LOCKER FINANCIAL SERVICES, LLC
*FEE ONLY FINANCIAL PLANNING*

**LAUREN LOCKER**
CERTIFIED FINANCIAL PLANNER™ practitioner
Registered Investment Advisor
50 East Main Street, Suite 5 • Little Falls, NJ 07424
973-256-2555 • Lauren@lockerfinancial.com

**ANDREW CHAN**
CERTIFIED FINANCIAL PLANNER™ practitioner
Certified Investment Management Analyst™ practitioner
550 Cochituate Rd., Suite 25, East Wing • Framingham, MA 01701
508-663-4878 • Andrew@lockerfinancial.com

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# Avoid These Investor Mistakes

Avoid these common mistakes when making investment portfolio decisions:

✔ **Chasing performance.** Investors often pull out of sectors that are not performing well, moving that money to high performing investments. But the market is cyclical, and often those high performers are poised to underperform, while the sectors just sold are ready to outperform. A classic example is technology stocks in early 2000. Many investors rushed to purchase technology stocks just as they reached their peak and were headed for a long slide down. Rather than trying to guess which sector is going to outperform, broadly diversify your portfolio across a range of investment sectors.

✔ **Looking for get-rich-quick investments.** When your expectations are too high, you have a tendency to chase after high-risk investments. Your goal should be to earn reasonable returns over the long term, investing in high-quality investments.

✔ **Avoiding the sale of an investment with a loss.** When selling a stock with a loss, an investor has to admit that he/she made a mistake, which is psychologically difficult to do. When evaluating your investments, objectively review the prospects of each one, making decisions to hold or sell on that basis rather than on whether the investment has a gain or loss.

✔ **Selecting investments that don't add diversification benefits to your portfolio.** Diversification helps reduce your portfolio's volatility, since various investments respond differently to economic events and market factors. Yet it's common for investors to keep adding investments that are similar in nature. This does not add much in the way of diversification, while

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## Planning Year Round

Many people confuse tax planning with tax preparation and only think about it when preparing their annual tax return. However, there is little you can do to actually lower your tax bill when preparing your return. If your goal is to reduce income taxes, you need to be aware of tax planning opportunities throughout the year.

Take time early in the year to assess your tax situation, looking for ways to reduce your tax bill. Consider a host of items, such as the types of debt you owe, how you're saving for retirement and college, which investments you own, and what tax-deductible expenses you incur. It often helps to discuss these items with a professional.

During the year, consider the tax consequences before making important financial decisions. This will prevent you from finding out later that there was a better way to handle the transaction for tax purposes.

Look at your tax situation again in the fall, which gives you plenty of time before year-end to implement any additional tax planning strategies. At that point, you'll also have a better idea of your expected income and expenses for the year. ❍❍❍

## Investor Mistakes

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making the portfolio more difficult to monitor.

✔ **Not checking your portfolio's performance periodically.** While everyone likes to think their portfolio is beating the market, many investors simply don't know for sure. So analyze your portfolio's performance periodically. Compare your actual return to your targeted return. If you aren't achieving your targeted return, you risk not achieving your financial goals. Now honestly assess how well your portfolio is performing. Are major changes needed to get it back in shape?

✔ **Letting market predictions cause inaction.** No one has shown a consistent ability to predict where the market is headed in the future. So don't pay attention to gloomy or optimistic predictions. Instead, approach investing with a formal plan so you can make informed decisions with confidence.

✔ **Expecting the market to continue in its current direction.** Investors tend to make investment decisions based on current trends in the market. Thus, if the stock market has been performing well for a period of time, investors tend to move more and more funds into that area. However, when the markets have an extended period of above or below average returns, they have a tendency to revert back to the average return. For instance, following an extended period of above-average returns in the 1990s, the stock market experienced a significant downturn, helping to bring the averages back in line.

✔ **Not understanding that saving and investing are two different concepts.** Saving involves not spending current income, while investing requires you to take those savings and do something with them to earn a return. Saving often becomes easier when separated from the choice of where to invest. Find ways to make saving as automatic as possible, then take your time to research and select specific investments.

✔ **Considering only pretax returns.** One of the most significant expenses that can erode your portfolio's value is income taxes. Thus, don't just consider your pretax returns, but look at after-tax returns. If too much of your portfolio is going to pay taxes, implement strategies that can help reduce those taxes.

