The Hanover Advisor

HANOVER ADVISORS

December 2020

Don’t Let Inflation Derail Your Retirement Plans

With the massive amount of stimulus spending, many economists fear we may see a spike in inflation. While we are of the mind that such a spike will likely be short-lived, it does highlight an important issue. Inflationary pressures have been tepid for so long that many of us may not pay much mind to what a dramatic impact it can have on our financial plans.

This is especially true for retirees. Over time, even moderate inflation can take a serious bite out of your nest egg. Understanding how inflation can impact your retirement plans is key to ensuring that your assets will last through your entire retirement.

Let’s assume that over the course of your retirement, inflation will average 3%. This is higher than we have seen in recent years, but historically is considered average. If you need $35,000 per year to cover your expenses, you might look at your retirement accounts and calculate that you have enough saved to cover $35,000/year for 20 years or more, depending on your anticipated longevity, and think you’re set. However, failing to factor in inflation could be setting yourself up for a disaster. At a 3 percent inflation rate, in 10 years your $35,000 in expenses would grow to $47,037. In 20 years, you would need $63,214 to maintain the same standard of living. The general rule of thumb is that at a 3% inflation rate, your cost of living will double after 24 years.

The issue is doubly important for retirees who expect to rely on Social Security benefits for much of their income. A recent study found that even a tepid inflation rate of just 1% would, over the course of 20 years, diminish the purchasing power of a retiree’s Social Security benefits by up to $34,406. At the historical 3% inflation rate, the shortfall would amount to more than $117,000. Social Security benefits do receive an annual cost of living adjustment (COLA) meant to keep pace with inflation. These adjustments are based on a metric that often lags behind other gauges of inflation though, and they usually fail to keep pace with the true cost of living.

Of course, inflation also impacts retirees differently than the general population. Official measures of inflation like the consumer price index (CPI) can remain low, even as retirees’ cost of living continues to grow. The primary cause of this is medical spending and healthcare costs. The Centers for Medicare and Medicaid Services estimated that average inflation in 2018 was 2.4%. That same year, the cost of healthcare expenditures increased by 4.6%, nearly double the base inflation rate. This increase also impacts retirees more. A

separate study found that per capita spending on healthcare by the elderly was three times what it was for working adults. This means that even if inflation is low, retirees' cost of living will rise more than others because the costs that affect them most will continue to climb.

The best way to address inflation in retirement is to have a plan. It is important to take into account your family history and current health and really consider your longevity. You may be looking at a very long retirement, 30 years or more, over the course of which, inflation will have a huge impact. You also need to consider not just day-to-day expenses, but unexpected costs like major medical expenses, which get more expensive every year. It is important to create a strategy for retirement income that addresses the rising cost of living and healthcare, allowing you the peace of mind that comes from knowing you will be able to afford tomorrow's expenses.

Another important factor to keep in mind is the construction of your investment portfolio. As investors get older, they tend to become more conservative. They focus more on income generation and principal protection and try to reduce exposure and limit risk as much as possible. These are sensible moves to make, but they may leave the portfolio more vulnerable to inflation. When it comes to protecting against inflation, diversifying with a mix of investments usually makes the most sense. While there are no guarantees, investments like real estate investment trusts and energy sector stocks are generally safe, and historically outpace inflation. The most secure way to combat inflation is to invest in Treasury Inflation Protected Securities (TIPS). These are a type of Treasury bond that are pegged to an inflation gauge, and as inflation increases, so too does the principal value of the bond. This means that the purchasing power of the bond is always protected.

Another straightforward way to combat inflation in retirement is to keep working. Inflation is often treated as something that is a negative in and of itself, but it is only a problem if wage increases do not keep pace with inflation. In fact, for those with mortgages or student loans, inflation can be beneficial, because it allows them to pay yesterday's debts with the value of today's dollars. The problem for retirees is that they have no wages, so even moderate inflation can eat away at their savings. If you can continue to work into your retirement years, you will continue to collect wages and benefits that are keeping pace with inflation. This will allow you to not only put off the deleterious impact of inflation, but potentially has the added benefit of giving you a higher overall final salary, which can lead to higher retirement income and better benefits.

Regardless of what your plan ultimately ends up being, the important thing is to have a plan. You do not want to end up 10 or 20 years into your retirement only to find yourself stretched thinner and thinner, struggling to keep up with the climbing cost of living.

