Breed's Hill Newsletter

Planning Your Financial Future

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Is It Time to Declare Your Financial Independence?

No matter how much money you have or which life stage you're in, becoming financially independent starts with a dream. Your dream might be to finally pay off the mountain of debt you've accumulated, or to stop relying on someone else for financial support. Or perhaps your dream is to retire early so you can spend more time with your family, travel the world, or open your own business. Financial independence, however you define it, is freedom from the financial obstacles that are keeping you from living life on your own terms.

Envision the future

If you were to become financially independent, what would change? Would you spend your time differently? Live in another place? What would you own? Would you work part-time? Ultimately, you want to define how you choose to live your life. It's your dream, so there's no wrong answer.

Work at it

Unless you're already wealthy, you may have had moments when winning the lottery seemed like the only way to become financially secure. But your path to financial independence isn't likely to start at your local convenience store's lottery counter.

Though there are many ways to become financially independent, most of them require hard work. And retaining wealth isn't necessarily easy, because wealth may not last if spending isn't kept in check. As income rises, lifestyle inflation is a real concern. Becoming — and remaining — financially independent requires diligently balancing earning, spending, and saving.

Earn more, spend wisely, and save aggressively

Earn more. The bigger the gap between your income and expenses, the quicker it will be to become financially independent, no matter what your goal is. The more you can earn, the more you can potentially save. This might mean finding a job with a higher salary, working an extra job, or working part-time in retirement. And a job is just one source of income. If you're resourceful and able to put in extra hours, you may also be able to generate regular income in other ways — for example, renting out a garage apartment or starting a side business.

Spend wisely. Look for opportunities to reduce your spending without affecting your quality of life. For the biggest impact, focus on reducing your largest expenses — for example, housing, food, and transportation. Practicing mindful spending can also help you free up more money to save. Before you buy something nonessential, think about how important it is to you and what value it brings to your life so that you don't end up with a garage or attic filled with regrettable purchases.

Save aggressively. Set a wealth accumulation goal and then prioritize saving. Of course, if you have a substantial amount of debt, saving may be somewhat curtailed until that debt is paid off. Take simple steps such as choosing investments that match your goals and time frame, and paying yourself first by automatically investing as much as possible in a retirement savings plan. Time is an important ally in the quest for financial independence, so start saving as early as possible and build your nest egg over time. (Note that all investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.)

Keep going

Make adjustments. Life changes. Unexpected bills come up. Some years will be tougher financially than others. Expect to make some adjustments to your plan along the way, especially if you have a long-term time frame, but keep going.

Track your progress. Celebrate both small milestones and big victories. Seeing the progress you're making will help you stay motivated as you pursue your dream of financial independence.

Should You Invest Internationally?

In April 2019, despite some positive economic developments, the International Monetary Fund cut its outlook for global growth in 2019 to 3.3%, the lowest level since 2009. At the time of that report, IMF Managing Director Christine Lagarde said a recession was not expected in the near term.

Source: Bloomberg, April 9, 2019

The risks associated with investing on a worldwide basis include differences in financial reporting, currency exchange risk, and economic and political risk unique to the specific country. These risks may result in greater share price volatility and should be carefully managed in light of your goals and risk tolerance.

Investing in foreign stocks provides access to a world of opportunities outside the United States, which may help boost returns and manage risk in your portfolio. However, it's important to understand the unique risk/return characteristics of foreign investments before sending a portion of your money overseas.

Reasons to go abroad

Here are some of the potential benefits of international investing.

Additional diversification. Other countries may be at a different stage in the business cycle than the U.S. economy. They could recover more quickly (or more slowly) from a recession.

Long-term growth potential. Some of the world's most rapidly growing economies are located in emerging markets that may be reaping the benefits of new technologies, a growing consumer base, or natural resources that are in high demand.

Possible hedge against a weaker dollar. The U.S. dollar has been strong in recent years, but having some investments denominated in foreign currencies may help offset (or even take advantage of) any future dips in its value.

Reasons to proceed with caution

Here are just some of the potential risks.

Politics and economic policies. A nation's political structure, leadership, and regulations may affect the government's influence on the economy and the financial markets.

Currency exchange. Just as a weak U.S. dollar could work for you, additional strengthening in the dollar could work against you. That's because any investment gains and principal denominated in a foreign currency may lose value when exchanged back.

Financial reporting. Many developing countries do not follow rigorous U.S. accounting standards, which often makes it more difficult to have a true picture of company and industry performance.

