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ModelWealth

Financial Planning Summary

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Executive Summary

You two have done a masterful job at managing your finances. As a result, this analysis has mostly been a confirmation of all you do right rather than a list of recommendations for improvement. We explain this in the pages that follow. Ahead of that, we offer this executive summary.

Your $1.7 million portfolio is massive when compared to most Americans. It's even more massive when we think how many years of savings you have ahead of you. Consider that a few months back we raved about a 40-year old couple that had already saved $750,000 and was saving $50,000 per year. You two have more than double that value, and you can probably save twice as much!

One of your portfolio's most impressive characteristics is its "tax diversification". Your balance of after-tax, pre-tax, and tax-free investments is outstanding. Your portfolio is worth $1.7 million and 27 percent of the value is tax-free! We're certain you'll continue this story by making "back door" Roth IRA contributions, maximizing a health savings account, and aligning your investments so that the greatest long-term returns occur in your tax-free accounts. All the while, you'll continue to get valuable tax deductions through your current 401(k) contributions.

To illustrate just how much you've saved, consider some simple math… If you never add another dollar and you retire in 2036, your portfolio could be worth today's feel of $3.3 million at that time. That's based on you earning a modest 4 percent inflation-adjusted average annual return over the next 17 years. Include your $62,300 annual savings and the number jumps to $4.9 million (again, in today's dollars).

Yet you might barely need your portfolio when 2036 arrives. This is thanks to Kate's deferred compensation plan paying $100,000 per year of inflation-adjusted income during the first 10 years of retirement. As a result, most of your portfolio is not 17 years away, but more like 27 years away and beyond.

At that time, you'll be 70- and 65-years old and just beginning to collect Social Security… Social Security we project at $60,000 in today's feel. It's our belief that your already substantial wealth, your future savings, and your projected retirement income could make for an incredibly large portfolio as you age.

But what if Kate's loses her partnership and reverts to earning, say, a $200,000 income? Or what if one of you dies? Or both of you? Or maybe Kate becomes disabled and can no longer work and earn this big income that affords so much of your lifestyle? You'll be glad to know we tested each of these scenarios and the results were positive.

We also ran the numbers for Ella's college. These too look great. Her 529 plans appear to afford at least three years at expensive out-of-state schools and all four years at in-state schools. Of course, she could end up choosing an expensive private school and receive no scholarship money whatsoever. In that case it appears you'll have the extra cash flow to pay any shortfalls.

Speaking of cash flow, we project you have lots of it. If we're correct, you can increase your annual savings and be even wealthier in retirement. But why? To spend more money as an older, slower, and more wrinkly couple? What if we said you can spend more today? Because you can. And perhaps you should. We're glad to hear you'll someday be remodeling your current home into the home of your dreams. That's a good start. Is there anything else?

Thankfully there were a few small recommendations we could offer to justify our purpose here. It looks like an analysis of your home, auto, and umbrella insurance resulted in a 25 percent savings in premiums. We're also certain we can make your portfolio an even more well-oiled machine than it is today, and probably save you lots in taxes over the next many decades.

In closing, we're glad you found us and gave us the trust to help with your finances. We hope the following information and its accompanying reports are everything you need to feel confident with your money!

Sincerely,

Randy Bruns Alex Offerman Anna Thornburg

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Base Facts

1. Kate is 42 (born 11/16/1976) and John is 38 (born 01/26/1981).
2. You have one child, Ella, who is 8 (born 06/19/2011).
3. You do not plan to have any more children.
4. You live in Milwaukee, Wisconsin and have no plans to move.
5. You hope to perform a major renovation on your home within the next 10 years.
6. Your net worth is roughly $2.2 million.
7. Kate is a partner with XYZ Consulting and makes approximately $467,500 before taxes.
8. Kate’s income includes a base salary of $400,000, partnership distributions of $25,000, and a bonus equaling 10 percent of the previously mentioned amounts ($42,500).
9. John will soon begin part-time work in IT, making $15,000 to $20,000 per year.
10. You’ve been saving $62,300 per year, which includes Kate’s 401(k) ($19,000), Kate’s profit-sharing plan ($24,300), Kate’s Roth IRA ($6,000), John's Roth IRA ($6,000), and your HSA contribution ($7,000).
11. It’s likely that you have excess cash flow beyond the savings mentioned above.
12. You’ve been spending roughly $147,000 per year, based on Kate’s bi-weekly draw of $4,500 and an additional $30,000 withdrawal.
13. You’d like the opportunity to retire in or around 2036, when Kate is 60 and her partnership expires.
14. In retirement you’d like to assume a similar level of spending as today, adjusted for inflation.
15. You’d like to pay for Ella's college in its entirety, less any scholarships or other financial aid.
16. You have four 529 college savings plans for Ella (through both Illinois and Wisconsin) that are worth $133,000 in total.
17. You are comfortable with the historical fluctuation of stocks and bonds in an allocation considered prudent for your age (70 to 80 percent stocks).
18. Kate has long-term disability insurance through her employer that covers 60 percent of her pay up to $25,000 per month.
19. Kate has $2.5 million of 20-year term life insurance (purchased in 2013) and John has $1 million of 15-year term life insurance (purchased in 2016).
20. You’ve completed estate planning documents that include wills, trusts, and powers of attorney.