✔ **Not realizing that help is only a phone call away.** The investment world has become very complex, with a vast assortment of investment vehicles now available. If you need help with your investment decisions, please call. ❍❍❍

## Retirement Planning Mistakes to Avoid

There are some common mistakes that people make when it comes to retirement planning that you should avoid:

**Not Taking Advantage of Your Employer Match —** If your company offers a 401(k) with a match program, you should contribute enough to the account to take full advantage of the match.

**Borrowing from Your Retirement Account —** When you take money out of the account, you're losing the opportunity for the money to grow and compound, and it is hard to make up for lost time. An additional risk when borrowing from your retirement plan is if you leave the company before paying back the loan. In some situations, it may be treated as an early distribution.

**Not Diversifying Investments —** When the market is doing well, higher risk investments can produce some great returns. But when the market takes a correction, having all your funds in one asset class can seriously damage your retirement plan. With a proper diversification strategy, you can reduce your risk while maximizing your return. When one asset class is doing poorly, other asset classes may be performing better, which balances your risk and returns.

**Not Rebalancing Your Portfolio —** A portfolio that started with 50% stocks and 50% bonds will shift over time. For example, if stocks experience significant growth and bonds are not growing very much, your portfolio could change into a mix of 70% stocks and 30% bonds. It is important to rebalance your portfolio on a regular basis with a mix that is appropriate for both your age and risk tolerance.

**Cashing Out Your 401(k) —** Often times, when people leave their employer for another job, they cash out their retirement account. Some do this with the intent to reinvest the funds into another retirement account, and then miss the 60-day window for investing the money into a qualified account. If you intend to roll the money over into another account, you should do a trustee-to-trustee transfer so that you don't have to worry about paying taxes and a penalty.

If you intentionally cash out the account, be forewarned that you could lose up to half the value of the account due to taxes and a penalty based on your age and how vested you are in the account.

**Becoming Paralyzed —** Retirement planning can be overwhelming, but avoidance and inaction are the biggest mistakes you can make. Time is your friend when saving for retirement, so just start saving in an employer plan or an IRA to get started. ❍❍❍

# Taxes and Your Investments

One of your portfolio's largest expenses is probably taxes. One way to help keep your portfolio growing is to invest in a tax-efficient manner. Some suggestions include:

✔ **Contribute to your 401(k) plan.** Contributions are made on a pre-tax basis, so you don't pay income taxes currently (Social Security and Medicare taxes are paid) and earnings grow on a tax-deferred basis until withdrawn. In 2020, you can contribute a maximum of $19,500 to a 401(k) plan, although your contributions may be limited to a certain percentage of your pay to comply with nondiscrimination rules. Individuals over age 50 may be able to make an additional catch-up contribution of $6,500 in 2020. Many employers also match your contribution, so you get additional funds at no cost to you.

✔ **Make contributions to an individual retirement account (IRA).** In 2020, you can contribute a maximum of $6,000, plus those over age 50 can make an additional $1,000 catch-up contribution. Investigate whether you're eligible to contribute to a traditional deductible IRA or a Roth IRA and then decide which option is best for you. While you can't deduct your contributions to a Roth IRA, your earnings grow tax free as long as you make qualified distributions from the IRA. With a traditional deductible IRA, your contribution is deductible on your current year income tax return and earnings grow tax deferred.

✔ **Carefully decide which investments to hold in tax-advantaged and taxable accounts.** Gains from investments held in retirement accounts, such as 401(k) plans and traditional IRAs, are taxed at ordinary income tax rates when withdrawn, rather than the lower capital gains tax rates. It may make sense to hold investments that produce ordinary income or that you want to trade frequently in retirement accounts, and investments that generate capital gains in taxable accounts. But factors such as your investment period should also be considered.

✔ **Analyze the tax consequences before rebalancing your portfolio.** Portfolio rebalancing is a taxable event that may result in a taxable gain or loss. In general, avoid selling investments from your taxable portfolio for reasons other than poor performance. Bring your asset allocation in line through other methods.

✔ **Consider municipal bonds or stocks generating dividend income if you are in a high tax bracket.** Since municipal bond interest is exempt from federal (and sometimes state and local) income taxes, your marginal tax bracket is a major factor when deciding whether to include municipal bonds in your portfolio. Thus, you should determine how a muni bond's yield compares to the after-tax yield of a comparable taxable bond.

