

## Hourly Advice for Do-It-Yourself Investors

Dear Elizabeth,

Thank you for using our financial planning services. We discussed several topics on our recent call.

You are 36, married to Marcus (39), with two children, Marcia (6) and Bilbo (4). At Evanderson, you earn \$180,000 annually. At Global Widgets, Marcus earns \$1MM. You estimate your living expenses at \$570,000 per year – including your mortgage, but excluding taxes.

You have \$7.7MM in investment accounts. You also have \$150,000+ in 529 accounts for *each* child. You own your home (\$4MM), with a \$2.6MM mortgage.

You are looking for help with investing, tax planning, college planning, and estate planning. Here are your financial planning *To-Dos* in light of your goals from our call.

### Tax-Advantaged Investment Accounts

One of your biggest challenges is managing the tax impacts of investments in your taxable accounts. Therefore, you want to take advantage of tax-sheltered investment accounts where possible.

- ❑ **HIGH-DEDUCTIBLE HEALTH PLAN (HDHP) HEALTH SAVINGS ACCOUNT (HSA):** If you decide that a high-deductible health plan (HDHP) meets your health care goals, contribute the maximum to your HSA annually: 7,200 for 2021.

Invest all available cash in low-cost index funds. Continue to pay for medical expenses with cash, letting HSA investments grow tax-deferred. Save all receipts for qualified medical expenses to make future tax-free distributions. [Learn more here.](#)

- ❑ **TRADITIONAL 401(K) CONTRIBUTIONS:** Continue to contribute the maximum annually to *each* of your traditional 401(k) (\$19,500 for 2021) to take advantage of the tax savings available by using this account.
- ❑ **ELIZABETH'S MEGA BACK-DOOR ROTH 401(K):** A mega back-door Roth utilizes your retirement plan's unused contribution limit (\$58,000 in 2021) to make a Roth contribution. Not all plans offer this feature. Marcus's plan does not.

You (Elizabeth) should ask your Human Resources Department if your plan has the two following features:

1. Non-deductible voluntary after-tax contributions. These "voluntary after-tax" contributions are **not** the same thing as post-tax or Roth contributions.
2. Either in-plan Roth conversions or in-service distributions.

If these features are available in your plan, then, in addition to contributing the maximum \$19,500 to your employer plan, contribute the maximum annually in voluntary after-tax dollars

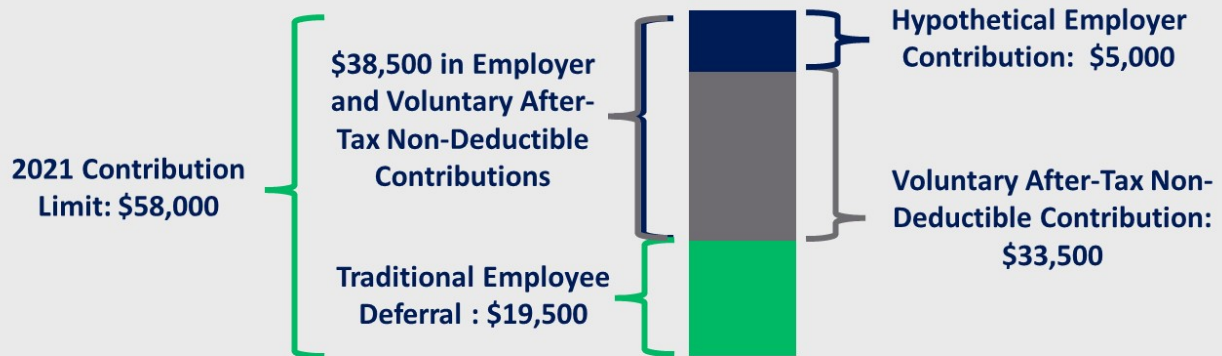
– up to \$38,500, minus the amount of any employer contribution. (The amount your employer contributes to your plan decreases the amount of voluntary after-tax dollars you can contribute to your workplace retirement plan.)

