Get Ready for 7 Serious Life Transitions Ahead

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Most baby boomers will face seven key events in their last stage of life that will color their finances and investments. Prepare for these events by thinking about them now.

It can be dangerous to generalize about the baby boom generation, but there are seven key events that nearly everyone will face as they move through the last third of their lives. Unlike earlier, happier events such as getting married, having children, and moving up the career ladder, some of these events may be anticipated with dread. For this reason many boomers may put off facing them. But lack of preparation can make a bad situation even worse.

Warning: the terminology used here is rather blunt.

1. Your parents will get old

If your parents are still living active lives, you will have to face the fact that your parents will eventually get old. You should start thinking about this now and begin gathering resources so you won't be at a complete loss when your parents can no longer function independently. There is nothing worse than to discover that a parent has lost the ability to pay bills, make nutritious meals, or seek proper medical care when a little attention and advance planning can allow you to step in before your parents harm themselves. Here are some of the things you should begin discussing with your parents:

Health status. As parents age and the possibility of medical complications increases, make yourself aware of your parents' health status.

Long-term care. Every family needs to consider the possibility that the parents may someday become unable to function independently. What type of care would your parents want? What plans have they made to pay for it?

Power of attorney. By signing a durable power of attorney for health care and a durable power of attorney for finances, your parents can appoint you or another family member to step in and make decisions and execute financial transactions should they become unable to do so.

Estate planning. Do your parents have a will? Does an existing will need to be updated for new grandchildren or other family members?

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2. Your parents will die

Sorry to be so blunt about it, but this is the natural order of things. You will face both emotional and financial issues when your parents die. Go to A Healing Place (www.ahealingplace.org) for insights and resources that can help with the emotional issues. As far as financial matters go, this is what you will face:

The estate must be settled. If you've never experienced a death in the immediate family, you may not realize that there are many steps involved in settling an estate. Knowing about these ahead of time will help prepare you for your responsibilities.

Inherited assets must be managed. Financial institutions across the nation are just waiting to swoop down on boomers who will be receiving some trillions in inherited wealth. Find an advisor now that you can trust so that if and when you come into these assets, you'll have a ready source of guidance.

3. You will fight to stay healthy

Boomers are starting to come to terms with aging, but serious illness is still largely unexplored territory for most of them. More and more, boomers will be paying attention to their health, either working hard to stay healthy or managing chronic illnesses. Here is a glimpse of what's ahead:

Navigating the health care system. Boomers who have been healthy all their lives will be in for a shock if they encounter insurance deductibles, co-pays, and denied claims resulting from inadequate insurance and lack of preparation for expenses they thought would be fully covered.

High out-of-pocket costs. Even with private health insurance and/or Medicare, many boomers will find themselves paying out-of-pocket health care expenses. These may include premiums for Medicare Part B (outpatient care) and Part D (prescription drugs) as well as the costs of alternative treatments and other private-pay services for boomers who want the very best in health care.

4. You will reach retirement age

Whether or not you ever plan to retire in the traditional sense of the word — and many studies have shown that you won't — the vast majority of boomers will reach traditional retirement age. This is the age at which you may take advantage of certain tax benefits and entitlement programs developed under the traditional retirement system. Boomers who aren't thinking about retirement as such will still want to take advantage of them.

Social Security. Full retirement age is the age at which full Social Security benefits may begin. For baby boomers born between 1943 and 1954, full retirement age is 66. You can apply for Social Security anytime between age 62 and 70. Get some help deciding when is the best time to file.

Medicare. To avoid a 10% penalty on Part B premiums, you'll need to apply for Medicare at age 65 unless you are covered by a health plan at work. Go to www.medicare.gov for more information on Medicare.

Tax issues. The IRS calls people age 65 and older "the elderly." Boomers are not likely to identify with this term, but if you can admit to turning 65, you can claim an extra standard deduction for the elderly and/or blind. See IRS Publication 554, "Tax Guide for Seniors," for more tax issues that will come up as you age.