Net Worth

21. Your net worth is roughly $2.2 million.
22. Your assets are worth $2.6 million, and your debt is $377,000.
23. Your financial accounts are worth $1.7 million and include cash of $225,000 (at both XYZ Consulting and in savings), taxable investments worth $476,000, pre-tax retirement accounts worth $568,000, tax-free retirement accounts worth $448,000, and a health savings account worth $7,000.
24. You also own a partnership stake in XYZ Consulting worth $250,000, a home worth $550,000 and two automobiles worth $23,500 and $18,750.
25. Your only debt is your mortgage balance of $377,000.
26. This is an incredibly large net worth for a 42- and 38-year old couple.
27. You also have a very healthy balance of taxable (40 percent), pre-tax (33 percent), and tax-free accounts (27 percent) across your net worth… known as “tax diversification” by personal finance experts.

28. This has lots to do with many years of Roth contributions – when you were eligible – and your ongoing strategy of employing "back door" Roth contributions – which few investors in your position take advantage of.
29. Click here to view your net worth statement.

Cash Flow - Inflows

30. We estimate your combined income from employment to be $487,500.
31. This income is derived from Kate's base salary of $400,000, Kate's partnership distribution of $25,000, Kate's bonus equaling 10 percent of the prior two sources ($425,000 x 10 percent = $42,500), and John's estimate of $20,000 per year of part-time income.
32. After taxes and savings, we estimate that you are receiving $232,800 of annual income.
33. Kate may have opportunities to increase her partnership levels in the future, levels that are offered in $125,000 increments up to a maximum total partnership of $500,000.
34. For our projections, we assume Kate will increase her partnership to the $500,000 level in 2024 (5 years from today).
35. At that point, Kate's partnership distributions will increase to $50,000 per year and her bonus rises accordingly.
36. Click here to view a summary of these inflows in a 5-year cash flow projection.

Cash Flow - Outflows

37. Your outflows are comprised of money you save, money you spend to live your life, and money for taxes.
38. We assume you're saving $62,300 per year towards retirement and health savings accounts.
39. Your savings includes Kate's 401(k) ($19,000), Kate's profit-sharing plan ($24,300), Kate's Roth IRA ($6,000), John's Roth IRA ($6,000), and your HSA contribution ($7,000).
40. Of the $62,300 mentioned above, $38,000 comes out of your income/cash flow mentioned in line 31, while $24,300 is an employer contribution on top of this income.
41. Your lifestyle spending is roughly $147,000 per year, based on Kate's bi-weekly draw of $4,500 and your additional $30,000 withdrawal (the latter of which helps pay income taxes).
42. Our software estimates your income taxes to be about $158,000 based on your projected income. (See your Income Tax Projections report.)
43. Looking at our 2020 estimates (which include some inflation effects), we have you earning $499,155 from employment while spending $348,783 of this on savings ($38,700), living expenses, mortgage, and insurance ($151,737), and income taxes ($158,346).
44. The difference implies possible excess cash flow in 2020 of $150,372 ($499,155 minus $348,783), or $12,531 per month.

Excess Cash Flow Potential

45. To be safe, we didn't want to assume your excess cash flow mentioned above is certain.
46. And even if it is, we didn't want to assume you'd save all or even most of it.
47. So, we instead assumed you'll save $40,000 of your annual excess cash flow (inflation-adjusted).
48. This is in addition to the $62,300 you're already putting away between you and your employers.
49. And we assumed every bit of the rest gets spent… by you… on something.
50. If you begin with your 2020 excess cash flow of $150,372 and you remove $41,008 (next year's inflation-adjusted

$40,000 additional savings), you're left with $109,364.

51. This $109,364 can be seen in the "Spend Year End Savings" column in the breakdown of your living expenses on page 12 of your Lifetime Cash Flow Analysis.

Understanding Kate's Deferred Compensation

52. Kate expects to receive a deferred compensation payout of $100,000 per year, inflation-adjusted, beginning at age 60 and lasting through her age 70.
53. This deferred compensation is calculated as 2.5 times Kate's annual income, paid in equal installments over ten years.
54. If we assume Kate's income to be $400,000, we can then estimate Kate's total deferred compensation to be $1 million ($400,000 x 2.5 = $1 million).
55. This is an extraordinary benefit to your retirement as it allows much of your nest egg to remain invested for another ten years beyond 2036, until 2046, when you're 70 and 65.
56. It also helps the case for Kate delaying her Social Security until age 70 for maximized benefits, which is explained in the next section.