Year-End Tax Saving Moves You Can Still Make

As we near the end of the year, many of us are already looking past Christmas and New Year's and focused squarely on Tax Day, dreading the massive check we may have to cut to Uncle Sam. However, even though there are only a few weeks left in the year, there is plenty of time to make moves before December 31 that can reduce your tax bill for 2020. Here are a few to consider:

1. Give to Charity

Giving to charity can always be a powerful way to reduce your tax burden, but that is especially true in 2020. As part of the CARES Act, taxpayers who itemize their tax returns can deduct up to 100% of their adjusted gross income in donations to qualified charities. In other years, the deduction is capped at 60% of adjusted gross income. In addition to cash, you may want to consider donating appreciated stock. In such a donation, you would be able to claim the fair market value of the stock and avoid potential capital gains taxes.

Even if you take the standard deduction instead of itemizing, the CARES Act has a provision allowing for an above-the-line deduction of up to $300 in cash donations to charity. If you do plan to take any deductions, be sure to keep the receipts, even for small donations.

2. Consider a Roth Conversion

2020 was a difficult year, and for many of us, our income will be lower than in normal years. One way to take advantage of having a down year is to convert funds in a traditional IRA to a Roth IRA. With traditional IRAs, the tax benefit is frontloaded. You receive a tax benefit for contributions, but when you make withdrawals, it is treated as taxable income. A Roth IRA offers no upfront tax benefits, but your withdrawals in retirement are tax-free, making them valuable for reducing the tax burden you will face in retirement. They also do not have required minimum distributions, giving you more control over how and when you make withdrawals during your retirement. Roth IRA's also keep their tax-free status when inherited, making them a useful vehicle for estate planning.

When you convert a traditional IRA to a Roth, you will have to pay income tax on any converted funds. If your income this year is down enough to put you in a lower tax bracket, it may be a smart move to make a conversion now, paying a lower income tax rate and allowing your funds to grow tax-free.

3. Consider Your Deductions

We all had to adjust to the "new normal" in 2020. Whether it meant working from home or starting a side-gig, "business as usual" became a thing of the past. This is important to keep in mind as you consider your deductions for the year. Business expenses that are considered "ordinary and necessary" are tax-deductible.

Whether this is something as simple as a webcam for Zoom meetings or a full home-office setup, you are able to write-off business expenses. Keep track of any mileage, materials, equipment, or anything else you purchased for business purposes. Even if you do not itemize your deductions, there are many standardized de-

ductions for business expenses, so start keeping track of them now and gathering your receipts to make sure you get credit for everything when you prepare your taxes.

4. Max Out Your Retirement Contributions

You should always seek to maximize your retirement contributions. First, it allows you to lower your tax bill for the year, and second, saving as much as possible early on will allow your contributions to compound and see substantial growth over time. If your employer offers a company-sponsored 401k, that should be your priority, especially if they offer to match your contributions. For 2020, you are allowed to contribute up to $19,500 if you are younger than 50, and $26,000 if you are older than 50. Even if you cannot afford to maximize your contribution, you should try to contribute at least the amount your employer will match.

You should also try to maximize contributions to an IRA. One thing to keep in mind is that the deadline for IRA contributions is April 15, Tax Day. This means that you could make contributions after January 1 and still be able to reduce your 2020 tax bill. You can contribute up to $6,000, plus an additional $1,000 if you over the age of 50. IRAs can sometimes be complicated, as the IRS has eligibility guidelines regarding income and deductibility, so it is important to meet with an advisor to discuss how to best take advantage of these valuable accounts.

Hanover Advisor Bulletins
Special Reminders to all Hanover Clients

- Pershing will be implementing a new fee of $2 for mailed hardcopies of monthly statements and $1 for trade confirmations. We recommend that all clients switch to electronic copies of these documents to avoid this fee. If specific statements are needed, Hanover can provide them at no cost, upon request. If you have any questions or concerns about this, please contact us.
- We invite all clients to schedule an online portfolio review. Because we respect your time, we offer three different meeting formats that vary in length and level of specificity. For more information or to schedule a meeting, please contact us.
- Since the start of the pandemic, Hanover employees have been working remotely, conducting meetings online or over the phone. However, we would like to remind our clients that we still have our main office in Greenville, SC and conference facilities in Atlanta, GA. We are happy to hold in-person meetings at either of these locations or any other that works for you.
- The Hanover Advisors website can be accessed at hanoveradvisorsinc.com. There you will find our latest newsletter and investment commentary, articles, our blog, and videos. You can also learn more about our services, access both the Black Diamond performance reporting system and your Pershing brokerage account (s).
- All Hanover clients have free access to our internet-based reporting system known as Black Diamond. This robust system provides comprehensive performance reporting, asset allocation and risk assessment on clients' portfolios. Our office is available to assist in accessing and utilizing the Black Diamond system.

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