Risk/return potential

Some international investments may offer the chance for greater returns, but as with other investments, stronger potential comes with a greater level of risk. For example, over the past 30 years, foreign stocks have outperformed U.S. stocks, bonds, and cash alternatives 11 times. However, they have also underperformed 11 times, tying cash for the highest number of lowest-performing years during the same time period.

	Number of highest-performing years, 1989-2018
Cash	4
Bonds	5
U.S. Stocks	10
Foreign stocks	11

	Number of lowest-performing years, 1989-2018
Cash	11
Bonds	6
U.S. Stocks	2
Foreign stocks	11

If you decide to spread some of your investment dollars around the world, be prepared to hold tight during bouts of market volatility. And remember to rebalance your portfolio periodically to help align your asset allocation with your long-term investment strategy.

Performance is from January 1, 1989, to December 31, 2018. Cash is represented by the Citigroup 3-month Treasury Bill Index. Bonds are represented by the Citigroup Corporate Bond Composite Index. U.S. stocks are represented by the S&P 500 Composite Price Index. Foreign stocks are represented by the MSCI EAFE Price Index. All indexes are unmanaged, accurate reflections of the performance of the asset classes shown. Returns reflect past performance, which does not indicate future results. Taxes, fees, brokerage commissions, and other expenses are not reflected. Investors cannot invest directly in any index.

The principal value of cash alternatives may fluctuate with market conditions. Cash alternatives are subject to liquidity and credit risks. It is possible to lose money with this type of investment. The return and principal value of stocks may fluctuate with market conditions. Shares, when sold, may be worth more or less than their original cost. U.S. Treasury securities are guaranteed by the federal government as to the timely payment of principal and interest, whereas corporate bonds are not. The principal value of bonds may fluctuate with market conditions. Bonds are subject to inflation, interest rate, and credit risks. Bonds redeemed prior to maturity may be worth more or less than their original cost. Diversification is a strategy used to help manage investment risk; it does not guarantee a profit or protect against investment loss.

According to the 2018 Senior Report from America's Health Rankings, social isolation is associated with increased mortality, poor health status, and greater use of health-care resources. The risk of social isolation for seniors is highest in Mississippi and Louisiana and lowest in Utah and New Hampshire.

Quiz: How Much Have You Thought About Health and Health-Care Costs in Retirement?

When planning for retirement, it's important to consider a wide variety of factors. One of the most important is health and its associated costs. Thinking about your future health and the rising cost of health care can help you better plan for retirement in terms of both your finances and overall well-being. This quiz can help you assess your current knowledge of health and health-care costs in retirement.

Questions

1. Health-care costs typically rise faster than the rate of inflation.

True.

False.

2. You could need more than $500,000 just to cover health-care costs in retirement.

True.

False.

3. Medicare covers the costs of long-term care, as well as most other medical costs.

True.

False.

4. The southern, warmer states are generally the healthiest places for seniors to live.

True.

False.

5. If you're concerned about health-care costs in retirement, you can just delay your retirement in order to maintain your employer-sponsored health benefits.

True.

False.

Answers

1. True. The average inflation rate from 2010 to 2017 was less than 2%, while the average spending on prescriptions, doctors, and hospitals grew between 4% and 5%. From 1970 to 2017, annual per-capita out-of-pocket spending on health care grew from about $600 to approximately $1,100 (in 2017 dollars).[1]

2. True. In 2017, America's Health Rankings projected that a 45-year-old couple retiring in 20 years could need about $600,000 to cover their health-care costs, excluding the cost of long-term care. The same report projected that about 70% of those age 65 and older will need some form of long-term care services. And according to the Department of Health and Human Services, the average cost of a one-year stay in a nursing home (semi-private room) was $82,000 in 2016.[2]

3. False. Original Medicare Parts A and B help cover inpatient hospital care, physicians' visits, preventive care, certain laboratory and rehabilitative services such as physical therapy, and skilled nursing care and home health care that are not long term. Medicare Part D helps cover the cost of prescriptions (within certain guidelines and limits). Medicare does not cover several other costs, including long-term care, dental care, eye exams related to eye glasses, and hearing aids. Seniors may need to purchase additional insurance to cover these and other services not covered by Medicare.[3]

4. False. Interestingly, America's Health Rankings found that the five healthiest states for seniors were (1) Utah, (2) Hawaii, (3) New Hampshire, (4) Minnesota, and (5) Colorado.[4]

