Modern retirement monthly

2020 Retirement Guide

Chief Investment Office GWM | 06 February 2020 8:52 pm GMT
Ainsley Carbone, Total Wealth Strategist Americas, ainsley.carbone@ubs.com

- On 20 December 2019, the Setting Every Community Up for Retirement Enhancement (SECURE) Act was signed into law introducing a number of significant benefits for investors including the delay of the age at which required minimum distributions (RMDs) must start.
- Social Security's cost-of-living adjustment for 2020 is 1.6%. In order to understand what this increase means for your retirement plan, we suggest looking at how your personal expenditures increase relative to Social Security benefits.
- The start of a new decade is leaving many investors feeling anxious, particularly given the rising geopolitical tensions and the uncertainty that comes with a presidential election.
- Having a long-term plan in place—and following through with it—can help you look past near-term concerns and easily adapt to evolving circumstances so you can remain focused on your long-term objectives.

What's in this report?

In this report, we'll update you on what's new this year for the retirement planning landscape and discuss how you can incorporate some of these changes into your overall financial plan. And to address the widespread uncertainty on investors' minds regarding the US presidential election and geopolitical concerns in the year ahead, we'll present a framework you can use to help increase confidence in your ability to meet near-term spending needs so that you can remain focused on achieving your long-term goals no matter what the market throws at you.

Planning with the new RMD age

Retirees who turn age 70 ½ on or after 1 January 2020 can delay required minimum distributions (RMDs) until age 72. Those in need of their retirement assets to fund near-term expenses will see little to no benefit as a result of this—it's unlikely their distribution plans will change if funds are needed today. However, retirees who don't need the funds to meet daily living expenses have the flexibility to leave assets in the tax-advantaged accounts for one to two more years in some cases.

While leaving assets in your retirement account for as long as possible may seem like the obvious response to this new rule—the longer assets remain in tax-advantaged environments, the greater the potential of maximizing tax-deferred growth—retirees should review their distribution plans in light of new circumstances to make sure they aren't overlooking potential tax savings strategies.

Should you delay distributions until age 72? RMDs are included in taxable income and are taxed as ordinary income. This can be problematic if your income level is close to the upper end of your tax bracket—a significant distribution amount may push you up into the next highest tax bracket, meaning the cost of your distribution will be greater. Put simply, more taxes will be paid than they otherwise would have.

But, now that mandated distributions can be delayed until age 72, some investors may have a wider window of opportunity to take advantage of lower-than-normal tax rates. These lower-than-normal tax rates, or "gap years," typically represent the period between your retirement date and the point at which you begin receiving Social Security benefits and RMDs. Absent working income and other sources of taxable income, these years have the potential to be some of the lowest taxable income years of your retirement.

Withdrawing tax-deferred assets during gap years in an amount that "fills up" your tax bracket can help get money out of the account at a lower cost (i.e., lower tax rate). What's more, these accelerated distributions will also lower the basis of which future RMDs would be calculated on. And, if the money is used to meet near-term expenses, it might allow retirees to defer Social Security payments until age 70 for a larger benefit and possibly a larger monthly benefit for a surviving spouse.

While this strategy may help investors minimize marginal income tax rates over the course of their retirement, it comes at a cost: the loss of tax-deferred growth potential. However, if you don't need these funds for living expenses, converting these distributions to a Roth IRA would allow assets to continue growing in a tax-friendly environment and bypass lifetime RMDs. And since Roth distributions aren't included in taxable income, adding this tax treatment to your balance sheet can help investors manage future tax liabilities by increasing tax diversification.

Flexibility is, as always, key. Most retirees aim to generate the greatest after-tax wealth while paying the least taxes possible. But, with so many variables that factor into an individual's tax liability, combined with the uncertainty of future tax policies, this can be difficult to achieve.

While these gap years may allow you to withdraw funds at a lower cost, there's no way to know with certainty without knowing what future tax rates will be. Investors with larger account balances—and therefore larger ensuing RMDs—and are concerned with the adverse tax effects of RMDs should consider incorporating tax diversification into their plan as a way to manage future tax liabilities in the presence of uncertainty.

Instead of basing your decision of how much to withdraw and when off an assumption that taxes will go one way or another, a good starting point is to project what your future wealth may be and to identify future income streams. Then with your assets spread across multiple tax treatments, and by understanding your options of accounts from which to draw income along with each account's tax implications (Table 1), investors can draw from each account strategically and optimally given whichever circumstances they are dealt with.

To be fair, these gap years aren't new to retirement planning. The SECURE Act just adds one to two more years of flexibility regarding your retirement plan distributions. But since these additional years coincide with an age when the majority are receiving Social Security benefits, you may only see a small opportunity for tax savings. Still, *some* opportunity for tax savings is better than no opportunity at all, so it's worth looking into it.