**Voluntary After-Tax Contribution Limit = \$38,500 – Employer (Profit-Sharing) Contribution**

Convert voluntary after-tax contributions to Roth dollars via either an in-plan Roth conversion or an in-service distribution to your Roth IRA. [Learn more here.](#)

If the second feature (in-plan Roth conversions or in-service distributions) is not available, making non-deductible voluntary after-tax contributions is still worthwhile.

## 2021 MEGA-BACK DOOR ROTH CONTRIBUTIONS



- Traditional Employee Contribution; Tax-Deductible; Taxed at the Marginal Rate at Distribution
- After-tax Employee Contribution; Not Deductible; Tax-Free at Distribution if Converted to Roth
- Employer Contribution; Taxed at the Marginal Rate at Distribution



- **ELIZABETH'S ANNUAL BACK-DOOR ROTH IRA:** With no money in your tax-deferred IRA accounts, (traditional IRA, rollover IRA, etc.), you (Elizabeth) can make back-door Roth IRA contributions *without* running afoul of the pro-rata rule (and thus creating an additional tax bill for making a back-door Roth IRA contribution).

Each year, contribute the maximum to your traditional IRA (\$6,000 for 2021). Do not claim a deduction for these contributions on your tax return. Then, convert the contributions to your Roth IRA. Invest the conversions for long-term growth using low-cost stock funds.

In your first year doing this, leave \$1 in your traditional IRA – so that the investment custodian does not close what would otherwise be an account with a \$0 balance.

To take advantage of future tax planning opportunities, avoid rolling over your workplace retirement plans to a traditional/rollover IRA. [Learn more here.](#)

## BACK-DOOR ROTH IRA



### □ MARCUS'S IRA-TO-401(K) TRANSFER AND SUCCESSIVE BACK-DOOR ROTH IRA

**CONTRIBUTIONS:** Transferring money into Marcus's 401(k) is appropriate in light of the low-cost investment options available in his 401(k) plan.

Marcus should transfer his entire rollover IRA to his 401(k). For his traditional IRA, Marcus will make a *partial* transfer to his 401(k). Marcus will transfer *only* the traditional IRA *earnings* to his 401(k) – and not the basis, the non-deductible contributions. To calculate the total of your non-deductible contributions, reference form 8606 on your tax returns. You can also reference the transaction history with your investment custodian (Vanguard).

## TAX-DEFERRED IRA DOLLARS TO 401(K) TRANSFER



 Tax-Deferred Dollars of Deducted Contributions & All Account Growth; Taxable at Distribution

 After-tax Dollars of Non-deductible Contributions; Tax-Free at Distribution



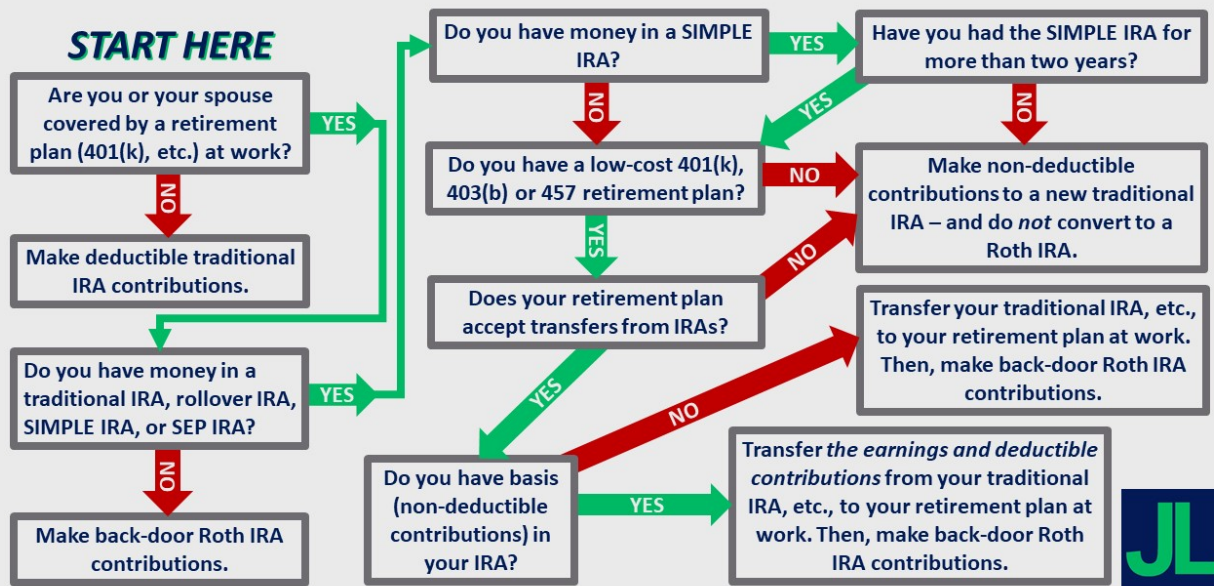
With the earnings transferred out of Marcus's traditional IRA, he will be on track to make back-door Roth IRA contributions tax-efficiently. He can then convert his traditional IRA – with his traditional IRA now holding exclusively non-deductible contributions – into a Roth IRA *without* generating an extra tax bill.

