HOW TO MANAGE YOUR RETIREMENT ACCOUNT

ADAM GROSSMAN, CFA

Dear Reader,

Thank you for your interest in *How to Manage Your Retirement Account.*

I created this ebook–and founded my firm–for one reason: Because I believe that the financial services industry too often makes personal finance seem more complicated than it needs to be. Yes, as a successful professional, your financial life will have many moving parts. But, I firmly believe that there is a set of universal financial principles that applies to every individual. In the following pages, you will find those principles.

I hope you find this information helpful, and please contact me at any time with questions.

Best regards,

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INTRODUCTION

Ted Benna is not a household name, but I'm sure you're familiar with his invention. In 1978, Benna created the 401(k) retirement plan.

By any standard, Benna's creation has been a massive success. Fifty million Americans entrust more than $5 trillion of retirement savings to 401(k)s and their close cousins, 403(b)s.

Despite that success, Benna has misgivings about his invention. He once said, “I'd blow up the existing structure and start over.” In fact, he wrote an entire book describing the system's failures. Why? Benna explains: “I'm talking about the way investing is done.” The original 401(k), Benna says, was simple: It had just two investment options, a stock fund and a bond fund, and they were available in just a few combinations.

What Benna doesn't like about today's typical 401(k) is the complexity. The average plan gives employees nearly 20 fund choices. And these funds can be combined in a nearly infinite number of combinations. In Benna’s view, 401(k)s have been taken over by mutual fund companies, who have stuffed them full of complicated, overpriced offerings. This is Benna’s chief complaint. In the following pages is a step-by-step guide to help you navigate that complexity.

STEP 1: START WITH A LOGICAL FRAMEWORK

When investing, it is important to adhere to a logical framework.

The **first step** in constructing a portfolio is to decide on the most appropriate asset allocation to meet your financial goals—that is, the mix of stocks, bonds, cash and other types of assets. This, in my view, is the most important step.

Within each asset class, the **second step** is to decide on a sub-asset-class allocation. For example, within your stock portfolio, you want to decide how much to allocate to large company stocks and how much to small company stocks.

The **third and final step** is to choose individual investments–individual bonds or bond funds and/or individual stocks and stock funds.

Because of the way the mutual fund industry advertises, many investors start with the last step first. That is, they choose a fund without first thinking through their goals and without using those goals to establish an asset allocation. That is why I recommend this three-step process to ensure that your investment portfolio is best aligned with your objectives.

STEP 2: TURN TIME TO YOUR ADVANTAGE

“When should I start saving for retirement? Should I wait until I have paid off my student loans?”

That’s a question I hear frequently, and my answer is always the same: today. Regardless of your financial status, the best time to start saving is now. While you might worry that it is not worth saving anything if you can only afford to save a small amount, the fact is that any savings is better than none, for three important reasons:

An earlier start gives you more time to reach your goals. Even if you are just putting away 1% per year, those contributions will begin to add up over time. So, as soon as you are earning any money at all, you should start saving, even if you are still early in your career and still paying off student loans. Save as much as you can, as early as you can.

Savings is a habit. Just like diet and exercise, saving is a habit. It’s not easy, but once you form the habit, it becomes much easier to stick with it. You will quickly get used to living on your remaining income and won’t miss the dollars that are going into your retirement account. In fact, not only will you stick with it, but as you begin to see the benefits, in the form of a rising bank balance, you will feel energized to build upon this habit and to increase your

savings. Many people who begin saving just 1% of their income soon realize that they can afford to put away 2%–thereby doubling their savings. A good strategy here is to increase your contribution rate every time you get a raise. That way you won't ever see your paycheck go down, but your savings will steadily increase.

The most powerful reason to start early is the concept of "compounding." In simple terms, compounding is money you make on the money you've made. Consider a simple example: Suppose you invested $100 in the stock market, and after one year it appreciated by 10%. It would be worth $110 at the end of that first year. Now, assume the market does the same thing the following year and returns another 10%. At first glance, you might think that your investment would increase by another $10 to $120, but you would be overlooking the $10 you made in the first year. You would gain 10% on both your original $100 *as well as* on the $10 you made in the first year. That's the money you make on the money you've made. So, in the second year you will earn $11, not $10. That is the power of compounding, and that is the most important reason to start saving today.