Distributions from tax-deferred accounts and Roth conversions can trigger severe tax consequences—more taxable income can raise taxes on Social Security benefits and possibly generate higher Medicare premiums. Investors should only come to the decision to accelerate distributions after carefully considering the potential implications that may occur on the rest of their financial situation.

Please note that we did not cover another change resulting from the SECURE Act that further strengthens our case for tax diversification: the elimination of Stretch IRAs. For further reading on this topic, please see our report We'll probably survive the "new death tax" and the whitepaper, Advanced Planning Insights: The SECURE Act, published December 2019.

Table 1: Tax treatments on retirement accounts

Depending on the account, assets will be taxed differently when contributing to them and distributing from them. Each account has different restrictions, limitations, and provisions. Investors should consider each account's stipulations before adding them to their financial plan.

		Tax treatment					
		Contributions are pre-tax	Investment earnings grow tax-free	Qualified distributions are tax-free	Income restrictions	Contribution limits (2020)	Required Minimum Distributions (RMDs)
Tax-deferred	Traditional 401(k)	X	X		No	$19,500 ($26,000 if age 50+)	Yes
Tax-deferred	Traditional IRA	X	X		Deduction is phased-out completely if MAGI is at least $75,000 (single) or $124,000 (married filing jointly)*	$6,000 ($7,000 if age 50+)	Yes
Tax-exempt	Roth 401(k)		X	X	No	$19,500 ($26,000 if age 50+)	Yes
Tax-exempt	Roth IRA		X	X	Ability to contribute is totally phased out if MAGI is at least $139,000 (single) or $206,000 (married filing jointly)	$6,000 ($7,000 if age 50+)	No
Tax-exempt	Health Savings Account (HSA)**	X	X	X	No	- Individual: $3,550 ($4,550 if age 55+) - Family: $7,100 ($9,100 if both spouses are age 55+)	No

*If neither you nor your spouse is eligible for a 401(k), the contribution is 100% deductible, regardless of modified adjusted gross income (MAGI).

**Must be enrolled in a High Deductible Health Plan (HDHP) for eligibility.

Source: IRS, UBS

Social Security's purchasing power

Social Security's cost of living adjustment (COLA) is intended to protect the purchasing power of retirees' benefits by offsetting inflation. However, according to The Senior Citizens League, Social Security benefits have lost 33% of their purchasing power between 2000 and 2019. That's largely because the COLA calculation is based on an inflationary measure that doesn't properly represent expenditures that are unique to retirees. So, while Social Security's COLAs will likely track economy-wide inflation, most retirees will find that they do not keep pace with their own personal expenditure's inflation.

2020's COLA: It's all relative. Instead of taking this year's 1.6% COLA at face value, it's important to take the time to understand how the increase stacks up relative to your personal expenditures. Looking at household income in comparison to expenses allows for a better understanding of true purchasing power.

Retirees can expect a 1.6% increase in their gross income from Social Security, but that won't necessarily yield a 1.6% increase in net benefits. That's because Medicare Part B premiums are typically deducted directly from retirees' Social Security payments. Whenever there are increases in Part B premiums from one year to the next, those increases eat into Social Security's COLA. And since these premiums are one of the fastest-growing costs for older Americans, it's no wonder why Social Security benefits have been struggling to keep up with retirees' expenses.

Who will see a greater net increase in their Social Security benefits? The standard monthly premium for Medicare Part B in 2020 is USD 144.60 (per person), up from USD 135.50 in 2019. The average retirement benefit in 2019 was USD 1,479, meaning their net benefit—assuming they had the standard Part B premium deducted from their Social Security payments—was USD 1,343.50. Going into 2020, their net benefit will increase to USD 1,358 per month, or 1.1% more in take-home pay than last year.

However, since Part B premiums are subject to income-related surcharges (Table 2), retired couples living on higher incomes won't feel the COLA nearly as much, if at all. The maximum benefit for a 65-year-old who retired in 2019 was USD 2,757 (or USD 2,296.50 assuming the Part B premium associated with the highest income level was taken out of her Social Security benefit). Going into 2020, the COLA and Part B premium increases mean her net benefit would be USD 2,309.50, which translates to only 0.6% more in her take-home pay.

Planning considerations: Social Security was never intended to be the sole source of income in retirement. However, when used as a supplement to other parts of your financial plan, it can help hedge longevity risk and mitigate sequence risk. We suggest reviewing your financial plan and budget annually when the COLA and Medicare premiums are announced every year. Routine check-ups on your current spending habits help to ensure you're still on track to meet your future spending needs.

