MARKET MONITOR

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How to Make the Switch from Paycheck to Paying Yourself

BY: MICHAEL ALEXENKO, CFA

It's tough enough to just work to earn a paycheck. When it's time to face the fact that the regular paychecks will be stopping and we need to live off what we've saved for retirement, that reality can cause the daily grind to turn into outright fear.

Over the course of a career, nearly everyone is sure to have experienced some job insecurity, but as long as we remained employed, we have little doubt that the payroll checks would clear the Bank. The risk of employers running out of cash typically doesn't seem probable, unless of course you've had the misfortune of working for an SVB Bank or one of many retailers that have been Amazon-ed.

The risk of not having enough cash becomes very real once we've made the decision to say goodbye to our employer or to sell the company that we built. A regular income disruption also can come in the form of an unwelcome surprise in the event of a death or divorce. We know that we have a finite amount of resources and that we have to be good stewards of our money. If not, we might someday find our checking account empty.

For the people who have saved, invested (at least 10%+ of annual salary each year) and spent responsibly during their work years, the transition from a paycheck to paying themselves looks a whole lot better than those who never attended their employer's 401(k) sessions. Those boring employer retirement program meetings were important and regrettably there may be no such thing as a successful retirement opsimath – sorry!

Besides having saved money during retirement, it's also important that we kept our debts under control. Entering retirement with excessive credit card bills and a hefty mortgage is a bad situation. Unless you have significant wealth, having a large housing payment in retirement will exert some real pressure on your budget. A general rule to follow is to have no mortgage when the paychecks stop. If you have many years left on a mortgage or even worse, rent payments, you probably have many years left to work.

If you want to reduce the risk of running out of money, then stick to the 4% rule. If your portfolio can make 5%-6% and you keep your spending down to around 4% of your investment portfolio, then most financial planning programs will give you a high chance of success (AKA: not outliving your nest egg). Upon retirement you can plan to withdraw about 4% of total liquid assets each year on an inflation adjusted basis to meet your cash needs. This means if you need $100,000 annually you should have $1.3 million in assets and including total Social Security benefits of around $4K monthly for a married couple will get you to your number. The next year you could plan to spend a little more to account for price increases. Or, if your investments are having a particularly bad span, remain flexible with your spending and trim back a little if possible. To increase your financial security, think about adhering rigidly to the 4% rule and spend no more of that amount even if a bear market has just whacked it by 20%. But be aware that this technique will cause you to periodically experience real spending cuts.

After leaving the workforce, several other simple administrative issues that we've never had to address can cause confusion. We need to plan on how to get money from our investment accounts. Which assets do we sell to raise the cash we will need? Should the money come from our IRA or our individual account? How do we pay our income taxes

TIPS ON PAYING YOURSELF

- **Limit Spending to 4% of Total Liquid Assets**
- **Establish Regular Electronic Transfer to Your Checking Account**
- **Roll Investment Income Into Your Money Market Fund**
- **Keep Sufficient Cash on Hand, but not too Much**
- **Increase Bond Exposure**
- **Use IRAs Last**
- **Determine Estimated Tax and Remit Electronically**

See "Plan to Pay..." page 2

You Can Avoid Panic When You Plan to Pay Yourself

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since we no longer have Uncle Sam automatically grabbing his fair share? How much will our tax liability be?

If your assets are split between an IRA and personal investment accounts you may want to keep cash reserves in your personal account of around $50,000 (one full year of cash need). Set up your investments so that all interest and dividend payments are paid to your money market funds. This will help to provide the cash flow you need to meet your distributions. To keep your spending disciplined, consider setting up a monthly electronic transfer from your brokerage account into your bank account. This will help you feel like you are once again receiving a regular paycheck.

It's probably best that you delay withdrawing assets from your IRA as long as possible. Distributions from your IRA are taxable as ordinary income and will cause your tax liability to increase. If you want to save your heirs from higher taxation on inherited assets, then you could consider tapping IRA funds first, or be sure to use them aggressively to pay for healthcare costs in years when those expenses are high. This will help to reduce or possibly eliminate taxes paid on your IRA distributions.

Living off investments creates a need for regular income that will cause most people to increase their investment in bonds. Bonds are an excellent provider of income and they will also fulfill the need for capital preservation that most people desire as they age. Having a consistent income stream from bonds will help you avoid having to sell more investments to meet cash needs. Unless you are a skillful trader it's best to avoid being forced to sell stocks to meet cash needs. Having some bonds and methodically selling a little stock can reduce the damage done to portfolios if you're forced sell stocks in down markets. Don't let the market dictate to you when the right time is to sell. Having adequate cash balances and regular portfolio rebalancing can help us avoid "selling low."

Uncle Sam is always trying to finds ways to make it easier for us to pay taxes. It is very possible you will have to pay estimated taxes four times a year. Consult with your accountant to determine what amount you might have to pay and he/she should be able to instruct you on how to make automatic electronic payments to the IRS.

Many changes in life can be a bit scary, but if you plan a little then paying yourself a check does not need to be one of them.

Market Snapshot:

Monetary Market and Stock Market are Moving in Opposite Directions

By: Michael Alexenko, CFA

The stock market is doing great Up 14.5% YTD, but our monetary markets are another story. The speed at which money pushes through the economy known as the velocity of money is coming down sharply. This is important because cash in the system is like blood in our veins. If the blood stops pumping, we stop moving and if the cash stops circulating through the economy, it means a recession is more likely. One of the reasons that the velocity of money has slowed is because excess cash in the system has been falling. The Federal Reserve has been shrinking its balance sheet which means it is taking cash out of the system and consumers have depleted their stimulus pandemic savings. Loan demand is dropping off too. Without loan demand its hard for money to flow through the economy because low borrowing and low spending are connected. It is good news that the Federal Reserve is done with raising interest rates and that our employment market is solid. The bad news is that these are not uncommon things to happen prior to recessions. These are not arguments for selling stocks aggressively but they are data that suggest that chasing the rally and loading up on stocks at this point could lead to disappointment.

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