On Balance

Enjoying Today, Preparing for Tomorrow

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Forgotten 401(k) Assets

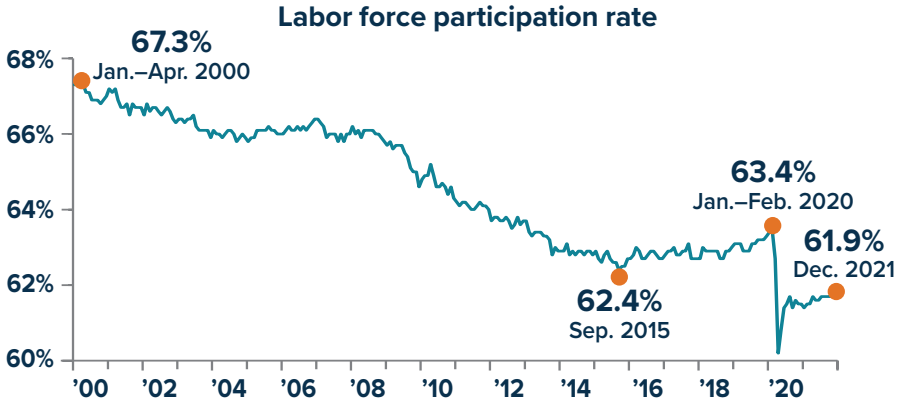
It's estimated that workers have left more than 24 million 401(k) accounts with former employers, and some accounts are forgotten, leaving valuable retirement savings behind. If you have retirement assets with a former employer, you can leave them in the plan. But for more control, you can roll your assets to an IRA or to a new employer plan (if allowed) — both of which can preserve their tax-advantaged status — or cash out, which will typically incur income taxes.

Source: *Financial Planning*, August 31, 2021

Where Are the Workers?

The labor force participation rate — the percentage of Americans age 16 and older who are working or actively looking for work — peaked in early 2000, when it began to drop due to aging baby boomers and more young people in college. Participation was beginning to increase before plummeting at the onset of the pandemic.

The rate has only partially recovered due in large part to accelerated retirement among workers age 55 and older. Other reasons include fewer child-care workers, reduced immigration, and workers unwilling to return to low-paying jobs. Some experts believe it may never return to pre-pandemic levels. The question for the U.S. economy is whether technology and other productivity measures can maintain economic growth with a smaller percentage of the population in the workforce.



Sources: U.S. Bureau of Labor Statistics, 2016 & 2022; *The Wall Street Journal*, October 14, 2021; CNN, December 15, 2021

Practical Insights for Your Financial Goals

Mutual Funds: Do You Know What's in Your Portfolio?

An estimated 102.5 million investors — representing almost 46% of U.S. households — owned mutual funds at the end of 2020 (most recent data). These individual retail investors held about 89% of the $23.9 trillion in assets invested in U.S. mutual fund companies.[1]

Mutual funds offer a convenient way to participate in a broad range of market activity that would be difficult for most investors to achieve by purchasing individual securities. With almost 7,500 funds available on the U.S. market, you should be able to find appropriate investments to pursue your goals.[2] However, it's important to periodically examine the mix of funds you hold.

Risk and Growth

If you are approaching retirement or already retired, this may be a good time to assess the risk level and growth potential of your funds, along with any other investments in your portfolio. It's generally wise to reduce risk as you near retirement, but you may also need to pursue long-term growth opportunities.

The following overview describes some basic types of funds in rough order of risk, from lowest to highest. Although performance is never guaranteed, risk and growth generally have an inverse relationship. Lower-risk investments typically have low to moderate growth potential, while investments seeking to achieve higher returns carry an increased level of risk.

Money market funds invest in short-term debt investments such as commercial paper and certificates of deposit, and are typically used as a cash alternative. *Although a money market fund attempts to maintain a stable $1 share price, you can lose money by investing in such a fund. Money market funds are neither insured nor guaranteed by the FDIC or any other government agency.*

Municipal bond funds generally offer income that is free of federal income tax and may be free of state income tax if the bonds in the fund were issued from your state. Although interest income from municipal bond funds may be tax exempt, any capital gains are subject to tax. Income for some investors may be subject to state and local taxes and the federal alternative minimum tax.

Income funds concentrate their portfolios on bonds, Treasury securities, and other income-oriented securities, and may also include stocks that have a history of paying high dividends.

Balanced funds, hybrid funds, and **growth and income funds** seek the middle ground between growth funds and income funds. They include a mix of stocks and bonds and seek to combine moderate growth potential with modest income.

Value funds invest in stocks of companies that appear to be undervalued by the market. They are more volatile than balanced funds, but typically offer dividend income and may have solid growth potential if the market recognizes the underlying value.

Growth funds invest in the stock of companies with a high potential for appreciation but low emphasis on income. They are more volatile than many types of funds.

Global funds invest in a combination of domestic and foreign securities. **International funds** invest primarily in foreign stock and bond markets, sometimes in specific regions or countries. There are increased risks associated with international investing, including differences in financial reporting, currency exchange risk, economic and political risk unique to a specific country, and greater share price volatility.