Table 2: 2020 Medicare Part B premiums by Modified Adjusted Gross Income (MAGI)

High income earners will pay higher Medicare Part B premiums

Individuals with a MAGI...	Standard Part B premium	MAGI adjustment	Total / month
of $87,000 or less	$144.60	$0.00	$144.60
above $87,000 up to $109,000	$144.60	$57.80	$202.40
above $109,000 up to $136,000	$144.60	$144.60	$289.20
above $136,000 up to $163,000	$144.60	$231.40	$376.00
above $163,000 up to $500,000	$144.60	$318.10	$462.70
above $500,000	$144.60	$347.00	$491.60

Married couples with a MAGI...	Standard Part B premium*	MAGI adjustment*	Total / month*
of $174,000 or less	$144.60	$0.00	$144.60
above $174,000 up to $218,000	$144.60	$57.80	$202.40
above $218,000 up to $272,000	$144.60	$144.60	$289.20
above $272,000 up to $326,000	$144.60	$231.40	$376.00
above $326,000 up to $750,000	$144.60	$318.10	$462.70
above $750,000	$144.60	$347.00	$491.60

Source: Social Security Administration, UBS

How to stay focused on your plan

Long-term goals, such as retirement, can be seemingly impossible to remain focused on when we're so consumed with near-term events. And given what's on the agenda for 2020, it's no surprise that investors are preoccupied with concerns when looking to the year ahead.

To help you stay focused on your plan, we recommend using a framework called Liquidity. Longevity. Legacy. (3L framework) which segments wealth according to time frames and specific needs. Here's how it works:

First, the Liquidity strategy consists of funds you can spend from during periods of market stress. Don't rely on "income" from stocks and bonds. Create your own income stream that's specific to your needs by establishing an appropriately sized and well-structured Liquidity strategy.

Second, once you've funded your retirement spending, don't allow the market to determine your success. Your Longevity strategy, which consists of assets utilized for lifetime spending, should be structured so a recession doesn't force you to work longer, spend less, or make other changes to your plan.

Finally, we really shouldn't be worried about near-term recessions and volatility with money that won't be used for decades. Identifying Legacy assets, and managing them appropriately, can help you take advantage of declines in the market.

One of the key advantages to this framework is that it acknowledges the link between risk and time horizon. Assets that are earmarked to be spent in the next few years can't "wait out" short-term volatility, so they need to be invested conservatively. Such assets, like cash, are well suited to meet short-term cash flow needs, but they typically offer low expected returns and lose purchasing power over the long term. By contrast, assets earmarked for long-term spending objectives that won't occur for decades have the inherent "patience" to wait out temporary market losses, so they can be invested more aggressively.

This time-linked framing can also help investors overcome behavioral biases, which are especially prone to showing up during times of market stress. Our research found that equity mutual fund investors underperformed the performance of the equity mutual fund itself by an average of 0.9% p.a. between April 2007 and March 2016, largely due to poor trading decisions.

To be clear, the 3L framework isn't a panacea for solving emotional biases. But by embedding major financial decisions in the family's specific goals and objectives, instead of trying to time markets, the framework provides guidance for action during difficult periods so you can stay on track for a successful retirement.

For related content from the UBS Chief Investment Office, please visit:

- ubs.com/yearahead
- ubs.com/electionwatch
- ubs.com/houseview

Liquidity. Longevity. Legacy. disclaimer: Timeframes may vary. Strategies are subject to individual client goals, objectives, and suitability. This approach is not a promise or guarantee that wealth, or any financial results, can or will be achieved.

Appendix

UBS Chief Investment Office's ("CIO") investment views are prepared and published by the Global Wealth Management business of UBS Switzerland AG (regulated by FINMA in Switzerland) or its affiliates ("UBS").

The investment views have been prepared in accordance with legal requirements designed to promote the **independence of investment research.**
Generic investment research – Risk information:

