduction, as high as $24,000 per married couple. Actual allowable itemized deductions are deductible only to the extent they exceed the standard deduction. Consider bunching deductions every other year to maximize the impact of actual itemized deduction expenses in excess of the standard deduction.
- Consider donating a security with a large unrealized gain to charity instead of cash to meet your charitable pledge obligation. You'll get a charitable deduction (subject to the new standard deduction rule men-

tioned above) for the fair market value of the security, and the unrealized gain in the donated security is not taxed to you.

- As in prior years, compensation income is taxed at the highest rates. Continue to maximize tax deductible contributions to retirement plans.

Perspective

Strength

Setting an Appropriate Retirement Spending Guideline

What is "retirement"? Some refer to it as a stage of life while others look at it as the attainment of a certain age. A common denominator, regardless of what retirement means to you, is that it is a point in one's life where financial independence has been reached. Simply stated, financial independence is achieved when you have enough money saved that you no longer need to earn income from personal services to pay your bills. Some fortunate individuals may be born into wealth and thus are technically financially independent from birth. Others have to work, perhaps for their entire lives, in order to earn and save enough to reach this status.

The personal finance writer Michael Kitces recently published an interesting article from his blog that challenges the concept of recommended savings rates for retirement. The premise of the article is that a focus on spending rates will have a much more impactful benefit on retirement than searching for a magic savings rate.

Common savings rate rules of thumb range from recommended annual savings rates, to age based guidelines to targeted retirement income replacement rates. However, each of these savings tools relies on a presumption that the household has flexible discretionary dollars available to save in the first place. The sad reality is that most households struggle to save because there is no money left at the end of the month to save in the first place. Their problem isn't a savings rate that's too low; it's a spending rate that's too high, in one or more categories, that is causing all of the available household income to be consumed before the end of the month is even reached. This isn't a phenomenon reserved only for low income families. Spending all of one's income frequently happens at all income levels.

The key point though is that it's not really the "savings rate" that defines a successful savings path to retirement. It's actually the spending rate – and having a spending rate that is less than 100% of household income – because functionally most people don't "choose" what to save per se. They choose what to spend, and then save the limited dollars that may or may not be left over after covering their fixed/essential expenses and any discretionary spending they choose to engage in.

The takeaway is that you can't actually choose or control your savings rate because there may not be any money left to save in the first place. But you can choose and control your spending rate and create the dollars left over that are available to save.

One of the reasons why it's important and useful to consider a spending rate as opposed to a savings rate is that it puts both spending and income into the proper context. The essence of the spending rate is that the household is healthier when the spending rate is lower. Which, as with any fraction, means you are either decreasing the numerator (spend less) or increasing the denominator (save more). In other words, you can improve your spending rate and therefore have more money available to save by either spending less, or by spending the same but earning more.

This distinction is important because for households where the fixed spending rate is relatively high (e.g., lower-income households or those in higher-cost-of-living areas), trying to focus on cost-cutting savings isn't likely to have much impact because there's not a large enough percentage of the budget that is discretionary and flexible to really matter. Instead, trying

to earn more – whether by getting or retraining for a new job or industry, putting in extra hours for a promotion, or starting a side-business can have far more immediate and positive impact on the spending rate.

Health Insurance Coverage for Pre-Retirees

The AARP Public Policy Institute estimated there were more than 63 million U.S. adults in their 50s and early 60s—approximately 20 percent of the population in 2015. The rising cost of health care has made access to adequate, affordable health care coverage problematic for many in this age group. Without sufficient coverage and treatment, they face the prospect of declining health and insufficient care, consequences that will follow many of them into Medicare.

Fidelity Investments estimates that the average married couple will need $280,000 in today's after-tax dollars for medical expenses in retirement. And this excludes any costs for long-term care. Thus, health care is expected to be one of a retiree's largest expenses in retirement, after housing and transportation costs. Gone are the days of employer or union-sponsored retiree health benefits, so heath care costs will likely consume a larger portion of your retirement budget, and you need to plan for that.