5. You will need to manage multiple sources of income

Even boomers who say they'll "never retire" will likely have multiple sources of income that will need to be managed. These may include the following:

Self-employment income. Boomers who leave their primary careers to do consulting or freelance work will need to ensure that this new form of income is adequate to meet their needs and that they make estimated tax payments as necessary. They will also need to consider how their earnings will affect their Social Security benefits.

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IRA distributions. Whether you start these early under a program of substantially equal periodic payments or wait until you are forced to take required minimum distributions at 70½, you will need advice and counsel on how to plan out your IRA withdrawals over your remaining life.

Investment income. If you are used to receiving regular paychecks from an employer, you'll need to shift your mind-set toward paying yourself. That means carefully managing all investment accounts to ensure sufficient inflation-adjusted lifetime income.

6. You will get old

Boomers can barely imagine it now, but like their parents, boomers themselves will get old someday. And they — and their children — will face the same issues you faced when your parents were getting old. What types of assisted living arrangements will you want to consider? How will you pay for it? What can you do now to make this phase of life more comfortable?

Another term that is commonly used under traditional retirement and entitlement systems that boomers tend not to relate to is "disability." Definitions vary depending on the program, but any boomer with a chronic illness or condition may qualify for various private or public disability benefits.

7. You will die

Again, sorry to be so blunt, but you know it's going to happen. Boomers seem to be somewhat more open to contemplating their own deaths than their parents' generation, perhaps because they still see it as a long way off.

Life expectancy. Go to the Living to 100 website (https://www.livingto100.com), and take a test to estimate how old you will live to be, along with list of things you can do differently to increase that age.

Legacy planning. As they review their lives, boomers are starting to consider legacy planning and ethical wills. This life-centered approach to death can lead to some of the estate-planning tasks you should be executing now, including advance directives and wills. It's a good idea to review your estate plan or specific tax situation with your estate attorney.

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Retirement Income: Which Accounts to Tap First

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Many people assume that when retirement rolls around, they should draw cash from their taxable accounts first. Generally, this is a good idea; but not always.

A basic tenet of tax planning is to put off paying taxes for as long as possible. By investing money rather than turning it over immediately to Uncle Sam, you can earn returns that are yours to keep; tax deferral becomes like a loan that actually pays interest to the borrower. This is why IRA rollovers are such a great idea—you can keep deferring the taxes on your retirement distributions and put that money to work in investments, rather than losing a chunk to current taxes.

For many people, in fact, the idea of tax deferral is so appealing that, when the time comes to start taking retirement income, they draw from taxable accounts first to keep tax-deferred accounts growing for as long as possible. But while this strategy may be appropriate for some, it's by no means a rule of thumb.

When deciding which retirement accounts you should tap first, you'll need to consider not just the character of the account itself— taxable, taxdeferred, or tax-free—but also the particular investments within each account. These investments, in turn, relate to your risk tolerance, time horizon, and income needs.

Cash bucket

The first order of business is to create a cash bucket that contains anywhere from two to five years of living expenses in safe, liquid investments such as money market funds, Treasury bills, shortterm bonds, or CDs. If you know where your next few years of mortgage payments and groceries are coming from, you are far better equipped to tolerate the volatility that can go along with a diversified portfolio.

Make sure you set aside whatever size cushion you think you need before laying the foundation for your retirement portfolio. With each passing year, you'll need to replenish that bucket. At that time, you'll need to decide which securities to liquidate and which accounts to draw from.

The downside of tax deferral

The downside of tax deferral as it relates to IRAs, unfortunately, is that it can't go on forever. You must start taking required minimum distributions at age 70-1/2 and the larger the account, the larger the distributions—and the tax—will be. Prior to age 70-1/2, you can calibrate your withdrawals to strike an optimal balance between having enough income live on and not

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paying an excessive amount of tax. After age 70-1/2, you may no longer have this control. If the account is very large, the required distribution could throw you into a higher tax bracket, forcing you to pay more tax than if you'd drawn down the account earlier and paid some of the tax sooner but at a lower rate.