Do **not** roll over your workplace retirement plan back into a traditional/rollover IRA within the same calendar year. [Learn more here.](#)

Next year and every year thereafter you have sufficient earned income, Marcus should make back-door Roth IRA contributions: contribute the maximum to Marcus's traditional IRA annually (\$6,000 for 2021). Do not claim a deduction for these contributions on your tax return. Then, convert the contributions to Marcus's Roth IRA. Invest the conversions for long-term growth using low-cost stock funds.

If you have not yet made a non-deductible IRA contribution for the 2021 tax year to Marcus's traditional IRA, make that contribution and convert that amount to Marcus's Roth IRA as per the above.

## IRA CONTRIBUTIONS FOR HIGH EARNERS



- **FUTURE TAX PLANNING:** To take advantage of future tax planning opportunities, avoid rolling over your workplace retirement plan to a traditional/rollover IRA.

**FULLY-FUNDED COLLEGE SAVINGS:** In the absence of plans to fully fund an Ivy League education, and/or graduate schools, consider your 529 plans fully funded. No further account contributions are necessary.

Maintaining the current Vanguard 529 age-based aggressive investment option is appropriate. Over time, you can switch to the moderate, and ultimately the conservative age-based investment options.

## Investments

- **ALTERNATIVE ASSETS & COWBOY/GIRL ACCOUNTS:** More than one analysis has shown that investors are better with a portfolio of low-cost index funds than a portfolio containing alternative assets. If you intend to invest in alternatives, [read this book on best practices for investing in alternative assets](#).

The prudent approach suggests limiting speculative investments (anything but the asset allocation described below) to no more than 5-10% of your liquid investable assets. [Learn more here](#).

As discussed on our call, your substantial savings empowers you to have a larger cowgirl account. You could certainly afford to invest in as much as \$1,000,000 in a poor-performing asset. In that scenario, you would still be just fine – given the balance of your investments being in low-cost, broadly diversified index funds.

- **EMPLOYER RETIREMENT PLANS:** The target-date funds in both your 401(k)s are exceptionally low. Investing exclusively in the 2045 target-date funds is appropriate.
- **ALLOCATION:** We discussed an 80% stock and 20% fixed income portfolio. This portfolio is appropriate given your high savings rate, ample savings, and timeline to retirement.

For an 80/20 stock/bond model portfolio, see the below:

- The U.S. stock default is a total stock market index fund – 45%
  - Vanguard Total Stock Market Index Fund (VTI/VTSEX)
- The international stock default is a total international stock index fund – 35%
  - Vanguard Total International Stock Index Fund (VXUS/VTIAX)
- The bond default is an intermediate-term Treasury fund – 20%
  - Vanguard Intermediate-Term Treasury (VGIT/VSIGX)
- **TAXABLE ACCOUNT HOLDINGS LIQUIDATION:** You have several dividend funds in your taxable account. Dividend investing is challenging for several reasons, including the oft-neglected risk of capital loss, tax inefficiency, and more. [Learn more here](#).

At the very least, you do not need the income from the dividends. Moreover, you are paying taxes on this income you do not need.