✔ **Look into tax-advantaged ways to save for college.** If you are saving for college, look at education savings accounts (ESAs) and Section 529 plans. The annual contribution limit to ESAs is $2,000. While you can't deduct the contribution on your tax return, earnings grow tax free as long as funds are used for qualified education expenses. With Section 529 plans, you can contribute up to $75,000 to a qualified plan ($150,000 if the gift is split with your spouse) in one year and count it as your annual $15,000 tax-free gift for five years. However, if you die within the five-year period, a pro-rata share of the $75,000 returns to your estate. Distributions from 529 plans to pay qualified higher-education expenses are excluded from income.

✔ **Consider owning a home.** Owning a home has significant tax advantages. Mortgage interest and property taxes can be deducted on your tax return. When you sell your home, you can exclude up to $250,000 of gain if you are a single taxpayer and up to $500,000 of gain if you are married filing jointly, provided the home was your primary residence in at least two of the preceding five years. You no longer have to purchase another home to qualify for the exclusion. ❍❍❍

# How to Talk Finances with Your Parents

There comes a time when even the most independent of parents will need to start relying on their children, especially when it comes to money. But control is a big deal — no one likes to give it up, especially those who have been taking care of themselves for decades.

Sometimes the best route to take is involving a third party. Parents can have a difficult time opening up to their children about sensitive matters. Using a financial planner, tax advisor, or elder law attorney can remove their feelings of damaged pride or worries that you might think less of them.

When the time comes to get everything in order for them, you will need a lot of paperwork. This includes:

✔ **Sources of retirement income**. If they don't have the records readily available, you may need to check the mail or their online bank accounts to determine what they have coming in through investments, retirement plans, social security, etc.

✔ **Residential preference**. Your parents may want to live in the family house forever, but it is likely that they will not be able to remain independent indefinitely. This means you will need to know what they can afford and where they would prefer to stay.

✔ **Last will and testament**. Make sure your parents have an updated will so their surviving loved ones do not end up in a legal battle upon their passing. The best way to make sure their wishes are followed is to record them in their will.

✔ **Durable power of attorney**. The legal authorization to take over your parents' finances and make decisions on their behalf is an important matter to have settled. You will also need to determine who will have durable power of attorney for healthcare to make healthcare-related decisions.

✔ **Living will.** This is similar to a durable power of attorney for healthcare, but is also a reflection of the direct wishes of the incapacitated person, such as if they would prefer to not be resuscitated or what life-saving measures they want.

✔ **Funeral arrangements**. Your parents may have already sorted out some of these issues, but seniors often forget to tell their children about this.

✔ **Update beneficiary forms**. Your parents will need up-to-date beneficiaries for everything from insurance policies to insurance payouts. ❍❍❍

## Sharing an Inheritance

Married individuals who receive a large inheritance face a tough decision — should you share the assets with your spouse or hold them separately? Legally, you aren't required to share the inheritance, even in community property states where almost all other income must be split equally. Even if all other marital assets are owned jointly, you might want to keep an inheritance separate for a couple of reasons:

✔ Should you get divorced, you probably wouldn't have to split a separately held inheritance with your spouse.

✔ When you die, you control who receives the inheritance. If the inheritance is owned jointly, it goes to your spouse. If your spouse remarries, there is a chance the inheritance will ultimately go to a second spouse or children from a second marriage.

However, those reasons may be difficult to explain to a spouse. Rather than remaining evasive, discuss the inheritance and your concerns openly. Even if you decide to keep the inheritance separate, that doesn't mean you can't share some of the assets for common goals. ❍❍❍

# Financial Thoughts

For the academic year 2019-2020, average tuition and fees were $10,116 for a public in-state university, $22,577 for a public out-of-state college, and $36,801 for a private university. The average amount spent on college costs for academic year 2018-2019 was $26,226 (Source: *Journal of Financial Planning*, January 2020).

Approximately 24% of families borrowed money to pay for college for the academic year 2018-2019 (Source: Sallie Mae, 2019).

About 43% of people who attended college have incurred at least some debt for their education (Source: The Federal Reserve, 2019).

Almost 35% of 18- to 34-year olds are living with their parents (Source: U.S. Census Bureau, 2019).

Currently, we have the highest average first-time marriage age in national history — 28 for American women and 29.8 for men, up from 22 for women and 24.7 for men in 1980 (Source: *Journal of Financial Planning*, January 2020).

According to the Bureau of Labor Statistics, the average high school student earns $1.7 million and the average college graduate $2.6 million during their lifetime (Source: 2019). ❍❍❍