AWM Financial Planning

Do I need an umbrella policy?

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One type of insurance we recommend is an umbrella liability policy, especially given our litigious society.

The liability coverage under your homeowners and auto policies is your primary layer of protection. But if you need additional protection of up to $1 million or more, an umbrella policy is the answer.

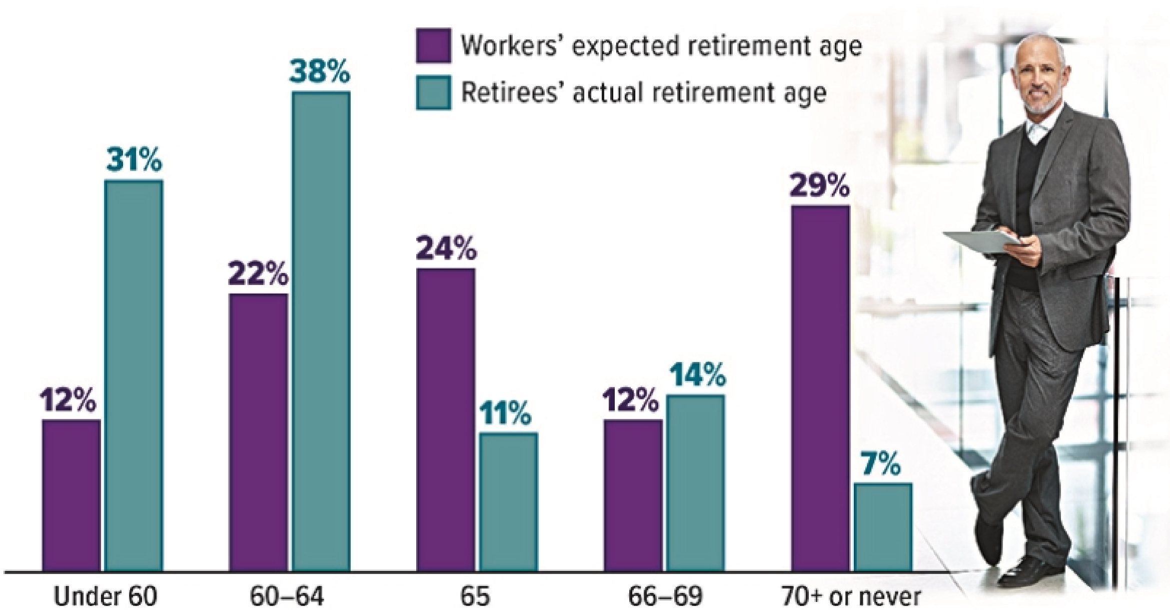
Personal umbrella liability protection is secondary coverage that works with your primary policy. When the liability limit of your primary policy is exhausted, the umbrella policy may pay the balance of a liability claim against you (up to the umbrella policy's limit).

John was sued after a tree on his property fell and injured a neighbor, his homeowners liability coverage paid the $100,000 in damages (the policy limit). The remaining $900,000 of the court-ordered settlement was paid by his umbrella policy.

An umbrella policy may cost around $300 per year and significantly expand liability coverage (typically $1 million of coverage). A cost-effective way to protect your wealth!

Retirement Age Expectations vs. Reality

Workers typically plan to retire much later than the actual age reported by retirees. In the 2022 Retirement Confidence Survey, 65% of workers said they expect to retire at age 65 or older (or never retire), whereas 69% of retirees left the workforce before reaching age 65. When choosing a retirement age, it might be wise to consider a contingency plan.



Source: Employee Benefit Research Institute, 2022

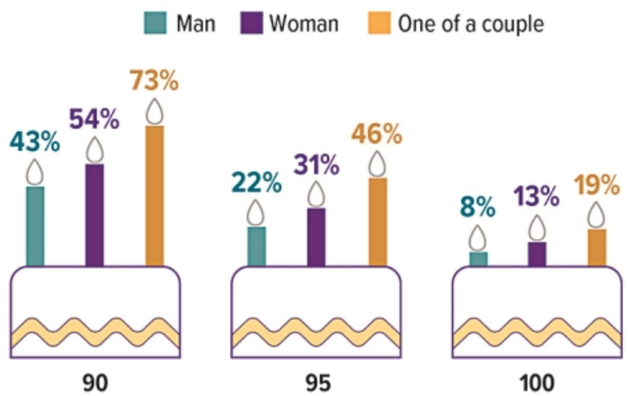
Fixed for Life: What Can an Annuity Do for You?

With stock and bond markets both faltering over the past year, it's easy to see why more near-retirees have a newfound appreciation for fixed annuities — insurance contracts that guarantee a specified rate of return. A fixed annuity maintains its value regardless of market conditions, and yields on these products have risen in response to the higher interest-rate environment.

When you purchase a fixed annuity, you are shifting the risk for future investment returns to the insurance company. It's also a way to create a pension-like income stream for retirement, starting right away or when you are older.

