Focus on Financial Freedom

Maintaining Your Financial Health

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Company Stock and Your Portfolio: Keep Your Eye on Concentration Risk

The opportunity to acquire company stock — inside or outside a workplace retirement plan — can be a lucrative employee benefit. But having too much of your retirement plan assets or net worth concentrated in your employer's stock could become a problem if the company or sector hits hard times and the stock price plummets.

Buying shares of any individual stock carries risks specific to that company or industry. A shift in market forces, regulation, technology, competition — even mismanagement, scandals, and other unexpected events — could damage the value of the business. Worst case, the stock price may never recover. Adding to this risk, employees who own shares of company stock depend on the same company for their income and benefits.

Time for a concentration checkup?

The possibility of heavy losses from having a large portion of portfolio holdings in one investment, asset class, or market segment is known as concentration risk. With company stock, this risk can build up gradually.

An employee's compensation could include stock options or bonuses paid in company stock. Shares may be offered at a small discount through an employee stock purchase plan, where they are typically purchased through payroll deductions and held in a taxable account. Company stock might also be one of the investment options in the employer's tax-deferred 401(k) plan, and some employers may match contributions with company stock instead of cash.

Investors who build large positions in company stock may not be paying attention to the concentration level in their portfolios, or they could simply be ignoring the risk, possibly because they are overly optimistic about their employer's future. Retirement plan participants might choose familiar company stock over more diversified funds because they believe they know more about their employer than about the other investment options.

What can you do to help manage concentration risk?

Look closely at your holdings. What percentage of your total assets does company stock represent? There are no set guidelines, but holding more than 10% to 15% of your assets in company stock could upend your retirement plan and your overall financial picture if the stock suddenly declines in value.

If you work for a big company, you may also own shares of diversified mutual funds or exchange-traded funds that hold large positions in your employer's stock or the stock of companies in the same industry.

Formulate a plan for diversifying your assets. This may involve liquidating company shares systematically or possibly right after they become vested. However, it's important to consider the rules, restrictions, and timeframes for liquidating company stock, as well as any possible tax consequences.

For example, special net unrealized appreciation (NUA) rules may apply if you sell appreciated company stock in a taxable account, but not if you sell stock inside your 401(k) account and reinvest in other plan options, or if you roll the stock over to an IRA. You could miss out on potential tax savings, because future distributions would generally be taxed at higher ordinary income tax rates.

An appropriate allocation of company stock will largely depend on your goals, risk tolerance, and time horizon — factors you may want to review with a financial professional. It may also be helpful to seek an impartial assessment of your company's potential as you weigh additional stock purchases and make decisions about keeping or selling shares you already own.

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. Diversification is a method used to help manage investment risk; it does not guarantee a profit or protect against investment loss.

Ten Year-End Tax Tips for 2017

Deductions may be limited for those with high incomes

If your adjusted gross income (AGI) is more than $261,500 ($313,800 if married filing jointly, $156,900 if married filing separately, $287,650 if filing as head of household), your personal and dependent exemptions may be phased out, and your itemized deductions may be limited. If your 2017 AGI puts you in this range, consider any potential limitation on itemized deductions as you weigh any moves relating to timing deductions.

IRA and retirement plan contributions

For 2017, you can contribute up to $18,000 to a 401(k) plan ($24,000 if you're age 50 or older) and up to $5,500 to a traditional or Roth IRA ($6,500 if you're age 50 or older). The window to make 2017 contributions to an employer plan generally closes at the end of the year, while you typically have until the due date of your federal income tax return (not including extensions) to make 2017 IRA contributions.

Here are 10 things to consider as you weigh potential tax moves between now and the end of the year.

1. Set aside time to plan

Effective planning requires that you have a good understanding of your current tax situation, as well as a reasonable estimate of how your circumstances might change next year. There's a real opportunity for tax savings if you'll be paying taxes at a lower rate in one year than in the other. However, the window for most tax-saving moves closes on December 31, so don't procrastinate.

2. Defer income to next year

Consider opportunities to defer income to 2018, particularly if you think you may be in a lower tax bracket then. For example, you may be able to defer a year-end bonus or delay the collection of business debts, rents, and payments for services. Doing so may enable you to postpone payment of tax on the income until next year.

3. Accelerate deductions

You might also look for opportunities to accelerate deductions into the current tax year. If you itemize deductions, making payments for deductible expenses such as medical expenses, qualifying interest, and state taxes before the end of the year, instead of paying them in early 2018, could make a difference on your 2017 return.