Understanding Social Security Estimates

57. Our analysis assumes Kate's Social Security at "full retirement age" (67) will equal today's equivalent of $2,861 per month (34,332 per year).
58. This $2,861 amount is the maximum monthly Social Security benefit one can collect at full retirement age in 2019.
59. That said, we assume Kate will delay her Social Security until age 70 (the maximum age for increased benefits).
60. Kate delaying Social Security will increase her payment by 8 percent per year (plus inflation) during the three years between 67 and 70 (a total increase of 24 percent).
61. We therefore assume Kate will begin Social Security at age 70 and collect today's feel of $3,547 per month ($42,571 per year).
62. Because we don't know John's future earnings outlook, we assume he'll receive one-half of Kate's full retirement age amount.
63. We make this assumption because spouses are entitled to receive the higher of their own Social Security benefits or one-half of their spouse's "full retirement age" amount, whichever is higher.
64. We assume John will collect Social Security at 67 (his full retirement age), which will equal today's feel of $1,430 per month ($17,160 per year).
65. This makes for combined Social Security payments of $4,977 per month ($59,724 per year) in today's dollars once you're both collecting.

Getting a Bit Nerdy on Social Security

66. If you care to know how the system works, here goes…
67. (Otherwise, you should skip this section entirely.)
68. Social Security considers every year of earnings (while paying into Social Security) over your entire working life.
69. That is, every year of earnings only up to the Social Security "wage base" for that year.
70. In 2019 the Social Security wage base is $132,900.

71. Therefore, even if Kate earns $400,000 as a base salary, only $132,900 matters for Social Security purposes.
72. In the process of tabulating your earnings record for Social Security, each year of prior earnings is "indexed" for inflation to create a level playing field in today's dollars.
73. These inflation-adjusted annual earnings are then stacked from highest to lowest…
74. And only the highest 35 years are considered for Social Security calculations.
75. If an individual does not have 35 years of earnings, zeroes are entered for those empty years.
76. The highest 35 years of inflation-adjusted earnings are then totaled.
77. And that total is then divided by 420, which is the number of months in 35 years.
78. The resulting number is your "Average Indexed Monthly Earnings", or AIME.
79. Your Average Indexed Monthly Earnings number is applied to a formula that determines your full retirement age Social Security benefit… also known as your "Primary Insurance Amount", or PIA.
80. Your Primary Insurance Amount is the sum of (a) 90 percent of the first $926 of your average indexed monthly earnings, (b) 32 percent of average indexed monthly earnings over $926 and through $5,583, and (c) 15 percent of average indexed monthly earnings over $5,583.
81. Delay collecting beyond your full retirement age and your Primary Insurance Amount increases by 2/3 of one percent for every month.
82. Collect before your full retirement age and your Social Security is reduced by 5/9 of one percent for each month up to 36 months.
83. If you collect earlier than 36 months ahead of your full retirement age, your Social Security is further reduced by 5/12 of one percent for those months.

Understanding Your Investment Return Assumptions

84. Financial planning requires you to make assumptions for your investment returns.
85. Because the things you'll buy will likely change in price over time, you should think of your potential investment returns in relation to the rising cost of whatever you're saving for.
86. The return on your investments relative to the changing cost of your future expenditures is known as your "real return".
87. Fortunately, we have 93 years of measured history (1926-2018) to show what these returns have been.
88. This can be seen in the third column of Vanguard's Risk and Reward table, titled "Inflation-Adjusted Average Annual Returns".
89. Looking at history, you'll notice that cash has earned about 0 percent real returns (aka no real return), bonds have earned about 2 percent real returns, and stocks have earned about 7 percent real returns.
90. Meanwhile, diversified portfolios of stocks, bonds, and cash have earned average annual returns somewhere in the middle of these numbers, depending on the allocation.
91. Our Lifetime Cash Flow Analysis report projects a 7.29 percent average annual return on your retirement investments while working and a 6.12 percent average annual return while retired… all this while inflation is assumed to be 2.52 percent.
92. Note: This equates to real return expectations of +4.65 percent over inflation during your remaining working years and +3.51 percent over inflation during your retired years.
93. These returns are slightly lower than historical averages.

A Low Return Decade for Ella's 529 Plans

94. Although history can serve as guide for understanding markets, it's widely believed that returns will lag historically averages over the next 10 years.
95. In its 2019 Economic and Market Outlook, Vanguard cautioned investors to assume lower than average annual returns in the coming decade.
96. Morningstar expressed a similar market forecast, including its own thoughts with those of Vanguard and others in this January 2019 article by Christine Benz.
97. We think a low return decade matters mostly for Ella's college (beginning in 10 years and depleting quickly) rather than your retirement (beginning in 17 or more years with very small annual withdrawals).
98. Also, within a few years, Ella will likely switch to conservative investments with low yields.
99. A muted outlook for returns combined with conservative investing justifies using low real return expectations for Ella's 529 investments.
100. You can view Ella's College Analysis report, available by clicking here.