5. Maybe true, maybe false. Many people believe they will work well into their traditional retirement years, both to accumulate as large a nest egg as possible and to take advantage of employer-sponsored health benefits (if offered beyond Medicare age). While this is an admirable goal, you may not be able to control when you actually retire. In a 2018 retirement survey, nearly 70% of workers said they planned to work beyond age 65; 31% said they would retire at age 70 or older. But the reality is that nearly 70% of current retirees retired before age 65. Many of those individuals retired earlier than planned due to a health problem, disability, or other unforeseen hardship.[5]

The bottom line is that while it's hard, if not impossible, to predict your future health needs and health-care costs, it's important to work these considerations into your overall retirement planning strategies. Take steps now to keep yourself healthy — eat right, exercise, get enough sleep, and manage stress. And be sure to account for health-care expenses in your savings and investment strategies.

1 Consumer Price Index, Bureau of Labor Statistics, 2018, and Peterson-Kaiser Health System Tracker, 2018

2 Preparing for Health Care Costs in Retirement, America's Health Rankings, 2017, and LongTermCare.gov, 2018

3 Medicare.gov

4 Senior Report, America's Health Rankings, 2018

5 2018 Retirement Confidence Survey, Employee Benefit Research Institute

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Do I need to pay estimated tax?

Taxpayers are required to pay most of their tax obligation during the year by having tax withheld from their paychecks or pension payments, or by making estimated tax payments. Estimated tax is the primary method used to pay tax on income that isn't subject to withholding. This typically includes income from self-employment, interest, dividends, and gain from the sale of assets. Estimated tax is used to pay both income tax and self-employment tax, as well as other taxes reported on your income tax return.

Generally, you must pay federal estimated tax for the current year if: (1) you expect to owe at least $1,000 in tax for the current year, and (2) you expect your tax withholding and refundable tax credits to be less than the smaller of (a) 90% of the tax on your tax return for the current year, or (b) 100% of the tax on your tax return for the previous year (your tax return for the previous year must cover 12 months).

There are special rules for farmers, fishermen, and certain high-income taxpayers. If at least two-thirds of your gross income is from farming or fishing, you can substitute 66-2/3% for 90% in general rule (2)(a) above. If your adjusted gross income for the previous year was more than $150,000 ($75,000 if you were married and filed a separate return for that year), you must substitute 110% for 100% in general rule (2)(b) above.

If all of your income is subject to withholding, you probably don't need to pay estimated tax. If you have taxes withheld by an employer, you may be able to avoid having to make estimated tax payments, even on your nonwage income, by increasing the amount withheld from your paycheck.

You can use Form 1040-ES and its worksheets to figure your estimated tax. They can help you determine the amount you should pay for the year through withholding and estimated tax payments to avoid paying a penalty. The year is divided into four payment periods. After you have determined your total estimated tax for the year, you then determine how much you should pay by the due date of each payment period to avoid a penalty for that period. If you don't pay enough during any payment period, you may owe a penalty even if you are due a refund when you file your tax return.

Withholding and estimated tax payments may also be required for state and local taxes.

How long could it take to double your money?

If you're saving for college, retirement, or a large purchase, it can be useful to quickly calculate how an anticipated annual rate of return will affect your money over time. To find out, you can use a mathematical concept known as the Rule of 72. This rule can give you a close approximation of how long it would take for your money to double at any given rate of return, assuming annual compounding.

To use this rule, you simply divide 72 by your anticipated annual rate of return. The result is the approximate number of years it will take for your money to double.

For example, if your anticipated annual rate of return is 6%, you would divide 72 by 6. Your money can be expected to double in about 12 years. But if your anticipated annual rate of return is 8%, then your money can be expected to double in about 9 years.

The Rule of 72 can also be used to determine what rate of return you would need to double your money in a certain number of years. For example, if you have 12 years to double your money, then dividing 72 by 12 would tell you that you would need a rate of return of 6%.

Another way to use the Rule of 72 is to determine when something will be halved instead of doubled. For example, if you would like to estimate how long it would take for annual inflation to eat into your savings, you could divide 72 by the rate of inflation. For example, if inflation is 3%, then it would take 24 years for your money to be worth half its current value. If inflation jumped to 4%, then it would take only 18 years for your purchasing power to be halved.

Although using a calculator will give you more precise results, the Rule of 72 is a useful shortcut that can help you understand how long it might take to reach a financial goal, and what annual rate of return you might need to get there.