

Investment Essentials

Planning Your Financial Future



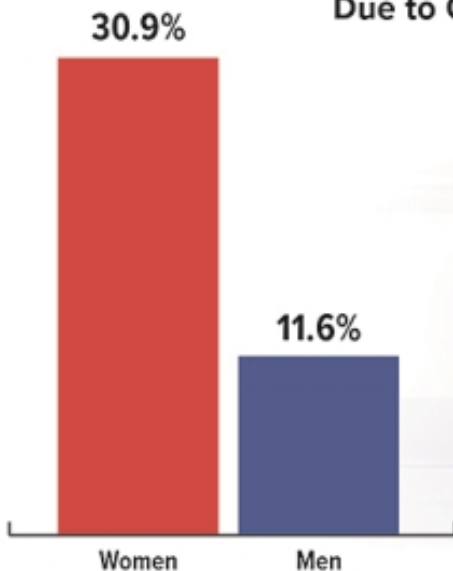
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Impact of COVID-19 on Working Parents

The sudden shift to remote learning and stay-at-home orders imposed during the coronavirus pandemic forced many parents to juggle working at home with taking care of children and helping them with schoolwork. According to the U.S. Census Bureau, around one in five working-age adults (ages 18 to 64) with children said the reason they were not working was because COVID-19 had disrupted their child-care arrangements. Of those not working, women ages 25-44 were almost three times as likely as men to not be working due to child-care demands.

Percent of Adults (ages 25 to 44) Not Working Due to Child-Care Issues During the Pandemic



Source: U.S. Census Bureau, July 2020

Sharing Your Money Values Can Be Part of Your Legacy

When it's time to prepare the next generation for a financial legacy, you might want to bring your family members together to talk about money. But sitting down together isn't easy, because money is a complicated and emotionally charged topic. Rather than risk conflict, your family may prefer to avoid talking about it altogether.

If your family isn't quite ready to have a formal conversation, you can still lay the groundwork for the future by identifying and sharing your money values — the principles that guide your financial decisions.

Define Your Own Values

What does money mean to you? Does it signify personal accomplishment? The ability to provide for your family? The chance to make a difference in the world? Is being a wise steward of your money important to you, or would you rather enjoy it now? Taking time to think about your values may help you discover the lessons you might want to pass along to future generations.

Respect Perspectives

The unspoken assumption that others share your financial priorities runs through many money-centered conversations. But no two people have the same money values (even relatives). To one person, money might symbolize independence; to another, money equals security. Generational differences and life experiences may especially influence money values. Invite your family members to share their views and financial priorities whenever you have the opportunity.

See Yourself as a Role Model

Your actions can have a big impact on those around you. You're a financial role model for your children or grandchildren, and they notice how you spend your time and your money.

Look for ways to share your values and your financial knowledge. For example, if you want to teach children to make careful financial decisions, help them shop for an item they want by comparing features, quality, and price. If you want teenagers to prioritize saving for the future, try matching what they save for a car or for college. Teaching financial responsibility starts early, and modeling it is a lifelong effort.

Practice Thoughtful Giving

How you give is another expression of your money values, but if a family member is the recipient, your generosity may be misconstrued. For example, your adult son or daughter might be embarrassed to accept your help or worried that a monetary gift might come with strings attached. Or you may have a family member who often asks for (or needs) more financial support than another, which could lead to family conflicts.

Defining your giving parameters in advance will make it easier to set priorities, explain why you are making certain decisions, and manage expectations. For example are you willing and able to:

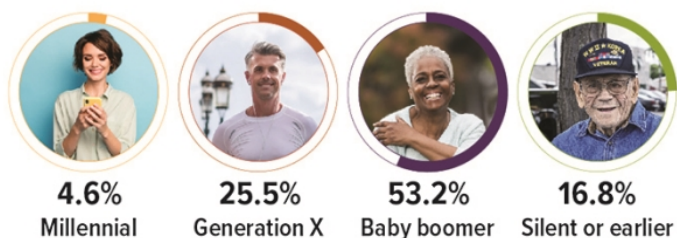
- Help fund a college education?
- Provide seed money for a small business?
- Help with a down payment on a home?
- Pay for medical expenses?
- Contribute to an account for a family member with special needs?
- Offer nonfinancial help such as child care or transportation?