Ella's 529 College Savings

101. You may have already saved about enough for Ella's college.
102. The math below reaches similar conclusions as Ella's College Analysis report, but with a simpler approach.
103. We think Ella's 529 plans may be worth today's feel of $162,887 when she's 18 (in 10 years).
104. These calculations are based on Ella having $133,624 of value today and earning a +2 percent average annual return above college costs over the next 10 years.
105. To arrive at the $162,887 number, you can simply type $133,624 in your computer's calculator, multiply by 1.02, and hit enter 10 times.
106. This could potentially afford $40,721 per year of college costs ($162,887 divided by 4 years).
107. These estimates run closely in line with per year average college costs of $25,290 for in-state, $40,940 for out-of-state, and $50,900 for private colleges, according to this article by ValuePenguin/LendingTree.
108. If there's a shortfall, you can cover it with excess cash flow and/or personal savings.
109. Although balanced portfolios of stocks and bonds have earned approximately 5 percent over inflation during the past 93 years, we think the 2 percent expectation is a more reasonable estimate.
110. We conclude this because of the muted expectation for markets over the next decade by many experts and because Ella will soon have a very conservative allocation as college approaches.
111. You could add more to your Wisconsin 529 plans and deduct up to $3,280 per year from your Wisconsin state income taxes…
112. But doing so will save you just $171 per year, according to calculations performed on your behalf using Vanguard's 529 state tax deduction calculator.
113. You're investing in the age-based investment options at both Edvest and BrightStart, and we think those are terrific choices for you.
114. Age-based investment programs (like yours) are designed to be the complete portfolios of prudent investors, based on the age of the child, and are automatically managed and adjusted for the shortened time horizon as college approaches.

Longer Term Growth Potential for Your Retirement Funds

115. Unlike Ella's 529 plans, the bulk of your retirement investments have multiple decades for markets to find their long-term averages.
116. We're not just talking about the 17 years until your desired retirement ages of 60 and 55 (2036).
117. Even if you retire in 17 years, we project another 10 years of substantial income (today's feel of $100,000 per year) to be paid out from Kate's deferred compensation plan between 2036 and 2046.
118. Our simulation shows you withdrawing just 1.30 percent or less during these first 10 years of retirement.
119. This sets up a possible scenario where you have $1.7 million today, add more than $60,000 per year to it, have a 17-year time frame to leave these investments to grow, barely touch the investments during the 10 years after that, and then begin Social Security thereafter.
120. This and other information are illustrated in your Lifetime Cash Flow Analysis report, which is included separately and discussed in the next section.

Your Lifetime Cash Flow Analysis Explained

121. Your Lifetime Cash Flow Analysis report provides an in-depth year-by-year look at all the moving parts of your financial life.
122. In it we review all your inflows, outflows, savings, taxes, cash flow excesses and shortfalls, the impact these have on your portfolio, and the potential value of your portfolio over time.
123. In a way, it's like everything we could cram into the most thorough spreadsheet of your financial life.
124. And because long-term averages are far more predictable than short-term returns, we added a Monte Carlo simulation to test your wealth against the randomness of markets.
125. Monte Carlo simulations begin with the premise that long-term average annual returns only tell part of the story about how your wealth will change over time.
126. The short-term volatility associated with long-term average returns creates drastic differences in eventual wealth when cash is added and withdrawn under different market circumstances.
127. Your Monte Carlo simulation randomized 1,000 separate sequences of market returns – as a backdrop to all the projected cash flow in your future – to estimate a range of what your portfolio could be worth later in life.
128. In no test did you run out of money, and the median result was that you have today's feel of $13.4 million at ages 90 and 85.
129. The bottom line is that your Monte Carlo results were outstanding.
130. You'll find our comments throughout the PDF of your Lifetime Cash Flow Analysis as a narrative guide.

What if Kate's Income Falls to $200,000?

131. We ran one additional simulation showing Kate's income falling to $200,000.
132. This scenario assumed her partnership interest is returned and partnership distributions cease.
133. We also assumed there'd be no deferred compensation plan nor 10-year payout at age 60.
134. Savings is reduced to Kate putting away the maximum into a 401(k), receiving a 3 percent of income match, and you continuing to maximize your health savings account.
135. With these changes we also assumed you'd work until ages 67 and 62, rather than ages 60 and 55.
136. All other assumptions were left unchanged.

137. You'll be glad (and perhaps surprised) to hear that this scenario also has great results.
138. Your reduced income still affords about all your living expenses, with the biggest change being you not able to save as much for the future.
139. And although income and annual savings is reduced and there is no deferred compensation payout, these losses are partially offset by a delayed retired age from your preferred scenario.
140. Ultimately, you've saved such a massive amount to date that saving less in future years is fine.