Sector funds invest almost exclusively in a particular industry or sector of the economy. Although they offer greater appreciation potential, the volatility and risk level are also higher because they are less diversified.

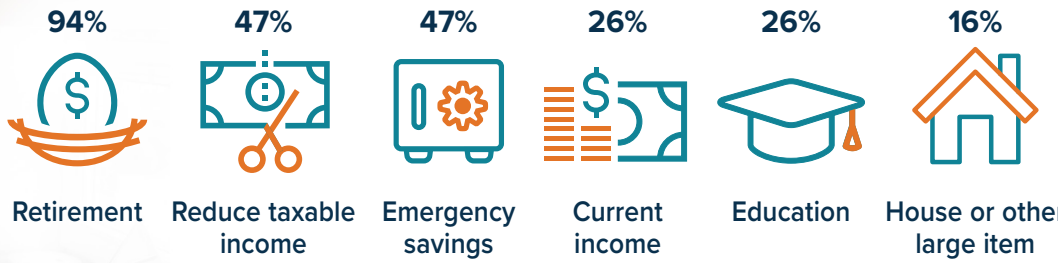
Aggressive growth funds aim for maximum growth. They typically distribute little income, have very high growth potential, tend to be more volatile, and are considered to be very high risk.

Bond funds (including funds that contain both stocks and bonds) are subject to the interest-rate, inflation, and credit risks associated with the underlying bonds in the fund. As interest

REASONS TO INVEST

Seventy-five percent of U.S. households who own mutual funds cite retirement as their *primary reason* for investing. However, people invest in funds for multiple reasons.

Percentage of mutual fund–owning households who cited these reasons for owning funds



Source: Investment Company Institute, 2021

rates rise, bond prices typically fall, which can adversely affect a bond fund's performance. U.S. Treasury securities are guaranteed by the federal government as to the timely payment of principal and interest. Dividends are typically not guaranteed.

Asset allocation and diversification are methods used to help manage investment risk; they do not guarantee a profit or protect against investment loss. Mutual fund shares, when sold, may be worth more or less than their original cost.

Mutual funds are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

1–2) Investment Company Institute, 2021 (number of mutual funds as of November 2021)

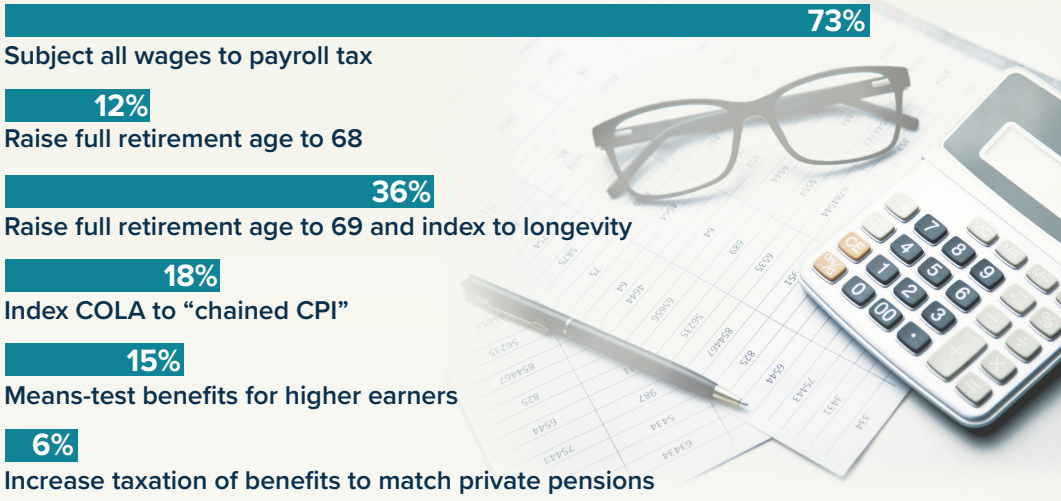
Fixing Social Security

According to the 2021 Social Security Trustees Report, the Old-Age and Survivors Insurance (OASI) Trust Fund, which helps fund Social Security retirement benefits, will be depleted in 2033, one year earlier than last year's projection, due to the effects of the pandemic. At that time, the program will be able to fund only 76% of scheduled benefits. If the OASI Fund is combined with the Disability Insurance (DI) Fund, which is not permitted under current law, the combined OASDI Fund would last one more year and be able to pay 78% of scheduled benefits.[1]

This is a serious situation, but it's important to keep in mind that Social Security will not go bankrupt or disappear, because payroll taxes on workers will continue to fund the program at the projected levels. However, the depletion of the trust funds, established when more workers paid into the program for each beneficiary, would mean significant benefit cuts unless Congress takes action.

CLOSING THE GAP

The chart below shows the estimated percentage of the 75-year Social Security funding gap that would be closed by selected changes to the program.



