

# Joe Ciaramitaro - Fall 2020

Coaching Your Financial Future



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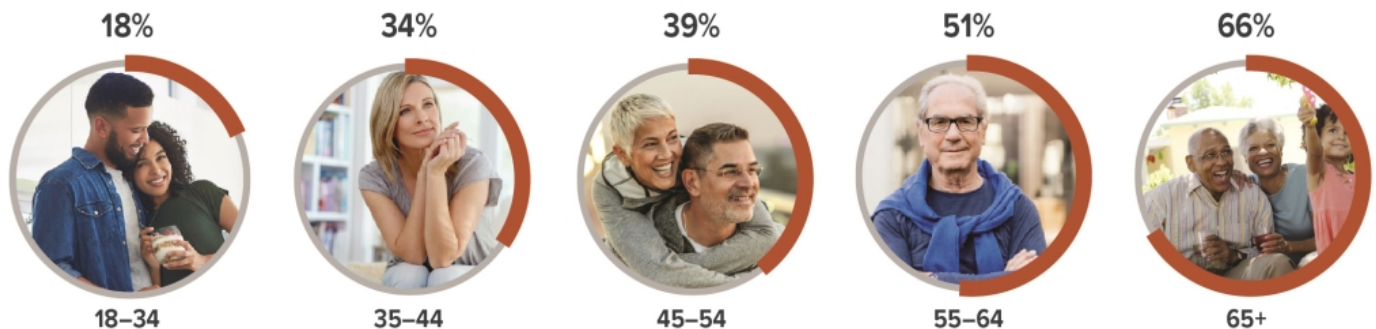
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## Do You Have a Will?

Although 76% of U.S. adults say having a will is important, only 40% actually have one. The most common excuse is, "I just haven't gotten around to it." It's probably not surprising that older people are more likely to have a will, but the percentage who do is relatively low considering the importance of this legal document.

Percentage of U.S. adults who have a will, by age group



Source: Caring.com, 2019

# Four Questions on the Roth Five-Year Rule

The Roth "five-year rule" typically refers to when you can take tax-free distributions of earnings from your Roth IRA, Roth 401(k), or other work-based Roth account. The rule states that you must wait five years after making your first contribution, and the distribution must take place after age 59½, when you become disabled, or when your beneficiaries inherit the assets after your death. Roth IRAs (but not workplace plans) also permit up to a \$10,000 tax-free withdrawal of earnings after five years for a first-time home purchase.

While this seems straightforward, several nuances may affect your distribution's tax status. Here are four questions that examine some of them.

## 1. When does the clock start ticking?

"Five-year rule" is a bit misleading; in some cases, the waiting period may be shorter. The countdown begins on January 1 of the tax year for which you make your first contribution.

For example, if you open a Roth IRA on December 31, 2020, the clock starts on January 1, 2020, and ends on January 1, 2025 — four years and one day after making your first contribution. Even if you wait until April 15, 2021, to make your contribution for tax year 2020, the clock starts on January 1, 2020.

## 2. Does the five-year rule apply to every account?

For Roth IRAs, the five-year clock starts ticking when you make your first contribution to any Roth IRA.

With employer plans, each account you own is subject to a separate five-year rule. However, if you roll assets from a former employer's 401(k) plan into your current Roth 401(k), the clock depends on when you made the first contribution to your former account. For instance, if you first contributed to your former Roth 401(k) in 2014, and in 2020 you rolled those assets into your new plan, the new account meets the five-year requirement.

## Roth by the Numbers

**19%**

U.S. households who owned Roth IRAs in 2019



**36%**

Roth IRA-owning households who contributed to them for tax year 2018



**69%**

Employers that offered a Roth 401(k) plan in 2018



**23%**

Eligible employees who contributed to a Roth 401(k) in 2018



## 3. What if you roll over from a Roth 401(k) to a Roth IRA?

Proceed with caution here. If you have never previously contributed to a Roth IRA, the clock resets when you roll money into the Roth IRA, regardless of how long the money has been in your Roth 401(k). Therefore, if you think you might enact a Roth 401(k) rollover sometime in the future, consider opening a Roth IRA as soon as possible. The five-year clock starts ticking as soon as you make your first contribution, even if it's just the minimum amount and you don't contribute again until you roll over the assets.<sup>1</sup>

## 4. What if you convert from a traditional IRA to a Roth IRA?

In this case, a different five-year rule applies. When you convert funds in a traditional IRA to a Roth IRA, you'll have to pay income taxes on deductible contributions and tax-deferred earnings in the year of the conversion. If you withdraw any of the converted assets within five years, a 10% early-distribution penalty may apply, unless you have reached age 59½ or qualify for another exception. This rule also applies to conversions from employer plans.<sup>2</sup>

<sup>1</sup> You may also leave the money in your former employer's plan, roll the money into another employer's Roth account, or receive a lump-sum distribution. Income taxes and a 10% penalty tax may apply to the taxable portion of the distribution if it is not qualified.

<sup>2</sup> Withdrawals that meet the definition of a "coronavirus-related distribution" during 2020 are exempt from the 10% penalty.

