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Financial Outlook

FALL 2020

Estate Planning Considerations for Children

It takes special care to create an estate plan that efficiently distributes your assets and meets your goals for every person and cause important to you. But no part of the process means more to most people than that which involves their children. After all, for most of us, our children are our most important legacy, and how your estate documents treat them will have an impact long after you're gone.

To help organize this process, it is useful to think of children in three categories: minors, young adults, and fully grown adults with spouses and children of their own.

Minor Children

Children from infancy through high school have a different set of needs than children of other ages. One is simply to be able to rely on an income for daily needs in case you're no longer there for them. Since the parents of young children usually don't have large savings or net worth, the challenge is to provide an instant estate, for which life insurance is the best answer.

There are several rules of thumb for how much life insurance to buy — from four to 10 times your annual income. The right amount should be the result of a thorough needs analysis of your entire family, which can be accomplished by asking your spouse and yourself a series of probing questions, including:

❍ How much do the two of you

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Finding a Balance between Risk and Return

One of the most basic investment principles is that returns reward you for the risks you take. While investors are often uncomfortable with the concept of risk, it is this uncertainty that makes higher rates of return possible. Some basic investment principles related to risk and return include:

❍ Returns on specific investments are not known in advance. Investors can review historical rates of return, but there is no guarantee that past returns will be indicative of future returns.

❍ There is usually the possibility that an investment will not meet your return expectations.

❍ The uncertainty regarding your actual return creates risk. Greater uncertainties typically lead to greater risk.

❍ Investments are subject to many different types of risk. Cash is primarily subject to purchasing power risk, or the risk that its purchasing power will decrease due to inflation. In addition to purchasing power risk, bonds are subject to interest rate risk, or the risk that interest rates will increase and cause the bond's value to decrease, and default risk, or the risk that the issuer will not repay the principal or interest on the bonds. Stocks are primarily subject to nonmarket risk, or the risk that events specific to a company or its industry will adversely affect a stock's price; and market risk, or the risk that a particular stock will be affected by overall stock market movements.

❍ There is generally a tradeoff between risk and return. Low levels of risk are the most desirable and typically have lower return potential, while higher levels of risk are typically undesirable and must offer higher return potential to encourage investors to invest. Be

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Estate Planning

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already have saved?

- ❍ Will your spouse be able to work full- or part-time? If so, what will childcare cost?
- ❍ Will your children go to public or private elementary and secondary schools?
- ❍ How much will your children need in college funds by the time they're ready to attend?
- ❍ How much will your spouse need for retirement, and how much of that will he/she be able to accumulate on his/her own?

After you determine how much life insurance to buy, you need to think about who will raise your children if you and your spouse both die before the children are adults. This calls for naming a guardian in both of your wills. If you don't have a will, a state court will appoint a guardian for you, and it may not be someone you or your spouse would have wanted for this role. In addition, parents might also wish to designate a person to manage the children's assets, known as a custodian or trustee. This can be the same person as the guardian, but designating an unrelated third party, like an attorney, banker, or trust company officer, who can be charged with thinking only of your children's welfare, appeals to some people.

Among the other major decisions you have to make is whether and how to split your assets between your surviving spouse and your children, and if you leave some assets directly to your children, how to determine the split among them. Often, it can make sense to leave all or most of your assets to your spouse and to divide assets you bequeath to your children evenly. But this might overlook such considerations as children with special medical needs or special abilities.

Young Adults

Once children reach the age of majority — 18 in most states — a new set of considerations enters the picture. By this age, your children no longer require a guardian and are legally capable of spending their money in any way they want — and therein lies a potential problem. What if you leave $250,000 for college, and instead, your children decide to waste the money and skip college?

One way to control how the inheritance is spent is to establish a trust with a schedule for distributions. One option is to delay a full distribution until they reach a certain age, like 25 or 30. Another choice is to give them a series of partial distributions over many years. Another increasingly popular strategy is the incentive trust. This vehicle makes payouts contingent on your child's achievement of specific accomplishments — like maintaining a certain grade point average; graduating from college, graduate, or professional school; marrying; or buying a home.