Long-Term Disability Insurance

141. Your financial plans are largely dependent on one big thing: your ability to work and earn income.
142. Lost income as a result of disability – cancer, for example – has the potential to change everything.
143. Disability insurance is therefore critical to keep paying the bills today and save for tomorrow.
144. Fortunately, Kate has long-term disability insurance through XYZ Consulting that pays 60 percent of her salary, up to $25,000 per month.
145. This insurance is based on an "own occupation" definition, meaning it pays out if Kate cannot perform the specific duties associated with her XYZ Consulting position.
146. In other words, the insurance should not be denied even if Kate can find other employment.
147. Kate's long-term disability insurance begins after 90 days of disability, also known as a "90-day elimination period".
148. It's a standard provision that disability policies pay no more than 60 percent of pre-disability income, because any greater amount can act as a deterrent to the insured individual returning to work.
149. Because Kate's income affords all your current expenses while also allowing you to save more than enough for retirement, we do not feel John requires disability insurance.

Life Insurance

150. We think your life insurance needs are adequately covered by the policies you own.
151. John has a 15-year term life insurance policy that was established 5/31/16 for $1 million.
152. Kate has a 20-year term life insurance policy that was established 10/22/13 for $2.5 million.
153. Helping your life insurance needs are you having Ella's college costs possibly covered, you having a sizeable net worth that could afford her life until she's an adult (if both of you die), you having $1.7 million of financial assets already (which means less need for retirement savings in future years), and each of you having the ability to work and earn income as a survivor if one of you dies.
154. As of right now, Kate's income is the bulk of what we've based our analysis upon.
155. And we know there's lots of excess cash flow from Kate's income.
156. The prior two points make a case for John needing less rather than more life insurance to help Kate if John dies.
157. Therefore, John's $1 million appears to be enough.
158. On the other hand, Kate's death would mean a big income loss for the family.
159. However, Kate has a $2.5 million policy that would pay out to John (tax-free) if she dies.
160. These proceeds should be more than enough to fulfill any spending shortfalls John incurs.
161. Not to mention, John could likely return to a higher paying job if he chose to do so.
162. You've wisely chosen term life insurance policies because they cover the period (term) of your life where a

death is most dangerous to your finances, and they do so in a very affordable manner.

163. Nevertheless, your net worth makes life insurance far less necessary than others who haven't saved so much.

Choosing Your Asset Allocation

164. We see no reason why you shouldn't invest your retirement funds with at least 70 percent stock exposure (and therefore no more than 30 percent bond exposure).
165. Our specific recommendation is that you invest 80 percent in stocks and 20 percent in bonds.
166. This is considered a normal allocation for your age.
167. After all, retirement is likely 17 or more years away.
168. And even if you retire in 17 years, Kate's deferred compensation payout will mean only small percentage withdrawals will be needed from your investments during that first decade of retirement (2037 to 2046).
169. Looking at page 30 of the Lifetime Cash Flow Analysis, you're projected to withdraw 1.30 percent or less of your portfolio during the first 10 years of retirement.
170. Actually, we think your retirement portfolio is mostly three or more decades away from significant use.
171. We think volatility can be tolerated just fine with such a time horizon.
172. Your stock exposure should be allocated 60 percent across the broad US stock market and 40 percent across the broad international stock market.
173. Two great examples of funds to achieve these recommendations are Vanguard Total Stock Market Index (broad US stocks) and Vanguard Total International Stock Market Index (broad foreign stocks).
174. We recommend your bond exposure be allocated 70 percent to high quality, intermediate-term US bonds and 30 percent to high quality, intermediate-term foreign bonds.
175. Two great examples of funds to achieve these recommendations are Vanguard Total Bond Market Index (US bond market) and Vanguard Total International Bond Index (foreign bonds).
176. These weightings match the internal proportions of Vanguard's Target Date Retirement and Vanguard's LifeStrategy® series of pre-built portfolios.
177. You don't need to use these exact funds, but your portfolios should have similar broad market exposure that is both low cost and simple to manage.
178. We argue in favor of "index" mutual funds as your most desirable choice for investing, and we think there's no better article on the matter than Chip and Dan Heath's "Made to Stick: The Myth of Mutual Funds" (*Fast Company,* 2008).
179. We get specific to your recommendations later in this report and in an attached Investment Policy Statement.

Asset Location Matters

180. Taxes present a significant cost that can reduce your net investment returns.
181. While your asset allocation will largely determine the risk and return of your portfolio, further steps can be taken to increase wealth through tax management.
182. This can be achieved by strategically allocating your asset classes across your taxable, pre-tax, and tax-free accounts in way that maximizes your after-tax return.
183. In other words, you shouldn't apply an 80/20 allocation to each account you own.
184. This concept is known as "asset location".