4. Factor in the AMT

If you're subject to the alternative minimum tax (AMT), traditional year-end maneuvers such as deferring income and accelerating deductions can have a negative effect. Essentially a separate federal income tax system with its own rates and rules, the AMT effectively disallows a number of itemized deductions. For example, if you're subject to the AMT in 2017, prepaying 2018 state and local taxes probably won't help your 2017 tax situation, but could hurt your 2018 bottom line. Taking the time to determine whether you may be subject to the AMT before you make any year-end moves could help save you from making a costly mistake.

5. Bump up withholding to cover a tax shortfall

If it looks as though you're going to owe federal income tax for the year, especially if you think you may be subject to an estimated tax penalty, consider asking your employer (via Form W-4) to increase your withholding for the remainder of the year to cover the shortfall. The biggest advantage in doing so is that withholding is considered as having been paid evenly through the year instead of when the dollars are actually taken from your paycheck. This strategy can also be used to make up for low or missing quarterly estimated tax payments.

6. Maximize retirement savings

Deductible contributions to a traditional IRA and pre-tax contributions to an employer-sponsored retirement plan such as a 401(k) can reduce your 2017 taxable income. If you haven't already contributed up to the maximum amount allowed, consider doing so by year-end.

7. Take any required distributions

Once you reach age 70½, you generally must start taking required minimum distributions (RMDs) from traditional IRAs and employer-sponsored retirement plans (an exception may apply if you're still working for the employer sponsoring the plan). Take any distributions by the date required — the end of the year for most individuals. The penalty for failing to do so is substantial: 50% of any amount that you failed to distribute as required.

8. Weigh year-end investment moves

You shouldn't let tax considerations drive your investment decisions. However, it's worth considering the tax implications of any year-end investment moves that you make. For example, if you have realized net capital gains from selling securities at a profit, you might avoid being taxed on some or all of those gains by selling losing positions. Any losses over and above the amount of your gains can be used to offset up to $3,000 of ordinary income ($1,500 if your filing status is married filing separately) or carried forward to reduce your taxes in future years.

9. Beware the net investment income tax

Don't forget to account for the 3.8% net investment income tax. This additional tax may apply to some or all of your net investment income if your modified AGI exceeds $200,000 ($250,000 if married filing jointly, $125,000 if married filing separately, $200,000 if head of household).

10. Get help if you need it

There's a lot to think about when it comes to tax planning. That's why it often makes sense to talk to a tax professional who is able to evaluate your situation and help you determine if any year-end moves make sense for you.

Five Myths About Group Disability Insurance

You may think that the chances of becoming disabled during your working years are slight, and even if you did get hurt or had to miss time at work, you could get by because you have group disability insurance. Unfortunately, you may be in for a big surprise. Here are some myths and misunderstandings about group disability insurance.

Myth 1: It won't happen to me.

You're not really worried about your group disability insurance coverage because you're sure you won't suffer a disability. In fact, your chances of being disabled for longer than three months are much greater than you may realize. Even the healthiest and ablest can become disabled. According to the Social Security Administration, one in five Americans lives with a disability, and more than one in four 20-year-olds becomes disabled before reaching retirement age.[1] So maybe you could miss work for an extended period of time due to a disability. But you have group disability insurance to cover all your income, right?

Myth 2: I work for a good employer, so I'm sure it provides disability insurance.

Well, you better get something in writing confirming that you're covered under your employer-sponsored group disability insurance. According to the Bureau of Labor Statistics, 39% of private industry workers took part in employer-sponsored short-term disability insurance, and 33% were covered by group long-term disability insurance. Workers in service occupations, such as waiters/waitresses, hair stylists, and dental hygienists have the lowest access rates, about 20% for short-term disability insurance and only about 10% for long-term group coverage. On the other hand, 54% of workers in management, professional, and related occupations have access to short-term disability coverage, and 59% are covered by long-term group disability insurance.[2]

Myth 3: Group disability insurance will replace my income.

Actually, group disability insurance replaces some of your income — typically about 60% of income if you become disabled and can't work. And most coverage has a monthly income cap of roughly $5,000 to $8,000, which may be less than 60% of your income. Also, the income used to calculate your disability insurance benefit usually applies only to your base salary and doesn't include bonuses and commissions.

Myth 4: I won't be taxed on my disability insurance benefits.

You won't be taxed on your disability insurance benefits if premiums are paid from your income with after-tax dollars. However, most employers pay the premium for group policies, which means any benefits you receive are likely taxable to you as ordinary income.

Myth 5: As long as I'm with the company, I'll have coverage.

Generally, group disability insurance is a voluntary benefit offered by the employer, which is under no compulsion to maintain coverage or pay for its cost. The employer can switch plans to a policy that doesn't offer the same coverage options, or the employer can stop offering coverage altogether. Sometimes, if the company has an unusually high number of expensive disability claims, the insurer may exercise its right to significantly increase the premium or terminate the coverage.

Okay, so what are my options?