Adult Children

Many of the same kinds of considerations that apply to minors and young adults can also influence your decisions regarding adult children. Do they, their spouses, or their children have special medical needs? Have your adult children fallen on hard times or are they irresponsible with money? How many children do they have and how much help will they need to finance their education?

Another consideration has as much to do with your own objectives for minimizing estate taxes. If your estate is much larger than you and your spouse's combined estate tax exemptions (currently $11.58 million for each spouse in 2020), you might want to shrink it with an aggressive campaign of gifts to your children and grandchildren. On the other hand, any funds you leave to your children might encumber them with estates equally as large as yours or larger, with the same tax challenges. In this case, you might want to transfer some of your assets to a generation-skipping trust, which bypasses your children and names your grandchildren as the beneficiaries.

Don't go it alone when mulling over these decisions. Most importantly, you need to reach a meeting of the minds with your spouse and even your children, especially if they are adults. One thing you don't want to do is to create bad feelings after you're gone, either toward you or among your survivors. Please call if you'd like to discuss this in more detail. ❍❍❍

Finding a Balance

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cautious of claims of high returns with low risk.

There are strategies that can be used to reduce the total risk in your investment portfolio:

- **Diversify your portfolio.** You should diversify among several different investment categories, including cash, bonds, and stocks, as well as within investment categories, such as owning several types of stocks. A properly diversified portfolio should contain a mix of asset types whose values have historically moved in different directions or in the same direction with different magnitudes. By owning several investments rather than just one, a downturn in any one should not have a significant impact on your total return. Of course, the opposite is also true — if you have one investment with exceptional returns, your total return will be lower than if that were your only investment.
- **Stay in the market through different market cycles.** Remaining in the market over the long term helps to reduce the risk of receiving a lower return than expected, especially for more volatile investments, such as stocks.
- **Use dollar cost averaging to invest.** Rather than accumulating cash so you have a large sum to invest, invest small amounts regularly. Dollar cost averaging involves investing a certain sum of money in set amounts at regular intervals. This spreads your purchases over a period of time, preventing you from making one major purchase at high prices. Since you are investing a set amount, you purchase more shares when prices are lower and fewer shares when prices are higher. While a valuable investment strategy, dollar cost averaging does not ensure a profit or protect against losses in declining markets. Before starting a program, consider your ability to continue purchases during periods of low price levels. This strategy requires the discipline to invest consistently, regardless of market prices, and can help develop a habit of regular investing.

If you'd like to discuss how to balance risk and return in your portfolio, please call. ❍❍❍

Manage Your Nest Egg after Retirement

You may think that after retirement you can sit back and stop worrying about money…after all, you scrimped and saved for decades. You're comfortable with what you've put away and now it's time to relax. Well…not quite. If not for inflation and market volatility, you might be right, but you still need to watch your portfolio.

The current U.S. rate of inflation is a little over 2%, but it fluctuates constantly. A 3% rate of inflation per year means that after 23 years, a fixed sum of money has lost half of its value. What you may have only noticed from time to time at the grocery store before retirement, you will see as a threat to your savings. And unfortunately, safe assets do not keep you ahead of inflation in the long run.

Managing your portfolio in retirement can be difficult and complicated, but by doing so, you can keep it growing and combat the threat of inflation. Here are some key points to consider:

- Keep some of your portfolio invested in stocks.
- Maintain a rate of withdrawal below your annual rate of return. This is no more than 3% or 4% per year, so that the remaining balance can be reinvested to continue growing.
- Keep your essential expenses separate from nonessential expenses in your budget. Consider structuring your portfolio to have assets like dividend-paying stocks or long-term bonds pay for your essential expenses, but are otherwise untouched.
- Rebalance periodically. This means selling off a portion of the assets in an asset class or sub-class that has grown larger than your intended allocation. Use the proceeds from the sell-off to purchase assets in classes or sub-classes that have shrunk in value. While it is wise to rebalance once per year, it is also good to consider rebalancing when any category of assets has grown or shrunk by 5% to 10%.
- Withdraw as little as possible from your investments and review them regularly. If your investments have gone down in value, you will deplete your balance quickly by continuing the same withdrawal rate as before.
- Build up a reserve of investments not tied to the stock market, preferably totaling three or four years of retirement expenses. If you have this reserve to fall back on, you will not need to sell stock investments during periods of market decline.
- Withdraw funds in a tax-efficient way to make them last longer. For example, you should withdraw your taxable investments first so that tax-deferred investments can continue to grow.
- Reassess your asset allocation periodically. Make changes gradually to increase diversification in your portfolio.