185. Asset location is especially valuable for you because of your already terrific tax diversification across taxable, pre-tax, and tax-free accounts.
186. You should instead carefully place your various asset classes (stocks and bonds) into the accounts that will collectively leave you with the highest after-tax return.
187. Vanguard has made famous the phrase "It's not what you earn, it's what you keep", which lends itself in part to these conversations.
188. Vanguard briefly mentions such tax strategies on page 23 of its Vanguard Principles for Investing Success guide.

Asset Location Recommendations

189. You should prioritize stock market exposure in your Roth IRAs.
190. If stocks outperform bonds over the long-term, which is a fair assumption, putting these larger returns in Roth accounts maximizes the effects of tax-free growth.
191. Conversely, one could argue that holding more conservative investments with smaller returns would be a less-than-optimal use of the Roth's tax-free benefits.
192. Next, you should own broad stock market index funds in your taxable accounts as they are incredibly tax-efficient for accounts that offer little tax protection.
193. Putting stock exposure in your taxable accounts allows long-term stock appreciation to receive favorable capital gains tax rates (currently 0 to 20 percent).
194. If you instead earned these gains in a pre-tax retirement account, you'd eventually pay ordinary income tax rates (which exceed long-term capital gains tax rates) on that same growth.
195. Holding stocks in your taxable accounts also diverts potentially large stock market gains from being counted towards IRS required minimum distributions (RMDs) after age 70 ½.
196. And unrealized capital gains of taxable accounts currently pass to heirs free from taxes (thanks to an something called "stepped up cost basis").
197. Lastly, your pre-tax retirement accounts should be whatever allocation is necessary to tie your entire portfolio (across all accounts) back to your 80/20 stock/bond target.
198. Therefore, if your taxable and Roth accounts are entirely comprised of stock mutual funds, your pre-tax retirement accounts must own more bonds to keep the total allocation at 80/20.
199. You should periodically review your aggregate allocation to determine if rebalancing is necessary.
200. If rebalancing is needed, it's likely you can do all the necessary trades within your tax-deferred accounts to bring the aggregate allocation back to 80/20.
201. This is a wonderful way to rebalance because it means no capital gains find your tax return.
202. With almost all your wealth in stocks at your current ages, asset location won't matter quite as much today as it will later in life.
203. But as you grow older and you increase exposure to bonds, it'll be especially wise to consider asset location.

Back-Door Roth Contributions

204. "Back door" Roth IRA contributions are an additional strategy that increases your after-tax wealth.
205. You've already been making back door Roth IRA contributions and we suggest you continue.

206. The big value in making back door Roth contributions is that you're shifting an even greater percentage of your future net worth to tax-free status, which translates to a less taxing retirement and, ultimately, more money in your pocket.
207. And it costs you pretty much nothing to do it.
208. Here's a reminder of how it works…
209. Neither of you are eligible to make Roth IRA contributions as a result of your income exceeding certain limits.
210. You can however indirectly make Roth IRA contributions through a "back door" Roth IRA strategy.
211. To begin, each of you make non-deductible traditional IRA contributions of $6,000 (the limit) in 2019.
212. (Anyone under age 70 ½ with earned income (or a spouse with earned income) can make non-deductible contributions to a traditional IRA.)
213. No tax deduction can be taken, as your modified adjusted growth income exceeds the $199,000 limit to do so.
214. At this point your traditional IRAs are each worth $6,000 and are comprised entirely of after-tax money.
215. You then convert these funds to Roth IRAs, which is something anyone can do (up to any amount) in any given year.
216. This conversion out of a traditional IRA means recognizing income on any and all pre-tax portions of your converted amounts.
217. But because no deductions were ever taken on the original traditional IRA contributions, no taxes are owed as a result of the conversions.
218. Effectively, you move $12,000 in 2019 ($6,000 per person) into Roth IRAs even through your income wouldn't allow for a normal Roth IRA contribution.
219. You just made Roth IRA contributions "back door" by way of traditional IRAs.

Roth IRA and HSA Recommendations

220. For your Roth IRAs and HSA, we recommend Vanguard Total World Stock Index Fund (VTWAX) as the sole investment.
221. This fund provides complete exposure across the global stock market (more than 8,200 stocks) with an expense ratio of 0.10 percent.
222. As mentioned in the "asset location" explanations of this summary, global stocks will hopefully provide significant long-term growth and therefore maximize the tax-free benefits of your Roth IRA.
223. Note that your Roth accounts could hold far more investments than this single index fund…
224. However, doing so would mean building a more complicated portfolio that attempts to achieve the very same allocation as what the Vanguard Total World Stock Index Fund provides.
225. Note: If any part of you wishes to own a low-cost "actively managed" stock mutual fund, we think your Roth IRA is the best place to do so.