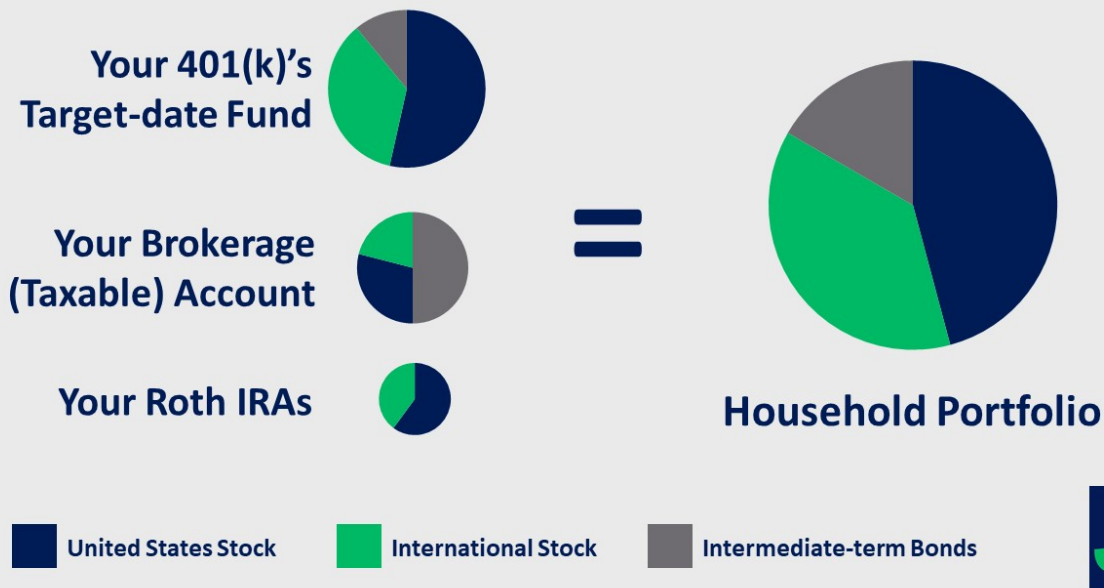
Selling the dividend funds today – undergoing a one-time tax hit on the appreciation – makes sense. Selling the funds avoids the lifetime additional tax bill from receiving dividend income in future years.

- **INVESTMENT POLICY STATEMENT (IPS):** Create an IPS to help hold you accountable for your investment strategy. [Learn more about Investment Policy Statements – and download a free template – here](#).

- ❑ **REBALANCING:** Review your portfolio annually, and rebalance if necessary. [Learn more here.](#)
- ❑ **TRADING:** Limit your trading risk by using *limit orders* when buying and selling stocks and Exchange-Traded Funds (ETFs). [Learn more here.](#)
- ❑ **ASSET LOCATION:** To get the most out of the tax-free growth of your Roth and HSA accounts, hold only stock funds in these accounts. Do not hold bonds or cash in your HSA or Roth accounts. [Learn more here.](#)

You will need to leverage your spreadsheets skills to balance your total household portfolio across your multiple accounts.

## ALLOCATING ACROSS YOUR ACCOUNTS



*Sample investment allocation, not to scale.*

## Tax-Loss Harvesting

Tax-loss harvesting (TLH) can generate some annual tax savings, allowing you to write-off losses at your higher tax rate today (compared to your lower tax rate in retirement).

You can offset up to \$3,000 per year in ordinary income. If your net capital loss exceeds this limit, you can carry the loss forward to later years.

Considering your other financial planning To-Do's, consider tax-loss harvesting a lower-priority project.

- ❑ **TRACKING TAX LOTS:** Opt for "Specific Identification", instead of "First in, First out" (FIFO), "Last in, First out" (LIFO), etc., with your investment custodian.