Source: Social Security Administration, December 13, 2021

Hard Choices

Numerous bills have been introduced, but lawmakers have stalled because every potential fix requires increased taxes or benefit reductions. Yet the longer Congress waits, the bigger the problem becomes and the more drastic the changes will have to be. These are some commonly considered fixes, and it is likely a combination will be required to return the program to solvency. Most proposals seek to maintain or increase benefits for current and near-term beneficiaries, while higher-income and future beneficiaries bear the brunt of the changes.

Raise the cap on taxable wages. In 2022, the Social Security payroll tax applies only to wages up to $147,000, with annual increases for inflation. Proposals include eliminating the cap or maintaining the cap and then reinstating the tax at higher income levels. By comparison, there is no cap on the 2.9% Medicare tax.[2]

Raise the retirement age. The current full retirement age (FRA) for Social Security is 66 for people born in 1943 to 1954 and increases gradually to 67 for those born in 1960 or later. Raising the FRA by gradual steps would improve the fiscal outlook but delay benefits for future retirees. It would also impact benefits when filing before or after FRA.[3]

Raise payroll taxes. The Social Security payroll tax is currently 12.4%, split evenly between the employee and the employer. According to the Trustees report, payroll taxes would have to be immediately increased to 15.76% for the combined OASDI Trust Funds to be fully solvent. If delayed until 2034, the tax would have to be increased to 16.6%.[4]

Other potential fixes include means-testing benefits for high earners, increasing taxation of benefits to match private pensions, and reducing the cost-of-living adjustment (COLA) by using a different inflation index. There are also proposals to increase benefits for some beneficiaries, reduce taxation, and increase COLAs by using a more favorable index, to be balanced by cost savings from other changes.[5]

The Trustees report has cast new urgency on the Social Security fiscal dilemma, so there may be some action by Congress in the relative near term, even if it is not a permanent fix.

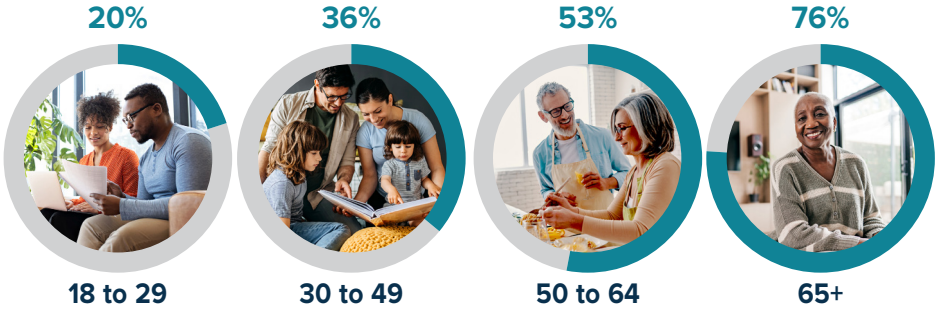
1, 4) 2021 Social Security Trustees Report
2–3, 5) Social Security Administration, 2021

If You Don't Have a Will, You Probably Should

A 2021 Gallup poll found that only 46% of U.S. adults have a will — similar to the results of other Gallup polls over the last 30 years. It's not surprising that older people are more likely to have a will, as are people with higher incomes.[1]

Regardless of age or income, having a will is an essential step to pass your assets to your heirs with clarity and confidence.

PERCENTAGE OF AMERICANS WHO HAVE A WILL, BY AGE GROUP



Source: Gallup, 2021

Distribute property. A will enables you to leave your property at your death to anyone you choose: a surviving spouse, a child, other relatives, friends, a trust, or a charity. Transfers through your will take the form of specific bequests (e.g., heirlooms, jewelry, furniture, or cash), general bequests (e.g., a percentage of your property), or a residuary bequest of what's left after your other transfers. It is generally a good practice to name backup (secondary) beneficiaries.

There are some limits on how you can distribute property using a will. For instance, your spouse may have certain rights with respect to your property, regardless of the provisions in your will. Also, assets for which you have already named a beneficiary pass directly to the beneficiary (e.g., life insurance, pension plans, IRAs).

Name an executor for your estate. A will allows you to select an executor to act as your legal representative after your death. An executor carries out many estate settlement tasks, including locating your will, collecting your assets, paying legitimate creditor claims, paying any taxes owed by your estate, and distributing any remaining assets to your beneficiaries.

Appoint a guardian for children. In many states, a will is the only way to specify who you want to act as legal guardian for your minor children if you die. You can name a personal guardian, who takes personal custody of the children, and a property guardian, who manages the children's assets. This can be the same person or different people. If your children are grown and have children of their own, you might want to emphasize the importance of a will for your grandchildren.

Various software programs enable you to create a will, but it is generally better to consult an attorney who is familiar with the laws of your state. If you do use a software program, be sure it has been updated for your specific state laws, and make sure your heirs and executor have a copy of your will or know where to find it.

1) Gallup, 2021

Would you like to review your portfolio? Do you have questions about how Social Security fits into your retirement strategy? Call us for an appointment today.