Please call if you'd like to discuss this in more detail. ❍❍❍

Financial Data

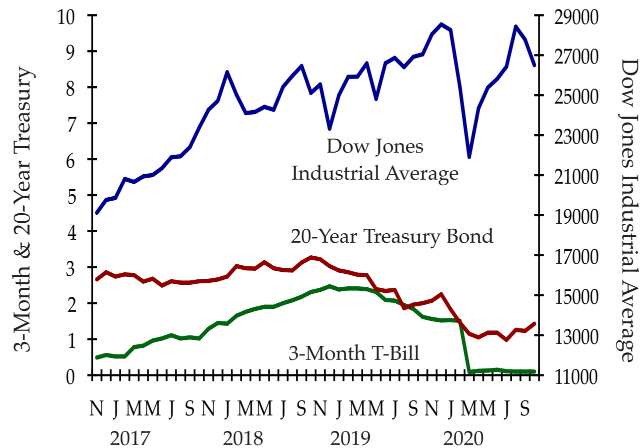
Indicator	Aug-20	Sep-20	Oct-20	Dec-19	Oct-19
	Month-end				
Prime rate	3.25	3.25	3.25	4.75	4.75
Money market rate	0.23	0.22	0.19	0.58	0.71
3-month T-bill yield	0.10	0.10	0.10	1.52	1.62
20-year T-bond yield	1.26	1.23	1.43	2.25	2.00
Dow Jones Corp.	2.22	2.17	2.23	2.84	2.90
30-year fixed mortgage	1.90	1.96	1.92	3.31	3.33
GDP (adj. annual rate)#	-5.00	-31.40	+33.10	+2.10	+2.10

Indicator	Aug-20	Sep-20	Oct-20	YTD	12 Mon
	Month-end			% Change	
Dow Jones Industrials	28430.05	27781.70	26501.60	-7.1%	-2.0%
Standard & Poor's 500	3500.31	3363.00	3269.96	1.2%	7.7%
Nasdaq Composite	11775.46	11167.51	10911.59	21.6%	31.6%
Gold	1970.00	1886.90	1881.85	23.6%	24.5%
Consumer price index@	259.10	259.92	260.28	1.2%	1.4%
Unemployment rate@	10.20	8.40	7.90	125.7%	125.7%

— 1st, 2nd, 3rd quarter @ — Jul, Aug, Sep Sources: *Barron's, Wall Street Journal*

4-Year Summary of Dow Jones Industrial Average, 3-Month T-Bill & 20-Year Treasury Bond Yield

November 2016 to October 2020



Past performance is not a guarantee of future results.

Should You Serve as a Guardian?

When asked to serve as the guardian of someone's minor children, it is usually meant as a compliment that the person trusts you to serve in this important role. While you may fear that you'll hurt your relationship with that person by saying no, don't accept this role without giving it serious thought. Consider the following:

- **Are your lifestyles compatible?** Go over all details involved in raising the children. Will the children move in with you? If so, will that mean relocating them far from their current home? What are the parents' preferences regarding education, religion, lifestyle, and other factors? How well does your family get along with their children? Consider the impact on your children, including the fact that you will probably have less time available for them.
- **How much financial support will be available?** This involves more than making sure money is available for college and other expenses directly attributable to the children. Additional children in your house will increase many of your bills. Your house may now be too small, requiring an addition to your current home or moving to a larger home.
- **Are you comfortable taking on responsibility for the children's finances?** Just because you agree to take physical custody of the children does not mean you have to handle their finances. You may feel more comfortable with another person involved.
- **Has a contingent guardian been named?** Find out if a contingent guardian has been named in case you cannot serve. However, don't use this as an excuse to say yes when you really want to decline. It is better to indicate that you do not want to take on this responsibility now, so another guardian can be chosen and has the opportunity to go over all these details. Also, if your situation changes in the future, inform the parents immediately. ❍❍❍

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