This publication is **for your information only** and is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product. The analysis contained herein does not constitute a personal recommendation or take into account the particular investment objectives, investment strategies, financial situation and needs of any specific recipient. It is based on numerous assumptions. Different assumptions could result in materially different results. Certain services and products are subject to legal restrictions and cannot be offered worldwide on an unrestricted basis and/or may not be eligible for sale to all investors. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness (other than disclosures relating to UBS). All information and opinions as well as any forecasts, estimates and market prices indicated are current as of the date of this report, and are subject to change without notice. Opinions expressed herein may differ or be contrary to those expressed by other business areas or divisions of UBS as a result of using different assumptions and/or criteria.
In no circumstances may this document or any of the information (including any forecast, value, index or other calculated amount ("Values")) be used for any of the following purposes (i) valuation or accounting purposes; (ii) to determine the amounts due or payable, the price or the value of any financial instrument or financial contract; or (iii) to measure the performance of any financial instrument including, without limitation, for the purpose of tracking the return or performance of any Value or of defining the asset allocation of portfolio or of computing performance fees. By receiving this document and the information you will be deemed to represent and warrant to UBS that you will not use this document or otherwise rely on any of the information for any of the above purposes. UBS and any of its directors or employees may be entitled at any time to hold long or short positions in investment instruments referred to herein, carry out transactions involving relevant investment instruments in the capacity of principal or agent, or provide any other services or have officers, who serve as directors, either to/for the issuer, the investment instrument itself or to/for any company commercially or financially affiliated to such issuers. At any time, investment decisions (including whether to buy, sell or hold securities) made by UBS and its employees may differ from or be contrary to the opinions expressed in UBS research publications. Some investments may not be readily realizable since the market in the securities is illiquid and therefore valuing the investment and identifying the risk to which you are exposed may be difficult to quantify. UBS relies on information barriers to control the flow of information contained in one or more areas within UBS, into other areas, units, divisions or affiliates of UBS. Futures and options trading is not suitable for every investor as there is a substantial risk of loss, and losses in excess of an initial investment may occur. Past performance of an investment is no guarantee for its future performance. Additional information will be made available upon request. Some investments may be subject to sudden and large falls in value and on realization you may receive back less than you invested or may be required to pay more. Changes in foreign exchange rates may have an adverse effect on the price, value or income of an investment. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information.
Tax treatment depends on the individual circumstances and may be subject to change in the future. UBS does not provide legal or tax advice and makes no representations as to the tax treatment of assets or the investment returns thereon both in general or with reference to specific client's circumstances and needs. We are of necessity unable to take into account the particular investment objectives, financial situation and needs of our individual clients and we would recommend that you take financial and/or tax advice as to the implications (including tax) of investing in any of the products mentioned herein.
This material may not be reproduced or copies circulated without prior authority of UBS. Unless otherwise agreed in writing UBS expressly prohibits the distribution and transfer of this material to third parties for any reason. UBS accepts no liability whatsoever for any claims or lawsuits from any third parties arising from the use or distribution of this material. This report is for distribution only under such circumstances as may be permitted by applicable law. For information on the ways in which CIO manages conflicts and maintains independence of its investment views and publication offering, and research and rating methodologies, please visit www.ubs.com/research. Additional information on the relevant authors of this publication and other CIO publication(s) referenced in this report; and copies of any past reports on this topic; are available upon request from your client advisor.
Important Information about Sustainable Investing Strategies: Sustainable investing strategies aim to consider and incorporate environmental, social and governance (ESG) factors into investment process and portfolio construction. Strategies across geographies and styles approach ESG analysis and incorporate the findings in a variety of ways. Incorporating ESG factors or Sustainable Investing considerations may inhibit the portfolio manager's ability to participate in certain investment opportunities that otherwise would be consistent with its investment objective and other principal investment strategies. The returns on a portfolio consisting primarily of sustainable investments may be lower or higher than portfolios where ESG factors, exclusions, or other sustainability issues are not considered by the portfolio manager, and the investment opportunities available to such portfolios may differ. Companies may not necessarily meet high performance standards on all aspects of ESG or sustainable investing issues; there is also no guarantee that any company will meet expectations in connection with corporate responsibility, sustainability, and/or impact performance.
Distributed to US persons by UBS Financial Services Inc. or UBS Securities LLC, subsidiaries of UBS AG. UBS Switzerland AG, UBS Europe SE, UBS Bank, S.A., UBS Brasil Administradora de Valores Mobiliarios Ltda, UBS Asesores Mexico, S.A. de C.V., UBS Securities Japan Co., Ltd, UBS Wealth Management Israel Ltd and UBS Menkul Degerler AS are affiliates of UBS AG. UBS Financial Services Incorporated of Puerto Rico is a subsidiary of UBS Financial Services Inc. **UBS Financial Services Inc. accepts responsibility for the content of a report prepared by a non-US affiliate when it distributes reports to US persons. All transactions by a US person in the securities mentioned in this report should be effected through a US-registered broker dealer affiliated with UBS, and not through a non-US affiliate. The contents of this report have not been and will not be approved by any securities or investment authority in the United States or elsewhere. UBS Financial Services Inc. is not acting as a municipal advisor to any municipal entity or obligated person within the meaning of Section 15B of the Securities Exchange Act (the "Municipal Advisor Rule") and the opinions or views contained herein are not intended to be, and do not constitute, advice within the meaning of the Municipal Advisor Rule.**

External Asset Managers / External Financial Consultants: In case this research or publication is provided to an External Asset Manager or an External Financial Consultant, UBS expressly prohibits that it is redistributed by the External Asset Manager or the External Financial Consultant and is made available to their clients and/or third parties.For country disclosures, click here.
Number 06/2019. CIO82652744