Taxable/Non-Retirement Account Recommendations

226. Your taxable investment accounts should be entirely invested in stocks and stock mutual funds that require a minimal amount of trading and other taxable activity.
227. We recommend holding onto your existing investments at Vanguard, Computershare, and Morgan Stanley.
228. This recommendation is supported (a) by the large capital gains you'd otherwise incur to sell them and (b) because we think these investments are fine components of a diversified portfolio.

229. Assuming you add money to your taxable accounts, we recommend investing in [Vanguard Total World Stock Index Fund (VTWAX)].
230. This fund offers the potential for significant long-term capital gains (a plus for taxable accounts) and little in the way of distributions, excessive income, and the undesirable taxes that result.
231. By investing in a single broad market index fund you'll avoid the tax implications of rebalancing a portfolio of many separate mutual funds.

Pre-Tax Retirement Account Recommendations

232. If your tax-free and taxable accounts target 100 percent stock exposure, your pre-tax retirement accounts must achieve whatever allocation is necessary to complete an 80/20 allocation across your total portfolio.
233. At this moment that requires a 56 percent stock / 44 percent bond allocation target for your 401(k) plans.
234. For John, we recommend Vanguard 500 Index (28%), Vanguard Total International Stock Index (28%), and Vanguard Total Bond Market Index (44%).
235. For Kate, we recommend Fidelity 500 Index (28%), Vanguard Total International Stock Index (28%), and Vanguard Total Bond Market Index (44%).
236. This is straightforward but will require periodic reviews of your aggregate allocation to determine if rebalancing is needed.
237. A nice side benefit to this overall strategy is that all rebalancing can likely be done inside of tax-sheltered accounts.
238. Note: We prefer a broader stock market index than the S&P 500 for your U.S. stock exposure here – one that includes small company stocks – but there isn't one available in either of your employer plans.

Morningstar's Snapshot of Your Aggregate Portfolio Recommendation

239. Click here for a Morningstar Snapshot of your recommended portfolio across all accounts.
240. Notice in the Morningstar style boxes near the top right of page 1 that your recommended portfolio holds more than 10,000 stocks and nearly 15,000 bonds.
241. In those style boxes you'll also see percentages showing your hypothetical allocation to large, medium, and small stocks representing growth, value, and blend tilts.
242. In the bond style box you'll see your hypothetical bond exposure allocated to high credit quality borrowers that are moderate (intermediate)-term in duration.
243. In the pie chart at the top left of page 1 you'll see your 80/20 split among US stocks, foreign stocks, and bonds.
244. The net expense ratio of this hypothetical portfolio is 0.08 percent, as shown near the bottom right of page 2.
245. The remaining pages of your Morningstar report illustrate your individual investment recommendations as well as the internal allocations of each separate account you own.
246. Note that John's 401(k) funds are "trusts" and are not the same exact "share class" of funds we show in the Morningstar snapshot.
247. The difference isn't meaningful; In fact, John's 401(k) funds might be slightly less expensive than those shown in this Morningstar snapshot.

Understanding the Market Risk of Your Portfolios

248. You should remember that risk and return are closely related.

249. Risk and day-to-day uncertainty are the primary reasons for why excess returns exist in the first place (over leaving your money in cash).
250. Academics define these excess returns over cash as "risk premiums".
251. Growth-oriented (80 percent stock 20 percent bond) allocations have earned +6.38 percent inflation-adjusted average annual returns since 1926.
252. However, 80/20 allocations saw returns of -31.21 percent (1973-1974), -32.69 percent (2000-2002), and -35.57 percent (2008-2009) during the last three major stock market crashes (at lowest month end).
253. If your approximate $1.7 million portfolio loses -35.57 percent of its value (like the 2007-2008 crash), it would decline by -$604,690.
254. Said another way, your $1.7 million would decline to roughly $1.1 million.
255. Diversified portfolios recovered significantly in the years that followed the 2008-2009 market crash, eclipsing pre-crash levels by a considerable margin.
256. Our recommendations assume you stick with your portfolios during such difficult markets.

Rebalancing Your Portfolio

257. It's important that your portfolio is "rebalanced" when necessary, which means getting your asset classes back to their intended weights of the total.
258. Rebalancing ensures no single asset class/investment becomes too large after a period of outperformance (potentially ahead of a crash), nor too small after a period of underperformance (potentially ahead of a bull market).
259. Franklin Templeton's "Why Diversify, Because Winners Rotate" chart provides a wonderful visual representation of the randomness of markets and why rebalancing is so important.
260. Studies have shown the most appropriate time to rebalance is whenever an asset class "drifts" beyond a certain percentage (or threshold) relative to its target percentage.
261. We recommend this drift be set at + or – 20 percent relative to the target percentage.
262. This 20 percent drift recommendation comes from groundbreaking research by Gobind Daryanani (Managing Director of TD Ameritrade's iRebal software), titled "Opportunistic Rebalancing: A New Paradigm for Wealth Managers".
263. It was later reinforced by personal finance expert Michael Kitces in his 2016 study "Finding the Optimal Rebalancing Frequency – Time Horizons vs. Tolerance Bands".
264. Looking at just broad US stocks, foreign stocks, and bonds, your recommended percentage targets and acceptable drift ranges are shown in the table below:

