



SMART WEALTH ACCUMULATION



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When it comes to accumulating wealth for retirement and other goals, individuals face many challenges. This is true if you are...

Just Now Hitting Your Income-Earning Stride (generally age 30 -37)
Succeeding in Your Career (generally age 37-45)
or Pre-Planning Retirement (generally age 45-55)

While each age bracket will have their own specific concerns, the main idea is that the longer you wait to build a financial plan meeting your objectives, the harder it will be to achieve them.

One central question you may be asking yourself is: ***How do I accumulate wealth and create a robust retirement while addressing my obligations?***



As you progress in your career, this question likely becomes louder. Thankfully, there are a number of solutions and strategies that can be employed to help individuals in your position answer this question. This guide provides wealth-building insight and a high-level overview of one potential solution.

WEALTH BUILDING BASICS

Three Kinds of Money

There are three kinds of money related to the wealth accumulation process. Understanding how these categories of money interact with each other and how they help or inhibit growth is crucial to efficient wealth accumulation.



Taxable

With these accounts, realized dividends, capital gains, and interest are taxed as earned annually. Think of money market funds, savings accounts, stocks, bonds, and certificates of deposit.

These types of accounts may offer upside potential and easy accessibility. While you may face drag on the growth each year, these accounts provide liquidity.



Tax-Deferred

A tax-deferred account helps you grow your investment by delaying taxation until distribution. Examples include 401(k)s, Traditional IRAs, and other qualified retirement accounts.

You may find that tax-deferred retirement programs involve contribution limits and early withdrawal penalties.



Tax-Free

As the name suggests, tax-free accounts are just that: tax-free. Tax-free accounts include municipal bonds, Roth IRAs, and others.



There may be stipulations and conditions applied to some tax-free accounts. For example, Roth IRAs involve contribution limits and income thresholds. For 2019 and 2020, the maximum annual contribution is \$5,550 unless you are older than age 50, in which case the limit is \$6,500. Additionally, Roth IRAs are only available to those making \$135,000 or less for single filers / \$199,000 for married filers.

Municipal bonds can count as provisional income and may increase taxation on your Social Security.

There is another account that is classified as a tax-free account and it combines the advantages found in taxable and tax-deferred accounts. Additionally, you can put as much money into this as you would like and also secure other important benefits. We discuss this later in the guide.

When building wealth, it is recommended to have money in all three types of accounts so that your financial mix is properly diversified. Ultimately what will work for you will depend on your unique situation and goals, which is why working with experienced and knowledgeable financial professionals can be so helpful.

THE 4 CHALLENGES EVERYONE FACES IN RETIREMENT

Everyone, from blue-collar workers to skilled, high-earning professionals, faces the following four challenges in retirement.



1.) Taxes

Tax liabilities will, of course, differ amongst various accounts and financial products. Depending on what you have, you may be taxed as interest grows or you may only face taxation upon distribution. Without getting too in-depth, the issue is that taxes may erode meaningful portions of your retirement resources. This can become a problem as you stop earning income from work and begin to draw on your retirement funds.

Social Security

Many retirees are surprised to find out that there are instances in which Social Security benefits may be taxable income. Generally, taxation of benefits applies to individuals with additional income, such as wages, interest, dividends, and other taxable income (which is reported on your tax return filed each year).

The current thresholds, as found on the SSA website, are as follows:



Those filing as individuals with \$25,000 to \$34,000 in taxable income may have up to 50% of their Social Security benefits taxed.



Those filing as individuals with more than \$34,000 in taxable income may have up to 85% of their benefits taxed.



Those filing a joint return with a combined income between \$32,000 and \$44,000 may have up to 50% of their benefits taxed.



Those filing a joint return with a combined income of more than \$44,000 may have up 85% of their benefits taxed.

Dividend Income

Gains collected on investments are subject to taxation, even in retirement. Depending on if the gains are ordinary dividends or qualified dividends, you will face different liabilities, with the qualified gains generally receiving more favorable tax treatment.

401(k)/ Traditional IRAs

Distributions from traditional 401(k)s and IRAs will generally be taxable as ordinary income upon distribution since contributions are typically made with pre-tax dollars. Additionally, you may be subject to an early withdrawal penalty if you take a distribution before age 59 ½.

Roth IRAs/Roth 401(k)s

Since contributions to Roth IRAs and Roth 401(k)s accounts are made with after-tax dollars, distributions and gains will be, in general, tax-free.

Tax Environment

The tax environment you retire into will affect your retirement funds. If you are a few years away from retirement, you may not retire into a significantly altered tax environment, though it is certainly possible. However, the further you are from your retirement event, the more opportunity there is for changes in the tax environment that will directly impact you.



2.) Longer Life Expectancies

The good news: Americans are living longer. From 1960 to 2010, life expectancy in the US rose nearly ten years, from 69.77 years to 78.54 years of age. While this means that the US population, on average, has more time in retirement to spend with family or pursue a passion, it also means that retirement income needs to last longer. There is a risk of outliving your money, which is why many consumers seek products that accumulate cash value or provide guaranteed lifetime income (as is the

case with some life insurance policies and annuities that have a lifetime income rider).

One other concern with longer life expectancies is the risk of experiencing a long-term care situation. According to longtermcare.gov, "70% of people turning age 65 can expect to use some form of long-term care during their lives." Without sufficient long-term care protection, medical costs associated with LTC can exhaust your retirement funds.

3.) Inflation

Your grandparents or parents might take delight in telling you how much a candy bar or gallon of milk cost back in their day. The price difference is due to inflation—and you most likely already have a pretty good understanding of its effects. Things tend to rise in cost over time, and hopefully, so do wages. But this has a drag on purchasing power.