A Long Retirement

Probability that a healthy 65-year-old will live to the following ages



Source: Society of Actuaries and American Academy of Actuaries, 2022

Income for Now or Later

An *immediate fixed annuity* is usually purchased at the beginning of retirement, often with a lump-sum premium. The fixed payments start within 12 months from the date the annuity is purchased and continue for the duration of the contract.

With a *deferred fixed annuity,* you can make a series of premium payments, and the income is delayed until a future date of your choosing. This type of annuity can be used to save for retirement or to provide income in your later years. The income payments reflect the value of the premiums paid, the annuity's compounded return, and the length of the payout period (or your life expectancy). Thus, the longer you defer your annuity, the higher the payout can be.

Unlike tax-advantaged workplace plans and IRAs, annuities have no annual contribution limits, so they present an opportunity to save as much as you want on a tax-deferred basis. When annuities are purchased with after-tax dollars, only the earnings portion of withdrawals is taxable as ordinary income. You can also invest in an annuity through a qualified (tax-advantaged) retirement plan. In this case, the qualified annuity is subject to the same tax rules as the qualified plan, so there is no additional tax benefit. For both qualified and nonqualified annuities, early withdrawals prior to age 59½ may be subject to a 10% penalty.

Annuitization Options

Converting the funds in an annuity to an income stream is called *annuitization.* A deferred annuity contract will specify the date at which you can annuitize and begin to receive payments as defined in the contract, but generally you are not required to do so at that time. Although a guaranteed income is often a sought-after feature of annuities, many owners choose not to annuitize.

Before annuitization, you can withdraw some or all of the annuity funds in a lump sum or a series of distributions. However, surrender charges typically apply if you withdraw more than a specified amount before the end of the surrender period. If you die before annuitizing, your heirs would receive the funds accumulated in the annuity. After you annuitize, you no longer control the funds, so you cannot take lump-sum distributions.

Whether you purchase an immediate or deferred fixed annuity, you'll have options for the income stream you will receive during the annuitization period. A straight, guaranteed lifetime income will provide the highest monthly payments and help protect against the risk of outliving your savings. But payments will typically end when you die, with no funds going to your heirs. A "period certain" provides income for a fixed number of years and will go to your heirs if you die before the end of the period, but you risk running out of income if you live beyond the period. "Life with a period certain" guarantees you a lifetime income along with a period of time in which it can pass to your heirs, but payments are generally lower.

The decision to annuitize — and the option you choose if you decide to do so — will depend on your financial situation, life expectancy, and risk tolerance.

Annuities have contract limitations, fees, and expenses, and they are not appropriate for every investor. Withdrawals reduce annuity benefits and values. Any guarantees are contingent on the financial strength and claims-paying ability of the issuing insurance company. Investors should be aware that when they purchase a fixed annuity, they may sacrifice the opportunity for higher returns that might be available in the financial markets, and that inflation could reduce the future purchasing power of their annuity payouts. Annuities are not guaranteed by the FDIC or any other government agency. They are not deposits of, nor are they guaranteed or endorsed by, any bank or savings association.

Debt Optimization Strategies

To help improve your financial situation, you might consider reducing your debt. Before starting any debt payoff strategy (or combination of strategies), be sure you understand the terms of your debts, including interest rates, payment requirements, and any prepayment or other penalties.

Start with Understanding Minimum Payments

You are generally required to make minimum payments on your debt, based on factors set by the lender. Failure to make the minimum payments can result in penalties, higher interest rates, and default. If you make only the minimum payments, it may take a long time to pay off the debt, and you will have to pay more interest over the life of the loan. This is especially true of credit-card debt.

Your credit-card statement will indicate your current monthly minimum payment. To find the factors used in calculating the minimum payment amount each month, you can review terms in your credit-card contract, which can change over time.

The minimum payment for credit cards is usually equal to the greater of a minimum percentage multiplied by the card's balance (plus interest on the balance, in some cases) or a base minimum amount (such as $15). For example, assume you have a credit card with a current balance of $2,000, an interest rate of 18%, a minimum percentage of 2% plus interest, and a base minimum amount of $15. The initial minimum payment required would be $70 [greater of ($2,000 x 2%) + ($2,000 x (18% ÷ 12)) or $15]. If you made only the minimum payments (as recalculated each month), it would take 114 months (almost 10 years) to pay off the debt, and you would pay total interest of $1,314. For consumer loans, the minimum payment is generally the same as the regular monthly payment.

Make Additional Payments

Making payments in addition to your regular or minimum payments can reduce the time it takes to pay off your debt and the total interest paid. Additional payments could be made periodically, such as monthly, quarterly, or annually.

Using the previous example ($70 initial minimum payment), if you made monthly payments of $100 on the credit card debt, it would take only 24 months to pay off the debt, and total interest would be just $396.

