It's Not What You *Earn*— It's What You *Keep*

BY LANE MARTINSEN

Bob was a highly respected attorney with a long and successful career. Bob and his wife Jane enjoyed an above-average income for more than 36 years. He and his family were shocked when Bob was diagnosed with stage 4 lung cancer at the age of 64, despite being a nonsmoker. Just 10 months later, Bob passed away.

Bob's death was unexpected and inancially devastating for Jane. While alive, Bob always had taken care of the family finances, and there had never been a problem. They'd always had plenty of money and enjoyed a very comfortable lifestyle, so it came as a surprise to their family and friends to see Jane struggling financially just one year after Bob's passing. Their small amount of savings did not last long. Jane started receiving Bob's Social Security survivor benefit in the amount of $3,154, which was barely enough to cover the mortgage payment, let alone all other household expenses. Jane, who never had financial stress when Bob was alive, became financially overwhelmed after his passing.

Bob had been an excellent attorney and a wonderful person. He was great at earning income, but he had built up no reserves.

What You End Up Keeping Matters

A surprising number of high-income earners in every profession find themselves in a similar situation as Bob and Jane—enjoying a comfortable lifestyle but with little to no savings. The two major issues here are "lifestyle creep" and "procrastination." Lifestyle creep is the tendency to increase our lifestyle spending as our incomes rises over time. When we earn more, the natural tendency is to spend more. Our former luxuries become our new necessities.

In George Clason's timeless book *The Richest Man In Babylon*, he wrote, "That what each of us calls our necessary expenses will always grow to equal our incomes unless we protest to the contrary."

Protest to the contrary

You cannot effectively "protest to the contrary" without a plan and a clear goal. First, you need to know where your money is going. You need to know your cash inflow and outflow, your income, and expenses. It's called a budget. The word "budget" is not a very popular word, as many people feel like they can be difficult to follow. If that is you, I would suggest you change the way you think of budget. Even give it a different name if that helps. In its simplest form, a budget is:

1. Knowing where your money is going
2. Prioritizing where your money is going

Human Capital vs. Financial Capital

At the beginning of your career, you typically are rich in human capital and poor in financial capital. Human capital is your ability to work and earn an income. Financial capital, on the other-hand, is comprised of your assets that work for you and can earn for you.

To establish and grow your financial capital, you must divert a percentage of your income to savings. A common mistake is to pay all your bills first and then save any money that may be left over. This is called paying yourself last—and it does not work!

Keep More of Your Own Money

When you have clarity on how much money is coming in, and where it is going every month, you will be empowered to make some changes and set important priorities. The first principle of building wealth is to keep more of your own money!

Those who find it difficult to save often have the wrong mindset. Don't think of savings as money you can't spend; rather, think of savings as capital that will work *for* you and will make you wealthy in the long run. It requires patience and delayed gratification, but compound interest is a magical thing. Your capital truly has the ability to earn you significant amounts of new capital over time. For example, if you achieve 10 percent growth over time, your capital will double every 7.5 years. The more capital you have, the more substantial the compounding.

Automate Your Discipline

With many years of experience as a financial planner, I have had the privilege of working with attorneys, doctors, engineers, business owners and other professionals. Through that experience, I have identified a distinct reason why some people end up with a large amount of financial capital, and others not so much. The number-one reason is not what most people think. It is not based on who earned more, nor is it based on who got lucky with their investments. Rather, it is based on who automated their savings process and who didn't. I have seen it over and over again. It really is the main differentiator.

The concept here is not only to pay yourself first, but also to utilize automation to ensure that it happens routinely. This is where the real magic happens.

If you have to make a decision every time you get paid as to how much you will spend and how much you will save, you are making it very difficult on yourself and setting yourself up for failure. Paying yourself first, and doing it automatically, simplifies the process and increases your chances of success. When your savings is taken off the top, before any other bills are paid, it forces you to live on what is left

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over, rather than the other way around.

How Much To Save

How much you should save depends on your starting point, your age, and your goals. If you are in your 20s, 10 percent or 12 percent may get the job done. If you are in your 30s or 40s, you should try to save up to 15 percent or 20 percent. If you are over 50, a detailed plan is even more crucial, as you have less time to recover from mistakes.