STEP 3: SAVE OFTEN

The stock market is nothing if not an unpredictable roller coaster. Over the past twenty years the market has been cut in half twice and doubled three times. What does this mean for your retirement plans? The chart below illustrates the S&P 500 Index of stocks between 1926 and 2015.

The big moves, including the crashes in 1929, 2000 and 2008, are clearly visible. Look more closely, though, and you will notice lots of little variations. And, sometimes those variations aren't so little. In the middle of 2011, the

market dropped 19%. Near the end of 2018, the market fell 20%, and in 2020, the market dropped 35%.

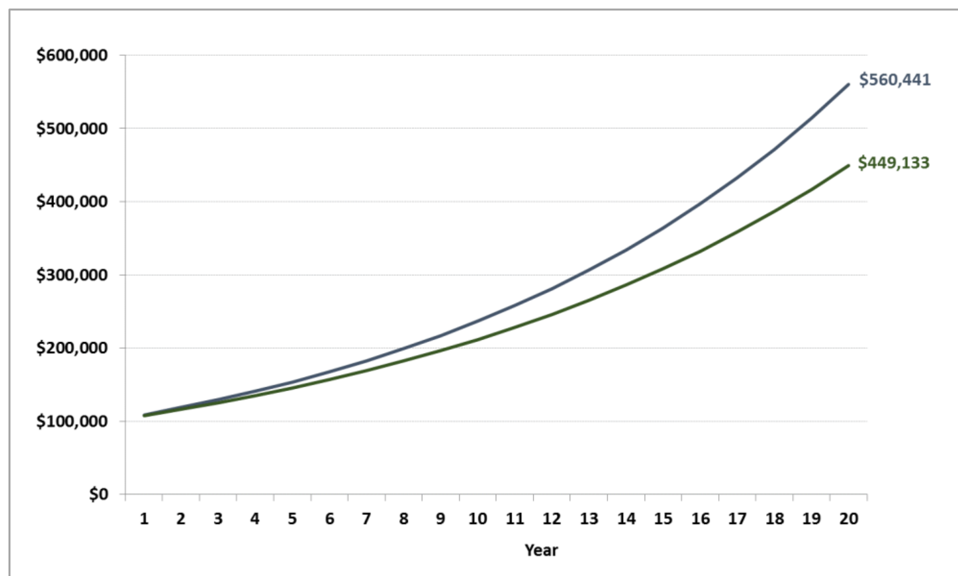
The most important thing, though, is to continue investing through those downturns. While they seem scary at the time, the reality is that they are the best time to be investing in the stock market because you are buying at lower prices.

The lesson: Be sure that you are always saving regularly–ideally, by withholding automatically from every paycheck through your 401(k), 403(b) or Profit Sharing Plan. Why? That way you'll always be a buyer when the "market goes on sale" as it does, unpredictably, from time to time.

STEP 4: BEWARE THE LAW OF SMALL NUMBERS

> *Wall Street makes its money on activity; you make your money on inactivity. If everybody in this room trades their portfolio around with every other person, you're all going to end up broke, and the intermediary [the broker] is going to end up with all the money.*
>
> - Warren Buffett

It’s hard to argue with Warren Buffett’s success as an investor, and there is a lot of truth to his statement about investment expenses. The chart below illustrates the corrosive impact of seemingly minor differences in fees.



In this example, two accounts start out at $100,000. They are both invested in the U.S. stock market, which has historically grown at 10% per year, on average. Over the next 20 years, both accounts grow very nicely, but as you can see, there is a big difference in ending value. What was the difference? *Only the fees*. The account that got up to $560,000 was paying 1% per year in fees, while the $449,000 account was paying 2%. That “small” 1% difference in fees would have resulted in a 25% higher standard of living in retirement. This is what I call the law of small numbers. So, it is worth

spending some time researching the cost of each of the investment options offered by your retirement plan.