# Managing Your Workplace Retirement Plans

About 80 million Americans actively participate in employer-sponsored defined contribution plans such as 401(k), 403(b), and 457(b) plans.<sup>1</sup> If you are among this group, you've taken a big step on the road to retirement, but as with any investment, it's important that you understand your plan and what it can do for you. Here are a few ways to make the most of this workplace benefit.

**Take the free money.** Many companies match a percentage of employee contributions, so at a minimum you may want to save enough to receive a full company match and any available profit sharing. Some workplace plans have a vesting policy, requiring that workers be employed by the company for a certain period of time before they can keep the matching funds. Even if you meet the basic vesting period, funds contributed by your employer during a given year might not be vested unless you work until the end of that year. Be sure you understand these rules if you decide to leave your current employer.

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## Reasons to Contribute

Percentage of households with assets in defined contribution plans who agreed with the following statements



Payroll deduction makes it easier for me to save

92%



My employer-sponsored retirement plan helps me think about the long term, not just my current needs

91%



My employer-sponsored retirement plan offers me a good lineup of investment options

83%



The tax treatment of my retirement plan is a big incentive to contribute

82%

Source: Investment Company Institute, 2018

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**Bump up your contributions.** Saving at least 10% to 15% of your salary for retirement (including any matching funds) is a typical guideline, but your personal target could be more or less depending on your income and expenses. A traditional employer-sponsored plan lets you defer income taxes

on the money you save for retirement, which could enable you to save more. In 2020, the maximum employee contribution to a 401(k), 403(b), or 457(b) plan is \$19,500 (\$26,000 for those age 50 and older).<sup>2</sup> Some plans offer an automatic escalation feature that increases contributions by 1% each year, up to a certain percentage.

**Rebalance periodically.** Your asset allocation — the percentage of your portfolio dedicated to certain types of investments — should generally be based on your risk tolerance and your planned retirement timeline. But the allocation of your investments can drift over time due to market performance. Rebalancing (selling some investments to buy others) returns a portfolio to its original risk profile and does not incur a tax liability when done inside a retirement plan. Consider reviewing your portfolio at least annually. Some workplace plans offer automatic rebalancing.

**Know your investments.** Examine your investment options and choose according to your personal situation and preferences; some employer-sponsored plans may automatically set up new employees in default investments. Many plans have a limited number of options that may not suit all of your needs and objectives, so you might want to invest additional funds outside of your workplace plan. If you do, consider the risk and overall balance of your portfolio, including investments inside and outside your plan.

**Keep your portfolio working.** Some employer plans allow you to borrow from your account. It is generally not wise to use this option, but if you must do so, try to pay back your loan as soon as possible in order to give your investments the potential to grow. Plans typically have a five-year maximum repayment period.

*All investments are subject to market fluctuation, risk, and loss of principal. When sold, investments may be worth more or less than their original cost. Asset allocation is a method used to help manage investment risk; it does not guarantee a profit or protect against investment loss. Distributions from employer-sponsored retirement plans are generally taxed as ordinary income. Withdrawals prior to age 59½ may be subject to a 10% federal income tax penalty.*

1) American Benefits Council, 2019

2) Employer contributions are not included in these annual employee limits for 401(k) and 403(b) plans. Employers typically do not contribute to 457(b) plans, but any such contributions will count toward the employee limit. There may be additional catch-up contribution opportunities for 403(b) and 457(b) plans.

# Three Things to Consider Before Your Next Trip

The health and economic crisis created by the coronavirus (COVID-19) pandemic will have a long-lasting impact on how we all will travel going forward. And though it may be difficult to think about planning a trip during these uncertain times, here are some things to consider if you do decide to travel.

## 1. Check your travel provider's cancellation policy.

As a result of the coronavirus pandemic, many airlines and hotels have relaxed their cancellation policies by waiving traditional cancellation and change fees. The type of reimbursements will vary, depending on your travel provider, but may range from full refunds to vouchers/credit for future travel. It's important to contact your travel provider directly to find out their individual cancellation policies before booking.

**2. Be aware of travel advisories.** During the height of the coronavirus pandemic, global travel advisories were at an all-time high, and domestic travel advisories were issued for certain geographic areas within the United States. Your first step before planning any travel should be to check the travel advisories for your destination. Be sure to visit the U.S. Department of State website at [state.gov](https://state.gov), along with your state and local government, for up-to-date travel warnings.

**3. Read the fine print.** Before you purchase a trip cancellation/interruption insurance policy, read the fine print to determine what is specifically covered.

Typically, it will reimburse you only if you cancel your travel plans before you leave or cut your trip short due to an "unforeseen event" such as illness or death of a family member. Most policies with cancellation and interruption coverage will exclude a "known event" such as COVID-19 once it's declared an epidemic or pandemic.

If you are concerned about having to cancel or cut short a trip due to the coronavirus pandemic, one option you may have is to purchase additional "cancel for any reason" (CFAR) coverage. This is usually an add-on benefit to certain traditional trip insurance policies and allows you to cancel your trip for any reason up to a certain date before your departure (typically 48 to 72 hours) and will reimburse a percentage of your trip cost.

CFAR coverage can cost quite a bit more than a basic trip cancellation/interruption policy and may have additional eligibility requirements. In addition, you usually have to purchase CFAR coverage soon after purchasing your original policy (typically within two to three weeks).

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