For example, let's say you receive a lump sum distribution of $800,000 at age 62 and roll it into an IRA. Over the next eight years, the account grows at a compound annual rate of 8% to $1.5 million. When you turn 70-1/2, your first required distribution will be $88,235. (We're assuming you are single for simplicity's sake.) This jump in income could force you into the 24% tax bracket, requiring you to pay more tax than if you'd started siphoning money out of the IRA earlier. If, between the ages of 62 and 70, you had taken voluntary distributions in an amount that just topped out the 12% tax bracket—say around $30,000 per year—you might pay less total tax than if you'd let the money ride. It's a question of paying tax at the 12% rate now, or at the 24% rate later. By siphoning off money this way, you would have about $1.25 million at age 70-1/2 and your first required distribution would be closer to $65,000 than $88,000.

Investments matter

It is possible, of course, to achieve tax deferral in a taxable account. One way is to buy growth stocks and hold them. So if your risk tolerance can handle it, you could conceivably turn the taxable account into the tax-deferral vehicle and draw income from the IRA. If you have plenty of assets and won't need to sell the growth stocks during your lifetime, your heirs will be happy, since they will receive a step-up in basis and owe no capital gains tax on the appreciation earned during your lifetime.

If you are sitting on big gains in stocks you don't want to sell, this could be a powerful reason to take income from the IRA. Beneficiaries must pay income tax on inherited IRA assets, and if your children are successful in their own right, they may end up paying federal tax at the top rate. If your portfolio of stocks stands to be a more valuable legacy than a fat IRA, you may want to draw from the IRA and pay taxes at the (presumably) lower tax bracket while saving low-basis stocks for last.

But let's say you are very risk-averse and you want mostly income-oriented investments, such as bonds and high-dividend-paying stocks. If you are already earning taxable income in the taxable account, you might as well use that for your retirement income in order to reduce or postpone taking taxable distributions from the IRA (as long as you are under 70-1/2 and have the choice, of course).

For example, let's say that, in addition to an $800,000 IRA, you also have $800,000 in a taxable account, all invested in securities yielding about 6%, or $48,000 per year. Even if that income is reinvested, you will pay tax on it, so you might as well use it for your spending needs while letting the IRA assets ride. When investing for income in the taxable account, you will have to determine whether the income should be taxable or tax-free depending on your tax bracket and investment objectives.

Save Roth for last

The argument in favor of siphoning money out of an IRA account early doesn't apply to the Roth IRA because of one very important feature: no required minimum distributions at age 70-1/2. Since you never have to pay the piper on Roth money, you'll definitely want to let it ride as long as possible, even into the next generation.

One of the most important areas of retirement counseling is deciding if you can or should convert to a Roth IRA. Once a Roth IRA has been established, the only real reason to take money out is if you need the income and have no other resources.You may also want to consult with a financial professional to assess all your options.the three-year window closes.

Watch for legal and regulatory changes

Of course, you may have to make course corrections as new rules and legislation take effect. The main consideration, of course, is your individual situation.

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There's no magic formula for planning retirement income. You must take into account your income needs, tax situation, risk tolerance, life expectancy, and estate planning needs, and continue to work throughout retirement to ensure all your needs are met.

(Note: the scenarios presented here are hypothetical and the rates of return used are not indicative of any actual investment, which will fluctuate and may lose value.)

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The Most Important Question in Retirement Planning

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By Erin Tamberella and Rick Wright

It's a touchy subject, but a life expectancy analysis is the best way to ensure you will have enough money to live your later years in comfort and ease.

What do people fear the most in retirement? Outliving their income. And what variable has the largest impact on whether or not they will outlive their income? Life expectancy. Your ability to successfully plan for retirement is largely dependent on how well you can estimate your life span.