My recommendation: Start by asking your human resources department and/or log on to your benefits website. Keep in mind that retirement plans often carry multiple layers of fees. Depending upon the plan, there might be administrative fees, investment fund fees, investment advisory fees, trustee fees, commissions and sales charges. But the most significant—and the one over which you have the most control—are the fees charged by the funds you select. The term you are looking for is “expense ratio.” Ideally, you’ll find funds that charge 0.1% or less. Even 0.5% is acceptable. If it’s much more than that, I would be wary.

STEP 5: LOWERING YOUR TAXES IS EASIER THAN YOU MAY THINK

Wouldn’t we all choose to lower our own taxes if we could? The answer to this question seems obvious, and yet most people don’t take advantage of valuable tax benefits that are well known and available to virtually everyone. Below are suggestions to streamline your tax obligations, giving you a good shot at increasing your income in retirement:

Be sure to contribute as much as you can to retirement accounts. Depending upon your work situation, this might be a 401(k), a 403(b) or an IRA. As you probably know, any dollars you contribute to a retirement account are deductible from your current year's income, meaning that those dollars are not taxed. However, those dollars (including any appreciation) *are* taxed when with you withdraw them in retirement. As a result, at first glance, this might just look like a wash – that is, you are just shifting the tax burden from today into the future. The math behind that conclusion makes sense, but it overlooks two major benefits – one potential and one certain:

The potential benefit: When you are at the peak earning years of your career, it is likely that your tax bracket will also be at its peak. Assuming no changes to the tax laws, most successful professionals can reasonably assume that their income, and therefore their tax rate, will be lower in retirement. If that is the case, then you would realize a nice tax savings by deferring income from your peak earnings years until retirement. This is not guaranteed because no one knows how tax rates might change in the future, but right now it is not an unreasonable assumption.

The certain benefit: There is another, more subtle but extremely important benefit in contributing to retirement accounts: Any income generated by investments in those accounts is not taxed in the year that it is earned. It is

only taxed upon withdrawal in retirement. This is important because, historically, dividends have accounted for up to 40% of U.S. stock market returns. So, there is a lot of value in being able to shield that 40% from taxes. It means that, first, your overall tax rate during your working years may be lower. And, it means that you are able to keep more dollars in your account, compounding for the future. **In the end, you can never fully avoid taxes, but there is quite a bit you can do to manage and optimize your tax burden.**

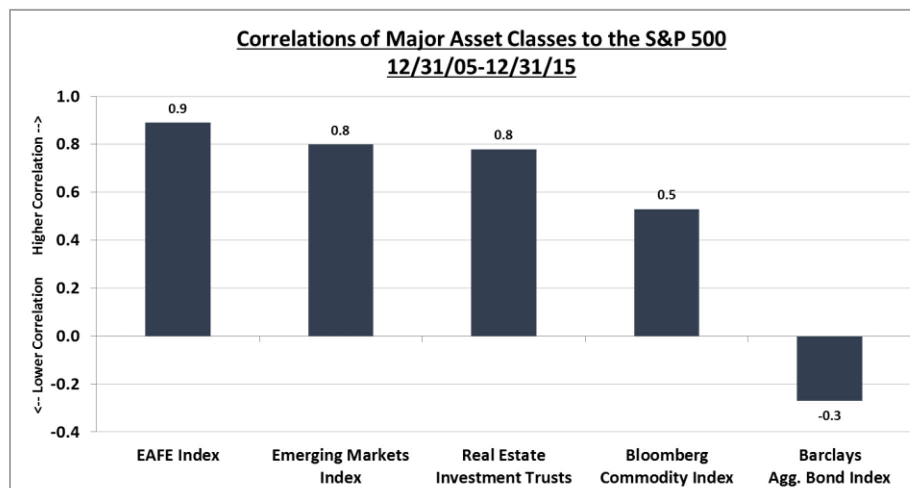
STEP 6: UNDERSTAND THE IMPORTANCE OF ASSET ALLOCATION

Many years ago, I met a married couple who had recently sold their small business for more than five million dollars. After years of hard work and long days, they were looking forward to a comfortable retirement, free from financial worry. But, with the ink barely dry on their deal, worrying is all they were doing. The husband – let's call him James – wanted to put the entire $5 million into stocks. Meanwhile, his wife – let's call her Susan – wanted to put the entire amount into government bonds. And to complicate things, one of their neighbors – let's call him Skip – told them that they were both wrong. Skip said the right approach was to put a little bit of money into lots of different things – a little into stocks and bonds, for sure, but also some into

gold, real estate, international stocks, international government debt, bank loans, and more.