For example, using the US Inflation Calculator (usinflationcalculator.com) we can see that something that cost \$100.00 in 1990 would cost \$186.53 in 2017. This represents a cumulative rate of inflation of 86.5% over the seventeen years between 1990 and 2017.

Why does this matter to your retirement? Well, depending on what products or accounts you use to build your retirement resources, your purchasing power upon distribution can be dramatically different than when you put the money into the accounts. If your retirement

accounts have little or no growth to beat inflation, the real dollar purchasing power you have in retirement can be significantly altered.

Typically, consumers have to choose between “safe” financial products (like 401(k), IRAs, CDs, or mutual funds) that have low-interest rates or investments that have more growth potential, but with more risk exposure.

Some strategies, such as indexed insurance products, work to provide growth potential with guaranteed returns.

4.) Market Volatility

Who remembers the Great Recession? While the economy has improved since then, many consumers took a significant hit to their 401(k)s and IRAs. This matters because gains needed to recover losses can be significant. Recovering losses takes away

from an important resource before and after retirement: time. If it takes you five to ten years to recover losses, you’ve not only lost time, you may have lost purchasing power due to whatever inflation occurs in the time period. And many consumers, as they transition into retirement, don’t have the ability to recover, since they aren’t earning income from work.

A UNIQUE SOLUTION

As you can tell from the previous section, there are a lot of moving parts and considerations to keep track of as you develop a wealth accumulation strategy.

So, is there a solution that addresses the four challenges of retirement discussed earlier and gives you the advantages of taxable, tax-deferred, and tax-free money?

To reiterate, here's what we're looking for.

- Accumulate funds to hedge against inflation and longer life expectancies.
- Grow funds tax-deferred.
- Receive distributions tax-free.
- Retain accessibility.
- Limit market exposure.

The answer to the question above is yes, there is a solution and it might surprise you: **life insurance.**

Life insurance—specifically maximum-funded, permanent life insurance—is one of the greatest wealth accumulation vehicles available.

More Than A Death Benefit

You may think that life insurance is only used to obtain a death benefit to cover final expenses and provide a financial resource for your survivors in the event of your death. While a death benefit is typically the main benefit consumers seek when exploring life insurance options, many types of policies include attractive features that factor into retirement planning.

Permanent life insurance policies give lifetime protection, provided premiums, and applicable charges are paid per the condition of the contract. This broad category of life insurance offers flexibility and builds tax-deferred cash value.

One type of permanent life insurance, Indexed Universal Life (IUL), is particularly advantageous for consumers planning to incorporate life insurance into their retirement planning.



How Indexed Life Insurance Works

Indexed Universal Life Insurance, often referred to as IUL, is a type of life insurance that can offer both a death benefit and a cash value. In addition to the option for growth based on a declared interest rate, the policy also has the option for interest crediting tied to a stock market index.

Like all Universal Life Insurance, Indexed Universal Life Insurance can be paid for through flexible premium payment options, provided premium targets are met. Payments over the cost of insurance are placed into a cash-value account, which is tied to a stock market index such as the Standard & Poors 500 or the Dow Jones Industrial.

For those of you familiar with annuities, indexed life insurance will be reminiscent of FIAs (fixed indexed annuities). The mechanics are very similar and as such, there is no direct market participation of the cash accumulation account.

Resetting at specified periods (typically on an annual basis), captured interest rates are only tied to positive stock market index movements. If the stock market index goes negative, the cash value in an index universal life policy won't decrease because of this negative performance. The growth potential of the indexed account will typically have a cap on the interest that can be captured each period. But growth will be tax-deferred and accessible through withdrawals or loans.



Policy Loans

With policy loans, you are borrowing money from the insurance company and using your accumulated cash value as collateral. These loans, like most other loans, incur an interest rate that accrues each policy year. Loan interest is typically compounded to the loan itself, rather than paid by the policyholder. If there remains an unpaid loan at the time of an insured's death, the outstanding amount will be deducted from the death benefit and the remaining amount paid to beneficiaries.

Withdrawals

Generally, insurance companies will allow policyholders to withdrawal in two ways. One with a decrease in coverage equal to the amount withdrawn and one without a decrease in coverage. It is important to consider the effect of a withdrawal. In the first method, you would see a reduction in death benefit because the partial surrender amount will equate to a reduction of coverage. In the second withdrawal method, the policy's death benefit would remain the same. Although one thing to remember is that taking withdrawals

out of a universal life insurance policy can affect the performance of the policy.

Both withdrawals and loans may require an increase in premiums to make the policy whole to remain in force. As with any type of financial instrument or life insurance, the particulars will vary based on the carrier, additional features, and insurance contract. This is why it is essential to seek out a trusted life insurance agent and to consult with a highly rated financial advisor about any tax concerns regarding policy loans and withdrawals.

Overfunding the IUL Contract

This is where Indexed Universal Life Insurance really proves its worth in retirement planning. There are two important ideas to keep in mind.

1. IUL's offer flexible premium options—so as long as the contract is held in force, either by meeting minimum premium payments or absorbing some of the accumulated value.
2. There is no contribution limit on an IUL policy, unlike an IRA or 401(k). You can put as much as you'd like into the contract and the amount will grow.

So, by overfunding your IUL policy, you can accumulate a cash value that is tied market performance, but not directly exposed to market forces. And your cash value is accessible tax-free.

Would you like to see if Indexed Universal Life or another financial strategy may be an appropriate solution for you? Please contact us at (832) 247-4784 to schedule a complimentary appointment.

The information contained in this meant to provide a high-level overview of several financial concepts and products. It is not meant to serve as advice. Every situation is unique.