- **DO NOT RE-INVEST DIVIDENDS:** Allow interest and dividends to flow into the money market fund. Use that cash plus any extra cash to buy more ETF shares of one fund where it's needed. This will make the number of tax lots you have manageable.
- **SELL LOTS AT A LOSS:** When the stock market falls, sell tax lots at a loss and harvest the tax losses.
  - Immediately buy a similar "swap" fund, so you're not out of the market. It is not a "tax wash" because they are different funds from different investment companies.
  - Swap Vanguard Total Stock Market into the iShares Core S&P Total U.S. Stock Market ETF (ITOT – 0.03% fee).
  - Swap Vanguard Total International Stock into the iShares Core MSCI Total International Stock ETF (IXUS – 0.10% fee).
  - If the markets continue down, you can swap back after 30 days.

BE CAREFUL not to buy any fund you sold for a loss within 30 days of the sale, including your retirement accounts. If so, you will cancel the tax loss. [Learn more here.](#)

## Liabilities

- **MORTGAGE DEBT:** Pay off your mortgage. Use your \$2.4MM cash holding.

It can make sense for investors with 100% stock allocations to leverage their investment portfolio by not pre-paying their debt. However, for investors with relatively less aggressive allocations (those holding *any* amount of bonds), holding debt means settling for a smaller investment return while bearing the same amount of risk as their 100% stock allocation peers. Said simply: holding debt while investing in bonds means enduring the same risk for less return. That's why pre-paying debt can make sense for investors who don't have 100% stock allocations. [Learn more here.](#)

## Estate Planning & Asset Protection

Having recently reviewed your estate planning documents (Will, Trust, Power of Attorney, Advanced Health Care Directive, and Side Letter of Instruction) and reviewed your beneficiary designations in 2019, you have few Estate Planning *To-Dos*.

- **ESTATE TAX EXEMPTION DECREASE PLANNING:** Your estate attorney can help you determine if a particular trust (ILIT, SLAT, etc.) is the right estate planning tool to mitigate estate taxes. This is given a possible future decrease in the estate tax exemption, whether from brand new legislation or the [scheduled decrease of estate tax exemption in 2026](#). Confer with an estate attorney if it is appropriate to create such a trust now – with the trust to be funded in the year of the estate tax exemption change.
- **SIDE LETTER:** Complete a Side Letter of Instruction listing professionals and account login information. Share this information securely with the appropriate parties (trustees, executor, attorneys-in-fact) via a password manager, such as LastPass or 1Password. Alternatively, store a hard copy of this information along with your estate planning documents. You can [use this template](#). [Learn more here.](#)

- **ASSET PROTECTION:** Speak with an attorney about titling your investment properties to a Limited Liability Company (LLC) to protect your assets.

## Insurance Planning

- **SUFFICIENT LIFE INSURANCE:** Life insurance can replace the lost income from the death of a loved one.

You currently have \$2,300,000 of coverage on Marcus. You have \$500,000 of coverage on yourself. Given this *and* your assets, you have sufficient coverage – assuming that you can materially decrease your expenses in a worst-case scenario.

If you decide that you cannot decrease your spending to align with your income, you can purchase more coverage. Do not purchase this coverage through your employer, as leaving your employer may complicate the task of maintaining your coverage. In a worst-case scenario, not performing a specific administrative requirement (faxing a form, etc.) could leave you without this critical insurance coverage.

Consider [Amica Mutual](#), a highly-rated insurance company renowned for its customer service.

- **LONG-TERM DISABILITY INSURANCE (LTDi):** LTDi replaces a part of your income when you cannot work from illness or injury.

Problematic is that many workplace-provided disability insurance policies have an *any occupation* definition after 24 months of benefits. Review your employer-provided disability insurance policies for this – and any other shortcomings. [Learn more here.](#)

In a worst-case scenario, both you and Marcus could become disabled. As with the life insurance discussion, your net worth provides you with a substantial ability to self-insure for disability. However, this would mean enduring a considerable lifestyle change. To ensure future spending at a higher rate, you can work with a disability insurance agent to determine if you can purchase a private policy. Any long-term disability insurance policy should:

- be inflation-adjusted, having a cost of living adjustment (COLA) rider,
- have an "own occupation" to age 65 clause to pay you if you/Marcus can work, but not in your/his industry, and
- include a partial disability provision.

Unfortunately, a high-quality private long-term disability insurance policy will not be inexpensive. You can save money on a policy by opting for a larger deductible and making annual payments – instead of monthly.