But the reality is that health care costs in retirement aren't needed as a "lump sum" on the first day of retirement, and the Medicare system actually makes health care costs a remarkably stable annual cost that can be planned for. In fact, looking at health care expense in retirement as a lump sum masks a number of more direct and substantive planning issues, from the fact that unhealthy retirees may face fewer years of costs but much higher annual costs, due to the challenges and additional costs of navigating health insurance as an early retiree via state health insurance exchanges.

Accordingly, a recent joint study by Vanguard and Mercer Health and Benefits analyzed the typical and potentially unexpected costs of health care in retirement, and showed that the ominous lump sum cost of retiree health care is actually little more than spending a few hundred dollars per month, per person for the better part of 2-3 decades in retirement.

As your retirement nears, you will have several big decisions to make, including when to stop working, when to claim your Social Security retirement income benefit, how you choose to pay for health care, and how to generate cash flow from your retirement assets. These decisions are interconnected and could make a difference in your living costs and lifestyle in retirement, and when you can retire. Many early retirees claim their Social Security retirement benefit at age 62 in order to help pay for health care expenses until they are eligible for Medicare coverage at age 65. Age 62 is the earliest age one can claim Social Security. However, if you can wait until your normal retirement age (age 65 – 67, depending on your birth year), your monthly benefit increases. Your retirement benefit increases by 8% per year for every year you postpone claiming social security until age 70 where the maximum benefit you are entitled to is reached.

As you plan for health care expenses through retirement, understand how paying for future health care expenses fits into your overall retirement income planning efforts because health care utilization tends to increase as we age. According to the Kaiser Family Foundation, the percentage of household budgets spent on health expenses is nearly 3 times as much for retirees on Medicare as for working households (14% vs. 5%).

Implications of Longevity on Wealth Management

Life expectancy for Americans today is increasing, and is longer than any other period in history. The systems and structures that support our lives will have to change. The planning and building of the infrastructure of our cities, workforce demographics, healthcare system, and educational institutions will all need to be redesigned. Moreover, our expectations for retirement lifestyle and our social contract will also need to be redefined.

Families with wealth will be hit with higher costs resulting from a higher spending rate for lifestyle and healthcare. Disability costs during one's lifetime will also become much more significant. Another likely byproduct will be higher taxes in order to fund the overall cost of longevity on the general population.

More living generations are sharing in the family wealth than ever before. Conventional wealth planning may not sustain the stress of multigenerational issues, and families will need to revisit and adapt their planning. While the traditional family wealth model was focused on preserving wealth for future generations, an updated model will need to address putting money to work in the wealth owner's lifetime.

Here are some ideas to consider as you think about the impact of longevity on your family:

- **Develop a longevity strategy.** Identify the risks to the family wealth, and the choices that will need to be made now and toward the end of life. For example, should the purchase of long term care and life insurance become a more common component of wealth planning?
- **Communicate wishes.** Aging and death and the issues associated with them, such as end-of-life care and funeral plans, are generally not the subject of standard dinner conversations. Discussion needs to take place, particularly while family members are healthy, to express each family member's wishes on these matters.
- **Stress test your planning.** Modern retirement capital sufficiency projections typically assess the adequacy of wealth through current actuarial projections of life expectancy, typically through your mid to late 80's. Stress test your model for a 100-plus year life expectancy. Instead of accumulating that retirement nest egg and then living off of it until you die, families will need to be continually evaluating ways to generate new cycles of wealth creation.
- **Family governance.** Older generations may need some coaching to find a future role and accept that they must relinquish control to the next generation. Younger generations need the education and training to be able to step into the role.

Contributing to this issue:

R. Craig Brubaker

2727 N Harwood, Suite 225

Dallas, TX 75201

214-855-2550

www.view-cap.com

View Capital Advisors, LLC was founded in 2004 by its principals with the mission of providing sophisticated investment asset management and financial and estate planning to our U.S. and Non-U.S. clients.

We seek to bring wealth planning best practices and a wide range of non-proprietary solutions to our clients. We also conduct our own research and diligence on world markets and investment alternatives.

For further information, please contact your investment representative or one of our wealth planning specialists:

R. Craig Brubaker 214-855-2556
cbrubaker@view-cap.com

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