There are no right or wrong answers as long as your decisions align with your financial values and you are sure that your gift will benefit both you and your family member. Maintaining consistent boundaries that define what help you are willing and able to provide is key. Gifts that are not freely given may become financial or emotional obligations that disrupt family relationships.

The Great Wealth Transfer

Seventy percent of U.S. household wealth is held by older generations. Although younger people may be far behind today, they stand to inherit much of this wealth in the coming decades, while also accumulating wealth through their own efforts.

Percentage of U.S. household wealth, by generation



Source: Federal Reserve, 2020 (Q2 2020 data)

Reveal Your Experiences with Money

Being more transparent about your own financial hopes and dreams, and your financial concerns or struggles, may help other family members eventually open up about their own.

Share how money makes you feel — for example, the satisfaction you felt when you bought your first home or the pleasure of giving to someone in need. If you have been financially secure for a long time, your children may not realize how difficult it was for you, or for previous generations, to build wealth over time. Your hard-earned wisdom may help the next generation understand your values and serve as the foundation for a shared legacy.

Sequence Risk: Preparing to Retire in a Down Market

"You can't time the market" is an old maxim, but you also might say, "You can't always time retirement."

Market losses on the front end of retirement could have an outside effect on the income you receive from your portfolio by reducing the assets available to pursue growth when the market recovers. The risk of experiencing poor investment performance at the wrong time is called *sequence risk* or *sequence-of-returns risk*.

Dividing Your Portfolio

One strategy that may help address sequence risk is to divide your retirement portfolio into three different "baskets" that could provide current income, regardless of market conditions, and growth potential to fund future income. Although this method differs from the well-known "4% rule," an annual income target around 4% of your original portfolio value might be a reasonable starting point, with adjustments based on changing needs, inflation, and market returns.

Basket #1: Short term (1 to 3 years of income). This basket holds stable liquid assets such as cash and cash alternatives that could provide income for one to three years. Having sufficient cash reserves might enable you to avoid selling growth-oriented investments during a down market.

Basket #2: Mid term (5 or more years of income). This basket — equivalent to five or more years of your needed income — holds mostly fixed-income securities, such as intermediate- and longer-term bonds, that have moderate growth potential with low or moderate volatility. It might also include some lower-risk, income-producing equities.

The income from this basket can flow directly into Basket #1 to keep it replenished as the cash is used for living expenses. If necessary during a down market, some of the securities in this basket could be sold to replenish Basket #1.

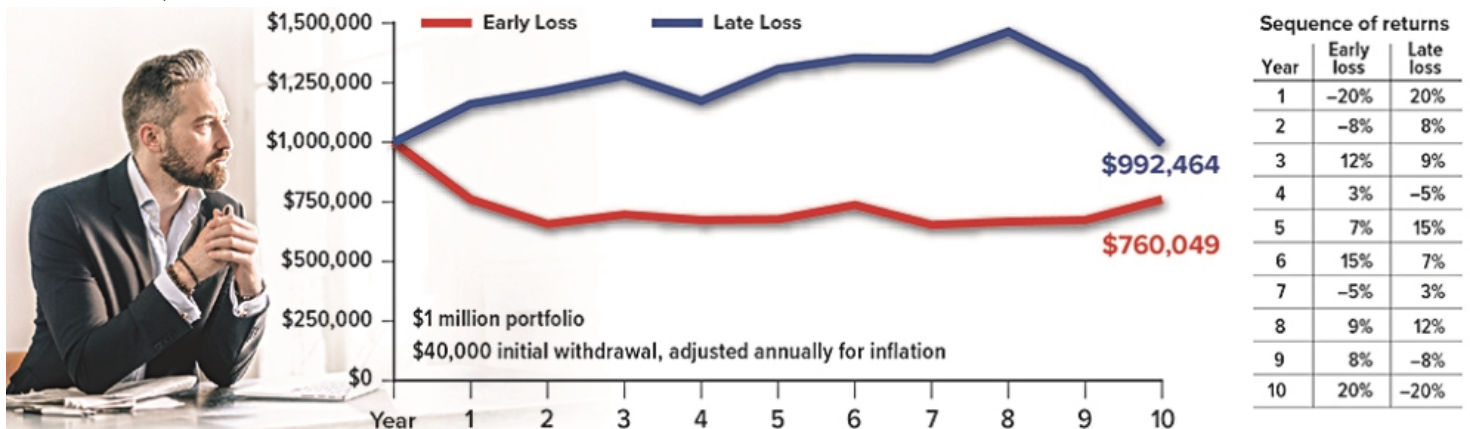
Basket #3: Long term (future income). This basket is the growth engine of the portfolio and holds stocks and other investments that are typically more volatile but have higher long-term growth potential. Investment gains from Basket #3 can replenish both of the other baskets. In a typical 60/40 asset allocation, you might put 60% of your portfolio in this basket and 40% spread between the other two baskets. Your actual percentages will depend on your risk tolerance, time frame, and personal situation.