- **MARCUS SWITCH'S TO A HIGH-DEDUCTIBLE HEALTH PLAN (HDHP) AT OPEN ENROLLMENT:** Only opt for an HSA-eligible HDHP if it meets your health insurance goals. The lower premiums of an HDHP can save you money. [Learn more here.](#)



- ❑ **SELF-INSURING FOR LONG-TERM CARE INSURANCE:** You have more than enough assets to self-insure for the cost of long-term care. You do not need to purchase long-term care insurance.
- ❑ **UMBRELLA INSURANCE INCREASE:** Great job getting a \$5MM umbrella insurance policy! Umbrella insurance increases the liability coverage of your auto and homeowner's insurance. Increase your umbrella policy coverage to \$10MM to better protect your net worth and your future income. Remember to maintain your underlying liability coverages at \$300,000 – or the amount required by your umbrella policy – on your various underlying policies (auto insurance, etc.). Make sure this increased coverage amount is per *occurrence*, and *not* just an annual aggregate limit.

Be sure to fulfill the requirements of your umbrella insurance provider to include your rental property/landlord policy insurance.

- ❑ **HOMEOWNER'S INSURANCE:** To save money, consider increasing the deductible on your homeowner's insurance policy. [Learn about optimizing your homeowner's insurance here.](#)
  - "Additional Coverages:" Consider stripping additional coverages to save money via self-insurance, such as jewelry and fur endorsements, and sewer drain back up.
- ❑ **FLOOD INSURANCE AND WINDSTORM INSURANCE:** A homeowners policy alone won't cover all potential hurricane damage to your home. Flood insurance and windstorm insurance can help protect the value of your home. Purchase flood insurance and windstorm insurance.
- ❑ **EARTHQUAKE:** Purchase Earthquake insurance from the California Earthquake Authority.
- ❑ **AUTO INSURANCE:** To save money, consider declining Comprehensive & Collision coverage on your automobile policy. You have sufficient assets to self-insure. At the very least, consider raising your deductible to the maximum allowable. [Learn more here.](#)
  - Underinsured/Uninsured: Opt for the highest Underinsured/Uninsured coverage.
  - "Additional Coverages:" Consider stripping additional coverages to save money via self-insurance, such as rental car reimbursement, or windshield glass replacement.
- ❑ **ROADSIDE ASSISTANCE:** To keep your auto insurance cost lower, only purchase roadside assistance through a provider that is not your automobile insurance company, such as AAA. [Using roadside assistance provided by your insurance company may count as an at-fault claim.](#)
- ❑ **RE-SHOP YOUR POLICIES:** Re-shop property and casualty (auto, homeowners, umbrella) insurance policies at least every three years to ensure you are paying a competitive rate.

## Cyber Security

- ❑ **PASSWORD MANAGER:** Store account logins and other sensitive information in a password manager. Consider LastPass, Dashlane, or 1Password. [Learn more here.](#) Do not store your

passwords unsecurely, such as with an unencrypted spreadsheet, unencrypted Word document, or written down or printed on paper held outside of a physical safe.

- ❑ **FREEZE YOUR CREDIT:** To protect against identity theft, freeze your credit with all three credit agencies. [Learn more here.](#)
- ❑ **TWO-FACTOR AUTHENTICATION (2FA):** If available, enable 2FA with the various financial institutions you use: your bank, your investment custodian, for example. [Learn more here.](#)
- ❑ **VIRTUAL PRIVATE NETWORK (VPN):** Install a VPN on all your devices (computer, cell phone, tablet, etc.), especially those you use to access financial accounts. It almost always makes sense to leave your VPN on all the time. [Learn more here.](#)



This covers most of our discussion and a little more. You're on the right track. I see no significant issues.

Your urgent projects are:

- your partially uninsured net worth (solved by increasing umbrella insurance coverage), and
- creating a side letter of instruction.

Please send me an email at [hello@jonluskin.com](mailto:hello@jonluskin.com) if you have any questions.

Good luck!

Best regards,

Jon Luskin, CFP®