Recommended Allocation (80/20)			Acceptable Range		
Asset Class	Allocation Target	Acceptable Drift	Low	To	High
US Stocks	48%	9.2%	38.8%	To	57.2%
Foreign Stocks	32%	6.4%	25.6%	To	38.4%
US Bonds	20%	4.0%	16.0%	To	24.0%
Total	100%				

265. For example, your U.S. stock target is 48 percent of your aggregate portfolio value and should be rebalanced if it falls below 38.8 percent or rises to more than 57.2 percent of your total portfolio value.
266. You should periodically review your percentage exposure to each of these broad asset classes (US stocks, foreign stocks, and bonds) across all accounts combined and rebalance if necessary.
267. As we mentioned in line 237, it's likely you can rebalance your portfolio back within an acceptable range by simply making a few adjustments to your 401(k) allocations.
268. You can also visit with us every so often and we'll show you exactly how to do it.
269. Rebalancing can be simple, but it may take a few real-life instances to get the hang of it.

Short-Term Cash

270. You've typically kept $80,000 in short-term cash-like accounts.
271. This cash is meant to pay for sudden, unexpected bills and to afford lump sum purchases within the next 24 months.
272. We assume you'll continue to keep $80,000 in cash for these purposes.
273. As mentioned earlier, cash-like investments have historically earned returns that follow inflation.
274. After-taxes, you should assume that your cash lags inflation.
275. If you pay your taxes out of cash flow, we expect your cash balances to move in lockstep with inflation.
276. Therefore, your $80,000 cash, with reinvested interest, should always be worth about today's feel of $80,000.
277. Your XYZ Consulting cash earns 4 percent interest is very attractive, even when compared to high interest online savings accounts that pay approximately 2 percent as of this summary.
278. However, you should remember that your XYZ Consulting accounts are not FDIC insured.

Estate Planning

279. As we understand it, your estate planning documents are up to date.
280. These include your trusts, wills, and powers of attorney for both property and health care.
281. If you haven't already done so, you should confirm with your attorney which accounts should be titled in the name of your trust and promptly contact your financial institutions with these instructions.
282. Relating to the prior point, you should also know exactly how primary and contingent beneficiaries should be titled on your retirement accounts and the 529 plans.
283. Note that you have an individually titled investment account with John's name only, and we wonder if that's correct according to your wishes.

Auto, Home, and Umbrella Insurance

284. Aside from its cost, we saw little need for change in your auto, home, and umbrella insurance policies.
285. Our records show you were paying $3,438 per year insurance before our analysis…
286. And you'll now be paying $2,592 per year.
287. That's roughly a 25 percent reduction, which we'd say is a big deal.

Paying for Advice

288. We don’t believe it's necessary for you to pay a percentage of your account value for financial advice.
289. However, that remains the most popular way consumers hire firms for financial advice.
290. We think this is mostly because consumers have little understanding of the real cost of seemingly small percentage fees.
291. Under your current scenario, reducing your inflation-adjusted return from 5 percent to 4 percent over the next 17 years would cost today’s feel of $866,067.
292. Continue the math deep into retirement and the loss could mean millions of dollars.
293. Portfolio management can practically be free nowadays, in the form of asset allocation mutual funds and portfolios that automatically rebalance themselves for you.
294. Or, as in your case, you can simply build an appropriate portfolio, leave it alone to do its work, and check in with a financial planning firm every six months or so for rebalancing and other planning-related questions.

Future Financial Reviews

295. We recommend 6- to 12-month reviews of your financial life, similar to seeing a doctor or dentist.
296. This frequency serves as a form of preventative maintenance for your financial well-being.
297. These reviews also work well with the fact that certain actions may be advisable within your tax year.
298. Reviews also keep your finances fresh in your mind, so you’ll never forget what you’ve set out to accomplish.
299. We bill based on actual hours during check-ups.
300. We do so because it’s just not much that work in most cases (unlike this up-front engagement).

Conclusion

301. We hope the work has answered all your questions and put you in a position to feel confident in financial planning of your retirement.
302. If you’ve been satisfied with our services, we’d love to maintain a relationship with you for ongoing maintenance and future financial planning engagements.
303. We’ll end this summary by saying we’re extremely grateful for your trust, cooperation, and patience as we completed this financial analysis on your behalf.
304. Thank you for reading!

Sincerely,

Randy Bruns | Alex Offerman | Anna Thornburg

Randy Bruns, CFP® RICP®
Principal

Alex Offerman, CFP®
Director of Financial Planning

Anna Thornburg
Director of Operations