With the basket strategy, it's important to start shifting assets before you retire, at least by establishing a cash cushion in Basket #1. There is no guarantee that putting your nest egg in three baskets will be more successful in the long term than other methods of drawing down your retirement savings. But it may help you to better visualize your portfolio structure and feel more confident about your ability to fund retirement expenses during a volatile market.

All investments are subject to market fluctuation, risk, and loss of principal. Asset allocation does not guarantee a profit or protect against investment loss. The principal value of cash alternatives may be subject to market fluctuations, liquidity issues, and credit risk. Bonds redeemed prior to maturity may be worth more or less than their original cost. Investments seeking to achieve higher yields also involve higher risk.

Early Losses

A significant market downturn during the first two years of retirement could make a big difference in the size of a portfolio after 10 years, compared with having the same downturn at the end of the 10-year period. Both scenarios are based on the same returns, but in reverse order.



Assumes a \$40,000 withdrawal in Year 1, with subsequent annual withdrawals increased by an inflation factor of 2%. This hypothetical example of mathematical principles is used for illustrative purposes only and does not represent the performance of any specific investment. Fees, expenses, and taxes are not considered and would reduce the performance shown if they were included. Actual results will vary.

Should You Pay Off Student Loans Early or Save More for Retirement?

For adults with student debt and extra money on hand, deciding whether to pay off student loans early or put those funds toward retirement can be tricky. It's a financial tug-of-war between digging out from debt today and saving for the future, both of which are very important goals. This decision is relevant today considering that roughly 65% of college graduates in the class of 2018 had student debt, with an average debt of \$29,200.¹ This amount equates to a monthly payment of \$295, based on a 4% interest rate and standard 10-year repayment term.

Let's assume you have a \$300 monthly student loan obligation. You have to pay it each month — that's non-negotiable. But if you have extra money available, what's the better course: pay more toward your student loans each month to pay them off faster or contribute extra funds to your retirement? The answer comes down to optimizing how those dollars can be put to work for you.

The first question to consider is whether you are taking full advantage of any 401(k) match offered by your employer. For example, let's say your employer matches one dollar for every dollar you save in your 401(k), up to 6% of your pay. If you make \$50,000 a year, 6% of your pay is \$3,000. So by contributing \$3,000 per year to your 401(k), or \$250 per month, you will get the full employer match of \$3,000. That's a 100% return on your investment.

If you are already contributing enough to get the full match, next compare the interest rate on your debt to the rate of return you could be earning on any extra funds you invest. When you make extra payments on a specific debt, you are essentially earning a rate of return equal to the interest rate on that debt. In the student loan example, the interest rate is 4%, so by applying extra money toward that debt you are "earning" a 4% return. If you think you can earn a higher rate of return by investing extra money in your retirement account, then those funds might best be put to work for you there.

Of course, no one can predict their expected rate of return with certainty. But generally speaking, if the interest rate on your debt is relatively low, the potential long-term returns you might earn in your retirement account could outweigh the benefits of shaving a year or two off your student loans. If you have time on your side when saving for retirement, the long-term growth potential of even small amounts can make contributing to your retirement account a smart financial move.

All investing involves risk, including the possible loss of principal, and there can be no guarantee that any investing strategy will be successful.

1) The Institute for College Access and Success, 2019

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