First, verify with your employer that you do, in fact, have group disability insurance coverage. Then review your plan to see how much income it actually would pay. Also, understand the group policy's definition of disability. Not every injury or illness that causes you to miss work may be covered.

Once you know how much you'd receive from the disability insurance, estimate whether it would be enough to cover your monthly expenses. If there's a shortfall, do you have other sources of income (e.g., investment income, spouse's income) to cover the difference, or would you have to access your savings? If you'll be using savings to supplement your disability income, you'll want to gauge how long your savings will last. The average duration of long-term disability is 31.2 months.[3]

You could consider purchasing supplemental disability coverage to help pay for some of your lost income not covered by your group disability policy. For instance, if your group plan pays 60% of your salary, a supplemental disability plan may increase your total benefit to 80% of your income. In any case, disability income policies contain certain exclusions, waiting periods, reductions, limitations, and terms for keeping them in force. Individual disability income insurance policies provide disability income insurance only. They do NOT provide basic hospital, basic medical, or major medical insurance.

[1] Social Security Administration, The Facts About Social Security's Disability Program, SSA Publication No. 05-10570, January 2017

[2] Beyond the Numbers: Pay and Benefits, vol. 4, no. 4 (U.S. Bureau of Labor Statistics, February 2015)

[3] Council for Disability Awareness, The Average Duration of Long-Term Disability Is 31.2 Months. Are You Prepared? January 18, 2016

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How much money should a family borrow for college?

There is no magic formula to determine how much you or your child should borrow to pay for college. But there is such a thing as borrowing too much. How much is too much? Well, one guideline for students is to borrow no more than their expected first-year starting salary after college, which, in turn, depends on a student's particular major and job prospects.

But this guideline is simply that — a guideline. Just as many homeowners got burned by taking out larger mortgages than they could afford (even though lenders may have told them they were qualified for that amount), students can get burned by borrowing amounts that may have seemed reasonable at first glance but now, in reality, are not.

Keep in mind that student loans will need to be paid back over a term of 10 years or longer. A lot can happen during that time. What if a student's assumptions about future earnings don't pan out? Will student loans still be manageable when other expenses like rent, utilities, and/or car payments come into play? What if a borrower steps out of the workforce for an extended period to care for children and isn't earning an income? There are many variables, and every student's situation is different. Of course, a loan deferment is available in certain situations, but postponing payments only kicks the can down the road.

To build in room for the unexpected, a smarter strategy may be for undergraduate students to borrow no more than the federal student loan limit, which is currently $27,000 for four years of college. Over a 10-year term with a 4.45% interest rate (the current 2017/2018 rate on federal student loans), this equals a $279 monthly payment. Borrow more by adding in co-signed private loans, and the monthly payment will jump: $40,000 in loans (at the same interest rate) equals a monthly payment of $414, while $60,000 in loans will result in a $620 monthly payment. Before borrowing, students should know *exactly* what their monthly payment will be.

As for families, there is no one-size-fits-all rule on how much to borrow. Many factors come into play including, but not limited to, the number of children in the family, total household income and assets, and current and projected retirement savings.

How can families trim college costs?

Trimming college costs up front can help families avoid excessive college borrowing and the burdensome student loan payments that come with it. Here are some ideas.

1. Pick a college with a lower net price. You can use a college's net price calculator (available on every college's website) to estimate what your net price (out-of-pocket cost) will be at individual colleges. A net price calculator does this by estimating how much grant aid a student is likely to receive based on a family's financial and personal information. Colleges differ on their aid generosity, so after entering identical information in different calculators, you may find that College A's net price is $35,000 per year while College B's net price is $22,000. By establishing an ideal net price range, your child can target schools that hit your affordable zone.

2. Investigate in-state universities. Research in-state options and encourage your child to apply to at least one in-state school. In-state schools generally offer the lowest *sticker* price (though not necessarily the lowest *net* price) and may offer scholarships to state residents.

3. Research colleges that offer generous merit aid. All colleges are not created equal in terms of how much institutional aid they offer. Spend time researching colleges that offer generous merit aid to students whose academic profile your child matches.

4. Graduate early. Earn college credit in high school by taking AP/IB classes and then graduate a semester or two early. Or look at colleges that specifically offer three-year accelerated degree programs.

5. Seek out free room and board. There are two ways to do this: The first is to live at home (though transportation costs might eat into your savings), and the second way is to become a resident assistant (RA) on campus, a job that typically offers free room and board.

6. Work during college. Working during college and contributing modest amounts to tuition along the way — say $1,500 to $3,000 a year — can help students avoid another $6,000 to $12,000 in loans.

7. Combine traditional and online courses. Does the college offer online classes? If so, you may be able to earn some credits at a lower cost over the summer or during breaks.