Longevity is the new buzzword in retirement planning, and rightfully so. It wasn't that long ago when most people retired at 65 and maybe lived another five to 10 years if they were lucky. Those days are over, which makes current retirement planning a much more challenging endeavor. People are living much longer, and their retirement nest eggs must live much longer as well. Not only are life spans increasing, but statistics tell us that the longer people live, the longer they *will* live.

Longevity estimates

According the Social Security Administration, a man who reaches the age of 65 today is estimated to live until he is 84 years old. A woman turning 65 today is expected to live, on average, until she is 87 years of age. In addition to that, 25% of all 65-year-olds will live past 90 and 10% will live beyond 95. This dramatic increase in life spans is also expected to continue well into the future.

Longevity planning is becoming a larger and larger component of successful retirement planning. In order to ensure you do not outlive your income, maintain a comfortable lifestyle, and have choices in retirement, you must be as accurate as possible in estimating your life expectancy.

Unfortunately, estimating longevity is not even close to an exact science. The traditional approach for most advisors is to rely on actuarial tables for a best estimate. However, with life expectancies increasing practically every year, the mortality tables may no longer be enough.

Overestimating life expectancy is almost as bad as underestimating it. You may think a safe response to the whole longevity question would be to simply assume death at the age of 105. While the former could result in you outliving your income, overestimating can affect your quality of life during retirement by being forced to spend less than you could.

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Individual life expectancy analysis

To increase the probability of success in estimating your life span, consider working with your advisor to develop an individualized life expectancy analysis. Everything you do in planning for your retirement revolves around this number. Therefore, it is critical to the success of your retirement plan that you are able to estimate your life span as accurately as possible. Only then can you begin to develop a plan that will adequately provide for that life span.

Areas you'll want to consider when doing individualized life expectancy analysis are: medical history, family history, and lifestyle habits. The following are some questions you might want to think about.

Medical and family history

- Have you ever had a heart attack or been diagnosed with any kind of heart disease?
- Are you or have you ever been on cholesterol medication?
- Have you ever been diagnosed with high blood pressure?
- If so, are you on medication?
- Have you or anyone in your immediate family—parents, grandparents, siblings—ever had a stroke?
- Have you or anyone in your family ever had any type of cancer?
- Are your parents still alive?
- If not, what did they die of and how old were they when they passed away?
- Are all your siblings still alive?
- Have any of your siblings experienced any serious health problems?
- Lifestyle habits
- On a scale of 1-10, with 10 being a health nut and 1 eating at McDonald's every day, how would you rank your diet?
- Do you exercise regularly?
- How many times a week?
- What kind of exercise?
- Have you ever smoked?
- Did either of your parents smoke?
- How many days a week on average do you consume alcohol?
- Do you always, sometimes, or never wear a seat belt?
- On a scale of 1-10, with 10 being you could go postal any second and 1 you're in a pleasant coma, how would you rank your daily stress levels?
- Do you get enough sleep?
- Do you participate in high-risk sports and other activities, i.e. football, skydiving, etc.?

It's probably best to go through these questions with your advisor so he or she has all the necessary data directly from you. Your advisor will then review your answers together with the actuarial tables to determine the life expectancy you'll be using when developing your retirement plan.

Once the mortality tables have been reviewed, you can decide whether years should be added or subtracted from your life expectancy based on your answers to the questions above. A large number of "bad" answers, especially the parents' age at death, would justify lowering your estimate, while a preponderance of "good" answers would suggest a higher estimate is appropriate.

The parents' age at death is generally considered an anchoring data point for most longevity estimates, unless death occurred by other than natural causes.

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Obviously no one can know for sure how long you will live. As mentioned earlier, this is definitely not an exact science, but it will likely give you a better estimate than relying on the actuarial tables alone.

The more accurate your estimate, the better your retirement planning will be. Going through this process will give you additional insight into appropriate strategies to use in your retirement planning as well as proper asset allocations at different stages of your retirement.

Erin Tamberella and Rick Wright are managing partners of the coaching firm Executive Transformations and authors of the book Plateau to Pinnacle: 9 Secrets of a Million Dollar Financial Advisor*, released in January 2015.*

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