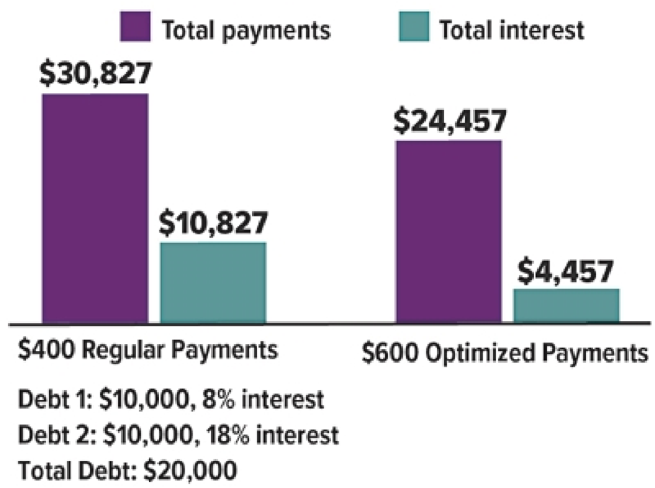
Here's another example. Assume you have a current mortgage balance of $300,000. The interest rate is 5%, the monthly payment is $2,372, and the remaining term is 15 years. If you make regular payments, you will pay total interest of $127,029. However, if you pay an additional $400 each month, it will take only 12 years and one month to pay off the mortgage, and you will pay total interest of just $99,675.

Pay Off Highest Interest-Rate Debt First

One way to potentially optimize payment of your debt is to first make the minimum payments required for each debt and then allocate any remaining dollars to debt with the highest interest rates.

For example, assume you have two debts, you owe $10,000 on each, and each has a monthly payment of $200. The interest rate for one debt is 8%; the interest rate for the other is 18%. If you make regular payments of $400, it will take 94 months until both debts are paid off, and you will pay total interest of $10,827. However, if you make monthly payments of $600, with the extra $200 paying off the debt with an 18% interest rate first, it will take only 41 months to pay off the debts, and total interest will be just $4,457.

Pay Off Highest Interest-Rate Debt First



Use a Debt-Consolidation Loan

If you have multiple debts with high interest rates, it may be possible to pay them off with a debt-consolidation loan. Typically, this will be a home-equity loan with a lower interest rate than the rates on the debts being consolidated. (Note that a federal income tax deduction is not currently allowed for interest on home-equity indebtedness unless it is used to substantially improve your home.) Keep in mind that a home equity-loan potentially puts your home at risk because it serves as collateral, and the lender could foreclose if you fail to repay. There also may be closing costs and other charges associated with the loan.

All examples are hypothetical and used for illustrative purposes only and do not represent any specific investments or products. Fixed interest rates and payment terms are shown, but actual interest rates and payment terms may change over time. Actual results will vary.

The Inflation Experience Is Painful and Personal

Inflation is a sustained increase in prices that reduces the purchasing power of your money over time. According to the Consumer Price Index (CPI), inflation peaked at an annual rate of 9.1% in June 2022, the fastest pace since 1981, before ticking down to 7.7% in October.[1]

The CPI tracks changes in the cost of a market basket of goods and services purchased by consumers. Items are sorted into more than 200 categories and weighted according to their "relative importance," a ratio that represents how consumers divide up their spending, on average. Basic needs such as shelter (33%), food (14%), energy (8%), transportation (8%), and medical care (7%) account for about two-thirds of consumer expenditures. Because the CPI is a comprehensive measure of prices across the U.S. economy, the index also contains many items that an individual consumer may purchase infrequently, or not at all.

Wide variations in spending patterns help explain why some consumers feel the sting of inflation more than others. This means that the extent to which you experience inflation depends a lot on where you live, as well as your age, health, income, family size, and lifestyle. In effect, your personal inflation rate could be significantly higher or lower than the average headline inflation rate captured in the CPI. Consider the following examples.

- In October 2022, the 12-month increase in the cost of shelter was 6.9%.[2] Shelter carries the most weight of any category in the CPI, which made fast-rising home prices and rents a top driver of inflation over the previous year. A first-time homebuyer, or a renter who signs a new lease, is likely to feel the full impact of these hefty price increases. However, a homeowner with a fixed-rate mortgage is generally insulated from these rising costs and might even benefit financially from home-equity gains.
- Gasoline surged 17.5% during the 12 months ended in October 2022.[3] Individuals who rarely drive, possibly because they are retired or work remotely, might have been able to shrug off the price spike. But for drivers with long commutes, filling up the gas tank regularly might have put a sizable dent in their households' finances, in some cases forcing them to cut back on other purchases.
- Food and beverage prices rose 10.9% over the same 12-month period, a trend that clearly affects everyone.[4] But rising food costs tend to put more pressure on the budgets of lower-income households because they spend a greater share of their income on necessities and typically have smaller financial cushions. Plus, shoppers can't easily switch to lower-cost options if they are already relying on them.[5]

1-4) U.S. Bureau of Labor Statistics, 2022

5) Federal Reserve, 2022

IMPORTANT DISCLOSURES

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