This question of how to divide up your investments is known as “asset allocation.” According to research going back more than thirty years (Brinson, 1986), asset allocation is the single most important decision you can make when structuring your investment portfolio.

Within asset allocation, the most important decision you can make is between stocks and bonds, as the chart below illustrates.



Wall Street, in its never-ending competitive derby, prefers to focus on the performance of individual funds, but this debate is a relative waste of your time. Yes, it is possible to find investments that will do significantly better than average, but the data are clear that this is very hard to accomplish

because past performance is not a guarantee of future results. Yesterday's winner is unlikely to be tomorrow's winner. As a result, you are far better off controlling what is within your control, and that is your asset allocation.

STEP 7: KEEP IT SIMPLE

Confucius supposedly once said, "Life is really simple, but we insist on making it complicated." That was 2,500 years ago. Imagine what he would say if he could see Wall Street today.

The investment landscape facing today's consumer is unprecedented in its complexity. In addition to the thousands of individual stocks listed on U.S. exchanges, there are nearly 8,000 mutual funds available. The average workplace 401(k) menu has more than eighteen different fund choices, up from just two when the first 401(k) hit the market in 1980.

At the same time, everywhere we turn, we are told about the virtues of simplicity. There is *Real Simple* magazine. There is even a Simplicity Institute. Similarly, a simplified investment portfolio has clear benefits for your retirement savings. These include ease of implementation, ease of monitoring, lower costs and generally lower taxes.

So why do we complicate our financial lives when it is so much easier to go the simple route? Understanding the reasons why can help you avoid falling into this trap yourself.

Internally, we all struggle with two conflicting ideals: the comfort of consistency vs. the excitement of novelty. We're always happy at our favorite restaurant but also enjoy discovering new ones. We go back to our favorite vacation spot year after year but also like finding new places. And so on. We know what we like, but after a point, too much of the same thing makes us bored. Unfortunately, when it comes to investments, it is better to be bored. That is because the latest financial invention is invariably more expensive than tried-and-true, straightforward investments. For that reason, it is better to keep things simple.

Our own successes sometimes lead us astray. When an investment pays off, it bolsters our confidence and increases our desire to repeat the success. If the next one doesn't work out, we discount the failure, telling ourselves "win some, lose some" and keep on doing the same thing. The lesson here: beware of your own successes. Think hard about the wisdom of each new investment and be sure you aren't loading up on risky bets.

CONCLUSION

Investors face an uphill battle in today's investment climate. Wall Street's marketing machine is constantly promoting new products, and our own behavioral biases make us easy targets. In the face of these challenges, your best defense is to keep things simple, sticking to a disciplined and consistent investment plan. Don't forget the message of Confucius: your financial life really can be simple; don't insist on making it complicated.

NEXT STEPS

- **Looking to learn more?** Visit Mayport's website to download other ebooks in this series.
- **To discuss how these principles apply to your own portfolio,** you can schedule a call with Mayport principal Adam Grossman.
- **For a complimentary review and analysis of your portfolio,** please get in touch.

ABOUT THE AUTHOR

ADAM M. GROSSMAN, CFA

Adam Grossman is the founder of Mayport Wealth Management. Adam founded Mayport with the goal of providing comprehensive service at a fair price. Specifically, this means that Mayport charges simple, fixed fees, rather than the typical 1%-of-assets fees that most firms charge.

Adam is a graduate of Williams College and holds an MBA from the Sloan School at MIT. He is a Chartered Financial Analyst and a member of the CFA Institute. Adam has several years of experience working with high net worth individual and families to help plan for a safe and secure financial future.

If you would like to discuss your individual needs, please contact Adam at adam.grossman@mayport.com or schedule a call at your convenience.

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