Retirement planning is more than just a target savings number

Today, the hot concept around retirement planning is that each person should "know his/her number." If you had $XX, you could retire and live the life you want today.

While there is utility in having a target number, it's not so much the number that matters but where and how those assets are invested that truly counts. Don't get me wrong, there is value in having a target. It helps to create a goal, which can lead to being a more disciplined saver. However, this train of thought fails to consider two important aspects of retirement planning: impact of tax-efficiency and need for diversification.

First, not all assets are treated the same. For example, 401(k)s, Roth IRAs, brokerage accounts, and bonds are all taxed differently. Once you hit age 59 ½, withdrawals from your Roth 401(k) or IRA are tax-free. Traditional IRAs and 401(k)s, along with CDs and bonds are taxed as ordinary income. Meanwhile, gains from brokerage accounts will be taxed at capital gains rates, which vary depending on your income and filing status. Based on this general concept, you can see that if you have the same amount of money in a tax-free account as opposed to a taxable one, your assets are much more valuable.

The retirement picture is further complicated by the fact that federal income tax-brackets and many state tax systems are tiered. This means that the more taxable income you receive in a year, the bigger the cut to Uncle Sam. Today, these tiers start at 10% and extend up to 37%. Your tax-filing status and income are huge factors in determining the amount of money you keep. Therefore, if a majority of the income generated from your retirement savings is taxable, your after-tax spendable income might be much lower than expected. Focusing on your withdrawal strategy may significantly reduce taxation, thereby increasing the amount you can safely spend and helping ensure your money lasts longer. Tax brackets change most years and therefore it's important to regularly revisit your income plans.

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Tax Rate	Single	Married filling jointly	Married filling separately	Head of household
10%	$0 to $9,875	$0 to $19,750	$0 to $9,875	$0 to $14,100
12%	$9,876 to $40,125	$19,751 to $80,250	$9,876 to $40,125	$14,101 to $53,700
22%	$40,126 to $85,525	$80,251 to $171,050	$40,126 to $85,525	$53,701 to $85,500
24%	$85,526 to $163,300	$171,050 to $326,600	$85,526 to $163,300	$85,501 to 163,300
32%	$163,301 to $207,350	$326,600 to $414,700	$163,301 to $207,350	$163,301 to $207,350
35%	$207,351 to $518,400	$414,701 to $622,050	$207,351 to $311,025	$207,351 to $518,400
37%	$518,401 or more	$622,051 or more	$311,026 or more	$518,401 or more

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In addition to tax-diversification, it is important to have asset diversification. In a given month, it is unlikely that all assets are positive or negative. For example, your bond positions might be up when your stock positions are down. Market volatility is to be expected and can create a challenge to the "know your number" retirement strategy. For example, let's assume that you've reached your target asset number and then the market experiences a fairly typical 15% correction or perhaps an even bigger 25% correction. Are you still able to retire? Do you need to wait for the market to recover before starting this next stage of life? One key to managing this timing risk is proper diversification in the types of investments you own in accordance with your risk tolerance and goals. Diversification is important when market corrections happen so you can strategically decide which investments to sell and when. Historically, stock markets rebound but it can take time. Diversification can help allow you to ride out the down periods. For example, during the financial crisis of 2008, U.S. and international stocks, as well as real estate all dropped roughly 40%, while bonds were up roughly 5% with some international bonds returning over 10%. Strategically, it may have made sense to sell bond assets and allow time for the other assets to recover.

Regardless of the reason for the market volatility (trade wars, pandemics, military conflict, etc.), this strategy is relevant in that different challenges impact different asset classes. Cash and cash equivalent assets also serve an important role in distribution planning. By always having cash on hand, you can reduce the risk you'll be forced to liquidate assets at the wrong time.

While proper tax and allocation strategies can greatly enhance your retirement picture, it's important to note that these are just two factors when developing a retirement income plan. Having a well-thought-out, dynamic financial plan focused around your specific goals and income needs is critical to long-term success.

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