No matter your age, don't give up. Identify your timeline and evaluate all the possibilities. For example, if you are 55 and in good health, you have 10 years before you are 65 and 15 years before you are 70. You can accomplish a lot in 15 years or 10 years—or even 5 years! It does, however, require intense focus and a solid plan of action.

If you are accustomed to spending all that you earn, saving 15 percent, 20 percent or 30 percent may feel impossible. Reducing lifestyle cost is always a difficult thing to do and will require making some tough decisions. If cutting back and saving more feels painful, keep in mind that, if you are caught financially unprepared later on down the road, you are going to experience even more pain. Choose your pain of preference wisely!

Another common mistake is to say, "I will start saving when my income increases." This is a form of procrastination. Maybe that will work out for you, but be careful as the years will fly by while you are waiting for your income to finally be "enough." I routinely hear clients say, "I don't know where the time went."

Where To Save?

The complexities associated with investment "allocation" and investment "location" can feel overwhelming and lead to analysis paralysis. Don't let investment complexity prevent you from getting started. In the very least case, just set money aside into a regular savings account. You can be saving while you figure out the best plan forward.

A great starting point is to build up a liquid emergency fund equal to six months of income, which is something everyone should have.

Tax Strategies Matter

The U.S. is hitting many firsts in its history. The largest generation to date is either currently retired or in the process of retiring. The Boomers' golden years will no doubt put an additional burden on Social Security, a benefit that is already strained. Life expectancy has nearly doubled since the turn of the 20th century, and the added longevity means more expenses. With all these changes, retirement income now needs to support our financial needs for a longer period of time, especially if long-term-care expenses come into play.

Often, financial advice is given in an à la carte fashion. More than ever, individuals need comprehensive holistic retirement planning, which can help leverage unrealized opportunity.

The U.S. national debt will soon surpass $32 trillion. The unfunded liabilities of the federal government now exceed a whopping $173 trillion. The fiscal path of the nation is unsustainable. Something must change, and some things *will* change. Higher taxes in the future are a likely reality.

Higher taxes will be a problem for retirees who have most of their retirement assets located within tax-deferred retirement accounts such as 401(k)s and IRAs. Even for people with a substantial amount of money saved in a 401(k), it is uncertain as to how much of it they will be able to spend in retirement, because future tax rates are unknown.

Tax Diversification

Deferring the payment of taxes on all retirement contributions is an outdated and even risky strategy. The tax-free growth that can be achieved within Roth accounts should not be overlooked. Most employer-sponsored plans nowadays offer an after-tax Roth option such as a Roth 401(k), Roth 403(b), or Roth TSP. With the recent passing of the SECURE Act 2.0 (see p. 58), SEP (simplified employee pension) and SIMPLE (Savings Incentive Match PLan for Employees) plans also allow Roth contributions beginning in 2023. The backdoor Roth IRA also remains a fully legitimate option for those with incomes too high for direct Roth IRA contributions. Cash value life insurance, if properly designed, also can be an important asset class with strong tax advantages.

Comprehensive Holistic Planning

Within the financial planning industry, "Adviser Gamma" is the relatively new term used to describe the synergy that results from tax-sensitive holistic planning. The key concept is based on the mathematical reality that the whole is greater than the sum of its parts.

In a retirement planning context, this synergy is referred to as "gamma." Holistic planning will translate into increased wealth, reduced risk and more cumulative retirement income. Every situation is unique, but the benefits of a comprehensive plan can make a life-changing difference.

Uncorrelated Financial Advice is Common

Often, financial advice is given in an à la carte fashion. For example, at work you may have a 401(k), 403(b), SEP or a similar type of employer-sponsored retirement contribution plan. You may have received advice and information that was specific to that plan, with the assumption that the many other financial aspects of your life are separate and unrelated issues. Be cautious of this, as it can result in financial inefficiencies, costing you more than you may realize. More than ever, individuals need comprehensive holistic retirement planning, which can help leverage unrealized opportunity.

Conclusion

The financial decisions made during an individual's earning years play a huge part in how much income will be available throughout retirement. Tax risk and tax strategies are only one aspect of holistic retirement income planning that can make a significant impact on preserving assets. The good news is that a tax-sensitive holistic financial plan is available to everyone and will leave you better prepared for an unpredictable future. AZAT